The three-way balancing act returns: Government plans for social rent convergence

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Last week the government began a consultation on social rent convergence. This briefing details what convergence is, some background, what questions the government is asking and what it might mean for social providers.

Responses to how to implement social rent convergence must be submitted by 11.45pm on Wednesday 27 August.

HQN will be working on a model to help individual providers calculate their rent convergence options, once more data is available. Contact the Housing Finance Network for more details. In the meantime, we urge all providers to respond to the consultation.

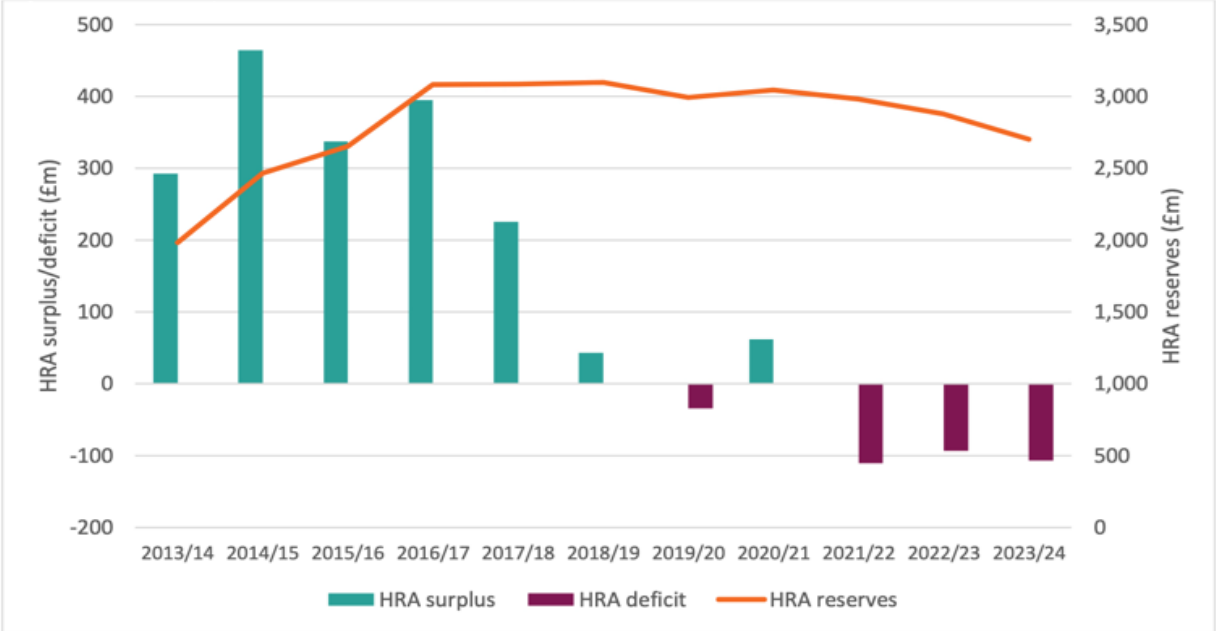
Some detail and history on rent convergence

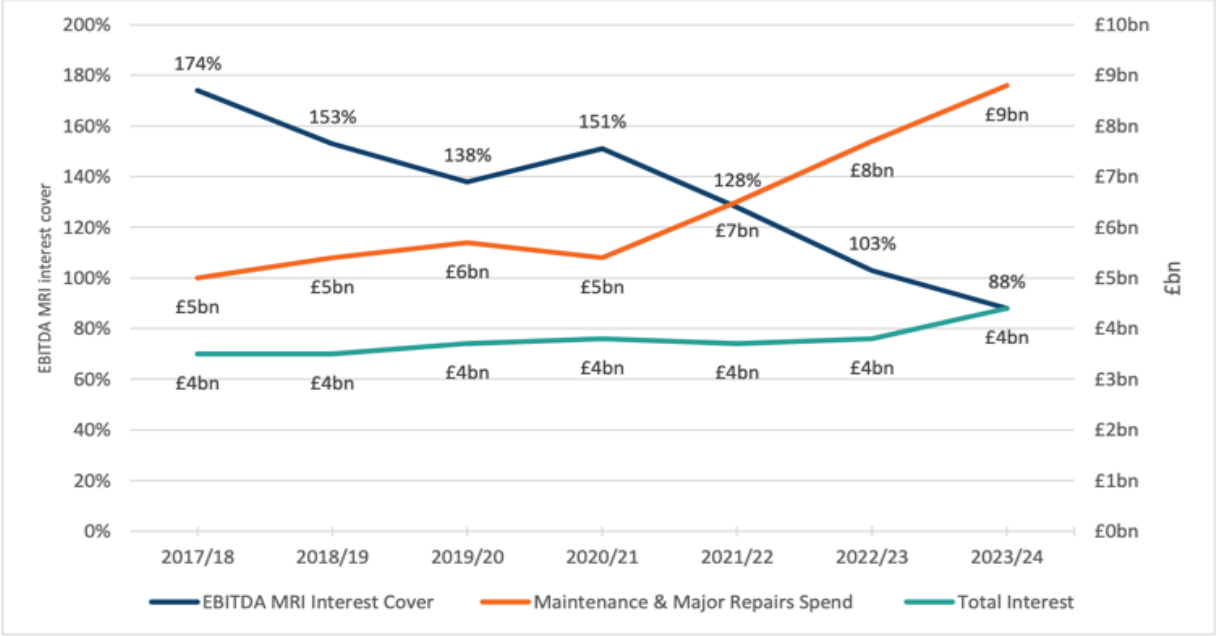
Those who have been around for a while will remember the rent convergence exercise begun by the new Labour government in 2002 and ended by the Conservatives in 2015. The idea was first floated in the Green Paper "quality and choice: a decent home for all". The idea was to ensure that similar rents are charged for similar social rented properties within an area, regardless of whether they were provided by a council or housing association (HA). Back then it was, as the title suggests, part of a drive toward market forces in social housing.

To achieve that goal, however, would mean council rents rising faster than those of HAs, since council rents were generally lower. In fact, the paper said, HAs might have to reduce some rents. It would also take many years because only limited extra rent increases (above the normal permitted annual level) would be possible, to avoid hardship for tenants. The higher rent levels would also bring a cost to the Treasury in the form of higher Housing Benefit (or now Universal Credit) payments.

Today the goal of similar rents for similar homes remains but the need for restructuring is being driven by the worsening finances of the sector. The demands for increased investment in existing stock (including for safety, a higher Decent Homes Standard and energy efficiency), together with the government's ambitious new build target, simply cannot be met with the sector finances in the shape they are currently.

MHCLG notes that across all 162 LAs with Housing Revenue Accounts (HRAs), spending has exceeded turnover in four of the past five years, propped up by using reserves. Private registered providers' (PRPs) interest cover has declined from 174% in 2018 to 88% in 2024. As a result, large PRPs dropped more than 100,000 new homes from their development plans in the two years to June 2024.





Source: MHCLG

Rent convergence, the government hopes, will both give increased borrowing headroom and the confidence from certainty over ten years to increase investment. Balanced against that is the Treasury's need to stay within fiscal rules, so whether maximum increases can be supported via the benefit system remains to be seen.

The technical background

Since 2001, rents for properties let at 'social rent' have been set based on a formula set by government that generates a formula rent, sometimes referred to as a 'target rent', for each property. This is calculated based on the relative property values at 1999 valuations, relative local income levels as of 1999 and the size of the property.

Since 2021, annual rent increases have been based on CPI inflation, plus or minus a percentage and in 2023/24 the increase was capped at 7%. From next year the government proposes that CPI+1% annually over ten years will be the starting point.

Rent caps will still apply a ceiling on rents charged, depending on the number of bedrooms in the property. Housing providers must not allow rents to rise above the rent cap level for the size of property concerned. Housing providers have some discretion over the rent set for individual properties, with flexibility to set initial rents at up to 5% above the formula rent for general needs properties and 10% for supported housing.

Under convergence, rents that are below the formula rent could be increased by an extra £1 or £2 a week on top of CPI+1%, though the formula rent could still not be exceeded. In addition, note that the department said: *"we are not changing the existing requirement that, where the rent for a social rent home exceeds the rent flexibility level, the rent may not increase each year by more than CPI."*

The government says that implementing convergence will be voluntary, though there are, of course, strong incentives to maximise rent income to support investment. Alternatively, RPs could apply convergence selectively or for only some of the ten years proposed.

What is proposed and the rationale

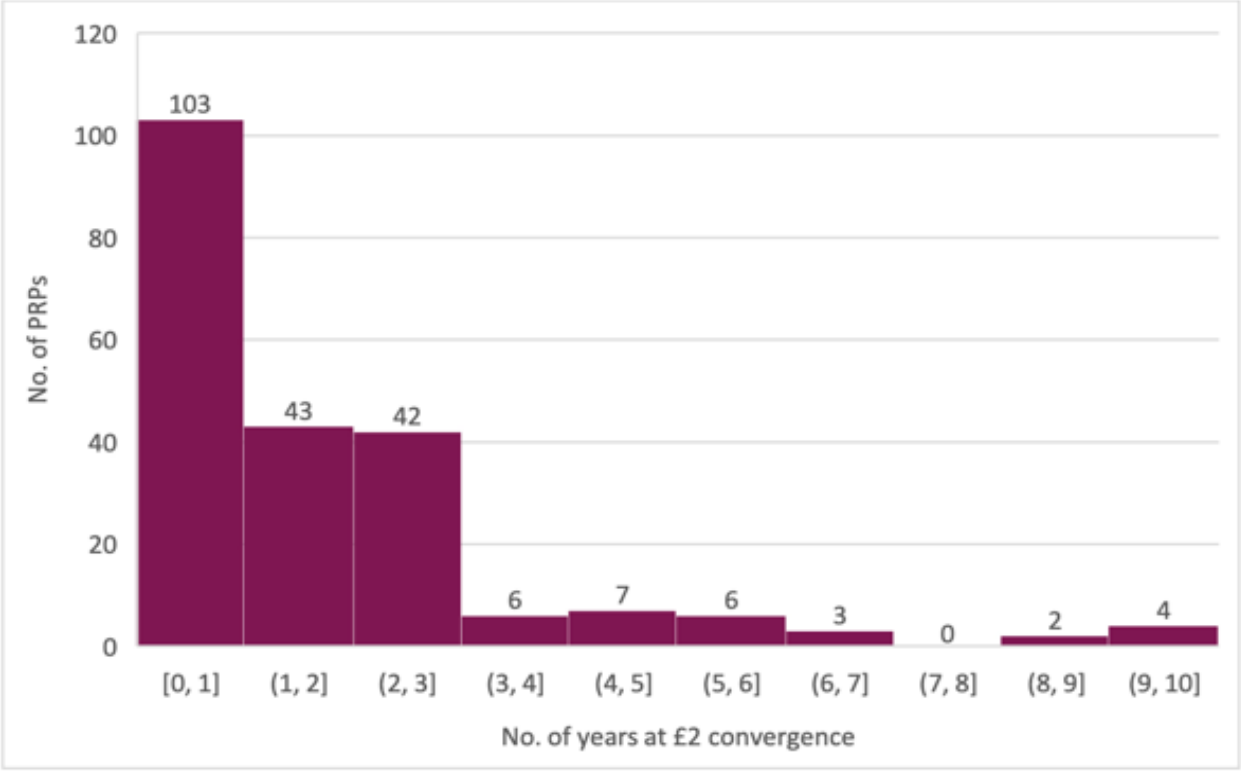
MHCLG finds that 99.9% of LA general needs housing requires convergence, compared to 61.3% of PRP homes. In 2024, among PRPs the average general needs social rent was £109.44 and the average formula rent was £112.11 – a gap of £2.67. Among LAs, the equivalent figures were £99.24 and £104.98 – a gap of £5.74. By far the greatest gap between actual and formula rents is in London and this is also where financial operating pressures are greatest.

So, the logic of supporting rent convergence is that it will help stabilise RP finances and create headroom for much-needed investment in existing and new homes. MHCLG acknowledges the increased cost to tenants at a time of great hardship for some but argues that others could potentially benefit from more energy efficient and comfortable homes and lower fuel bills. The department notes that two thirds of tenants in social housing receive HB or UC support towards their rent and says there will be limited effect on those subject to benefit capping or the bedroom tax. Only those currently paying less than the formula rent would be affected.

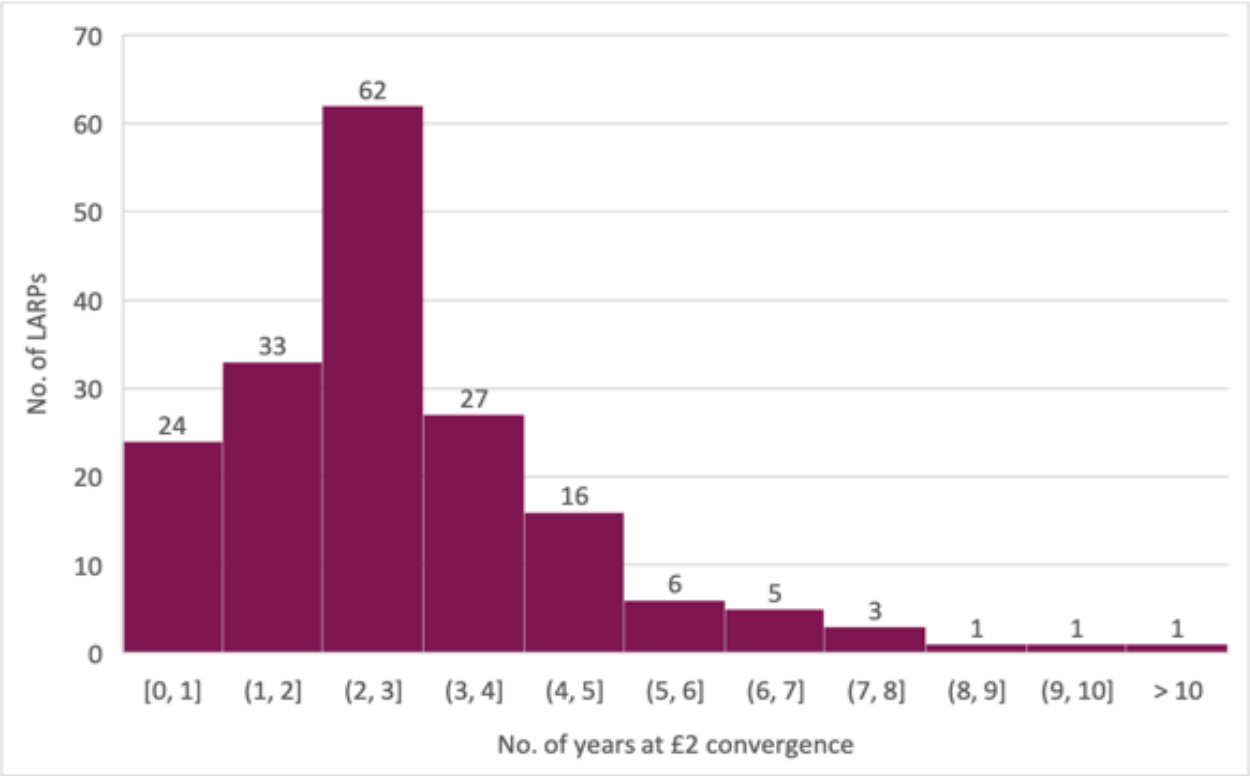
It is worth noting here that these details apply to general needs housing. In supported housing, the position is rather different as average rents for PRPs are already above formula rent in all regions of England – but that is not the case for LAs.

The timing is up for debate. Convergence over a full ten years would maximise income but cost tenants more. The department says: *"for working households not in receipt of housing support, we forecast rents to peak at 17.1% of income nationally and 20.4% in London. For pensioners not in receipt of housing support, we forecast rents to peak at 26.6% of income nationally and 36.9% in London."*

The number of years when rent convergence would be needed to achieve formula rent for all varies among providers. MHCLG offers this graph to show the position for PRPs at £2:



And for LAs:



Crucially, it would also cost the public finances more and this point is not resolved in the consultation. In the draft impact assessment, the department estimates that if convergence was implemented over the full ten years, with RPs applying the maximum CPI+1% plus £2 and no extra flexibilities, the cost to the Treasury in extra benefit payments would be £4bn.

The benefit to sector finances would be very substantial. The department estimates the £2 option would inject £6bn to RP finances over the ten years 2026-36, split evenly between LAs and PRPs (LAs have more to gain, though they are fewer in number).

With the £1 option, the cost to the public finances via Housing Benefit and Universal Credit is estimated at £3.6bn over the same ten year period but the gross increase in rental income for PRPs will be £5.3bn. With both options, the department estimates there would be a saving for some private rented sector tenants moving into the new social housing created.

The questions posed in the consultation are:

Question 1: At what level should social rent convergence be permitted?

- £1 per week
- £2 per week.

Question 2: How would the benefits for the supply and quality of social and affordable housing differ depending on whether convergence was permitted at £1 or £2?

Question 3: How would the impacts on households differ depending on whether convergence was permitted at £1 or £2?

Question 4: Should convergence be implemented from 1 April 2026 or from a later date and what would be the implications of implementing it from a later date?

Question 5: How long should convergence be in place for and what would be the implications of different durations of convergence?

The department has prepared a draft direction to the Regulator of Social Housing so that the new policy can be incorporated into its rent standard. The directive also includes a number of "minor" changes and clarifications on matters such as the basis of calculations and how to convert weekly to monthly rent charges where desired.

Commentary

The logic of rent convergence would be hard to ignore. The straightforward idea that tenants should pay a comparable rent for a comparable home within an area has fairness written all over it. To get from the complex picture of where we are to that state of greater fairness, however, will take some equally complex calculation. There can be no doubt that the sector needs the extra investment urgently if it is to provide decent housing for its tenants and greater supply as well.

Any move toward convergence will necessarily take time, to give those tenants affected a chance to adjust. Providers will need to work closely with their tenants, involving them in debate and coming to the most equitable decisions. The government is right to suggest convergence is likely to take ten years (and a little more in some cases).

Another question is when to begin the process. We must wait for the autumn budget to find out whether the Treasury can afford to support the policy in full and remain within fiscal rules. The assumption in the consultation is that the policy would start from April 2026, in line with the ten year CPI+1% rent formula. Much depends on whether individual providers would want to frontload the convergence process, delay or not implement it; what state the public finances are forecast to be in; and how powerfully the need for greater investment in social housing is heard in 11 Downing Street.

MHCLG acknowledges it is difficult to predict how rent convergence will play out because each organisation's situation is unique. It says: *"responses to the consultation will help us to better understand the impacts on individual RPs and tenants."* So, there is all the more incentive to get your responses submitted.

About the authors

Janis Bright is an award-winning journalist and a post-doctorate level researcher. Her research projects include analysis of high-performing organisations, governance in England and Scotland and resident involvement in European countries. She is editor of HQN's topical housing research newsletter Evidence and commissions Network briefings.

Ian Parker MBA, CPFA, FMAAT, MCMI has worked in the public sector for more than 40 years. During his career he has worked in senior positions in local government and has been the Finance Director at four RPs. Ian has worked as a consultant for 14 years and he has the developed the following financial models for HQN:

- VfM benchmarking
- Rent loss model
- Void appraisal model
- Stress test model
- Development appraisal models
- Rent validation.

Ian is HQN's lead finance associate and in that role he provides advice to members of the Housing Finance Network and also ensures that they receive relevant news and technical updates.

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