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SAVILLS RESEARCH

A new rent settlement?

What is the impact of increasing general needs rents for affordable housing by CPI+1% over the next ten years?

Future rent policy is only one component of securing the financial future of HAs and LAs alongside grant levels for new development and upgrades to existing stock. With sector finances acutely stretched and general needs rents low relative to recent historic benchmarks, there is both the need and the capacity to increase rents at CPI+1% over the next 10 years. By the end of a 10 year rent settlement in 2036, general needs rents would still be at a greater discount from private rents than they were before the pandemic.

With weaker balance sheets and a greater requirement to invest in existing stock, financial capacity has become increasingly constrained for Registered Providers (Housing Associations (HAs) and local authorities (LAs)). Predictability around future rental income would allow all Registered Providers (RPs) to more effectively plan for the future and HAs to access cheaper finance, giving them more money to spend on existing and new homes.

A 10 year rent settlement which allows RPs to increase general needs (GN) rents by a maximum of CPI+1% each year has been trailed in the media ahead of the Autumn budget. If confirmed, such a rent settlement will be based on social housing tenants having a larger discount compared to market rent than before the Covid-19 pandemic.

This briefing note looks at the impact of increasing general needs rent by CPI+1% over the next 10 years and how this compares to likely future growth in market rents. We have modelled increases in general needs and market rents to assess how the proposed rent settlement will affect the level of discount that social housing offers tenants.

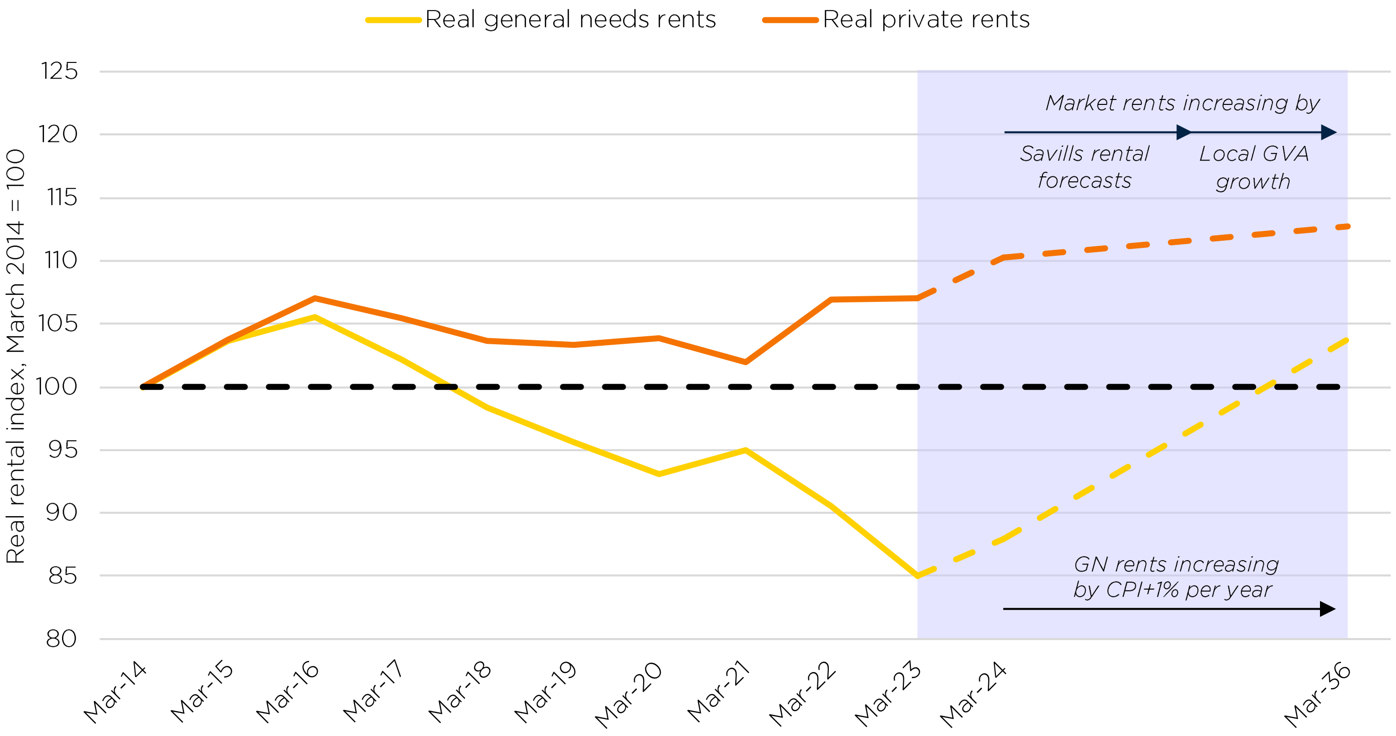
Central Government sets the level at which RPs can increase rents each year. In the current year 2024/25, RPs are able to increase their rents by a maximum of CPI+1%, in this case 7.7%.

But four years of mandated rent cuts from 2016-2020, followed by a below-inflation rent cap in 2023, have meant that general needs rents have fallen in real terms by at least -12% in the last decade, and are more than -16% lower than they would be under a CPI+1% benchmark. In contrast, rents in the private rented sector have increased sharply, particularly since the Covid-19 pandemic, growing by 10% in real terms in the last decade. This has created an increasing divergence between the two.

The gap between general needs rents and private rents is at its largest in more than a decade, as of the most recent data in 2023. Our modelling suggests that, by the end of a 10 year rent settlement at CPI+1% in 2036, general needs rents would still be at a greater discount from private rents than they were before the pandemic.

A decline in real rental income in recent years has further impacted the financial capacity of providers, leaving both HAs and LAs in their most challenging financial position since 2010, according to Global Accounts data from the Regulator of Social Housing and recent work undertaken by the Local Government Association. As a result of this reduced capacity, all RPs are having to prioritise existing homes over the development of new homes, particularly through Section 106.

Figure 1 General needs* rents have fallen in the last decade when adjusted for inflation, while private rents have risen



Source Savills using RSH, Zoopla – powered by Hometrack, Rightmove, Oxford Economics
*General needs housing covers the majority of affordable housing stock for rent. It refers to stock that is not designated for specific client groups.

Where are the largest discounts to market rents maintained under a rent settlement at CPI+1% over the next 10 years?

Registered Providers are seeking a long-term rent settlement from Government, with confirmation that they can raise rents by a maximum of CPI+1% over the next 10 years, beyond 2025/26 as specified under current policy. Greater certainty around rental income will mean RPs are better able to plan investment in existing and new stock and Housing Associations will be better able to leverage their income to access cheaper debt finance. Given that sector finances are stretched and general needs rents are low relative to recent historic benchmarks, there is both the need and the capacity to increase rents at this level.

We have modelled the impact of a 10 year rent settlement at CPI+1% on the discount offered by social housing compared to private market rents, using 2 bed homes and HA rents as an example. Our analysis shows that by 2036, general needs rent for 2 beds would be at less than 60% of market rent in two thirds of local authorities. And in all but nine LAs, general needs rents will remain below 80% of market rent levels.

The largest discounts to market rents are in locations where market rents are highest and there is the greatest need for housing support. In every borough of London bar one, for example, the average general needs rent for a 2 bed home will be less than 40% of the average 2 bed market rent.

The 15% of local authority areas where general needs rents will be at more than 70% of market rents are generally in the north of England, in areas where market rents are more affordable than in the south.

Compared against a historic context, general needs rents will therefore still be affordable relative to market rents in 2036.

Methodology:
We have forecast HA general needs rents and market rents for 2 bed properties to 2036, and have calculated the difference between the two.

We have assumed that general needs rents will increase by CPI+1% per year and that market rents will increase in line with our rental forecasts until 2028 and then by growth in GVA (a proxy for income growth) beyond that. Our forecasts for CPI inflation and GVA are from Oxford Economics.

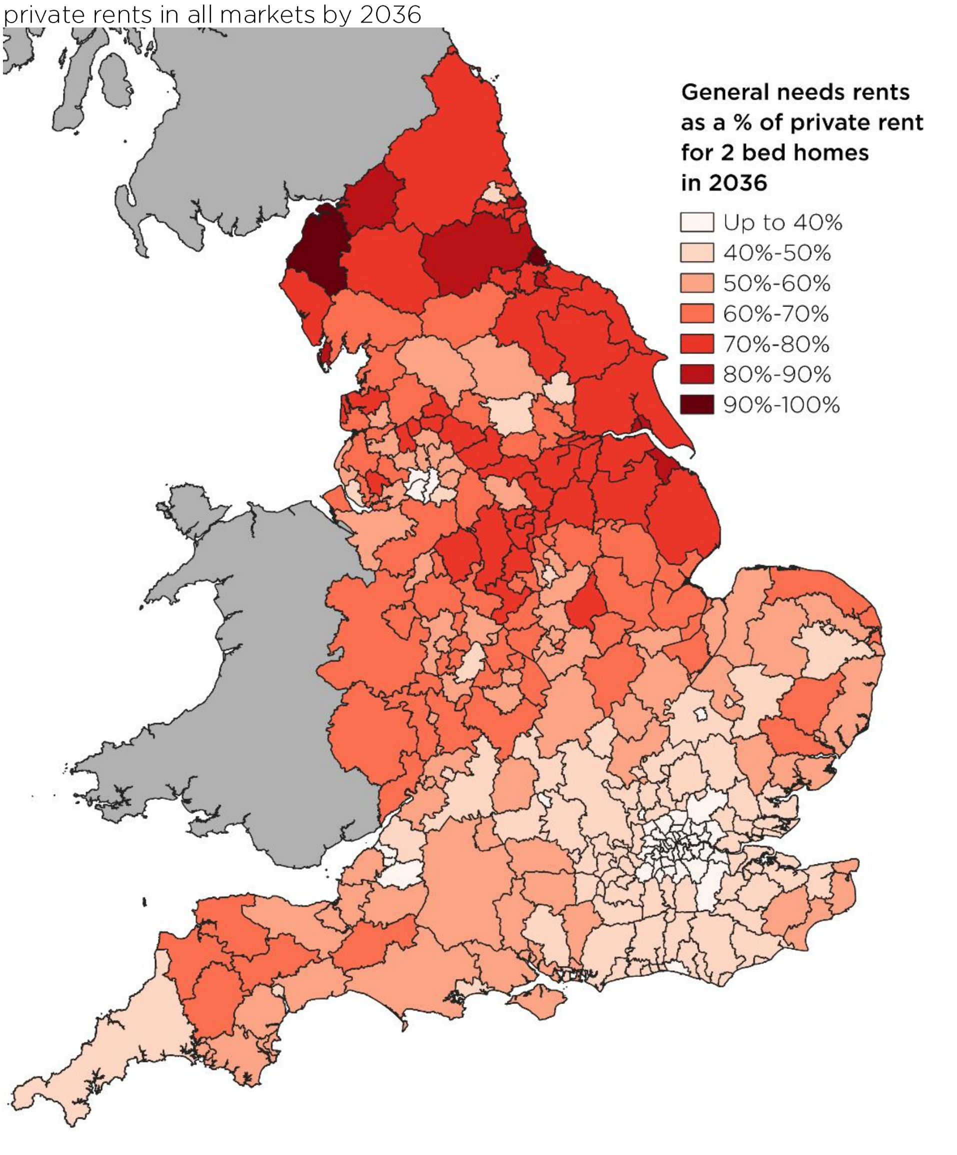
Equivalent LA general needs rents at March 2023 are c.10% lower than HA general needs rents.

Figures 3 and 4 show the discount which the average 2 bed general needs rent offers compared to market rent over time. Based on the most recent data in March 2023, general needs rents were particularly low in many areas relative to market rents.

This is the result of caps on rent increases in the housing sector after the Covid-19 pandemic, combined with private rental growth of 22.6% in the previous two years. Compared to this 2023 benchmark, a CPI+1% rent settlement to 2036 will result in a declining discount to market rent in social housing. But these lower GN rents in 2023 have left RPs at their most financially stretched in more than a decade. Compared to other benchmarks in 2014 and 2018, social housing will offer a more generous discount for its tenants in 2036.

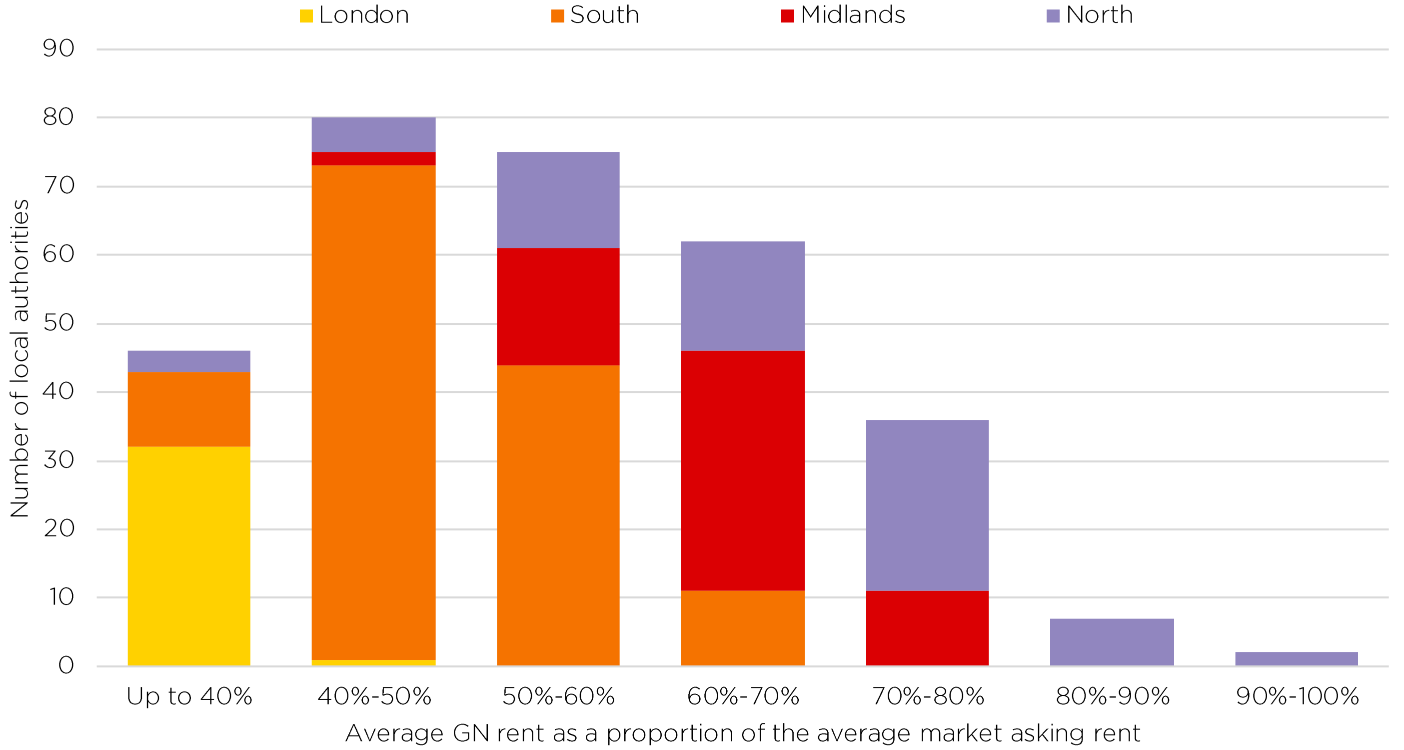
A 10 year rent settlement at CPI+1%, which delivers greater certainty on future rental income, would help RPs plan their programmes of investment in existing stock and will contribute to helping rebuild financial and balance sheet capacity. Such a rent settlement would bring general needs rents more closely in line with previous levels relative to market rents, and would result in a real rental increase of just 4% in the 22 years since March 2014, lower than the 13% seen in the private rented sector over the same period. Generally therefore, apart from in very limited local markets, CPI+1% rent increases for the next 10 years will not result in social rents growing to greater than 80% of the market level, and in fact will continue to offer significant discounts to market rents across the country.

Figure 2 Our analysis suggests that general needs HA rents will remain below private rents in all markets by 2036



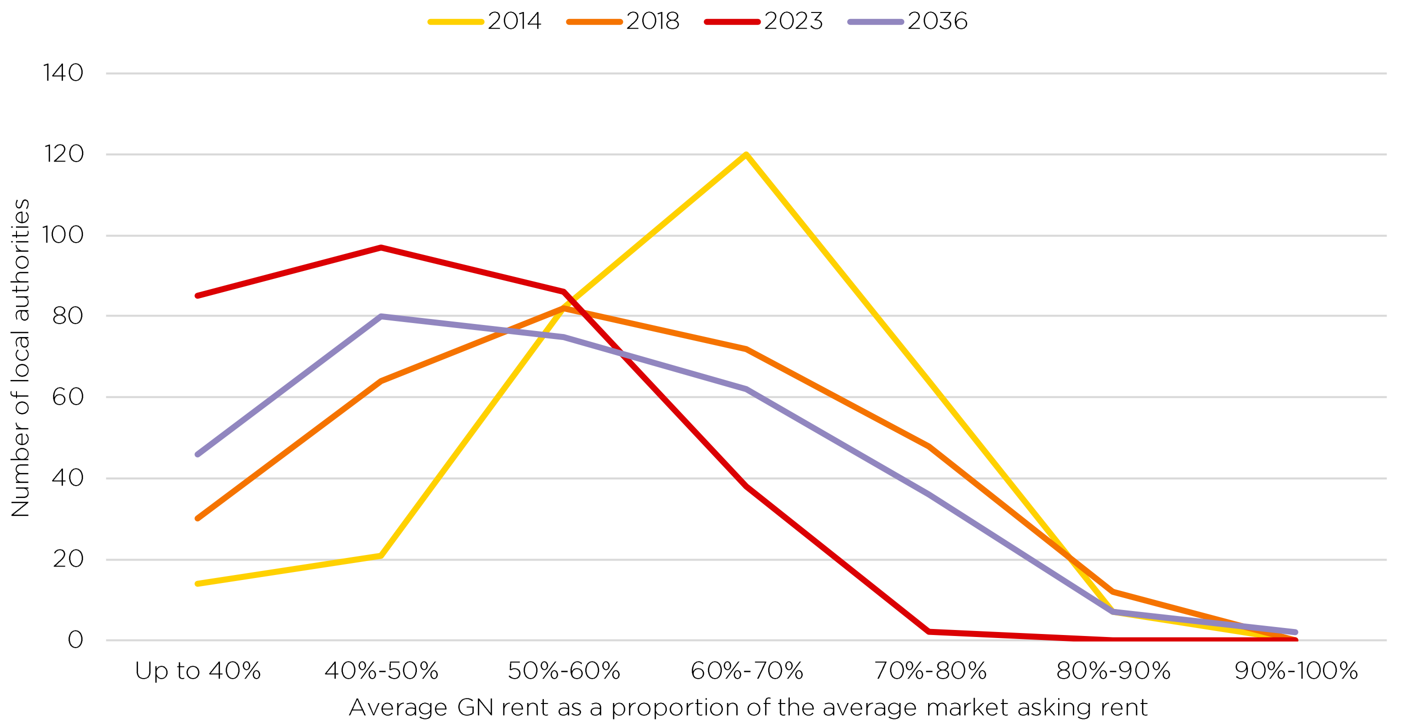
Source Savills using RSH, Zoopla – powered by Hometrack, Oxford Economics

Figure 3 General needs rents would be less than 60% of market rents in two thirds of local authorities in 2036 under a 10 year rent settlement at CPI+1%



Source Savills using RSH, Zoopla – powered by Hometrack, Oxford Economics

Figure 4 The level of discount offered in 2036 is more generous than was offered in 2014 or 2018



Source Savills using RSH, Zoopla – powered by Hometrack, Oxford Economics

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