

## RENT OPTIONS

## APPENDIX G

Baseline	Spending Review (5.4% in 2014/15 then CPI + 1% for 2015/16 @ 3%)
Option 1	One-Year Freeze (0% then 3%)
Option 2	Two-Year Freeze (0% then 0%)
Option 3	CPI + 1% (3.7% then 3%)
Option 4	Inflation only (CPI @ 2.7% then 2%)
Option 5	Fixed Rental Income (15.2% then 0% for three years)

### Summary of outcomes (rent debit impact)

	Dwelling Rent Income 2014/15	Dwelling Rent Income 2015/16
Baseline	£200.8m	£204.7m
Option 1	£190.6m	£194.5m
Option 2	£190.6m	£188.9m
Option 3	£197.6m	£201.4m
Option 4	£195.7m	£197.8m
Option 5	£214.7m	£213.0m

The rent debit outcomes for 2014/15 and 2015/16, and their impact in terms of a shift from the base scenario are set out in the table at the end of this appendix.

### Rent baseline – formula rent increase @ 5.4%, then CPI + 1% (assumed @ 3%)

The rent budget is rebased annually to reflect anticipated stock loss and void movements over the coming year (together with the removal of the 53<sup>rd</sup> rent week for 2014/15), which creates an immediate budget gap, before application of any rent increase or consideration of cost pressures and commitments.

The starting point for 2014/15 is a converging rent increase of 5.4%, which generates additional net rent income of £2.9 million. This is the baseline from which the rent loss outlined in the following options are calculated and also forms the basis on which the budget proposals for 2014/15 are predicated (December report). Any rent option that generates less rental income will necessitate compensatory budgetary measures to make up the immediate shortfall in 2014/15 and have a longer-term compounded effect over the life of the HRA business plan.

In 2015/16, an assumed increase at CPI + 1% would generate additional net rent income of £3.9 million, giving £6.8 million additional rent income over the two-year period (budgeted rent income £204.7 million). For reference, had convergence continued for 2015/16, budgeted rent income would have risen to £207.9 million and had we actually converged as assumed by government in the self-financing settlement, budgeted rent income would be £222.8 million.

### **Option 1 – One-year rent freeze, then CPI + 1% (assumed @ 3%)**

A one-year rent freeze means rather than raising additional rent income (£2.9 million as per the baseline above), the position moves negative with a reduction in rent income of £7.3 million. The cumulative reduction in cash terms is £10.2 million. This loss would be perpetuated unless rents were increased subsequently above the nationally prescribed increase of CPI + 1% from 2015/16 in order to recoup the resources foregone, though it is likely that limit rent levels set annually by the Department for Work and Pensions would prevent this.

In 2015/16, an assumed increase at CPI + 1% would generate additional net rent income of £3.9 million, but the cumulative effect remains a loss of £10.2 million over the two-year period.

### **Option 2 – Two-year rent freeze**

A rent freeze for two years would mean a cumulative reduction in rent income of £15.8 million compared to the baseline position – a fall of £9.0 million compared to an increase of £6.8 million. This would place considerable strain on the Council's ability to meet its primary policy objectives as a landlord to deliver high quality services and invest in the stock.

### **Option 3 – Early adoption of CPI + 1%**

This would equate to a 3.7% increase in 2014/15, without any further movement towards convergence. The current underlying rent inflation factor and the proposed new one happen to be identical for 2014/15 purposes (RPI @ 3.2% + 0.5% vs. CPI @ 2.7% + 1%).

It can be seen that an increase at this level would not be quite sufficient to counterbalance the loss in cash terms between the 2013/14 and 2014/15 base budget. The issue of an ongoing reduction in the base remains, but is mitigated somewhat compared to the freeze options. For 2015/16 the shortfall increases marginally to £3.3 million.

To set this in context, an 'early adoption' of CPI + 1% has a direct effect on the council in 2014/15 as rent income falls from £200.8 million to £197.6 million (£3.2 million), and this rolls forward into a reduced position of £201.4 million instead of £204.7 million in 2015/16, so there remains a long-term effect of taking part of the rent increase out of the base, albeit to a lesser extent.

### **Option 4 – Inflation only (CPI @ 2.7%, then 2%)**

An adapted version of option 3 would be to restrict the increase further to CPI only, foregoing the national rent top-up element. September CPI was 2.7%, and for HRA business planning purposes it is assumed to be 2% for 2015/16.

An inflation-only increase would generate a loss in cash terms between the 2013/14 and 2014/15 base budget of £5.1 million, and over the course of the subsequent year would end up virtually identical to the originally proposed rise for 2014/15 only (£197.8 million as opposed to £197.9 million). The issue of an ongoing reduction in the base remains, but once again is mitigated somewhat compared to the freeze options, though not by as much as option 3 would realise.

## Option 5 – Fixed rent income

An approach similar to that of a fixed-rate mortgage might be utilised, whereby a rent level is set at the start of a given multi-year period, and then frozen for the rest of that period. Whilst this is achievable, there are some obvious drawbacks; not least of which is the initially high increase required in 2014/15 and that the council assumes the income risk for variations in inflation above that assumed in the original calculation.

The table below shows anticipated average rent levels for the next four years if the 'base' case option is followed (5.4% then CPI + 1% for the next three), resulting in an estimated average rent in 2017/18 of £111.03. In order to avoid any diminution in rent levels through this measure (i.e. to ensure that rent levels were to be equivalent at the end of the four-year period as they would otherwise be with annual uplifts), rents would need to increase by 15.2% in 2014/15 followed by a three-year freeze.

Whilst it is possible to estimate total rent income over the period for the base case (c. £830 million), then set a rent to generate the equivalent amount in cash terms, the resultant average rent by 2017/18 would be notably lower than £111.03, necessitating an increase to restore rent level parity (i.e. without any inflation).

Whilst this has the advantage of requiring the HRA to be managed with rigor to keep to what becomes a set of cash-limited budgets, it removes flexibility from our approach, and unexpected/exceptional events thus become more difficult to deal with. Furthermore a rent increase of this magnitude would almost certainly fall foul of DWP rent limitation policy, meaning that we would have to fund an element of the housing benefit cost from within the HRA itself, a further drain on resources (DWP rent limits for 2014/15 have not yet been announced).

	Base Case		Fixed Rent	
2013/14 (base)		£96.40		£96.40
2014/15	5.4%	£101.61	15.2%	£111.03
2015/16	3.0%	£104.65	0%	£111.03
2016/17	3.0%	£107.79	0%	£111.03
2017/18	3.0%	£111.03	0%	£111.03

*N.B. CPI + 1% is assumed to equal 3% for the period 2015 – 2018.*

## Charts

The charts that form Appendix H illustrate the respective rent income positions for the next two years for the base and each of the five options. Appendix H1 excludes options 3, 4 and 5 for clarity, as it is intended to demonstrate the gap between government assumptions, i.e. converging to target rent (and a converged rent), against the actual Southwark position. The bar charts that follow (Appendices H2 – H3) set out the rental income generated by each option for 2014/15 and 2015/16.

### Rental incomes by option

	<b>Base 5.4%</b>	<b>Option 1 0%</b>	<b>Option 2 0%</b>	<b>Option 3 3.7%</b>	<b>Option 4 2.7%</b>	<b>Option 5 Fixed (15.2%)</b>
<b>2013/14 (53 weeks)</b> Dwelling Rent Debit	(£197.9m)	(£197.9m)	(£197.9m)	(£197.9m)	(£197.9m)	(£197.9m)
<b>2014/15 (52 weeks)</b> Dwelling Rent Debit	(£200.8m)	(£190.6m)	(£190.6m)	(£197.6m)	(£195.7m)	(£214.7m)
Change from 2013/14	+£2.9m	-£7.3m	-£7.3m	-£0.3m	-£2.2m	+£16.8m
<b>Average Rent for 2014/15</b>	<b>£101.61</b>	<b>£96.40*</b>	<b>£96.40*</b>	<b>£98.10</b>	<b>£99.00</b>	<b>£111.03</b>

\*not adjusted for stockloss

	<b>5.4% + 3%</b>	<b>0% + 3%</b>	<b>0% + 0%</b>	<b>3.7% + 3%</b>	<b>2.7% + 2%</b>	<b>Fixed (0%)</b>
<b>2015/16 (52 weeks)</b> Dwelling Rent Debit	(£204.7m)	(£194.5m)	(£188.9m)	(£201.4m)	(£197.8m)	(£213.0m)
Change from 2014/15	+£3.9m	+£3.9m	-£1.7m	+£3.8m	+£2.1m	-£1.7m
Cumulative change	+£6.8m	-£3.4m	-£9.0m	+£3.5m	-£0.1m	+£15.1m

### Change from base case by option

	<b>Base</b>	<b>Option 1 0%</b>	<b>Option 2 0%</b>	<b>Option 3 3.7%</b>	<b>Option 4 2.7%</b>	<b>Option 5 Fixed (15.2%)</b>
<b>2014/15 (52 weeks)</b> Change in Rent Debit		-£10.2m	-£10.2m	-£3.2m	-£5.1m	+£13.9m

	<b>Base</b>	<b>0% + 3%</b>	<b>0% + 0%</b>	<b>3.7% + 3%</b>	<b>2.7% + 2%</b>	<b>Fixed (0%)</b>
<b>2015/16 (52 weeks)</b> Change in Rent Debit		-£10.2m	-£15.8m	-£3.3m	-£6.9m	+£8.3m