

Spotlight Is Rent Freedom a Silver Bullet?

2017

Housing associations are focused on how to deliver more affordable homes for rent. Financing development hinges on a stable rent roll. The Government has promised clarity on rent policy beyond 2020. Options under discussion in the sector include rent freedom, which could unlock the potential for higher rents to support the development of more homes for households in need. This paper explores the potential for this to work.

In theory, within the social housing sector at least 88% of general needs homes could have increased rent without exceeding Local Housing Allowance (LHA) caps. But past differences between national social housing rent policy and local growth in market rents means that the scope for increase varies hugely across England. And hitting up against the LHA caps could bring housing even closer to the politics of welfare. Rents must be affordable to households both in and out of employment.

Market rents tend to grow in line with incomes. The average market rent in England increased 1.9% per year between 2000 and 2016, according to our analysis of the IPD sample. Inflation was 2.1% per year, so this was a small fall in real terms. Household incomes increased faster than inflation at 2.4% per year over the same period.

The problem with national averages

But these averages ignore the huge diversity of English housing markets. For instance market rents in the North East only increased by 0.5% per year during the five years to

April 2016, 1.8% slower than social housing rents. Rents in London have increased by 3.1% per year over the same period, 0.8% faster than social housing rents.

This means that across most of the country, social housing rents have closed the gap with market rents over the five years to April 2016 at least. Only in London did the gap between social rents and market rents widen. In Camden the average two-bed market rent is now 3.8 times the average target rent. In Hartlepool the average two-bed market rent is only 1.1 times the average target rent.

Rent Freedom

This problem might be solved by allowing local rent setting by housing associations. Rent freedom would allow them to react to local market conditions. It may also allow rents to be set at levels that meet specific local needs and fill a gap in housing provision.

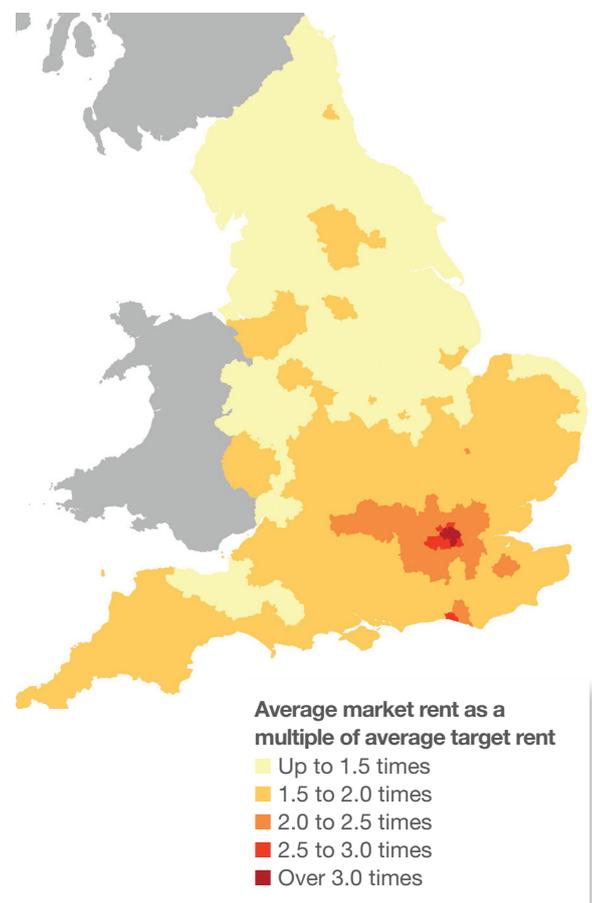
Much of this is already theoretically possible with Affordable Rent. The only restriction outside London is that the rent charged should be no higher than 80% of the market rent for the property, unless a Section 106 agreement or other local policy lowers the maximum.

In reality, the highest possible rents are charged in the majority of cases to enhance financial capacity. So what would be the limit under a free rent regime?

LHA cap

Since 63% of people in social rented housing are on Housing Benefit, LHA is likely to be the cap in most

FIGURE 1
Difference between average 2 bed market rent and target rent



Source: Savills using Rightmove and HCA SDR

areas. Problems with rent collection are more likely to arise if rents are increased beyond this level.

The LHA cap on Housing Benefit for social housing tenants will apply from April 2019 to any social tenancy agreed or renewed from April 2016 onwards.

→ LHA is in theory related to local rent levels, reflecting market diversity. However, in practice this is no longer the case, as LHA caps have been frozen until 2019/20. The current LHA is based on the 30th percentile of the distribution of market rents in the twelve months to September 2015.

Our analysis shows that there is capacity for 88% of general needs homes in England to have an increased rent without exceeding the LHA cap when it is introduced in 2019/20. But this national figure hides variation between local markets. The scope to increase rents to the LHA cap will be greatest where the gap between target and market rents is largest.

Localised effects

Across most of the south of the country, the gap between social rents and market rents is such that almost every general needs rent could be increased without exceeding the LHA cap on housing benefit. The uplifts could reach £7,500 per year in Inner London.

But in Scunthorpe, for example, two-thirds of new housing association general needs lettings in 2019/20 will already exceed the LHA cap and households will not receive sufficient Housing Benefit to cover rent. The similarity between social and market rents here means that there is a degree of competition between the

two tenures. Rent freedom in towns like Scunthorpe would not unlock any rent increase but may allow social rents to be reduced to make sure homes are let.

Reducing rents is currently a hard choice to make. But rent freedom may allow the lost rent in a lower demand area to be made up in a higher demand area where there is scope for rents to increase. This requires an organisation to own homes in a range of market areas.

How quickly?

How quickly rent freedom may unlock the full potential uplift in rental income will depend on the frequency with which social rented homes are re-let. The largest potential rent increases are in areas where there is a wide gap between existing social and market rents. But these are also the areas where the turnover of social rented housing is lowest. In some, it would take over 20 years to convert all general needs homes to a new rent regime.

Out of the frying pan...

The result of any widespread rent rises would be to increase the Government's benefit bill. The freezing of the LHA has already moved it away from being market linked towards being more of a political tool to control the Housing Benefit bill. So whilst rent freedom might allow a one off increase in rents, it may just result in a transition from one form of rent control to another. ■

See also our November 2016 Report, 'Releasing untapped potential for more housing' on the Savills website www.savills.co.uk/research

FIGURE 2 **Regional variation in rental growth in contrast with national social rent policy**



Source: Savills using ONS and Oxford Economics

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