

# **Dataspring**

## **The spatial pattern of target rents and their relationship with actual rents, 2002/03**

**Rents Briefing paper 2**

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# The spatial pattern of target rents and their relationship with actual rents, 2002/03

This Briefing Paper describes the spatial pattern of target rents across England and the extent to which target rents differ from actual rents. It also assesses whether the patterns vary across property sizes and across HA size, as well as across regions and districts.

## Key Findings

- Target rents are highest in London and above the national average of £60.44 per week in the South East and the East of England. The lowest target rents, below £50 per week, are in the North East and Yorkshire and Humberside. These figures are based on data provided by housing associations to the Housing Corporation in March 2003.
- The range of average target rents across districts within each region is highest in the South East, followed by the South West and London. There is a particularly narrow range in Merseyside.
- Average regional target rents are higher than actual rents in all regions except the South West.
- In London and the South East the range of target rents across all districts is significantly wider than the range for actual rents, whereas in the East Midlands, East of England and Yorkshire and the Humber, the range is narrower.
- Looking at two bedroom dwellings – the largest and most typical size- in over 40% of cases (defined as the average district rent for each HA) rents need to change by more than 10% if target rents are to be achieved. In London and Merseyside actual rents will need to increase by more than 10% to meet target in 56% and 34.5% of cases respectively. In the South West and the East Midlands actual rents will need to decrease by more than 10% in over 30% of all cases.
- The proportion of cases requiring increases of over 10% is greatest for smaller dwellings – particularly bed sits (44.7%) and decline consistently with increasing property size. The opposite is generally true for required reductions of over 10%.
- The need for rent reductions is concentrated in larger (5,000 units plus) HAs, while the need for increases are relatively evenly spread among different sizes of HA.
- In 58% of all cases average actual rents are already within  $\pm 10\%$  of average target rents. A change in rent of ten percent is only about three years' worth of allowed change in individual property rents. Therefore there should be no

problem in achieving rent restructuring over a ten-year period. Consistency across regions and localities defined by the government determined formula could equally be achieved.

## 1. Introduction

In the Housing Green Paper, *Quality and choice: A decent home for all* (DETR 2000) the Government identified the problem of inconsistency of rents between similar properties in similar areas owned by different social landlords of all types. The incoherence was seen as unfair and confusing for tenants and an impediment to implementing a policy of choice based lettings.

The pattern of current rents reflects many factors including when and where social housing has been built, changes in the subsidies given to social landlords, and the individual rent policies pursued by different landlords, as well as by government. These do not necessarily reflect either costs or value to tenants and are inherently inconsistent with one another. The Green Paper proposed a range of strategies to produce a more coherent structure of affordable rents across the whole social sector over a ten-year period. In order to avoid excessive year-on-year increases in rents and to allow gradual convergence between housing association and local authority rents (which start from a lower base) the Government also proposed a limit for annual increases that is lower for HAs than for local authorities.

Following consultation the Government opted for a formula that bases rents on regional earnings and relative property values (with a 70/30 split between earnings and property values) together with a weighting to determine differentials between property sizes. In addition there is a guideline limiting rent increases in any one year both for rents in general and for individual properties.

From 1 April 2002 most housing associations (HAs) have been required to calculate a target rent for each property and to adjust the actual net rent to meet the target rent in real terms over a ten-year period<sup>1</sup>. At the end of the ten-year restructuring period rents on individual properties should normally be within a band of five percent either side of the target rent.

The aim of this Briefing Paper is to describe the spatial pattern of target rents across England and its regions; to clarify the extent to which they differ from current actual rents; and to assess whether patterns vary across property sizes and across HA size as well as across regions and districts.

## 2. The target rent formula

The formula that HAs are required to use for calculating the target rent for each property is given in the *Guide to Social Rent Reforms* (DETR, 2001). It is set out in Box 1 below. Over the ten-year restructuring period target rents will be increased each year by RPI +0.5%. Individual property rents may also be changed by up to +/- £2 to bring them in line with target rents. The Government recognises that there will

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<sup>1</sup> The Government recognises that a very small proportion of HAs will be prevented for financial reasons from completing their restructuring within ten years. Those that are unable to do so are permitted, with agreement from the Housing Corporation, to adhere to restructuring plans that deliver as much progress as is considered possible. In addition some HAs have been permitted to defer the implementation of target rents.

be changes in relative property values and relative earnings between different parts of the country and will therefore consider how to update earnings and capital values at the time of the required three-year progress review.

#### **Box 1: Weekly target rent formula**

The target rent for an individual property is set at:

70 % of the average net rent for the HA sector at 31 March 2000 (£53.50)<sup>2</sup>

Multiplied by the relative county earnings<sup>3</sup>

Multiplied by bedroom weighting for the individual property<sup>4</sup>

Plus

30% of the average net rent for the HA sector

Multiplied by the relative value of the individual property<sup>5</sup>

The property value element of the formula is based on market valuations produced for each social landlord. This in turn reflects the attributes of the individual property such as location, size, design, age and state of repair. A concern expressed by respondents to the Green Paper was that the capital values element, even given a 70/30 split, would lead to too great a variation of rents across regions and areas in comparison to incomes of tenants impacting adversely on affordability.

The relative county earnings element of the formula addresses issues of general affordability, moderating the effect of property values on rent levels. It is based on the average gross weekly earnings of full-time male and female manual workers. The problem of affordability for individual tenants on inadequate incomes is seen as being resolved by their entitlement to Housing Benefit.

The bedroom weighting in the formula was included to address the issue of differential between properties of different bed size. Traditionally rents on larger properties have tended to be relatively low because of concerns about affordability in larger households.

In addition, in order to mitigate the effect of the rent restructuring formula on a small proportion of properties in high value areas, target rents are subject to a rent cap that varies by property size. In 2002/03 the rent cap for four or more bedrooms (for all regions) was £100.

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<sup>2</sup> Up rated to £58.23 for target rents calculated at 31 March 2003.

<sup>3</sup> 'Relative county earnings' are derived by the DTLR (now ODPM) from the New Earnings Survey (ONS) and represent the average gross weekly earnings of full-time male and female manual workers over the 1997-99 period, updated to 1999 prices.

<sup>4</sup> Bedsit=0.80, one bed =0.90, two bed =1.00, three bed =1.05, four+ bed =1.10.

<sup>5</sup> Based upon a January 1999 valuation date and an Existing Use Value, assuming continued residential use and vacant possession.

### 3. Method

The analysis uses data from the 2002/03 RSR for those housing associations that reported their target rents<sup>6</sup>. It is restricted to general needs social housing. In line with current Government policy on rent restructuring and as indicated by ODPM guidelines, the analysis uses net rents (i.e. exclusive of service charges). All target and actual rent data are expressed in £s per week.

Housing associations report average target and actual (net) rents by property size within each district<sup>7</sup>. The district and regional averages reported in this study are weighted by the quantity of stock held by each HA within the district/region.

The analysis looks first at the regional and inter-district patterns of target rents; second at the comparison between these target rents and actual rents; and finally at what is required to bring rents into line with targets with respect to size of property, spatial distribution and size of housing association. We are therefore able to examine both the pattern of target rents and how this will modify both the current spatial structure of rents and property size differentials.

### 4. The spatial pattern of target rents

#### 4.1 Average target rents across regions

Table 1 gives summary statistics for average target rents (first row for each region) at the regional level and for the range between districts in each region.

The average target rent for England is just over £60 per week. Regional average target rents can be ranked into three groups:

- (a) London (£77.97), the South East (£66.30), and the East of England (£61.96) which have the highest averages, all above the national average;
- (b) The South West, East Midlands, West Midlands and Merseyside which have average target rents between £53 and £56 – significantly below the national average; and
- (c) Yorkshire and the Humber, the North East and North West which have the lowest averages - all are around £50.

The greatest difference between the minimum district average target rent within a region and the regional average is in the South East at 23% (minimum district average = £51.04 and regional average = £66.30). The smallest differences, less than 7%, are in Yorkshire and Humberside and Merseyside.

The difference between the maximum district average target rent and the regional average is less than 10% only in Merseyside and the North East. The South West and the North West have the greatest differentials at 24% and 21% respectively.

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<sup>6</sup> HAs that did **not** report target rents in the 2002/03 RSR include LSVTs for the period 1 April 1998 to 31 March 2001, some BME HAs and HAs owning or managing 250 or fewer homes and/or bedspaces, including shared ownership dwellings.

<sup>7</sup> The term 'district' will be used throughout to denote local authority area (local authority, unitary authority and London borough).

Because the level of rent varies between regions it is also useful to examine the standardised range. The standardised range (defined in Box 2) is a measure of dispersion that is not influenced by the level of rent. The higher the value of the standardised range, the greater the difference in the average district rents within a given region.

**Table 1: Target and actual rents (£s per week) by region**

HC investment region	Average for region	Minimum district average	Maximum district average	Standardise d range
	target <i>actual</i>	target <i>actual</i>	target <i>actual</i>	target <i>actual</i>
London	77.97	64.43	92.29	0.36
	67.08	61.13	75.92	0.22
South East	66.30	51.04	77.8	0.40
	66.16	58.16	74.24	0.24
South West	56.39	48.20	70.12	0.39
	59.53	50.09	70.78	0.35
East Midlands	53.68	47.09	59.49	0.23
	52.44	44.06	62.48	0.35
East of England	61.96	53.30	72.19	0.30
	59.13	50.56	73.9	0.39
West Midlands	54.56	46.80	63.44	0.30
	52.77	45.98	60.63	0.28
Yorkshire and the Humber	49.22	46.09	56.19	0.21
	48.89	43.44	62.46	0.39
North East	49.76	41.85	54.4	0.25
	48.17	43.83	55.38	0.24
North West	50.82	45.40	61.39	0.31
	50.46	45.37	61.66	0.32
Merseyside	53.33	49.69	56.42	0.13
	49.08	46.03	52.02	0.12
<b>England</b>	<b>60.44</b>	<b>49.22</b>	<b>77.97</b>	<b>0.48</b>
	<b>57.64</b>	<b>48.17</b>	<b>67.08</b>	<b>0.33</b>

The South East, South West and London have the greatest standardised range in average district target rents. In these regions the difference between the highest and lowest average district rent is more than a third of the average regional target rent. There is relatively little variation in Merseyside, Yorkshire and the Humber and the

East Midlands - the difference between the highest and lowest average district rent in these regions is less than a quarter of the average regional target rent.

**Box 2: Definition of the standardised range**

For each region the standardised range is:

$$\frac{\text{Highest average district rent} - \text{lowest average district rent}}{\text{Mean average rent for the region}}$$

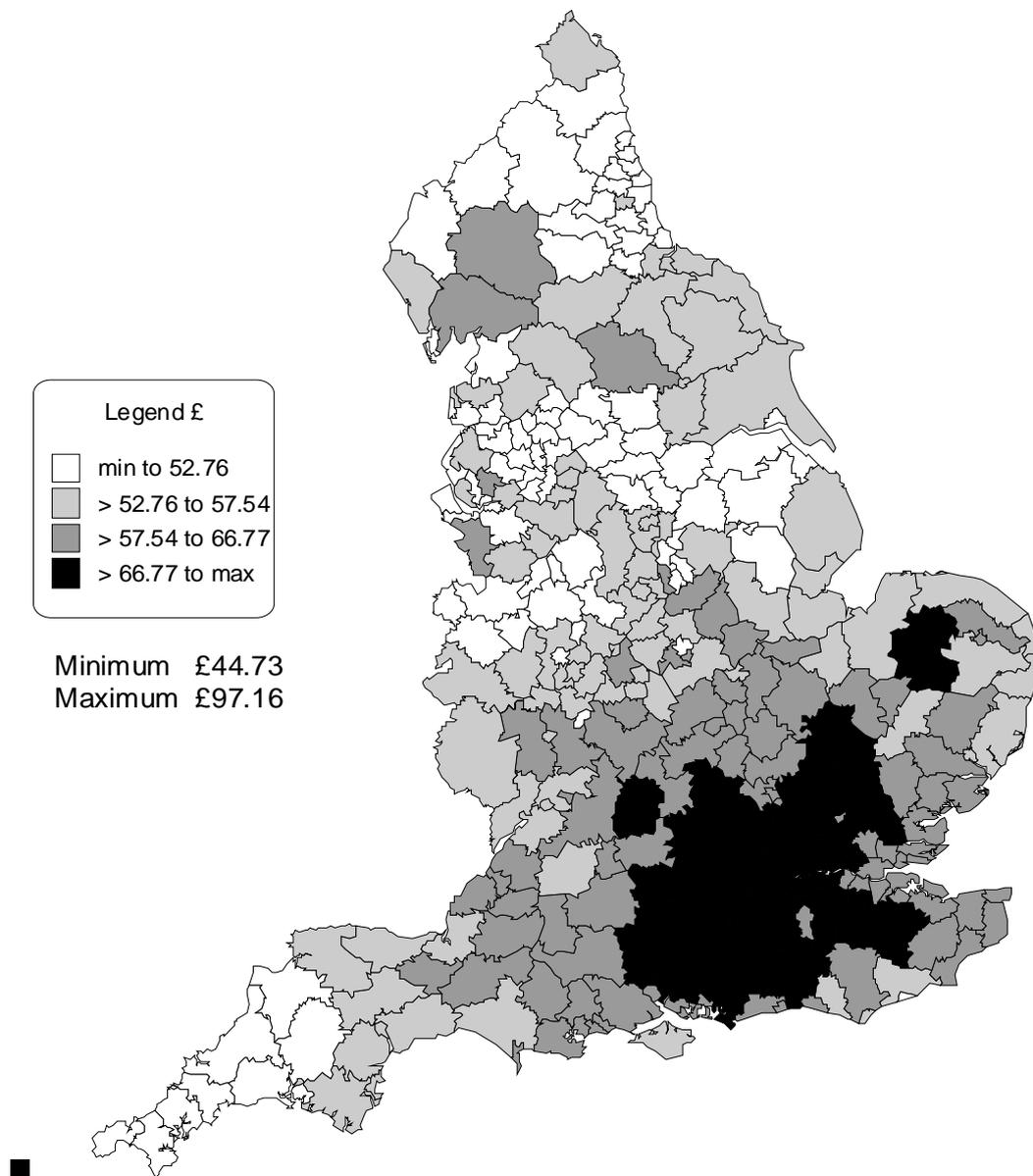
It may be helpful to think of the standardised range in terms of a multiple of the average rent. For example, a standardised range of 0.5 means that the difference between the highest and lowest average district rent within a region (the range) is half the average rent for the region.

## 4.2 Variation in average target rents across districts

We are also able to examine the extent of variation in target rents by mapping these across districts. Map 1 illustrates the variation in target rents across England for two bedroom properties, the most numerous property size across the HA sector. The map groups the average target rents for the 354 districts into four quartiles (each quartile containing 88 or 89 districts).

As is the case with all dwelling sizes, the map shows that the highest average target rents for two bedroom properties are in and around London and the South East region. There are also high rents in the East of England and all three regions have an average target rent that is above the national average for two bedroom properties of £61.33. A high proportion of districts in the North East have average target rents that fall in the lowest quartile. This is reflected in the relatively low regional average for two bedroom properties of £51.16.

**Map 1: Spatial pattern of average target rents by local authority area for two bedroom properties**



## 5. Comparing actual and target rents

Table 1 gives both the regional average target rents (first row for each region) and regional average rents (second row in *italic*).

The actual rents follow a similar regional ranking to the target rents with two exceptions: the South West and Merseyside, both of which shift away from group (b) the middle range. The average actual rent for the South West puts it into group (a) with the highest regional average actual rents. Merseyside, on the other hand, has an average actual rent that is similar to group (c) with the lowest regional averages.

The national average target rent (£60.44) for HAs reporting these rents is almost £3.00 higher than their average actual rent (£57.64). At the regional level, average target rents are above average actual rents for every region except the South West. However, in six regions the difference is only two or three percent. The exceptions to this are London (where the average target rent is 16% above the average actual rent), Merseyside (where target is 9% above actual), East of England (where target is 5% above actual) and South West, the only region where the regional average target rent is lower than the actual rent (by just over 5%).

In six regions, the variability of actual rents (as measured by the standardised range) is very similar to that for target rents (see the final column of Table 1). However, in London and the South East, the variability in average actual rents is less than for target rents. This means that in these regions, as actual rents converge to target the distribution of average district actual rents will become more spread out. In the East Midlands, the East of England and Yorkshire and the Humber, on the other hand, the variability of actual rents is greater than that of target rents - as HAs move towards target rents in these regions variability will decrease.

## 6. How much do rents have to change to meet restructuring requirement?

At the end of the ten-year rent-restructuring period, actual rents on individual properties are required to be within  $\pm 5\%$  of target rents. This section looks at the proportion of rents where the discrepancy between actual and target rents for two bedroom properties is currently more than  $\pm 10\%$  and within  $\pm 10\%$  of actual rents.

Ideally, for this analysis, individual rents for each of the properties owned by an HA would be considered. However, the RSR requires only that HAs report the average target and actual rents for each bed size by district. Depending on the degree of rental variation an HA has within each property size and district, this may or may not be an accurate reflection of all their rents. Nevertheless, the averages, when aggregated, display some distinct patterns that suggest that HAs of a particular size and operating within certain regions are more likely than others to have large differences between target and actual rents.

Tables 2 to 4 are based on the percentage of cases where an HA reported an average target rent for a district that differed from the average actual rent by more than  $\pm 10\%$ . Each case represents the difference between the average target rent and average actual rent reported by each HA for each of the districts within which it operates. Thus an HA that operates in six different districts will contribute six cases to the analysis. The final column of each table gives the number of cases. However,

while this gives some indication of magnitude - for example, in Table 3 London has 624 cases, whereas Merseyside has 116, reflecting both the larger number of districts and a larger number of HAs in London - it should be noted that each case represents an average that is based on varying quantities of stock.

## 6.1 .The relationship between property size and actual to target rent discrepancies

There appears to be a clear relationship between the extent of variation between actual and target rents and the size of dwelling. Table 2 shows that in only 8.6% of all cases was the average actual rent for bed sits more than ten percent above target rent. The percentage of cases that fall within this band increases as bed size increases, up to almost 33% for four-plus bedroom properties. Conversely, in 44.7% of all cases the average actual rent for bed sits was more than ten percent below target rent, in general the proportions fall with size such that the corresponding percentage for four-plus bedroom properties was 17.7%.

The pattern of variation between actual and target rents is very similar for two bed properties, the most numerous property size across the HA sector, as for all property types combined. One-fifth (20.4%) of the average actual rents reported for two bedroom properties were more than 10% higher than the target rent, while 57.5% were within  $\pm 10\%$  of target rents and 22.1% were lower than target rents.

One implication of this pattern is that actual rents for bed sits are more likely to adjust upwards rather than downwards in order to converge with target rents, whilst for two bedroom properties the probabilities are similar and for four-plus bedroom properties in particular more rents are likely to adjust downwards than upwards.

**Table 2: Difference<sup>1</sup> between average actual and target rents (percentage of cases<sup>2</sup> within each bed size category)**

<b>Bed size</b>	<b>Actual rent &gt;10% above target rent</b>	<b>Actual rent within <math>\pm 10\%</math> of target rent</b>	<b>Actual rent &gt;10% below target rent</b>	<b>Number of cases</b>
Bed sits	8.6%	46.8%	44.7%	1375
1 Bedroom	16.1%	55.5%	28.4%	3766
2 Bedrooms	20.4%	57.5%	22.1%	3989
3 Bedrooms	27.7%	56.1%	16.2%	3448
4+ Bedrooms	32.9%	49.4%	17.7%	1903
<b>All Properties</b>	<b>19.3%</b>	<b>58.1%</b>	<b>22.6%</b>	<b>4828</b>

### Notes

1. The difference is calculated by subtracting average actual rent from average target rent and expressed as percentage of actual rent.
2. Each case represents the difference between the average target rent and average actual rent reported by each HA for each of the districts within which it operates.

## 6.2. Actual to target rent discrepancies for two bedroom properties across regions

Table 3 shows which regions have the highest percentages of cases falling within each band of discrepancy (between actual and target rents) for two bedroom properties. Two bedroom properties are selected as an example because they form the largest proportion of stock and, in terms of the differences between actual and target rents, follow a similar pattern to all bed sizes combined (see Table 2).

London has a relatively low percentage of cases (39.3%) where reported district average rents were within  $\pm 10\%$  of target rents. In all other regions well over half of all cases are within  $\pm 10\%$  of target rent, the highest percentage being in the South East (66.8%) and the lowest in the North East (56.5%).

Looking at where rents can be expected to be restructured downwards, the South West and the East Midlands have the highest percentage of cases where the reported district average actual rent is more than 10% above the district average target rent (33.4% and 30.2% respectively). London (4.6%) and Merseyside (7.8%) have the lowest percentage of such cases. The rest of the country shows a West/East divide - the West Midlands (26.6%), Yorkshire and the Humber (26.5%) and the North West (23.9%) all have percentages above the overall percentage of 20.4% for England. The South East (20.3%) is close to the England percentage and the North East (17.6%) and the East of England (15.6%) have relatively low percentages.

More than half the cases (56.1%) in London and just over one third in Merseyside (34.5%) had reported district average actual rents that were more than 10% below the district average target rents. The percentage for the North East (25.9%) and the East of England (22.7%) are higher than the percentage for England (22.1%). All other regions had lower percentages, particularly the South West (7.3%).

**Table 3: Difference<sup>1</sup> between average actual and target rents for two bedroom properties (percentage of cases<sup>2</sup> within each region)**

HC investment region	Actual rent >10% above target rent	Actual rent within $\pm 10\%$ of target rent	Actual rent >10% below target rent	Number of cases
London	4.6%	39.3%	56.1%	624
South East	20.3%	66.8%	12.9%	767
South West	33.4%	59.3%	7.3%	482
East Midlands	30.2%	57.8%	12.0%	367
East of England	15.6%	61.7%	22.7%	551
West Midlands	26.6%	60.6%	12.8%	335
Yorkshire and the Humber	26.5%	57.1%	16.3%	245
North East	17.6%	56.5%	25.9%	193
North West	23.9%	58.6%	17.5%	309
Merseyside	7.8%	57.8%	34.5%	116
<b>England</b>	<b>20.4%</b>	<b>57.5%</b>	<b>22.1%</b>	<b>3989</b>

Notes:

1. The difference is calculated by subtracting average actual rent from average target rent and expressed as percentage of actual rent.
2. Each case represents the difference between the average target rent and average actual rent reported by each HA for each of the districts within which it operates.

### 6.3. Are actual to target rent discrepancies related to HA size?

One relevant question is whether discrepancies are related not just to bed size but also to HA size. Table 4 shows the percentages of cases falling within each band of discrepancy (between actual and target rents) for two bedroom properties, by size of HA.

The pattern of percentages indicate that the small and medium sized HAs are more likely to have reported district average actual rents within  $\pm 10\%$  of district average target rents than the large and very large sized HAs. Around one quarter of the cases reported by large and very large sized HAs have an average district actual rent more than 10% higher than the district average target rent (23.8% for large and 27.5% for very large) compared to 14.9% for small HAs and 14.4% for medium HAs.

Small and medium sized HAs are more likely to have reported district average actual rents more than 10% below target rents than the large and very large sized HAs, although here the differences between the different sized HAs are less marked.

**Table 4 :Difference<sup>1</sup> between average actual and target rents for two bedroom properties (percentage of cases<sup>2</sup> within size of HA category)**

<b>Housing association size</b>	<b>Actual rent &gt;10% above target rent</b>	<b>Actual rent within <math>\pm 10\%</math> of target rent</b>	<b>Actual rent &gt;10% below target rent</b>	<b>Number of cases</b>
Small (< 1000 units)	14.9%	62.1%	22.9%	462
Medium (1000 – 4999 units)	14.4%	60.2%	25.4%	1429
Large (5000-9999 units)	23.8%	55.9%	20.3%	1020
Very large (>10000+ units)	27.5%	53.6%	18.9%	1078
<b>All Sizes</b>	<b>20.4%</b>	<b>57.5%</b>	<b>22.1%</b>	<b>3989</b>

Notes

1. The difference is calculated by subtracting average actual rent from average target rent and expressed as percentage of actual rent.
2. Each case represents the difference between the average target rent and average actual rent reported by each HA for each of the districts within which it operates.

## 7. Summary and Conclusions

The introduction of target rents - based on county level incomes, the valuation of individual social sector dwellings and property size weightings – will change rent differentials across the country, between property sizes and between HAs.

An examination of the evidence provided by HAs to the Housing Corporation relating to 31 March 2003 suggests:

### In terms of spatial differentials

- The average target rent for England among HAs reporting target rents at £60.44 is almost £3.00 higher than the average actual rent of £57.64.
- London has a particularly high regional average target rent of £77.97 and the South East and the East of England also have regional averages above the national average.
- Yorkshire and the Humber, the North East, and the North West have the lowest regional average target rents, all around £50.
- Regional average actual rents are lower than regional average target rents in every region except the South West, although they are often quite close to one another.
- In six regions average target rents do not differ from actual rents by more than two or three percent; the exceptions are London (target 16% above actual), Merseyside (target 9% above actual), East of England (target 5% above actual) and the South West (target 5% below actual).
- In London and the South East, the variability in average target rents at the district level is greater than that of average actual rents. This means that in these two regions, as actual rents converge to target the distribution of district average actual rents will become more spread out.
- In the East Midlands, East of England and Yorkshire and the Humber, variability in actual rents is greater than that of target rents - in these three regions, as HAs move towards target rents, variability will decrease.

### In terms of how the differentials are distributed

- The discrepancy between average actual rents and average target rents varies with bed size. The likelihood of the average actual rent being **higher** than target rent by more than 10% rises as bed size increases.
- Average actual rents for two bed properties (the most usual property size) are more likely to be 10% or more **above** average target rents in the South West and the East Midlands than in other regions.
- Average actual rents for two bedroom properties are more likely to be more than 10% **below** average target rents in London and Merseyside.
- Average actual rents for two bedroom properties are least likely to be within  $\pm$  10% of target rents in London compared to other regions.
- Small and medium sized HAs are more likely to have average actual rent for two bedroom properties that were within  $\pm$  10% of target rents than the large and very large sized HAs.

### In terms of the government's objectives:

- The new system appears to be generating less spatial variation than many commentators expected. Such variation will be higher than currently especially in London, the South East and the South West. It will be

significantly lower in Yorkshire and Humberside, the East Midlands and the East of England.

- The proportion of cases requiring more than 10% reductions is clearly related to property size – with fewer than 9% of bed sits but nearly a third of four bed dwellings in this category. On the other hand nearly 45% of bed sits but fewer than 18% of four bed dwellings can expect increases of over 10%. Thus differentials between property sizes are set to decline as target rents are achieved compared to the current position.
- It is clear that it will be relatively easy to meet the objective of rent restructuring in line with their formula over the ten-year period. While in just over 40% of all cases rents probably need to change by more than 10%, a change of ten percent is only about three years' worth of allowed change in individual property rents.

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