Northern Housing Consortium response to consultation on how to implement rent convergence

The Northern Housing Consortium (NHC) is a membership organisation representing local authorities, housing associations and strategic authorities across the North of England. Our members own and manage nine out of ten affordable homes in the North.

We welcome the opportunity to respond to the consultation on how to implement social rent convergence. Our submission to the 2024 consultation on future rent policy made clear that social housing providers in the North would benefit from the reintroduction of rent convergence, as a means to strengthen sector finances and enable greater investment in new and existing homes.

In summary:

- Rent convergence should be reintroduced from 1st April 2026 at **£2 per week** and last for the **full ten-year rent policy period** at least.

- This would increase total rental income over the rent policy period by **£1.73 billion** for social landlords in the North while ensuring that social rent levels in the North remain affordable for residents. This benefit would be felt almost evenly by local authority landlords and housing associations in the North (52% vs 48%).

- In the final year of the rent policy, rental income would be **£216 million** higher for social landlords in the North than with no convergence mechanism.

- Using individual landlord averages, a £2 convergence policy would ensure that **88% of local authorities and 92% of housing associations in the North would reach convergence by financial year 2029/30**, allowing them to increase investment in new and existing homes within this parliament.

1) <u>At what level should Social Rent convergence be permitted</u>
    a. £1 per week
    b. **£2 per week**

2) <u>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?</u>

If rent convergence were permitted for the full ten-year rent policy, a policy of £2 per week convergence would leave social landlords in the North with an additional **£1.73 billion** from general needs lettings to invest in new and existing homes, above a rent policy of CPI+1% alone. **This is £266 million or 18.2% above that provided by a £1 a week policy** (£1.47 billion).

Furthermore, a policy of £2 per week convergence would mean that the benefits of convergence are experienced more quickly than under a policy of £1 per week. £2 per week convergence would mean that **88% of local authorities and 92% of housing associations achieve convergence within this parliament** (taken as achieving convergence by 29/30). Under a policy of £1 per week, only 19% of local authorities and 53% of housing associations will have reached convergence by the same point, limiting any additional investment benefits within this parliament.

All estimated impacts of different convergence policies in this submission use landlord averages, compiled using data from the Regulator of Social Housing's Standard Data Return and Local Authority Data Return. Using averages means that figures will not reflect when convergence has been reached for 100% of properties, but is indicative of when the vast majority of financial benefit of convergence has been achieved. This is because landlords generally have a 'tail' of properties significantly further from formula rent, which will take longer to fully converge, than most of their stock.

All calculations have assumed that landlords use the maximum rent convergence policy available to them each year until rents reach formula rent, and that CPI inflation will be 2% in each year of the policy, indicating a formula rent increase of 3%. Final numbers do not reflect the impact of re-letting homes at formula rent as they churn.

£1 a week convergence

If convergence were permitted for the entirety of the rent policy period at £1 per week, the total increase in general needs rental income for landlords in the North would be £1.47 billion. £758 million of this benefit (52%) would be felt by local authority landlords, and £708 million by housing associations (48%). This reflects the fact that while local authority landlords own a smaller proportion of the North's social housing stock compared to housing associations, their homes are generally further from formula rent and, a larger proportion of local authority homes are currently below formula rent.

In the final year of the rent policy (2036/37), general needs rental income in the North would be £212 million higher than without a convergence policy.

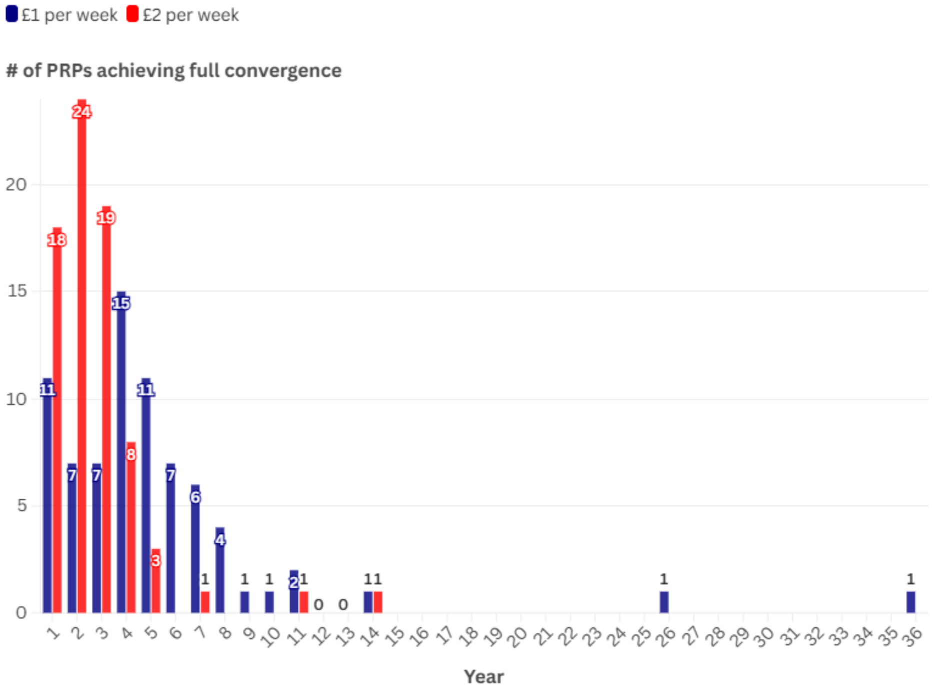
Data from the LADR indicates that of the 26 Local Authority Registered Providers (LARP) in the North who would be impacted by convergence, 25 would achieve full convergence within the ten year rent policy if convergence were permitted at £1 per week, and all would reach convergence if convergence were permitted at £2 per week.

For housing associations, 70 of 75 housing associations (93%) impacted by rent convergence in the North will achieve full convergence within 10 years at £1 per week, based on a landlord average.

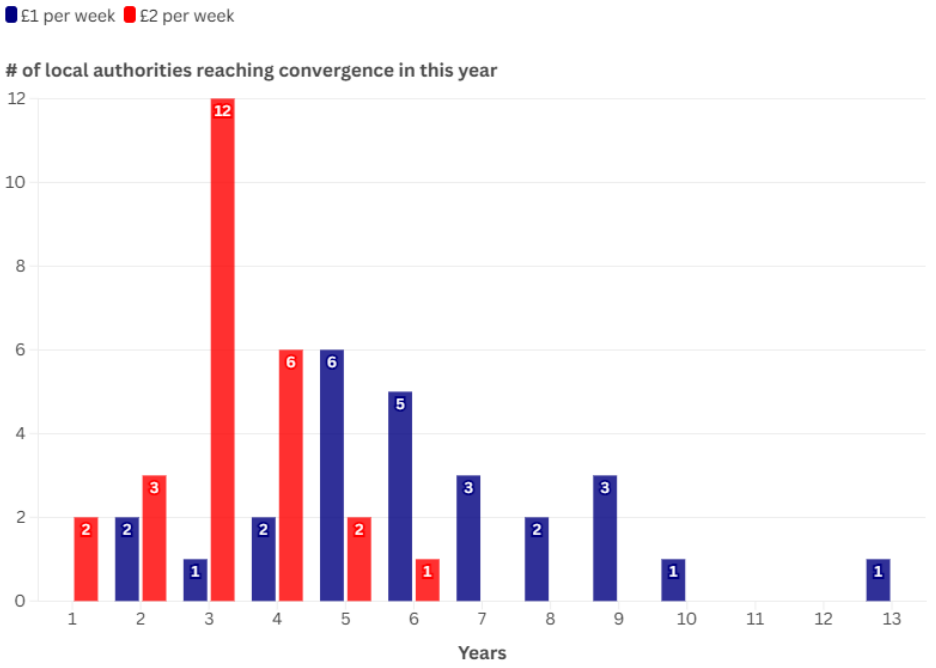
This is likely an overestimate as the use of landlord averages neglects the fact that landlords generally have a 'tail' of properties that are significantly further from convergence and will therefore take longer for rents to converge with formula rent. While the time to achieve full convergence on 100% of homes will be longer, the above is still indicative of when the vast majority of financial benefit of convergence will be achieved.

The charts below show the number of LARPs and PRPs that achieve convergence in each year under both a £1 and £2 convergence policy.

Time taken for Private Registered Providers (PRPs) in the North to achieve rent convergence under convergence policies of £1 and £2 per week



Time taken for Local Authority Registered Providers (LARPs) in the North to achieve rent convergence under convergence policies of £1 and £2 per week



<u>£2 a week convergence</u>

If convergence were permitted for the entirety of the rent policy period at £2 per week, the total increase in general needs rental income for landlords in the North would be £1.73 billion. £901 million (52%) of this benefit would be felt by local authority landlords, and £831 million (48%) by housing associations. This is £266 million or 18.2% greater than the total additional income provided by a £1 per week convergence policy.

Under a policy of £2 per week, in the final year of the rent policy general needs rental income would be £216 million higher than without a convergence policy. The relatively small difference between the final year income levels under both convergence policies is because the vast majority of properties will achieve convergence within ten years under both policies.

All 26 LARPs in the North will achieve convergence by year 6 of the policy under a policy of £2 per week, based on a landlord average. For housing associations, 73 of 75 PRPs impacted by rent convergence in the North (97.3%) will achieve convergence within the ten-year rent policy period. Again, this is indicative of when the vast majority of financial benefit from convergence will be realised, while the time for 100% of homes to reach convergence will be longer.

One major benefit of convergence at £2 per week over £1 per week, in addition to the £266 million of additional income over the rent policy period, is that the financial benefit of convergence is experienced more quickly by landlords. Under a policy of £2 per week convergence, 88% of local authorities and 92% of housing associations achieve full convergence by year four of the rent policy (29/30), based on a landlord average. These landlords will therefore be able to utilise large proportions of any additional income from convergence in this parliament. Under a policy of £1 per week, only 19% of local authorities and 53% of housing associations will have reached convergence by the same point, thus reducing the ability of landlords to increase development and investment in existing homes during this parliament.

Usage of additional financial capacity

While all of our members warmly welcome the reintroduction of convergence, there is no uniform approach as to what the additional rental income that rent convergence will bring about will be used for. Generally, from our engagement, landlords with greater financial headroom and in more robust financial health are more likely to use additional rental income to support greater levels of development. Individual landlord responses to this question will be instructive to see the varying assumptions and uses for this additional income.

Some landlords will use the funding to expand or extend their development programmes and build more new homes over the forthcoming years. For example, one major housing association landlord based in Yorkshire & Humber, who already have an established development programme, reported to us that the additional income from rent convergence on its own would enable them to increase development plans by between 2-3%, depending on the level at which convergence were permitted. In this example, this would result in around 135-190 additional new homes over a ten-year period. Alternatively, a North East-based housing association landlord with aspirations to increase development in the coming years told us that the increased certainty provided by a ten year policy of rent convergence at £2 per week, alongside the increased certainty provided by the recent announcement of the ten-year Social and Affordable Homes Programme, would mean that they could extend their currently committed development pipeline from three to five years.

Other providers have confirmed, however, that they will use additional capacity primarily, if not entirely, to invest in their existing homes. This includes meeting emerging Minimum Energy Efficiency Standards and the revised Decent Homes Standard. Since the recent publication of the consultations on the revised Decent Homes Standard and new Minimum Energy Efficiency Standards, many members have told us that these changes will cost more than they had originally anticipated, and more than the government's published impact assessments. This means that the potential for rent convergence to enable greater development could be reduced.

Ultimately, these decisions will depend on a landlord's financial headroom, and therefore the ability of additional rental income to enable further borrowing, existing development programmes and the investment requirements of their existing stock. This additional income will result in significant positive benefits for residents, whether they live in a new or an improved home.

Recently published analysis by Savills concludes that the additional income from convergence of £2 per week could enable up to an additional 99,461 new homes nationally, or 68,989 homes if a proportion of all additional income is reserved for asset management and investment in existing stock.

In the North, if all additional funding from convergence were directed towards new development, a £2 convergence policy would enable an additional 18,845 social and affordable homes, assuming a grant rate of 50% and using the most recent data available on build costs. This would be approximately 6% of the 300,000 new homes planned under the next Social and Affordable

Homes Programme. If convergence were limited to £1, and under the same assumptions, this figure would be 16,013 homes.

Finally, many of our members have indicated to us that if they were permitted to use rent convergence to reach formula rent plus the 5% flexibility currently allowed in specific circumstances, then this would significantly increase the additional landlord revenue generated by the policy. Many of our members make extensive use of the flexibility offered by the 5% rent flexibility level, especially those in housing markets with lower rents, which can sometimes struggle to cover the full costs of property maintenance and management. If providers who already utilise the 5% rent flexibility level were able to do so, this would significantly increase the impact of convergence for them. While there is no comprehensive data published on the proportion of providers that do utilise rent tolerance these areas tend to be found more in the North. One housing association member based in the North East, who have already been using rent flexibility, told us that permitting convergence back to this previously applied rent level would mean that their annual rental income would increase by approximately £1.1 million pounds, while this increase would be only £40,000 a year if converging just to formula rent.

3) <u>How would impacts on households differ depending on whether convergence was permitted at £1 or £2?</u>
Firstly, it should be stressed that rent convergence will only apply to households where rent is currently below formula rent, and the successful completion of convergence will mean that the property has reached a level of rent that the government has already considered to be appropriate and affordable through the establishment of formula rent levels.

Secondly, the end point of the rent policy period will be the same in the vast majority of cases, regardless of whether convergence is applied at £1 or £2, as almost all social landlords in the North will have reached convergence on the majority of their homes by the end of the rent policy.

Furthermore, when a new tenant begins a tenancy, they will in almost all circumstances pay full formula rent, or formula rent plus a 5% tolerance. This means that, ultimately, the current system represents a two-tier system of rents where new tenants pay more than existing tenants if their property is below formula rent. Rent convergence is, therefore, a mechanism that will ensure greater fairness and consistency in social renting.

For those households where rent is currently below formula rent, a convergence policy of £2 per week would result in more significant annual rent increases than £1 per week convergence, if landlords apply convergence fully. Our members are aware that this will need careful management and will make any decision on rent changes with careful consideration around the ability of existing residents to pay higher rents, local market conditions and the trade-offs involved between rental income and the ability to invest in new and existing homes. Boards and cabinets are best placed to provide the scrutiny and assessment around individual landlord rent decisions, within the bounds set by government policy, and will continue to strongly scrutinise their landlords with regard to rental affordability.

As we say elsewhere in this response, we also believe that allowing convergence to be implemented throughout the entire ten-year rent policy period would provide an additional level of flexibility for providers to smooth rent increases and better consider the different trade-offs mentioned above. For example, many landlords in the North do not need the full ten years to achieve the vast majority of the financial benefit that convergence represents, especially if convergence is permitted at £2 per week. The ability to use convergence for all ten years would, however, mean that providers could smooth increases across a larger time period than they need to, or they could choose to not apply convergence in years when inflation was high, with confidence that they could 'catch up' and recoup foregone income in subsequent years.

Issues of affordability with regard to convergence should also be viewed alongside the fact that some rent increases will be compensated for through home improvements which, in the case of meeting new Minimum Energy Efficiency Standards and the new Decent Homes Standard, will directly reduce the running costs of their home through improved energy efficiency.

4) <u>Should convergence be implemented from 1 April 2026 or from a later date, and what would be the implications of implementing at a later date?</u>

We and our members believe that rent convergence should be implemented from 1st April 2026.

Our members have made clear that there are no operational reasons why rent convergence cannot be implemented for the next financial year if the ability to do so was there.

Some landlords may decide not to apply convergence from next year, but individual landlords making this choice does not require limitations being placed upon all landlords. If the government makes clear when, and at what level, convergence will be implemented, our members will then make a firm decision on their approach, following engagement with their boards and cabinets. This will involve weighing up the multiple trade-offs involved around their financial viability, tenant affordability, potential for increased revenue and the ability to reinvest rental income in new and existing homes.

Any delay in implementation will inevitably reduce the impact of the policy by reducing the amount of additional rental income that convergence provides, and reducing rental income in any time that convergence will not apply compared to the counterfactual. Furthermore, any increase or decrease in rental income compounds over the business plan period, resulting in significantly larger impacts further down the line. This will have repercussions for the government's ambitions for implementing a new Decent Homes Standard by 2035. If the implementation of convergence is delayed, providers will have fewer resources available in 2035 to be able to meet the new Standard, than if convergence begins in 2026/27.

Delay, and the associated reduced rental income, will also mean that landlord borrowing capacity will be reduced in the relevant years, compared to convergence being implemented in 2026/27. This has significant potential ramifications for the government's ambition to build 1.5 million new homes over this parliament, with affordable housing playing a large contribution, as well as increasing council housebuilding. If convergence is delayed until 2027/28, this means that landlords who stand to benefit from convergence will see their borrowing capacity in 26/27 reduced, and therefore, will not be able to develop as many new homes as otherwise. Generally, our members work on an assumption that once they have agreed a grant allocation with Homes England, a development will take between 18 and 24 months to complete. This point can only, however, be reached when providers are certain that the scheme in question is deliverable. This includes obtaining planning permission, land acquisition, and ensuring a scheme's financial viability which is driven in large part by rental income and borrowing capacity. Given this process and the timescales involved with new development, if convergence is delayed until 27/28, it will have essentially no direct impact on new development plans until 29/30, at which point the parliament will be coming to an end.

5) <u>How long should convergence be in place for, and what would be the implications of different durations of convergence?</u>

In the North, the impact of how long convergence is permitted to take place for (five vs ten years) is smaller than the impact of how much rents will be permitted to converge by per week (£1 vs £2).

If convergence were permitted at £1 per week, 42% of Local Authority Registered Providers (LARPs) in the North would reach convergence within five years, compared with 68% of Private Registered Providers (PRPs). Over ten years, 96% of LARPs and 93% of PRPs would reach convergence.

At £2 per week, 96% of LARPs and 96% PRPs in the North would reach convergence within five years. All LARPs and 97% of PRPs would reach convergence within ten years. Those PRPs who would still not reach convergence generally have very small numbers of relevant stock which are substantially below formula rent. A £2 policy of ten years, therefore, would allow for the vast majority of landlords in the North to realise the financial benefits of rent convergence.

Even though most landlords in the North do not need the full ten years to realise the majority of the financial benefits that convergence brings, with average divergence rates shown below, there are still strong cases to do so. As a result, we believe that as a minimum, rent convergence should be permitted for the full ten-year rent policy period.

Region	**Average LARP general needs divergence**	**Average PRP general needs divergence**
North East	£4.36	£2.01
North West	£5.33	£2.07
Yorkshire & Humber	£3.65	£0.22

Firstly, while landlord averages indicate that most landlords will achieve convergence within five years, especially at £2 per week, almost all landlords will have a ‘tail’ of properties that are currently much further from formula rent and will, as a result, take much longer to achieve convergence. Individual responses from landlords will be instructive in further understanding how large this proportion of homes is, and how far they diverge from the rest of the stock. In addition to this, extending the period for which convergence is permitted from five to ten years does increase the total benefit for landlords, especially if convergence is only permitted at £1 per week.

If convergence were permitted at a level of £1 per week for ten years, this would increase general needs rental income for social landlords in the North by £1.47 billion over the entire rent policy period. If convergence was limited to only five years, fewer properties would reach formula rent level and this would reduce the total benefit to £1.34 billion (a reduction of £129 million or 8.8%).

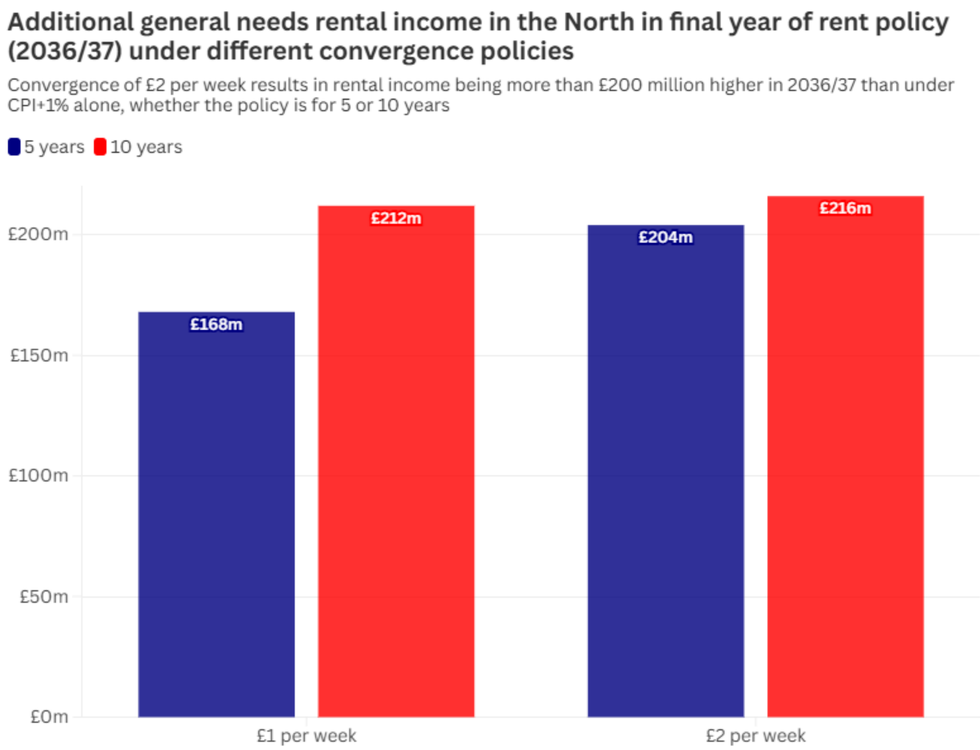
If convergence were permitted at a level of £2 per week, the impact of how long convergence is permitted for would be much smaller. If convergence were permitted for ten years this would increase general needs rental income for social landlords in the North by £1.73 billion over the rent policy period. If convergence were limited to five years, the reduction in rental income would be marginal (approximately £10 million or 0.6% over ten years).

The total impact on rental income in the North, of different convergence options, can be found in the table below:

Rent convergence policy	**Additional rental income above CPI+1% alone, over the ten year rent policy period**
£1 a week for 5 years	£1.34 billion
£1 a week for 10 years	£1.47 billion
£2 a week for 5 years	£1.72 billion
£2 a week for 10 years	£1.73 billion

In the final year of the rent policy period, if convergence were permitted at £1 per week for five years, total rental income in the North would be £168 million higher than under no convergence policy, and £204 million higher under a convergence policy of £2 per week.

If convergence were permitted to run for the entire ten-year policy, then under a £1 per week convergence policy, final year income would be £212 million higher than under CPI+1% alone, and £216 million under a £2 per week policy. The table below shows the impact on rental income in the final year of the rent policy under different convergence policies.



As well as maximising income for landlords, allowing rent convergence to take place for the full ten-year rent policy period would provide landlords with additional flexibility to manage their rent setting decisions with consideration to wider trade-offs such as tenant affordability. For example, if a landlord did not need to apply maximum convergence in all ten years to reach formula rent, they could smooth the path to that end point over a longer period by applying smaller convergence levels each year. Alternatively, in years where inflation is high, a landlord could choose not to apply convergence, limiting the annual increase experienced by tenants and affordability impacts, comfortable in the knowledge that they would be able to recoup foregone income in subsequent years.

In addition to this, and to maximise the impact of any convergence policy on total landlord income, there is also a strong case that convergence should be permitted for as long as it takes until rents converge with formula rent levels. This could be considered further by MHCLG officials in the future, with clarity on future policy and the future path of convergence provided part-way through the rent policy period. This will have a larger impact on landlords and areas where current and formula rent levels diverge the most, which are generally outside of the North. In the North, the additional income would likely be marginal beyond that which a ten year policy of £2 per week, but it would make a difference for those landlords who do have a large proportion of properties a long way from formula rent, and ensure that the current unfairness and inconsistency between rents that have and have not reached formula rent is eradicated.