Target rents in relation to market levels 2008/09 - Summary

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Summary

Target net rents for registered social landlord (RSL) properties are based on a mix of local earnings and individual property values. Although the formula is based on a 30:70 split, in absolute value terms the relative importance of capital values increases with market rents. The differential between property sizes is partially set administratively by a bedroom weighting attached to the earnings part of the formula.

The average net rent was originally set in 2000 and has increased each year by the guideline of retail price index (RPI) +1% to 2002 and RPI +0.5% thereafter. For all these reasons it might be expected that over the years there might be increasing differences between target rents and observed market rents. This paper examines this question as well as providing a detailed description of how target and actual rents differ from one another by size and location.

Key findings

• In 2008/09, the national standard figures of adjusted target rents and private rents for three core property sizes (a combination of one-, two-, and three-bedrooms) were £78.04 and £138.60 respectively. The gap between the two (henceforth adj.t-p gap) is thus £60.56 and the ratio (henceforth adj.t/p ratio) is 56.3%.

• At the regional level, London had the lowest adj.t/p ratio for each of three core sizes, with a declining pattern, by increase in property size (51.0%, 42.6% and 40.0%). The capital had the widest adj.t-p gaps, which expanded according to property size – £88.12, £139.02 and £169.10.

• The largest adj.t/p ratios were observed exclusively in the North East – 74.3%, 65.9% and 68.3% from one- to three-bedrooms. This region also had the narrowest adj.t-p gaps for all size categories – £20.58, £33.38 and £32.60.

• Across local authorities (LAs), the two sectors’ rents appeared significantly positively related – the correlation coefficients were 0.779 (one-), 0.819 (two-) and 0.756 (three-bedroom). The relationships indicate that current target rents reflected market elements to a discernible extent.

• The average adj.t/p ratios of LAs decreased in line with property size enlargement – 64.87% (one-), 57.95% (two-) and 54.43% (three-bedroom). The average adj.t-p gaps widened for larger sizes – £42.50 (one-), £63.48 (two-) and £82.82 (three-bedroom).

• LAs with the lowest twenty adj.t/p ratios (and consequently, negatively wide adj.t-p gaps) seemed to see high demand for social housing – they tended to have longer waiting lists. Across all the English LAs, however, the ratio and the length of the list failed to have a negative relationship with statistical significance, partly because the waiting list variable may have some errors which affect its usefulness in representing social housing demand in each locality (notably, double counting in multiple LAs).

• In terms of a rent index (the relative rent to the two-bedroom’s standard (an average for adjusted target rents and a lower quartile (LQ) level for private rents)), all regions saw the adjusted target rent indices outperforming the private counterparts for one-bedrooms. The adjusted target rent indices remained at around 0.9 with ±0.02 margins, owing partly to the size weight in the target formula. The private indices ranged from 0.74 in London to 0.83 in the North West and Yorkshire & the Humber.
In the three-bedroom comparison, all regions but the North East and Yorkshire & the Humber saw the adjusted target rent indices below the private counterparts. As seen in the one-bedroom case, the adjusted target rent indices appeared fairly stable across the regions with the minimum of 1.08 in Yorkshire & the Humber and the maximum of 1.11 in the East, the South East and the South West.

Across LAs, the adjusted target rent indices more narrowly ranged for both size categories than the private counterparts.

Price distortions (that is, indices of over (under) 1.00 for the one-bedroom (three-bedroom) index) were rarely observed, indicating that both private and ‘restructuring’ social sectors are employing a property size as one of key determinants of rent levels.

Conclusion

Overall, the latest comparisons between adjusted target rents and private rents appeared to sustain the patterns observed in the previous year’s study. In absolute terms, the restructured social rents were in a significantly positive relationship with private rents, while staying well below their counterparts, with substantial compression in high pressured areas. The findings are consistent with the two main policy objectives for restructuring social rents – fairness and affordability.

However, in relative terms, drawing on the two-bedroom standard, the relationship between social and private rents is not so straightforward. The two sectors’ rent indices were not correlated significantly. Adjusted target rent indices were overall below the private counterparts for three-bedrooms, but not for one-bedrooms so there is some inconsistency.

Adjusted target rents are clearly important not only in their impact on existing tenants but also for prospective tenants hence the inclusion of waiting lists in the analysis. The relationship of on the one hand, the ratio of target to private rents and the demand for social housing, and on the other hand waiting lists and the demand for affordable housing, would both benefit from further investigation.