



HOUSE-KEEPING: A FAIR DEAL FOR LONDON'S HIGHER EARNING SOCIAL TENANTS

Pete Redman

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BIOGRAPHY

Pete Redman

Pete Redman is a former leader of some of the largest housing associations and council housing services in England. As part of Circle 33 Housing Trust's executive management team he built one of the country's largest housing investment programmes. Pete has been Chief Executive of Leeds Federated Housing Association, Notting Hill Housing Group and Lambeth Living, and was responsible for the Area Management Teams of Southwark Council. He chaired the London Housing Federation, the RIBA Housing Client Forum, and is currently Chair of Ducane Housing Association. Pete is known as an innovative leader and has pioneered much of the policy development that shapes the social housing sector today. He continues to be a progressive force within housing policy research whether it is for housing clients, think tanks or academia.

Pete is now Managing Director of the Policy and Research function at TradeRisks, a city financier and financial advisor to social housing organisations.

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FOREWORD

Social housing in London has an excellent track record of providing decent affordable accommodation for those on no or low incomes. Social housing rents are often half of market rents – or even lower – and this is a great help to low income households who work hard to provide many of the essential and everyday services on which our capital city depends.

In this paper, Pete Redman and Centre for London propose a new rental policy founded on the principle of affordability, which could become an essential part of the social housing offer – the Higher Earnings Rent concept. This report sets out the rationale behind the concept, suggests how it might work in practice, and makes recommendations for its implementation.

It is a very welcome addition to the debate on fairness that our sector needs to be leading. We cannot exist in a moral vacuum; as social businesses, we must actively engage with this topic to ensure that the space is filled with positive ideas.

Housing providers need to overcome the public perception that much social housing is misused. Misuse is real but rare, and housing policy should not be formed around a very small number of isolated cases. We believe there is a better and fairer way: by asking those who can afford to pay more to do so. This would surely take us forward in terms of overcoming negative perceptions and increasing public support for some much needed further investment.

There are no quick fixes and we wouldn't claim otherwise. London is growing apace and projections published this April suggest that we will need to find accommodation for 52,600 additional households each year. That's an increase of 16,560 a year over the 2010 projection. Higher Earnings Rent has the capacity to provide £300 million of additional income to deliver 3,000 new social rented dwellings in London for those most in need every year.

It has the potential to work at the economic level by ensuring that social housing subsidy, provided by the taxpayer, becomes more efficient, but it also has a much needed social dimension. Retaining higher income households within the sector encourages balanced and mixed communities which are a core part of our joint mission as housing providers. This can only be a significant positive.

Conventional methods will not allow us to deliver the new homes London so desperately needs. A different mind-set is required, one with an innovative, practical and reformist approach. We very much hope that this paper on Higher Earnings Rent starts a conversation both within the sector and outside it.

Mark Henderson
CEO (Home Group)

Elizabeth Austerberry
CEO (Moat)

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EXECUTIVE SUMMARY

We badly need to build more homes in London and the South East. The proportion of Londoners identifying housing as the most important need facing the capital is growing, and the shortage has greatest impact on the poorest families.

At the same time, public attitudes to welfare spending are changing. While support for the fundamental principles of the welfare state arguably remains strong, the British public is increasingly concerned to know that welfare spending goes to those who are most deserving of it, and increasingly worried that the system is poorly managed and open to abuse.

In 2010 the British Social Attitudes survey asked people their priorities for improving the benefit system. Top of the list, at 35%, was 'Targeting benefits only at those who really need them', followed by 'Rewarding those who work or look for work' (18%). Only 6% identified 'Providing benefits for those who cannot work' as the top priority.¹

It is against this background that the Government recently proposed that, for the first time ever, the highest earning social tenants should pay a higher rent. This policy, if implemented, will mark a sharp break with over four decades of policy. Social housing has been offered as a home for life at a subsidised rent, regardless of the earnings of the tenant.

This report looks at the rights and wrongs of allowing higher earning social tenants to continue to pay a heavily subsidised rent, and lays out a set of proposals which we believe to be superior to both the status quo and the Government's proposed reforms.

We focus particularly on London, because London has by far the highest rents – and thus highest social housing subsidy – of any region, the greatest housing shortage, and the largest proportion of high earning social tenants.

Throughout our research we have sought to develop proposals that:

- 1 – are **fair** for those both funding subsidy and receiving it;
- 2 – are **efficient and effective**;
- 3 – **encourage work and aspiration**;
- 4 – **help those in greatest need** of subsidised social housing;
- 5 – **retain higher earners** in mixed-income neighbourhoods.

Until the 1970s social housing was for working households. It also provided a safety net for those facing a housing crisis. Since then there has been a relentless process of residualisation. We need to return to the concept of housing for all, providing enough at low rents to help those most in need while retaining higher earning households within the same communities, but at a reasonable rent.

London's social housing – that is council and housing association housing – provides decent, secure accommodation for 750,000 households – about 24% of all London's households. The average subsidy for a London council or housing association household – i.e. the difference between a social rent and a market rent – is £5,300 per year.

Half of social renting households have no earned income, due to disability, age, or unemployment, and a further 25% have such low earned income that their already heavily subsidised rent needs to be supplemented with Housing Benefit.

The remaining 25% earn enough that they don't receive housing benefit. A significant minority of these (9% of the total) are earning just above the benefit limits, but the rest – 16% of all social renting

households – are on higher earnings, such that their current rent represents a surprisingly low proportion of their income.

The Government has recently set out a 'Pay to Stay' proposal aimed at addressing the perceived unfairness of those on higher incomes occupying subsidised housing. In 2012 the then housing minister, Grant Shapps, said:

“For far too long, millions of people on waiting lists have watched helplessly as high-earning social tenants continue to occupy homes designed to help the most vulnerable. These high-income tenants are not only blocking homes that could benefit those in greater housing need, they're also relying on poorer taxpayers to subsidise their lifestyle.”²

The Daily Mail ran a poll in June 2011 on whether higher earners should keep their council or housing association tenancy. Over 80% said they should leave.³ The majority in a *Guardian* poll in June 2012 supported the view that higher earners leaving “will ensure that social housing is more geared to those in need.”⁴ Polls like these are, of course, neither methodologically robust nor reliable. Nevertheless it seems likely that most people would support the fundamental principle that relatively well-off social tenants should not benefit from heavily subsidised housing, especially when social housing is in such short supply.

Last year social landlords began to offer Flexible Tenancies. This government initiative aims to end the 'tenancy for life'. Fixed term tenancies (Flexible Tenancies from councils and Assured Shorthold Tenancies from housing associations) can now be offered, with most being for five years and then subject to review. The consequence being that tenants who improve their circumstances and better their income will have to move out. Here we offer an alternative to this draconian outcome – a higher earning household could stay by paying a rent in line with their income.

But the Flexible Tenancies policy only applies to new lettings. Almost by definition most of these will be on the lowest incomes. So, in the March 2013 budget the Chancellor announced:

“The Government will shortly take steps towards allowing social landlords to charge market rents to tenants with income of over £60,000. The Government intends to require these tenants to declare their income to ensure they make a fair contribution, with all additional income reinvested in housing.”⁵

We argue that this proposal has a number of weaknesses.

To begin with, we estimate that only around 15,000 households in London would pay the higher, unsubsidised rent, representing 1.9% of all social housing tenants. On this basis the policy would only raise about £30 million a year, paying for just 300 new social rented dwellings.

In addition, Pay to Stay seems to have fixed the penalty at an arbitrary level. On the Government’s proposals, social tenants who earn more than £60,000 will face a sudden and dramatic increase in rent.

This paper sets out an alternative rent regime for higher earners. We argue that rents should increase gradually as incomes rise, and fall back to target social rent levels if households’ incomes fall.

Higher Earnings Rent is only for households who are above the income threshold for receipt of Housing Benefit (or the housing element of Universal Credit). We estimate this will apply to 115,000 households (16%) with most paying only a small amount more than the target social rent.

Under our proposal, if a higher earning household were to leave, the dwelling would be re-let at the target social rent to a household on low or no income.

In total, the additional rent of £300 million a year in aggregate could deliver an annual supply of 3,000 new

social rented dwellings – ten times the amount from Pay to Stay.

The Higher Earnings Rent can be set at between 20% and 25% of the household’s gross income, similar to affordability ratios that are experienced by households just out of Housing Benefit.

As Higher Earnings Rent approaches market rent some households, particularly those with savings, may find it beneficial to exercise the Right to Buy or to become Shared Owners of their dwelling. Purchases will not only recycle subsidy more quickly to speed up the landlord’s ability to assist those in greater need, but will also retain higher income households with a commitment to their investment and to the neighbourhood.

At present those with higher earnings and a low rent have no cause to consider their alternatives. Many want to stay in the home that has been theirs for years, and in the neighbourhood they know. Higher Earnings Rent offers an alternative way to stay.

1 INTRODUCTION

London's social housing provides decent secure accommodation for 750,000 households – about 24% of all London's households. The vast majority of these have no earned income due to disability, age, or unemployment, or have such low income that their heavily subsidised rent needs supplementing with Housing Benefit.

Recent policy changes introducing fixed term tenancies and proposals to make higher earners 'Pay to Stay' imply that successful career progression could lead to the loss of the tenancy or a sudden jump in rent to market rent levels. Centre for London believes that these changes will be counterproductive. They will create major disincentives to finding work, to seeking promotion, and to striving for higher incomes.

An earlier Centre for London report, *Home-Work* set out the case for a flexible rent policy, to help those earning above the Housing Benefit thresholds to overcome these disincentives, thereby making work pay, enabling people to keep their homes, and ensuring neighbourhoods retain a balance of income levels.

This paper builds on that proposal, looking at details of the rents and incomes of London's social housing households and at the operation of a Higher Earnings Rent policy based on affordability principles. It shows that Higher Earnings Rent is particularly important for London as:

- The gap between social rents and market rents is so much larger than in England as a whole;
- There are proportionately more higher earning households in London's social housing than in England.

A Higher Earnings Rent policy for London:

- Will smooth the 'journey' into work allowing for a gradual increase in rent proportionate to

income, delayed for up to a year, and immediate decreases for those faced with reduced incomes;

— Will fund the provision of over 3,000 social rent dwellings a year by recycling subsidy;

— Would not require a change in the law. It could be introduced through changes in regulation and subsidy rules, and existing audit and monitoring processes will safeguard the use of public funds.

2 THE CURRENT POSITION

2.1 Social housing rents in London

The average London social housing rent is £102 per week. This is about 50% of the market rental value of such properties, which averages £205 p/w. These market rent estimates are lower than the average charged in the private rental sector.

Social housing dwellings, on average, have lower market values than the average private rented sector dwelling because of condition, style and location. The average London social housing dwelling is worth £204,000, and the average private rented dwelling £252,000.

The difference between London social rents and the market rent for that dwelling represents a subsidy to the tenant of, on average, £5,300 a year before Housing Benefit, and amounts to £4 billion a year from the taxpayer. This subsidy is usually delivered by grant aid or capital subsidy to reduce the initial cost of providing the dwelling – enabling the landlord to charge a social rent which covers its running costs – and a much reduced financing requirement.

In the significant majority of cases household incomes in London's social housing are very low and benefit dependent. Average social housing incomes in London are £20,000 p/a.

Taken overall, these highly subsidised social rent levels are justified. But with such large sums involved it is critical to public support for social housing that subsidy goes to those in need rather than those that can pay their own way in the open market.

Social housing is offered to those in most need at the point of letting, but many in need are unable to benefit because of the powerful rationing systems that exist to allocate a scarce resource.

There is much higher demand than supply. Only a small proportion of those in housing need get an offer. Later on, those housed in social housing may improve their circumstances and this is where Higher Earnings Rent has a role.

2.2 London social housing income distribution

Using Family Resource Survey data (2010–11 ONS special extract for London) and the most recent London data from the English Housing Survey we can estimate an income distribution for existing social housing tenants.

The table below shows the number of social households and all households in each income band. Income is expressed gross (before direct taxes) for all income sources, including the named tenant, other household members and any payments by lodgers. Income from welfare benefits is included with the exception of Housing Benefit. When we turn to rent paid we will use net rent after Housing Benefit.

This data is used in the Higher Earnings Rent proposal. The differences in distribution can be better

Table 1: Income of social rental households

Household Income Bands	Thousands of households		
	London Social Rent	National Social Rent	London All Tenures
£0 to £4,999	25	252	75
£5 to £9,999	100	1,204	229
£10 to £14,999	152	823	450
£15 to £19,999	175	514	295
£20 to £24,999	115	331	285
£25 to £29,999	67	216	273
£30 to £34,999	40	145	232
£35 to £39,999	25	95	190
£40 to £44,999	14	60	161
£45 to £49,999	10	40	140
£50 to £54,999	8	28	130
£55 to £59,999	7	21	125
£60 to £64,999	5	14	120
£65 to £69,999	3	11	117
£70 to £74,999	2	8	115
£75 to £79,999	2	8	113
Over £80,000	3	11	271
Total	752	3,781	3321

illustrated in Figure 1, showing the percentages of households in each income band in each group.

Relatively few social rent households – about 1.9% – have incomes above the lowest threshold of £60,000 suggested in the DCLG’s consultation on ‘Pay to Stay’. This is, however, higher than the national proportion of 1.4%.

The primary sources of data for this paper are the English Housing Survey, the Family Resources Survey and Housing Market prices from the ONS and the DCLG. We also commissioned from the ONS a special extract from the Family Resources Survey data. Sample sizes of these national surveys are small for London and even where two or three years of survey data are combined they are still too small to give figures with great confidence. The results of this analysis must therefore be considered as indicative rather than definitive. For this reason, and because of data protection on household information, it is not possible to provide Borough-level data.

A refinement would be to include wealth, investments and any property wealth above a disregarded amount, perhaps equated to £1 per week for each £250 of savings. This short-hand method is used in assessing Housing Benefit. In practice very few households with below average incomes have significant wealth. The section on Shared Ownership concerns those with significant assets.

Figure 1: Percentage of households in each income band



3 AFFORD- ABILITY

London's average household income (all tenures) is within the range of £45,000 to £50,000 – about four percent of social tenants exceed this. It would be a reasonable national goal that households with more than the average income should be able to afford a market rent on their social rented dwelling. Outside of London this could be extended to a broad social policy aim that a private market rent or purchase of a dwelling at or below the lowest quartile house prices ought to be affordable without subsidy, but in London private market rents and lower quartile house prices make this unobtainable – incomes of up to £60,000 are needed for average rents and prices, and higher still in the highest priced boroughs.⁶

For social housing, the average market rent is some 15% below local private rental sector average rents and, as we shall see below, is affordable to a household on the London average income (all tenures).

Affordability can be approached in two ways. The first is to consider residual income after net housing costs. Our welfare system uses this calculation so that, in theory, after Housing Benefit the household has enough income for other basics. This is most appropriate for no to low income households. It is inevitable in this formulation that the rate of withdrawal (taper) of benefits will be steep as incomes rise.

The second approach is to consider housing costs as a percentage of income. That is the method used in this paper for Higher Earnings Rents as we are considering households with incomes above the Housing Benefit thresholds, which are around £25,000 depending on household make-up and rent level. In this case we would expect to aim for rent to increase proportionate to income,⁷ i.e. much less steeply than the Housing Benefit taper.

4 PAY TO STAY

The Government intends to introduce a Pay to Stay regime. In the March 2013 budget it announced:

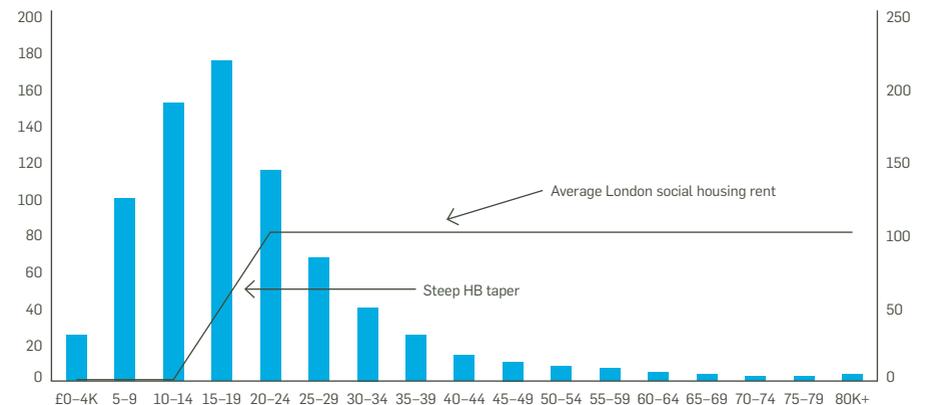
“The Government will shortly take steps towards allowing social landlords to charge market rents to tenants with incomes of over £60,000.⁸ The Government intends to require these tenants to declare their income to ensure they make a fair contribution, with all additional income reinvested in housing.”⁹

But will such an arbitrary income threshold ensure fairness? Figure 2 below shows the social rented household income distribution plotted with the average London social rent after Housing Benefit.

Above the steep Housing Benefit taper rent remains flat whatever the household income. At higher incomes the rent-to-income proportion drops to a very low level – 6.5% for an £80,000 income – and way below the usually accepted affordability ratios of 20% to 25% of incomes before tax.

Pay to Stay would introduce the following profile (shown in Figure 3). The sudden jump in rent presents a

Figure 2: Distribution of London social housing household incomes (Number in '000s LHS) and average rent paid (£ p/w RHS) after Housing Benefit.



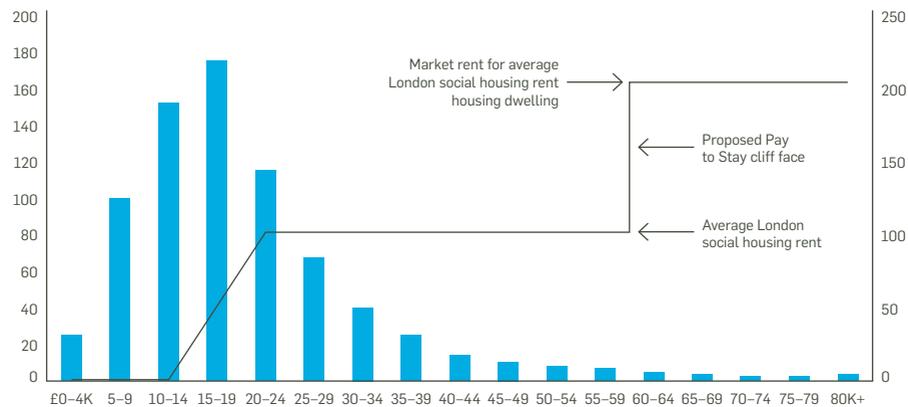
cliff face for the 1.9% of London social rent households with incomes over £60,000. It would generate about £30 million of additional rent income a year which is a low amount considering the administration required, and it is likely to prompt behavioural changes. Many of these highest income tenants will choose to leave the dwelling leading to further residualisation of social housing neighbourhoods.

Across the country the picture is even worse. The Government proposal takes no account of how affordable the market rent will be. At £60,000 p/a a market rent can represent an affordability ratio from 7% of gross income for a low value small social housing dwelling, to 39% for a high value family social housing dwelling. This is hardly a fair distribution of contribution.

We recommend (1): *that the Government avoids a simple income threshold such as that suggested in the recent announcements about Pay to Stay.*

Higher Earnings Rent overcomes these distortions by applying the affordability concept across all household and dwelling types.

Figure 3: Distribution of London social housing household incomes (Number in '000s LHS) and average rent paid (£ p/w RHS) with proposed Pay to Stay.



5 HIGHER EARNINGS RENT

The affordability benchmark used in this analysis is that on average a household just out of Housing Benefit currently pays 23% of gross income on the current social rent, and that a household on London's overall average income would also, on average, pay 23% on the market rent of the social housing dwelling. Still higher incomes would give lower ratios as the market rent for the dwelling is the upper limit.

Here we consider the average household in the average social rent dwelling. In the Appendix we give more detailed results for different household types in different dwellings sizes, and values. There we explore the interrelationship between the tax system (and especially tax credits), Housing Benefit and Universal Credit, and household incomes.

Incomes between the Housing Benefit threshold and average incomes require a gradation to maintain affordability, and there is some merit in not starting the Higher Earnings Rent immediately upon becoming ineligible for Housing Benefit in terms of amount and timing. The maintenance of the current social rent for a further income band of, say, £5,000 would help the small number of households moving in and out of Housing Benefit with small changes in income. This group represents a disproportionate number of those in serious arrears. We address the timing of Higher Earnings Rent changes in a later section, showing how social landlords can help those with frequent changes of income.

We now have sufficient data to construct a Higher Earnings Rent proposal. The chart below plots the income distribution and the rent paid using London averages. At no to low incomes Housing Benefit covers the full social housing rent. Then as incomes rise from £15,000 to £25,000 Housing Benefit tapers off. The taper range is actually much smaller for specific household types and rent levels, and hence steeper; here we show an overall effect across all household types.

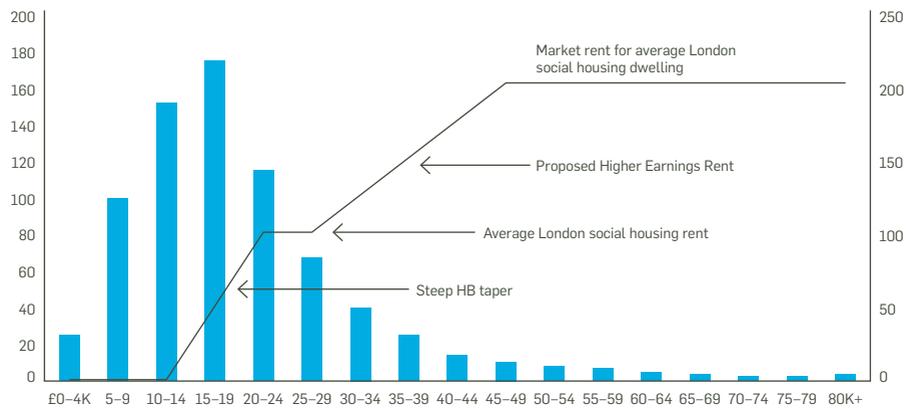
Then, as things currently stand, the full current social rent, at an average of £102 p/w, is paid no matter how much incomes increase. See Figure 4 on p32.

Our proposal is that:

Once household incomes exceed £5,000 p/a more than the Housing Benefit eligibility limit, gradual rent increases apply until the market rate is paid.

We recommend (2): *that the Government adopts graduated principles of affordability for additional rent paid by higher income households.*

Figure 4: Distribution of London social housing household incomes (Number in '000s LHS) and average rent paid (£ p/w RHS) with Higher Earnings Rent.



6 RESOURCES FOR HOUSING

6.1 Additional income

The calculation of additional income is highly sensitive to the actual distribution of incomes, the rents paid by individual households and the value, and hence market rent, of a home. Here we assess an overall increase in rent paid based on averages of rent and values and the estimated distribution of incomes for London as a whole. It gives an order of magnitude.

Multiplying the relevant rent increase, between target social rent and the proposed Higher Earnings Rent, by the number of households in each band gives a gross additional income of about £380 million per year.

From this must be deducted: additional administration costs, people leaving the sector, and other reasons for lower than theoretical collection.

6.1.1 Administration costs

Identifying household income for existing tenants not on Housing Benefit will be a new task for housing associations and council housing departments. It will also involve increased liaison with Housing Benefit departments. Furthermore not all rent receivable will be collected and at market rents bad debts are likely to be higher. A rough assessment is that 10% of additional rent receivable will be absorbed by additional landlord costs.

6.1.2 People leaving the sector

Higher rents for those on the higher incomes are likely to prompt some people to seek alternative accommodation, or to buy their current home (see Section 7). The numbers will be lower in London than nationally because of the cost of alternatives and of home ownership. It is estimated that 10% of higher earning households will cease being social tenants, leading to a reduction in Higher Earnings Rent income from 10,000 households.

The 10% lost additional Higher Earnings Rent income will of course be compensated for by 10,000 additional lettings to those in greater need. These

additional lettings are likely to be spread over the first five years or so. Rent levels will revert to target social rents when dwellings are vacated.

6.1.3 **Other reasons for reduced income**

The next most significant need to discount the theoretical income will be the timing of Higher Earnings Rent increases and reductions. It is proposed in Section 9 that increases will be made at normal anniversaries for rent increases whereas decreases could be applied on presentation by the tenant of verified changed earnings information. This is another way in which Higher Earnings Rent can help social housing tenants moving into and out of work or experiencing material changes in income.

There will be a few cases where landlord decisions are in dispute or information proves hard to obtain.

A small proportion of tenancies are under a contractual rent guarantee limiting increases (usually to an RPI formula) as part of a stock transfer obligation.

A small and decreasing number of tenancies have fair rents registered and not all of these can have rents increased to the levels suggested.

Overall it would be sensible to discount the additional income calculation by a further 10%.

This leaves a reduced aggregate annual additional rent income of £266 million p/a.

7 SHARED OWNERSHIP AND RIGHT TO BUY

As rents increase towards market rent for the dwelling, some households may wish to buy their home. A move to shared ownership should be encouraged for those with household incomes above £35,000 or so. Part purchases will not only recycle subsidy more quickly to speed up the landlord's ability to assist those in greater need, but will also retain higher income households with a commitment to their investment and to the neighbourhood.

In particular if households have equity in another property or savings exceeding, say, £50,000,¹⁰ then investing this in their current home, rather than a second home or buy to let property, should be a requirement. Income assessments will need to take into account savings and 'worth' in much the same way as Housing Benefit assessments.

For households on higher incomes and with savings of £10,000 to £20,000, a 50% share becomes an affordable purchase as rents approach the market level for the dwelling. Assistance could be given by using the Right to Acquire subsidy mechanism (currently £16,000 in London) pro rata to the share acquired. Associations and council landlords should discourage loan-to-value ratios above 80% (which is the current average for first-time buyers in the open market) but ultimately that is a choice for the purchaser, and their lender.

Property prices are generally rising in London in areas with above average prices (£450,000 for the open market in London) with falls more common in the lower value neighbourhoods – where our social housing is located. Take up of a shared ownership option should be encouraged by social landlords but volumes of sales may remain depressed whilst potential purchasers are wary of further price falls.

On purchase, most management and maintenance costs are transferred to the part owner. The Right to Acquire subsidy could also be supplemented by the landlord, who will see reduced operating costs and a higher return on retained equity (typically 2% to 3%) compared to net rental income after operating costs on

London social housing yielding 1.0% to 1.5%. Against this must be set the losses experienced on many service charge accounts. As a matter of law, service charges cannot exceed actual costs, yet in practice a proportion (estimated at up to 10% in London) remains difficult to collect.

With rents for higher earning households approaching market levels some tenants may consider using the Right to Buy route.¹¹ For councils the receipt from the proceeds of the Right to Buy sale can now, thanks to recent changes in regulations, be used to subsidise replacement programmes. The 30% rule limiting the use of net proceeds as a proportion of replacement costs will mean that most councils will replace RTB dwellings with Affordable Rent housing.

Right to Buy and Higher Earnings Rent highlight an important dynamic about discounts for purchasers. The value of a discount should be higher for tenants paying a low rent. As rents approach market levels the discount should reduce considerably. The system adopted by the Government does not allow for this. It is an example of administrative rules distorting the economic, and market, equation. Right to Buy needs a fundamental review but that is beyond the scope of this report.

Receipts from sales (RTB and Shared Ownership) are less predictable than rental income but if 40% of average value at £204,000 was paid and 4,000 acquired over the next five years then about £65 million p/a could be added to the £266 million net revenue income, although capital receipts are likely to reduce in later years as these purchases will reduce the 'stock' of households in the sector able to buy.

The table below shows the potential income of raising rents in accordance with the Higher Earnings Rent model, minus costs as set out in Section 6, plus projected additional income from housing purchases. With the subsidy for building or acquiring new social housing at a current average of £110,000 per unit, this equates to funding becoming available for more than

3,000 new social rental dwellings per annum for the next five years. Thereafter the amounts will be slightly lower as receipts from sales are likely to reduce.

Table 2: Additional annual income for recycling

Costs and Income	£m per annum
Gross calculation	380
Less:	
Administration and additional operating costs	-38
Leaving the dwelling	-38
Other reasons	-38
Net estimate	266
Add:	
Shared ownership and RTB receipts	65
Potential annual income	331
Social rent dwelling output	3,009 p/a

8

USES OF ADDITIONAL INCOME

The additional income offsets the initial capital subsidy, usually provided by the Government,¹² and as such should be used for similar purposes or, if not used in three years, should be returned to the source. There are parallels here with the Recycled Capital Grant Fund used by housing associations to account for grant subsidy when dwellings are sold or where there is a change of use, for example when a tenant acquires their dwelling using the shared ownership model. The RCGF attracts an interest charge until it is reapplied to subsidise another dwelling. This arrangement is part of the 'conditions of grant'. It is only if, after three years, it has not been applied that the conditions of grant are deemed not to have been met and the money has to be returned to the Greater London Authority, the government agency for housing capital subsidy in London.

In the case of Higher Earnings Rent the conditions of grant continue to be met and so the grant itself remains in place with the dwelling. The original grant amounts and terms of private finance loans remain unchanged. It is the additional rent income that becomes available for recycling, and is similar in nature to, but higher than, the interest earned on RCGF balances.

The net additional rent income,¹³ although small individual amounts, should be placed (monthly) into a Higher Earnings Rent Fund. This fund will be available to the social landlord to apply to further social housing investment.

In the case of councils with retained housing the Housing Revenue Account and Capital Receipts rules allow these funds to be used for substitute supply of subsidised housing, to invest in capital programmes for existing stock, and for housing related regeneration. Housing associations' use of recycled funds is more tightly defined. Both mechanisms provide an auditable tracking of subsidy and public funds.

There is scope in this proposal for housing associations to use some of the additional funds for regeneration projects (as opposed to bricks and mortar) including employment schemes and child care provision.

It is suggested that this should be on a prior agreed budget basis with the GLA, be limited to 20% of receipts, and be subject to data monitoring by the GLA of the effectiveness of these schemes. This last point picks up on an important part of the *Home-Work* report from Centre for London.

In the main the additional funds will be used for additional supply. £266 million a year from Higher Earnings Rents and £65 million from capital receipts could deliver 3,000 social rented dwellings a year in addition to the relets mentioned above.

We recommend (3): *that the Government requires that social landlords direct additional rent from higher earning households to an audited Higher Earnings Rent Fund.*

We recommend (4): *that social landlords apply resources from the Higher Earnings Rent Fund to invest primarily in social rented housing but that a proportion be allowed for other sub-market housing products and for regeneration activities.*

We recommend (5): *that Higher Earnings Rent Fund revenues not applied within three years be returned to the original source of the subsidy.*

9 INCOME ASSESSMENT AND APPLICATION FOR DIFFERENT TENANCY TYPES

9.1 Tenancy types and timing of rent changes

Social housing tenants can be in one of many different tenancy types:

- Secure and Introductory
- Assured and Probationary
- Registered

The latter is a small share of the sector as, other than successions, transfers and decants of some existing Registered tenancies, no new tenancies of this type have been granted since January 1989. The majority of these tenants are now pensioners. If a Registered tenant has a higher income, then a Higher Earnings Rent might be difficult to apply as the Valuation Office Agency may register a lower rent. In most cases a rent registered will be near to the Local Housing Allowance level, which has a London average of about £230 p/w. The average market rent of a social housing dwelling is about £205 p/w so most will comply, but not all.

Normally there is nothing in a Secure or Assured tenancy agreement to prevent a rent increase to a market level. The control on levels and on rates of increase lies in the landlord's duty to its regulator, and in subsidy rules. These can be changed by the DCLG and the GLA/HCA to allow Higher Earnings Rent to be used to recycle subsidy to those in greater need. The tenancy agreement does not need to be changed.

What cannot be changed without statute, and even then could not override existing tenancies, is the *frequency* of rent increases for assured tenants, which are limited to once a year and require one month's notice. Legally rents can be decreased at any time. Secure tenancy rents can be changed at any time subject to one month's notice, but anything other than an annual increase is rare and then only when a council's finances are in crisis.

Introductory and Probationary tenancies should be left to run to their conclusion, usually for twelve or six months, rather than introducing rent changes that may

compromise their review. Very few, if any, Introductory or Probationary tenants will have higher incomes.

For most of the 16% of social rented households on higher incomes, an annual increase to a Higher Earnings Rent, or a reduction after application, can be achieved by a change in regulations rather than in statute.

For the majority (84%) of social housing renting households the rent increase regulations will apply and no change is proposed to this principle. No change is proposed to Housing Benefit (and Universal Credit) regulations, tapers, thresholds or processes.

Rent setting and Housing Benefit calculations will continue to be based on the rent influencing regime, i.e. moving to target rents. In Section 12 we look at how the Higher Earnings Rent concept could inform future rent regimes post 2015.

9.2 Income information

A significant cultural change will be required – that occupancy of a dwelling with a rent subsidised with public money comes with the ‘conditionality’ that incomes and wealth must be disclosed to the landlord on an annual basis.

This is no different to the condition, indeed legal requirement, to provide this information to be assessed for Housing Benefit. In practice of course a social landlord can treat Housing Benefit recipients as having provided the necessary information (to the local authority) and need only request income data from those not in receipt of Housing Benefit.

A legal requirement to provide information on income to the landlord may not be necessary. The default position could be that those who do not comply with a request will, following a reminder and final request be charged the market rent for the dwelling at the next rent anniversary. In some cases this will encourage benefit take up. About 10% to 15% of households still do not claim despite being eligible.

Tenants should be permitted, by general agreement with the landlord, to request a rent reduction between

rent change anniversaries if they are paying a Higher Earnings Rent and their financial circumstances change for the worse. It is suggested that this should be limited to changes of £5 p/w or more,¹⁴ be subject to complete and acceptable documentation, and be backdated to the date of application. A loss of income which drops down to Housing Benefit eligibility levels (plus, say, £5,000 p/a) will trigger the reinstatement of the target social rent.

It would be good practice for the landlord’s staff or advisers to use the Housing Benefit or Universal Credit forms to calculate full household income.

Landlords will require lead in time to request information, assess it, and implement rent changes. It is suggested that requests for up-to-date income data would be made 3 months before the rent anniversary, giving two months to process and one month to implement, and that applications for mid-year decreases be allowed a similar timescale with backdating of the change.

Landlords will also need up-to-date data on the open market values, and hence market rent potential, of their stock. There is a strong argument that landlords should be doing this anyway even if not required to under information and gearing covenants with lenders, accounting policies, or to deliver an Intermediate Rent or Affordable Rent programme. Asset management strategies require an understanding of property values and the impact that a landlord’s policies such as reinvestment or neighbourhood income balance may have on these.

10

IMPLEMENTATION

The Higher Earnings Rent concept could be introduced into the conditions of grant for new schemes. Housing associations would accept the new mechanism as part of accepting new grants. The additional rent income will, however, not flow until some households allocated these new dwellings have started to achieve higher incomes, and this may take many years.

It will not be possible for the Government to insist on a retrospective application of Higher Earnings Rent for housing associations. Grant terms are a contractual matter and, although technically possible through statute, the Government would find it difficult to apply in retrospect. Associations can, however, voluntarily agree with the regulator to apply Higher Earnings Rent to existing social housing stock; the incentive being, for both parties, the raising of funds for additional social housing supply.

Despite the new permissive framework for local authorities there is still a need for mandatory requirements of councils by central government, for example on the terms of the Housing Revenue Account and for recycling of Right to Buy receipts. Many Councils will want, voluntarily, to apply Higher Earnings Rent and to reinvest the additional income. They would require consent from the Government and would need to set up an audited Higher Earnings Rent Fund. The Government could, however, make Higher Earnings Rent a statutory requirement for all Councils with retained council housing, if it so wished.

The Pay to Stay proposal may act as an introduction to Higher Earnings Rent. It appears as though it will be a permissive, rather than mandatory, scheme. Social landlords that use it first may well help to improve the design of some aspects of the proposal so that a wider application becomes realistic. There is a danger, however, that the cliff face nature of Pay to Stay, and its complete insensitivity to actual rent levels or affordability ratios, will lead to widespread opposition to the scheme, thus delaying or preventing the application of its underlying principle.

We recommend (6): *that the Government redesigns the Pay to Stay proposal to enable a piloting of the Higher Earnings Rent concept by a few social landlords in London.*

10.1 Pilots

It would be wise to pilot the Higher Earnings Rent concept within existing stock before making it a condition of new grants. There are a number of practical matters which need testing:

- Tenants will need adequate warning of the new policy;
- Some form of graduation may be needed to introduce the scheme, for example by delaying application of a higher rent for two years, or by limiting the maximum rent to half the difference between the target rent and market rent, or to the Local Housing Allowance, in the first few years;
- Methods of assessing household income need to be trialled. Some associations already have staff teams skilled at income verification, others may want to employ and pay local Housing Benefit teams to do this.

A pilot programme of, say, three housing associations with stock in London and two councils would help to design the scheme, identify administration costs, and set out the range of flexibility permissible, for a wider roll out.

11

THE IMPACT ON LANDLORDS

This section addresses concerns that have been raised recently about higher rents in the social housing sector. The Affordable Rent product has increased gearing, and hence risk to landlords' viability. Welfare Benefit changes bring uncertainty about future rental income and are forcing a more cautious approach to business planning. Both of these are dampening landlords' appetite for new investment in supply. Will Higher Earnings Rent add to these concerns? We take a more detailed look at some commonly expressed views.

11.1 Charitable housing associations should not charge market rents.

In practice very few social rented households will be charged the full market rent. Under Higher Earnings Rent most higher earning households will be charged a proportion of the market rent representing an affordable share of gross income.

Charging the full market rent may, however, raise questions about charitable status and tax liabilities. Poverty is a relative term – in high cost areas even average incomes can lead to housing poverty. And the majority of charitable housing associations have objectives beyond the relief of poverty. The provision of, and access to, housing can meet a range of charitable objectives, for example age- or disability-friendly, or neighbourhood regeneration. Councils and non-charitable associations have similar purposes but are not constrained by charitable status.

Each charitable association will have to make its own assessment of whether a full market rent meets its objectives. Much will depend on local circumstances and constitutional arrangements. In reaching a decision two factors are important. The first is the scale of activities relative to those activities that provide benefits to people in need and the second is the purpose to which surpluses are applied. If the first is a low proportion of activity, and the second is used to meet charitable purposes then the overall status of the charity is unlikely to be challenged. A slight discount to market rent for the highest earning

households may provide a safety factor but this would be at the expense of raising funds for additional social housing stock.

It is questionable whether the ‘do nothing’ option is preferable. A charity that continues to provide benefits to those whose incomes clearly mean that they are not in need may well be the first to be challenged.

11.2 Why not charge market rents for all dwellings and use the Housing Benefit system to make rents affordable to those on lower incomes?

There are three reasons why this possible scenario is not optimal. Firstly, as described above, the Housing Benefit system is designed to ensure basic residual income after housing costs does not fall below poverty levels. This is not a suitable system for rent subsidy for those well above the poverty line through to average household incomes. Secondly, work disincentives from benefit withdrawal are real yet do not affect a significant number of the population.¹⁵ To extend the trap across a second quartile of household incomes courts serious benefit dependency. Thirdly, pure revenue subsidy for (perhaps 40% to 50% of) the renting population that will never be economically active is more costly for the taxpayer than capital subsidy.

11.3 Social landlords should not become means testers.

Most are anyway. Most consider income levels at the point of letting – this is how they can be confident they serve their purpose and ensure that subsidy is put to best use. All consider incomes in some detail when offering low cost home ownership, as well as intermediate rent products, and will do so for Affordable Rent lettings. Means testing is not easy or likeable.

To some extent social landlord housing managers have been able to opt out of the detailed work because it has been led by council allocations and Housing Benefit departments. In fact, landlords could employ the local Housing Benefit team to make the Higher Earnings Rent income assessment for them. There is nothing wrong

with delegating functions to agents, but social housing landlords ultimately must be responsible for ensuring that means testing takes place, or else they deny their purpose.

11.4 The additional income will not be secure.

Higher rents paid by higher earning social housing tenants will, under the Higher Earnings Rent concept, not be a secure income flow in the same way that existing stock converted to Affordable Rent can be. Receipts of rent over target rent levels will be dependent on the changing incomes of households. The receipts should not be used to support new debt directly; they should be used as subsidy to assist in new supply of sub-market housing products.

11.5 Landlords face greater risks if rents are increased.

Operating costs will increase as rents approach market levels for the few social housing tenants on the highest incomes. Bad debts will increase. Expectations of service level will also increase and will lead to increases in management and maintenance costs. Experience of shared ownership and leasehold management of households within social housing schemes is that higher earning households do, in general, make higher demands on the landlord. We should not shy away from this customer pressure but we do have to recognise the financial impact. This is one of the reasons why the Higher Earnings Rent concept includes the provision that a small proportion (10% is suggested) of the additional rent income should be retained by the landlord to meet these costs and the extra administration costs associated with assessing household incomes.

11.6 Relationship with banks and providers of private finance may suffer.

Lenders are taking the opportunity to renegotiate terms when covenants are breached and landlords need to be especially careful not to trigger this by introducing new policies and practices. The sector regulator at the Homes

and Communities Agency expects Registered Providers to be risk averse in this respect. The Higher Earnings Rent concept, however, does not alter the original terms of the initial capital subsidy, or the debt position, on existing social housing. These remain in place, and income cover and gearing ratios remain unchanged. Indeed if and when the higher earning household, paying the Higher Earnings Rent supplement over target rent levels, has a reduced income or moves out, then rent will return to target levels. The re-letting of social housing, under Higher Earnings Rent, will be at target rents.

11.7 The Regulator may seek re-classification of ‘non-social’ housing activities.

The HCA requires providers to account separately for non-social housing activities, especially market level activities, so that public subsidy held within the social housing stock may be protected. If social landlords start charging Higher Earnings Rents approaching market rents will these dwellings need a separate classification? We would argue not; they should remain as social housing assets. It is the, probably temporary, additional rent income over target rent levels that requires a separate account. This arrangement also protects the subsidy provided by s106 planning obligations, or discounted land sales by local authorities to associations in return for nominations to social rented housing. The concepts behind the capital grant rules do not require any change other than to recognise that additional income, over and above the purpose of the original subsidy, should be treated as a form of subsidy recycling, and made available for investment in additional housing assets, or returned to the GLA if unused after three years.

There may be other concerns within the sector on the implications of the Higher Earnings Rent concept. We hope that this report will stimulate debate, and encourage innovation.

12 HIGHER EARNINGS RENT AND RENT SETTING POST 2015

12.1 Background

For many years after the introduction of assured tenancies for housing associations in 1988 there was no guidance on rent levels. One consequence was that competition for grants for new development was distorted by different rent levels for similar dwellings. Another was a growing divergence of rents between local authorities and housing associations.

Rent levels for housing associations grew each year at a rate far exceeding inflation or earnings. This was a predictable consequence of “housing benefit taking the strain.”¹⁶

The emergent ‘rent influencing regime’ announced in 2001¹⁷ sought to create coherence within the sector and between housing association and council rents. Rents have since been determined by property size, value and local manual wage levels. Although introducing manual wage levels into the regime was an anchor for affordability,¹⁸ it was emphasised that individual household incomes were not a deciding factor on rents. The value for money of grant input now had a key variable: fixed and competing bids for subsidy could be compared on a like for like basis.

12.2 The basic formula

Regulatory guidance from the HCA sets out the detailed target rents calculation.¹⁹ It is based on relative property values, and on relative average manual earnings by district, in 1999. Differentials are set for dwelling sizes by number of bedrooms. Maximums are set by rent caps. The formula determines not only the starting rent but also the maximum annual increase (RPI + 0.5%) within a maximum additional annual change of +/- £2 p/w so that those current rents below target levels can move towards the target, and those above can move down. The formula applies to HRA calculations for local authorities as well as to housing associations. It has led, 12 years after its introduction, to a high degree of coherence on rent levels (comparing like for like) within the social housing sector. The current regime is due to end in March 2015.

12.3 Changes ahead

In the March 2013 budget the Government announced:

‘At the 2015–16 Spending Round the Government will therefore set out a social rental policy that gives social landlords certainty until 2025.’²⁰

12.4 Discussion

In previous reviews the ‘rent influencing regime’ has focussed on dwelling attributes and location, and only indirectly considered tenant incomes. How can we bring the two together, and what are the options for future policy on rents?

Many hold the view that rents should be property-based and not determined by income. Capital subsidy for the dwelling ‘sets’ the sub-market rent and then Housing Benefit adjusts for the household income.

However you look at it, though, the rent for subsidised housing products has been income related. Social housing rents are charged of those on low incomes, intermediate and more recent Affordable Rents of those on moderate incomes. Indeed in the past some local authorities have delivered higher rent products for higher income groups. The important point is not the appropriateness and affordability of the product for each income group but that the taxpayer gets an outcome that is commensurate with the subsidy provided. Once grant input is fixed then the outturn rent should be determined.

The rent regime has not moved on. Here it is proposed that the target (social) rent, and of course the market rent, for the dwelling continue to be based on attributes and desirability, but these need to be kept up to date with market changes. The RPI plus 0.5% formula for increases based on relative property values in 1999 delivers this to some extent but it is not one that can continue indefinitely. Relative values need to be updated more frequently and the annual uplift needs to be linked more to changes in housing costs than to other consumption (on which RPI and CPI are based),

otherwise an unsustainable ‘gap’ will appear which makes investment in, and maintenance of, social housing unviable.

Furthermore, the current rent influencing regime has a low differential for dwelling sizes, making investment in family-sized dwellings costly in subsidy terms and discouraging supply.

London in particular needs products which are affordable for low- to middle-income groups and which require less subsidy. There is no reason why existing highly subsidised housing stock should not play a part. In fact there are many reasons why it should. The key to achieving this is through Higher Earnings Rents, ensuring that additional rent is recycled to maintain and increase the supply for those in greater need.

12.5 Relationship between capital subsidy and rents

Support for low income households in sub-market housing takes two forms. The first is a subsidy, usually a capital sum to reduce the cost of provision, to enable a lower-than-market rent to be charged which covers operating costs and loan charges. The second (Housing Benefit) is a subsidy to households on the lowest incomes to reduce the sub-market rent to the point where residual income after housing costs does not fall below the poverty threshold.

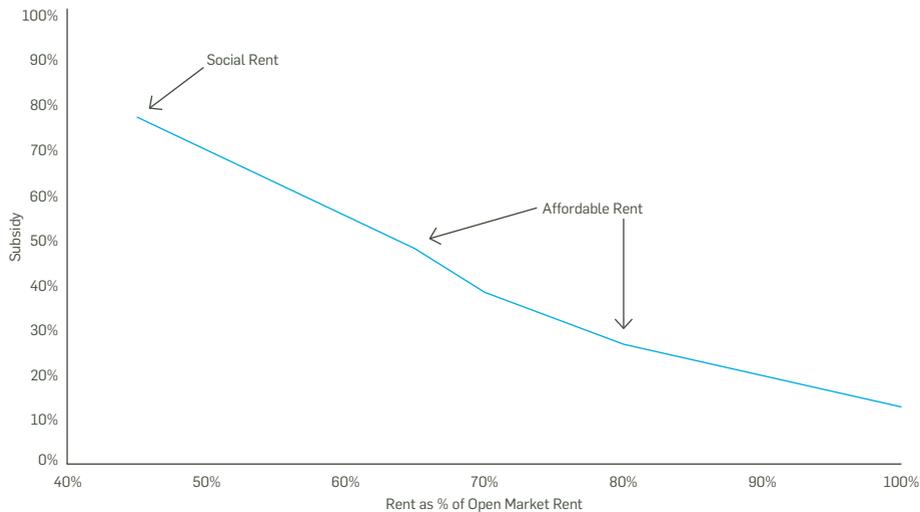
Some recent campaigns for change in the social housing rent influencing regime have argued that the Government should either control rents charged for the capital subsidy provided, or control the amount of revenue support available through the housing benefit system, but not both. This argument ignores the distinct role of both forms of subsidy and their complementary nature. Both are needed for the lowest income households.

Capital subsidy is most efficient, for the taxpayer and for the provider, for those households that are rarely or never economically active whether through age, disability, or caring responsibilities. For households that are economically active a revenue subsidy is more efficient. Some crossover mechanism is needed. This can be achieved through two means. The first is to offer a

range of products with different proportions of capital subsidy. The second is to apply the Higher Earnings Rent concept to those with higher incomes in the higher subsidised products. The relationship between rent levels and capital subsidy is shown below (Figure 5).

The calculation is for an average (two-bedroom) dwelling in London with an open market value of £245,000, which is midway between the value of new social housing provision and the value of the average private rented dwelling. The relationship is not linear, as operating costs, and the costs of provision, increase as rents approach market level. Even at market rent levels some subsidy is required as, generally, market rents are not economic rents. Here we are looking at the average London dwelling let to average households. There are, of course, many private rented schemes that work well and subsidy would not be appropriate, but it is important to note that a high proportion of these are in special locations or are aimed at special client groups such as students, or young mobile professionals.

Figure 5: Subsidy required as % of cost of provision versus rent as % of open market rent



There appears to be a need for capital subsidy to ‘remain’ even at market rent level for the average London private rental sector dwelling and client group. This is because investment values at market rent are some 5% to 10% lower than the capital cost of provision. This is partly a result of the state of the economy, a result of the balance of rights and responsibilities between tenants and landlords, and the fact that the market level is ‘set’ by a large number of small scale landlords whose service level and operation are ‘below cost’. For example, major repairs are often left to the next purchaser, boosting revenue yield and absorbed within capital yield.

12.6 Rent influencing regime defects

There are a number of defects in the current system which should be addressed by any change in policy:

12.6.1 Bedroom differentials

The target rent formula assumes a low differential with respect to size. This has favoured the production of smaller dwellings and made family-sized dwellings harder to finance. The differentials are compared below to the cost of provision or acquisition of dwellings (Table 3).

12.6.2 1999 valuation base

The formula is based on historic data at a fixed

Table 3: Rent differentials (relative to two-bedroom dwelling)

Dwelling size by bedroom	Target Rent	Cost of Provision
Studio	80%	70%
1	90%	85%
2	100%	100%
3	110%	120%
4	120%	140%
5	130%	160%
6+	140%	180%

point in time (1999). This has become out of date. The relative values of dwellings change between areas and the target rent formula has not kept up with these changes. This applies to both the open market property value and to the average manual earnings data.

12.6.3 Reinvestment and improvements

The formula gives a low weighting to property values. The effects of bedroom differentials and the manual earnings element are much stronger particularly in low value areas. This means that any changes in value, for example through improvements and reinvestment, are not reflected in the rent level in any significant way. Social landlords are discouraged from improving and enhancing their dwellings by this formula.

12.6.4 The wrong index

In the long run consumption price indices are not suitable for tracking earnings or housing costs. We really should be aiming for target rents to track below-average earnings. In this way the affordability for low income households will be maintained. Ideally relevant household earnings should be used to apply the affordability principle.

But there is insufficient household income data at a neighbourhood level, or even at a local authority level, to achieve this. The best substitute would be to track 15th percentile house prices.

In the short term the Government might be considering a move to CPI (as with LHA and other benefits). If so, the guideline should be $CPI + 1.2\%$ to recognise the structural difference in the calculation of CPI relative to RPI.

Furthermore the administrative nature of the current regime produces other anomalies for example for the family household in a low value area where the current target rent delivers a low affordability ratio of about 16% of gross income.

12.7 An alternative – ‘discount to market’

A logical conclusion from this is that a future ‘rent influencing regime’ should match a ‘discount to market’ rent to the capital subsidy provided.

Current property values for social housing should be used as the starting point, not the levels at 1999 or any other fixed historic date. Such a radical change would require a much wider review, and far more attention to the details, than is possible for the announcement due this summer.

At worst the Government has, this year, no room for manoeuvre. Debt financing of housing associations and local authorities is not only dependent on the absolute sub-market rent level but also on the future rate of increases. Any material change to the $RPI + 0.5\%$ guideline would undermine business plans for existing stock (and debt). It would undermine the recent settlement for council housing. It would cause a material change in the assessment of debt level and the redistribution between council Housing Revenue Accounts. It is inconceivable that the Government would want to trigger a major adjustment to the carefully negotiated national settlement completed in March 2012.

What is possible in the near term is to slightly change the constitution of the current regime so that a social landlord’s overall target rent (aggregated over all its stock) tracks, say, $RPI + 0.5\%$ but that within that the social landlord could have much greater flexibility to charge rents that better reflect the market differentials that exist within the neighbourhoods in which it operates.

We recommend (7): *that the Government maintains the current $RPI + 0.5\%$ guideline formula for another five years for annual increases in target rents and allows greater flexibility within a social landlord’s portfolio, and that a fundamental review is carried out with the sector and its funders for a longer-term regime post 2020.*

13

SUMMARY OF RECOMMEND- ATIONS

We recommend that:

- 1—The Government avoids a simple income threshold such as that suggested in the recent announcements about Pay to Stay.
- 2—The Government adopts graduated principles of affordability for additional rent paid by higher income households.
- 3—The Government requires that social landlords direct additional rent from higher earning households to an audited Higher Earnings Rent Fund.
- 4—Social landlords apply resources from the Higher Earnings Rent Fund to invest primarily in social rented housing but that a proportion be allowed for other sub-market housing products and for regeneration activities.
- 5—Higher Earnings Rent Fund revenues not applied within three years be returned to the original source of the subsidy or grant.
- 6—The Government redesigns the Pay to Stay proposal to enable a piloting of the Higher Earnings Rent concept by a few social landlords in London.
- 7—The Government maintains the current RPI + 0.5% guideline formula for another five years for annual increases in target rents and allows greater flexibility within a social landlord's portfolio, and that a fundamental review is carried out with the sector and its funders for a longer-term regime post 2020.

14

APPENDIX: ANALYSIS BY TYPE OF HOUSEHOLD

The range of household types and dwelling values

This report is a concept document. It explores ideas and proposals looking at the average social rent and the distribution of social housing household incomes in London. Individual household circumstances will vary as will dwelling rents and their potential market rent.

Here we look at different household types, different dwelling values and hence rents, and the impact of welfare benefit reforms. The household types considered are:

A—Single person of working age – working 35 hours per week – occupying a one-bedroom dwelling.

B—Couple of working age – one working 35 hours per week, one at college – occupying a two-bedroom dwelling – technically under occupying.

C—Couple of working age – one working 35 hours per week, one at college – with two children at school aged 14 (M) and 15 (F) – occupying a three-bedroom dwelling.

Calculations at all earned income ranges are made for tax, tax credits, child benefit, but not other benefits. These are compared against three value bands with the two-bedroom dwelling valued at:

1—£204,000 open market value – the London average for existing Local Authority and housing association stock. See Figure 6.

2—£100,000 open market value – the average for the rest of England excluding London. This is very low for London and probably only exists in some of the East London Boroughs and even then will be rare, but it does help us to consider the effect of a Higher Earnings Rent policy outside London where rents are lower and the gap between social housing target rents and market rents is much smaller. See Figure 7.

3 – £400,000 open market value – a high range for social housing in London but by no means exceptional in the Inner London Boroughs particularly in mixed tenure neighbourhoods. See Figure 8.

The results are displayed in the nine charts in this appendix. The figures above show how Higher Earnings Rent can be adjusted to maintain a similar level of affordability for all household types, target rent levels and market values.

Affordability

The concept paper uses an average target affordability of rent at 23% of gross income for those with incomes that are in excess of Housing Benefit eligibility levels – capped at the market rent level. This more detailed analysis by household type uses 25% for working age adult households with no dependents or care needs, and 20% for households with children.

High benefit households

There are some households in social housing in London in dwellings with high market values that can be in

receipt of benefits despite higher than average household incomes. A family with four children and with one or two family members with enhanced disability premiums could still be eligible for Housing Benefit (or the housing element of Universal Credit) with a gross earned-income of around £50,000 p/a, if rents were high.

The principle behind Higher Earnings Rent is that target rents apply for any household with incomes eligible for Housing Benefit or slightly above. So for this

Figure 6(b): Couple in average value 2 bed

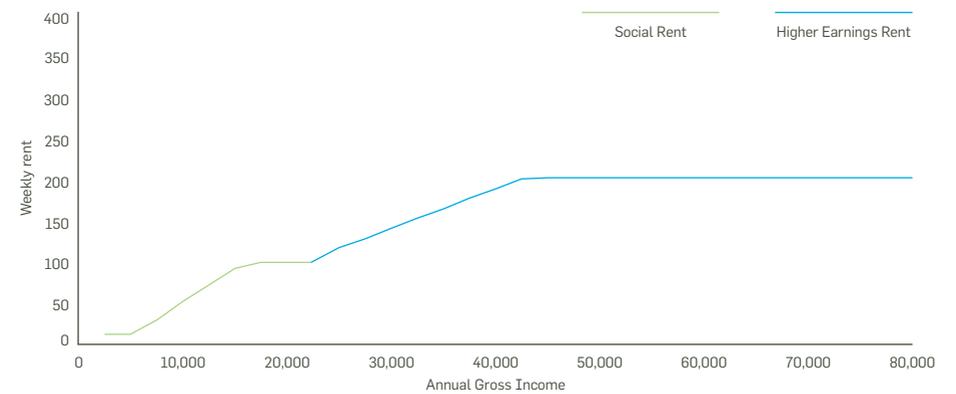


Figure 6(c): Family in average value 3 bed

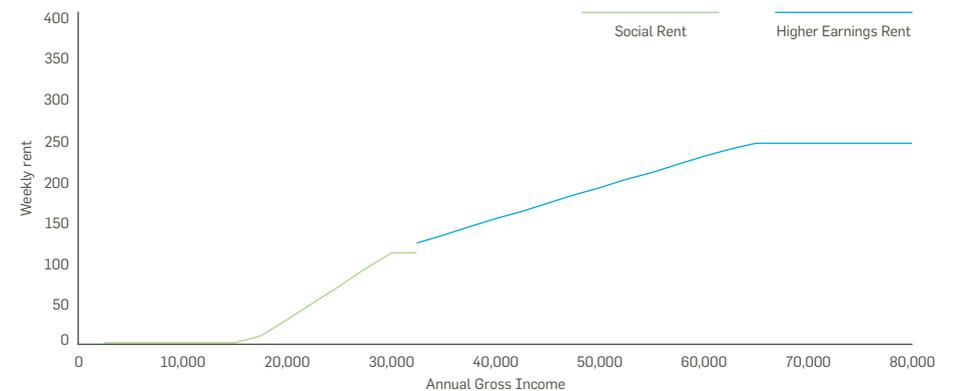
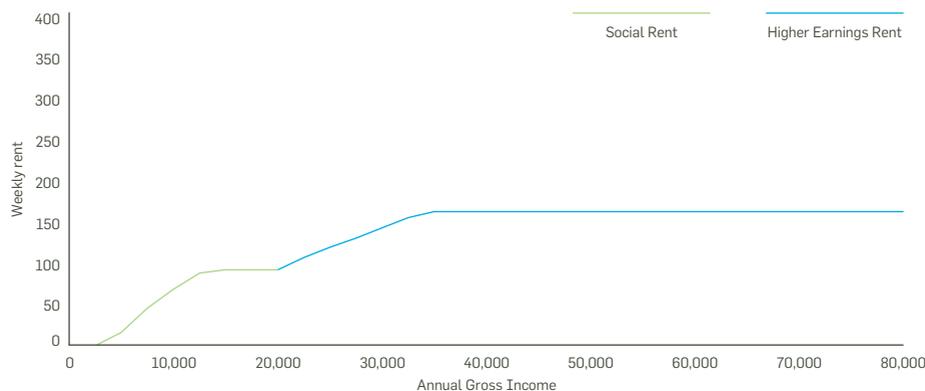


Figure 6(a): Single person in average value 1 bed



family the Higher Earnings Rent would not apply until the household income exceeded about £55,000 p/a.

Welfare Benefit reforms

The impact of the new arrangements for 2013 is far from being fully understood, particularly the behavioural changes that might be induced by increased conditionality in our welfare benefits system. There are three reforms which are directly relevant to the rent levels.

The first is the reduced eligible rent for benefit for under-occupiers. Figures 6(b), 7(b) and 8(b) show the couple under-occupying would always have to pay a part of the rent no matter how low their income. Assuming no change in behaviour (such as downsizing or taking in a lodger), there is a direct impact on benefit entitlement, which will also have the effect of a shift of ‘taper’, meaning that people will come off Housing Benefit earlier on the income scale – about £2,500 p/a earlier for one ‘spare’ bedroom and £5,000 p/a for two ‘spare’ bedrooms.

The second is the rent cap for the Local Housing Allowance. The LHA does not apply to target rents in social housing, but paying a Higher Earnings Rent might

mean a rent that exceeds the rent cap. The rent cap, however, applies to benefit eligibility. In this case the landlord would reduce the rent to the target rent from where benefit eligibility would be calculated.

The third is the benefit cap of £26,000 for Universal Credit. This will have significant impact for no or low income households, with four or more children and/or care needs in the private rented sector, especially in Inner London. It is the housing element that will be cut

Figure 7(b): Couple in low value 2 bed

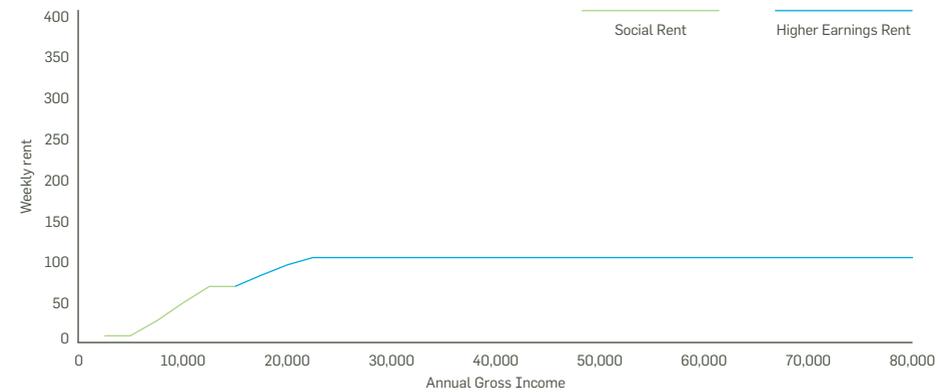


Figure 7(c): Family in low value 3 bed

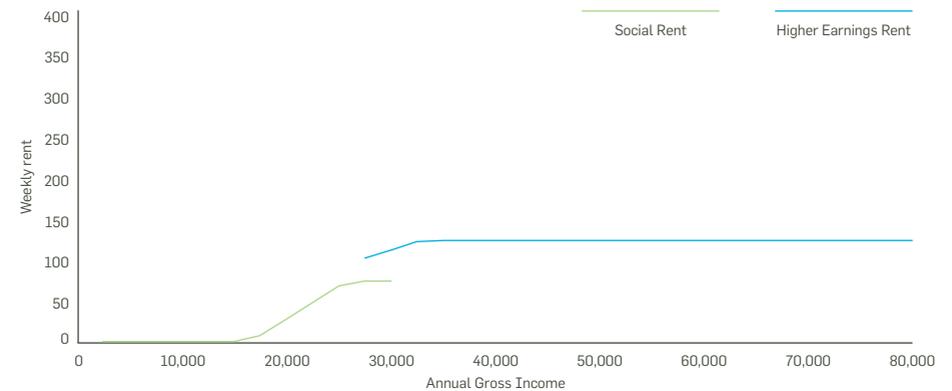
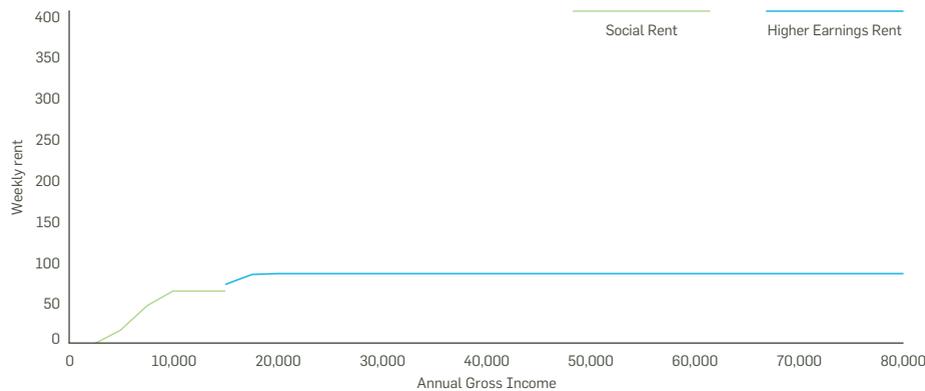


Figure 7(a): Single person in low value 1 bed



back to the level of the benefit cap. We have yet to see the full effect of this cap as pilots are only due to start (in four London Boroughs) this year. But using the Higher Earnings Rent principles, a household on Housing Benefit (or the housing element of Universal Credit) of any amount would be charged, and be assessed on, the target social housing rent. Very few social housing households will be affected by the benefit cap.

Figure 8(a): Single person in high value 1 bed

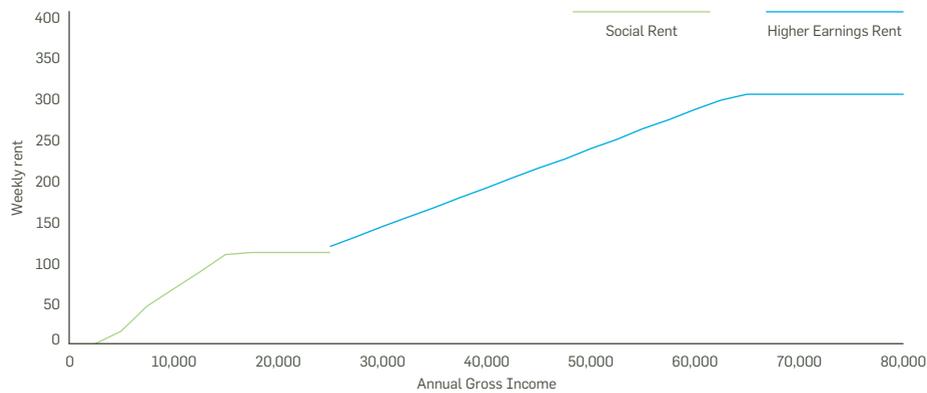


Figure 8(b): Couple in high value 2 bed

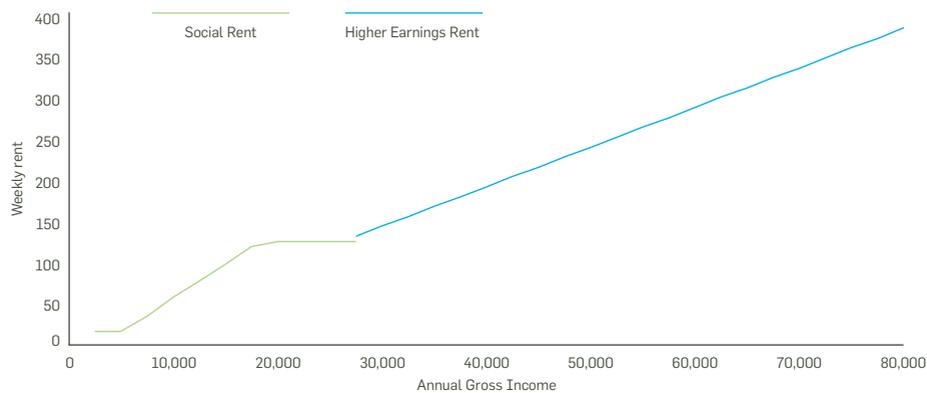
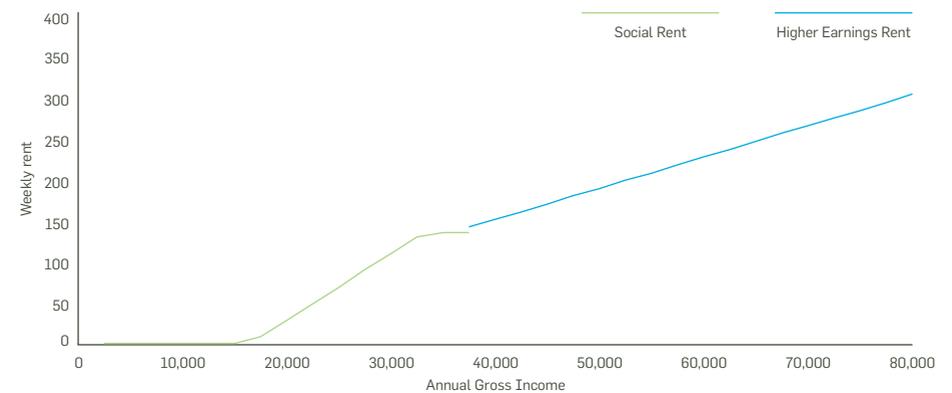


Figure 8(c): Family in high value 3 bed



Residual incomes

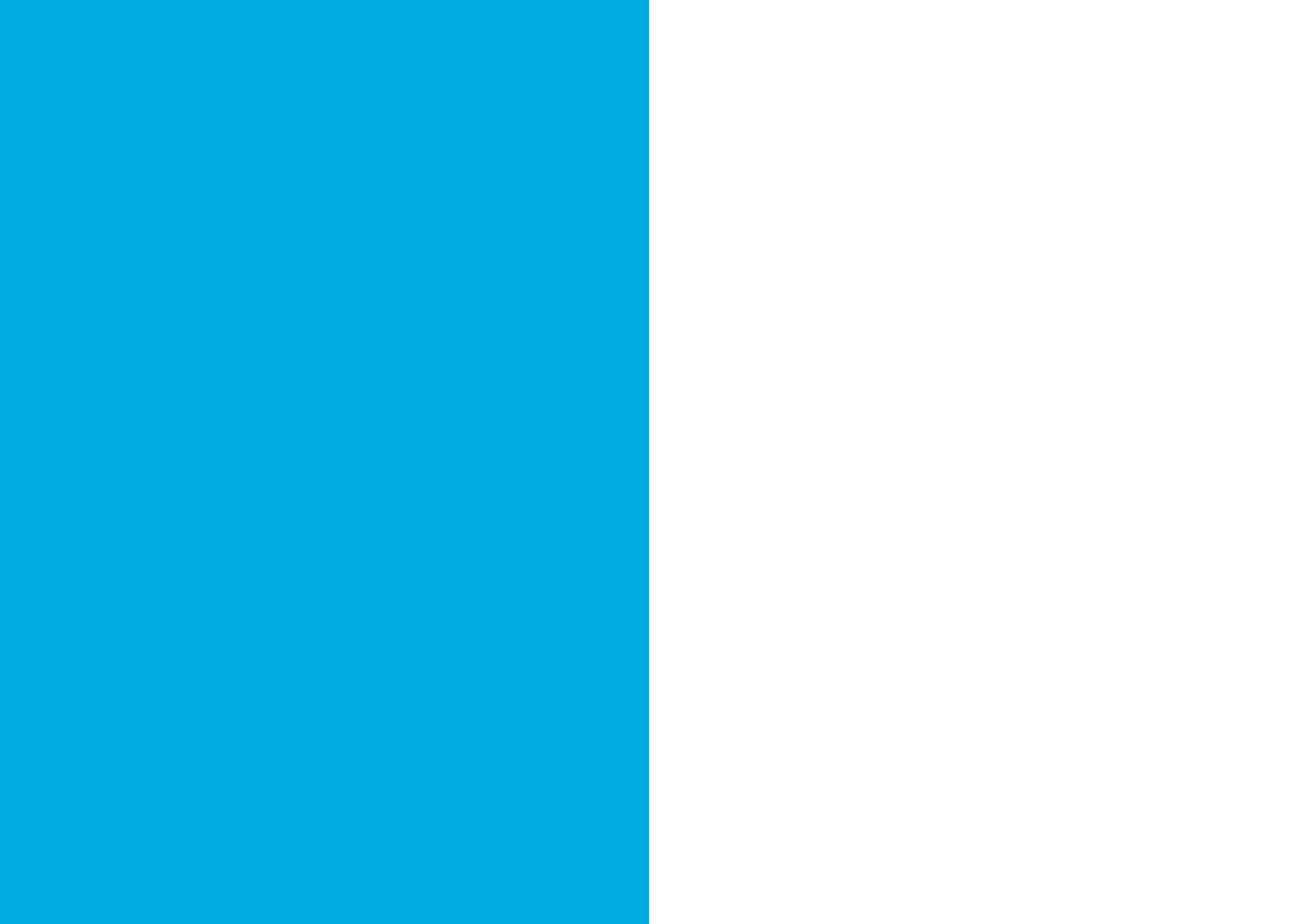
For the lowest incomes the benefit system aims to ensure that residual incomes after housing costs do not fall below the poverty line.

A final test of the affordability of Higher Earnings Rent is to ensure that residual incomes after tax and housing costs for higher earners are not only sufficient but progress as gross incomes increase and do so at least proportionally to gross incomes. Any system of sub-market rent setting that did not achieve this would create a work disincentive.

Tests have been run for each of the household types and property values for all gross incomes up to £80,000. The rate of residual income growth varies up the income scale as effective tax rates change (particularly for the taper out of child benefit for families with an earner exceeding £50,000). But in all cases residual incomes grow proportionately at between 40% and 60% of gross income increases.

NOTES AND REFERENCES

1. Elizabeth Clery, 'Are tough times affecting attitudes to welfare?' in Park, A., Clery, E., Curtice, J., Phillips, M. and Utting, D. eds., *British Social Attitudes: the 29th Report* (London: NatCen Social Research, 2012).
2. DCLG news announcement 13 June 2012. <https://www.gov.uk/government/news/paying-to-stay-in-taxpayer-funded-housing>
3. Colin Fernandez and Rob Cooper, 'I just can't afford private rent, says council tenant former minister on £66,000 salary', *The Daily Mail* (16 June 2011).
4. Liam Kelly, 'Do you support pay to stay?', *The Guardian* (21 June 2012).
5. HM Treasury, Budget 2013 1.113 p. 40.
6. This concurs with the recently amended eligibility limits for Intermediate Rent and Low Cost Home Ownership products in London of £64,300 for one- and two-bed dwellings and £77,200 for three-bedroom plus – effective from June 2012 – see First Steps, the GLA website for applicants to Low Cost Home Ownership schemes. At these income levels one would expect low capital subsidy, and perhaps no subsidy in the lowest-priced boroughs.
7. Interestingly, whilst, on average, London private sector rents are higher for those in higher income bands this is not true for social housing. Social housing rents are much the same whatever the income level, perhaps because the newer dwellings with higher rents have been more recently allocated to lower income groups whilst those now on higher incomes tend to be in older dwellings with lower rents.
8. It is not clear from this statement whether this policy will apply beyond social rented households to those in intermediate market products such as Affordable Rent. The latter are relatively new products and so the number of tenants whose income has progressed beyond £60,000 will be very small.
9. HM Treasury, Budget 2013 1.113 p. 40.
10. It is estimated that an order of magnitude of 2,000 social rent households in London have wealth in excess of £50,000 based on an extrapolation of Family Resource Survey data.
11. It is not easy to predict take up, given the new higher discounts. There is evidence that take up rates have doubled in the last six months but from a very low base of around 0.2% of stock per year.
12. Not all capital subsidy is strictly 'public subsidy'. Some will be contributions from S106 obligations, use of land at discounted value, charitable contributions, and internal funding by housing associations and councils.
13. i.e. Higher Earnings Rent collected, less Target Rent, less administration costs.
14. This equates to a change in annual income of roughly £1,000. Smaller changes can be picked up at the rent anniversary.
15. DWP sponsored research conducted in 2010 on the Local Housing Allowance showed that most people 'caught in the benefit trap' – and there were surprisingly few – preferred to work and to seek higher wages.
16. William Waldegrave, Housing Minister, speech to NFHA annual conference 1988.
17. Led by Nick Raynsford as Housing Minister in the late 1990s and early 2000s.
18. It is a moot point whether incomes add anything to the mix – in effect incomes and house prices go together. Alternative proposals at the time included social rents set at a discount to market level. The 'inertia' of the existing rent calculation for council housing subsidy, using a mix of property values and local wage levels, won the day.
19. <http://www.homesandcommunities.co.uk/ourwork/regulatory-framework>
20. HM Treasury, Budget 2013 1.112 p. 40.



London's council and housing association homes provide secure and decent accommodation for almost a quarter of the city's households at a heavily subsidised rate. Half of these 750,000 households are unwaged and another quarter are on very low incomes. Almost one sixth, however, earn above the London average wage.

With housing supply under extreme pressure, and the public and politicians increasingly concerned to ensure that welfare goes to those who most deserve it, the coalition government has set out proposals to ensure that high earning council and housing association tenants pay a market rent on their properties.

Yet, Pete Redman argues in this authoritative, timely and incisive report, the government's proposals will raise relatively little extra money for housing, and could discourage aspiration. *House-Keeping* sets out an alternative regime – one that would increase rent gradually for the 115,000 households earning above the London average wage and raise at least £300 million a year for new housing in the capital, while ensuring that work always pays.

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