

**Dataspring Discussion Paper 2**

**Getting Rents Right?  
The place of affordability in the rent setting process  
A Summary Report**

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The views expressed in this Research Report are those of the authors and do not necessarily reflect those of the Department of Land Economy.

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# Getting Rents Right?

## Executive Summary

### The Approach

1. The main aim of the research was to assess the use of the Continuous REcording system of lettings and sales (CORE) by Registered Social Landlords (RSLs) as a tool to use when measuring affordability. The detailed objectives of the research were threefold:
  - to determine how RSLs take account of affordability in their rent setting policies;
  - to clarify which factors should be taken into account to achieve affordability; and
  - to assess the potential use of CORE and other data to assist RSLs in setting affordable rents.
2. The questions were addressed in two stages:
  - *a survey of 50 RSLs examining current rent setting practice, the policy formulation process, RSL's understanding of the meaning of affordability and the potential use of CORE and other data to assess affordability;*
  - a set of examples clarifying how CORE and other local data could be used to build a clearer understanding of rents and affordability.

### Definition

3. Housing is defined as affordable if households can both pay for adequate accommodation and afford the other necessities of life. Affordability therefore depends not only on rents and incomes, but also on the benefit system and housing standards.
4. Affordability is only one of the factors which RSLs must take into consideration when determining rent policies. In particular, they must also maintain financial viability and meet regulatory requirements.
5. There are three broad approaches to measuring affordability more formally: rent to income ratios; residual incomes and freedom from benefit dependency.

### Rent Setting Policies

6. The majority of RSLs used a points based rent setting system to determine rent levels and structures within a given total income requirement.
7. RSLs tended to take a comparative approach to setting rents. Most looked to other RSLs and saw their aim as keeping their own rents in the lower to mid range.

8. The most commonly used data sets were CORE information on incomes, rents and lettings and the Housing Corporation rent publications.

### **How RSLs Address Affordability**

9. The vast majority of RSLs in the sample understood the Housing Corporation's requirements on rents.
10. The general concept of affordability was also well understood but few RSLs used formal measures as a benchmark for their own rent levels.
11. The two main problems identified with implementing formal affordability policies by RSLs were: the lack of an agreed definition of affordability and the lack of appropriate income data.

### **Use of CORE**

12. The majority of RSLs used CORE data. Its main strength was seen to be the capacity to compare; the main perceived weakness was the lack of consistency at the point of data collection.
13. RSLs requested more detailed breakdowns by local authority area and the availability of comprehensive tenant income data is seen as the missing link in assessing the affordability of rents.

### **A Desktop Approach**

14. Using data specific to the organisation and the local markets in which it operates, it is possible to provide an RSL with a better understanding of rents and affordability.
15. The approach is exemplified using a five step approach based on existing data.
16. The steps required are:
  - analysis of internal rent levels and structures;
  - comparison of the RSL's rent levels and structures with those of other RSLs;
  - comparison of the RSL's own rent levels and structures with rents in other tenures;
  - assessment of income and other information about households; and
  - application of formal measures of affordability.
17. The data sources required to enable these assessments to be made are listed in each relevant section. Detailed numerical examples are presented in the main report.

18. All examples make it clear that any affordability assessment must include details of rents, incomes and household types and that relevant household categories must be clearly identified.

### **Conclusions and Recommendations**

19. Current practice among RSLs is often limited to qualitative understanding or to the comparison of rent levels with those of other RSLs.
20. There is a lack of both clear guidance on definitions of affordability and appropriate incomes data which hinders RSLs' capacity to assess the affordability of their rents thoroughly.
21. Much can be done using existing sources, particularly CORE data, which will remain the most important source of incomes data.
22. Monitoring affordability at the local and individual RSL level will remain important even if the Green Paper recommendations on rent determination are fully implemented.

# Getting Rents Right?

## The place of affordability in the rent setting process

### A Summary Report

#### 1. Introduction

This project examined the extent to which Registered Social Landlords (RSLs) consider affordability in their rent setting policies. It aimed to clarify which factors should be taken into account in the assessment of affordability. The potential use of external data sources, particularly the COntinuous REcording for new lettings and sales by RSLs in England (CORE) data, were considered in order to assist RSLs in their setting of affordable rents.

The research was undertaken in two stages. First, interviews with 50 RSLs were carried out to examine current rent setting policy formulation and practice and to determine RSLs' understanding of the meaning of affordability. The potential use of other data to support RSLs in addressing affordability was also examined. Second, a desktop approach to assessing affordability was investigated. This exemplified how rents and affordability might be measured in the context of particular RSLs.

There is no currently agreed national measure of affordability. Rather there are measures implicit in the determination of Social Housing Grant (SHG) and in government statements such as those contained in paragraphs 10.6 and 10.11 of the Housing Green Paper (DETR, 2000). The National Housing Federation defines an affordable rent as:

*“rents are affordable if the majority of working households taking up new tenancies are not caught in the poverty trap (because of dependency on housing benefit) or paying more than 25% of their net disposable income on rent” (NHF 1993).*

Although this definition appears in rent policy statements, few RSLs actually have the means of measuring affordability in line with this definition. Of those who do spend time ‘measuring’ the affordability of their rents the majority do so in comparison to other RSL rents, seeing this as an indication of relative affordability.

At the most general level a rent is affordable if the householder can pay the rent and have enough disposable income left over to “afford the other necessities of life” (Freeman et al 1999). Underpinning affordability are the relationships between rents, incomes, the benefits system and housing standards. However, for the landlord rents are determined by their investment and financial viability and restricted by the Retail Price Index (RPI) + 1% rent increase rule. For the majority of social landlords, affordability takes second place in their rent setting process; their priority is to sustain a healthy rental income in order to maintain financial buoyancy. Therefore RSLs are in a position, because of regulatory requirements, of carefully balancing performance standards, rents and service charges first and foremost with affordability taking second place.



Turning to specific measures, any comprehensive affordability study must include detailed information about rents, incomes and household type. The relevant household categories must be clearly identified and the detail and nature of the analysis will vary depending on the purpose for which assessment will be utilised. There are three formal approaches to measuring affordability taking into account the above mentioned relationships: the rent to income ratio; residual income; and freedom from benefit dependency.

### **The Rent to Income Ratio**

The proportion of income that is spent on rent expressed as a percentage.

$$\text{Ratio} = \text{rent} \div (\text{income} + \text{housing benefit}) \times 100$$

This is particularly useful for measuring affordability over a period of time. As rents rise the ratio will increase. It also allows comparison across RSLs and categories of tenant. However it does not ensure that people with different needs will find rents affordable.

### **The Residual Income Measure**

The income that is left after the rent and other essential costs have been paid.

This is directly related to the underlying concept of affordability but is very closely linked to the more general welfare system. It is useful for instance in showing the impact of changing rents as a household moves from one sector to another and in comparing the proportion between different household groups.

$$\text{Residual income} = \text{income} - \text{rent} - \text{income support} + \text{housing benefit}$$

The higher the residual income the more affordable the accommodation becomes, in as much as it clarifies the disposable income left over to purchase other goods.

### **Housing Benefit Dependency**

Assessing household incomes where households are just at the point at which their housing benefit eligibility is zero has two advantages. First, it avoids the problem of how to treat housing benefit in the rent to income approach – whether as income or as a rent reduction. It also avoids the circularity of the definition of affordability in the residual income approach, where all rents are affordable because housing benefit ensures that no households' residual income falls below its applicable amount. Second, it directly addresses the objective of avoiding the poverty and employment traps created by being dependent on housing benefit (Freeman et al, 1999; Chaplin et al, 1994). However, especially since the introduction of working family tax credit, it can be more of a measure of the effectiveness of welfare in general. Its main strength is that it identifies those circumstances when it is rents which directly affect overall affordability.

This report looks first at what RSLs already do, then specifically at the use of CORE data and finally at what they might do. Although the report focuses on rent levels as a way of addressing affordability it must also be recognised that adjusting the benefit system, or increasing incomes, are equally valid ways of improving the affordability of housing.

## **2. Current RSL Practice: Findings from the Interviews**

### **Current Rent Setting Policy Formulation and Practice**

This part of the research focused on current practice to explore how RSLs determine their rent levels. We asked what factors were taken into account when formulating rent setting policies, whether equalisation was being sought between fair and assured rents, whether location was a determining factor, whether tenants were consulted and finally, whether costs were considered when formulating rent policies. Throughout this process the type and size of RSL was taken into consideration as time and resources can impact heavily on smaller RSLs in a way that larger RSLs may not have to consider.

- ***Rent setting systems***

72 percent of the RSLs interviewed during the research used a points based system for setting rents. The value of a point was determined by the income requirement divided by the total number of points attributed to the stock. In turn, the rent per property is determined by the value of the point multiplied by a predetermined number of points attributed to that property. In this way RSLs calculate their rents on the basis of their financial business plan for the forthcoming year and adjust rents in line with this. For the minority of RSLs who do not use a points based system, rents are either determined by the rent officer or are based on the financial requirements of the RSL with little consideration of the attributes of individual properties within the total stock of dwellings.

- ***Convergence***

Convergence is being sought between fair and assured rents. At the present time the two streams continue to run side by side. However, many RSLs who have had fair rents determined by the rent officer are seeking to equalise their fair and assured rents, either by capping fair rents at assured rent levels or by requesting rents from the rent officer that will facilitate the equalisation of rents in the near future. Equally, Large Scale Voluntary Transfer (LSVT) associations which are out of guarantee may phase increases differently between existing and new lets within the constraints of RPI + 1%.

- ***Location***

For many of the RSLs who operate in more than one local authority area there is no differentiation when setting rents in different areas. In the main, assessments of desirability were considered too subjective to be taken into account - what may be a desirable area for one household may not be for another. Of those who do differentiate between local authority areas, physical desirability and socio-economic factors prevailed. Property size differentials were, by

and large, either taken into account within the points based system or defined by external factors such as development costs.

- ***Differences between size of RSL***

The main distinction in policy and practice was found between small and large RSLs. Time, money and resources invested in rent policies and procedures were significantly greater amongst medium and larger RSLs. At one end of the spectrum a very large RSL had spent £150,000 on formulating its new rent policy. At the other end small RSLs used committees of volunteers to formulate policy at no cost. Few RSLs chose to use outside consultants. Only three RSLs in our sample utilised consultancies, and these were the three largest RSLs. Here cost seemed to be the significant factor.

- ***Tenant consultation***

Similarly, less than half of RSLs consulted with their tenants on rent policy formation and review. For those who did, consultation was achieved through tenants sitting as Board or Committee members. For the majority who did not consult with tenants there was a general view that tenant participation would increase in the future. At the present time tenant input with respect to rent policy formulation was not regarded as particularly important because of the central role of the business plan.

- ***Rent reviewing factors***

The factor most frequently taken into account when reviewing rent levels was a comparison of rents with those of other RSLs. 80 per cent of RSLs look at the rents of other RSLs as a benchmark to rent setting, each wishing to see their rents in the lower to middle range of rents published in the Housing Corporation's Source document, *Guide to Local Rents Part II: Social Landlord Rents*. The most frequently used data sets referred to by RSLs for rent setting were incomes, rents and lettings data from CORE and the above mentioned 'Source' documents published by the Housing Corporation.

## **How RSLs Address Affordability in Practice**

Having ascertained how RSLs set their rent levels and what factors were important in this process we then asked our sample to explain their understanding of the Housing Corporation's requirements on rents; what definitions or measures the RSLs utilised themselves in any assessment of affordability; and what strategies they had in place for addressing the affordability of rents. We also asked if there were any particular data or expertise that they would find helpful as an aid to assessing affordability.

- ***Housing Corporation requirements***

The majority of RSLs had a full understanding of the Housing Corporation's requirements on rents. Concerns were raised, however, over the implications of the RPI + 1% rule. These concerns are likely to have been exacerbated by the recent Housing Green Paper where it is proposed that, from 2002/03, rent increases may be restricted to RPI + 0%. RSLs (our research shows not just smaller ones) will feel the weight of the constraints of this rule in terms of

financial viability and also, for developing RSLs, when meeting bid rents to secure Social Housing Grant.

- ***Affordability***

The general concept of affordability was well understood in the form that it appears in the *Housing Corporation's Performance Standards* (1997). However, there was a lot of frustration that RSLs are simply required to ensure that rents are affordable to people in low paid employment rather than there being an agreed definition of affordability provided to support this regulatory requirement. Without a concrete definition, RSLs argue that it is impossible to measure the affordability of their rents accurately. The lack of a definition has hindered RSLs in assessing the affordability of their own rents. In any case, maintaining financial viability, which is a defined regulatory requirement, is considered more important.

- ***Limitations to Assessing Affordability***

The main limitation on data for assessing affordability by RSLs was the availability of incomes data. This was seen as the most relevant information for assessing affordability. Accurate data for both the incomes of existing tenants and those of potential tenants were viewed as vital missing elements in measuring the affordability of rents. A definition of low paid employment would also assist RSLs in assessing affordability.

- ***Measures of Affordability***

67 percent of RSLs have adopted the NHF's definition of affordability rather than devising their own.

- ***Utilisation of affordability measures***

60 percent of the RSLs who utilise a formal measure of affordability employ ratio measures - comparing rents with incomes. This involves dividing net rents by net income data from CORE for those households who are not eligible for housing benefit. The remaining 40 percent used a variety of means, including one large RSL who used a residual income approach by measuring residual incomes and adding income to benefit. Others used incomes data taken from new tenants at the point of application, while one took the average income from every original application form and assumed an RPI increase per year for every year of tenancy to make them more representative of likely current incomes.

- ***Further approaches***

Many of the RSLs have different starting points for addressing affordability. For some, energy efficiency, credit unions, childcare schemes to support working mothers and 'social economy work' such as the support of training for employment were considered just as valid for impacting on the affordability of accommodation as changing actual rent levels.

## **Current Use of CORE Data for Assessing Affordability**

The research process also aimed to discover whether RSLs use CORE data as an aid to assessing affordability and the particular variables considered to be the most helpful. The CORE data survey is designed to provide all inclusive information about all new tenants who move into the RSL sector at the point of letting. Data are collected at the beginning of a tenancy and any personal information, such as income details, are given at the discretion of the tenant. CORE publishes the analysed data in both reports and bulletins focusing on the number of lettings, household types, economic status of head of household, incomes, ethnicity and benefit dependency of all new tenants. Furthermore, RSL CORE participants receive, free of charge, published average rents from CORE by county and local authority area. Annual individual RSL profiles are also available from CORE providing a summary of an RSL's own lettings contained within a detailed report incorporating 40 tables. This report is focused at the local authority level by tenancy type and property size, giving average weekly rents and service charges. Income details are recorded by Housing Corporation investment region.

- ***Affordability and CORE data***

The majority of RSLs did refer to CORE data on a regular basis, but rarely specifically for addressing affordability issues. Accurate and representative incomes data, as stressed earlier, were seen as the key element to addressing or measuring affordability. While CORE does provide income data on new tenants who choose to divulge this information, it is thought to be too narrow because it only includes new tenants. It is also viewed as flawed due to a potential lack of consistency at the point of data collection. This results from the fact that CORE returns are completed by different housing managers at the point of tenancy start with minimal guidance as to interpretation of the data requirements of the form. As a result of these possible inconsistencies, the accuracy of the data is questionable.

- ***CORE variables***

For the RSLs who use CORE data, the most frequently used variables are rents, incomes and lettings (relet or new let data). Particularly useful are the published rents data which are used by RSLs comparatively to benchmark their own rents. A perceived drawback of the rents data was highlighted, in the main, by smaller RSLs. Too often they found their own figures got lost within the bigger data groupings and found it difficult to distinguish between types or sizes of RSLs or properties. Unfortunately, these tended to be the smallest and more specialised RSLs which did not have the capacity to obtain bespoke data that can be extracted from within these wider populations of RSLs.

- ***Usefulness of CORE***

There was an overwhelming feeling that, while CORE data were useful for making general comparisons, the existing information needs to be more specific and detailed if RSLs are to make progress on affordability issues. Demand for detailed data at local authority level and below was repeatedly requested by RSLs of all sizes. For smaller RSLs and Black and Minority Ethnic (BME) RSLs particularly, a lack of comparative rents data was seen as a hindrance. They would choose to compare like with like because of the often specific nature of their properties and services. In fact, since April 1998 CORE data has been obtainable at postcode level at an RSL's request, although all of the RSLs interviewed seemed unaware of this service.

- ***Specific needs***

In reality, although specialist RSLs found comparative data difficult to obtain, the majority were not aware of the flexibility of the CORE service. Although many referred to the standard reports and bulletins produced by CORE, albeit not necessarily for addressing affordability, many seem unaware that bespoke data could be requested to meet specific needs. However, some RSLs were reluctant to obtain bespoke data due to the perceived high costs relative to resources available. This was despite the fact that CORE have a policy that costs should not be prohibitive and are willing to come to arrangements over the cost of data.

- ***Data requirements***

Additional data requested by RSLs as an aid to assessing affordability primarily focused around the need for comprehensive income data, additional information on average rents and service charges and, as stressed earlier, a concrete definition of affordability. Tenant based information was also requested by RSLs, particularly income information for existing tenants as well as information on prospective tenants. These data are seen as the missing links for assessing the affordability of rents.

### **3. A Way Forward in Measuring Affordability**

The results of the research highlighted the fact that RSLs currently measure the affordability of their rents in a number of ways ranging from simple direct rent comparisons to more technical approaches directly addressing tenant incomes in relation to rents. The majority, however, take the simple comparative approach. This is not surprising as not all RSLs have the resources, expertise or the motivation to go beyond this. In particular, the Housing Corporation's rule on outlying rents gives all RSLs the impetus to compare rents with their peers. Within the Housing Corporation's Performance Standards it is stipulated that "*rents must not be significantly higher than the regional average or out of line with rents across similar stock, that is, rents must not be outliers without reason*" (Performance Standard D1.3). However, this approach to affordability has a starting point decided by others: someone else has determined what is affordable and as such it can be seen as both circular and relative. On the other hand there appears to be a reluctance to utilise relatively easily obtained data, data often already held for other purposes, to assess rent levels and structures because of perceptions about their applicability and questionable validity.

In light of these findings the report examined a number of analyses that RSLs could perform in assessing the affordability of their rents using available information.

Before assessing affordability, an RSL should be clear about the ways in which the assessment is to be used. Examples include:

- how affordability fits into the overall objectives and constraints of the organisation – is the assessment being carried out to assist in competitive tendering, to increase equity among tenants and/or to address issues of access to the labour market;
- whether the RSL's approach to affordability is more market based, value based or definition based – remembering that it must be consistent with government policy, financial requirements and market feasibility;
- whether the assessment is about rent levels or rent structures and between property types and/or locations; and
- whether the assessment is to relate to the whole stock and thus to existing tenants, to new lettings and tenants or to potential tenants, given the RSL's position in the local housing system.

There is no single definition or measure of affordability that can address all these issues together. Instead the report provides a five-step approach leading to a full assessment that reflects the range of current practice. It provides a description of each analysis, references suitable data sources available at both the national and local levels and points to tools and services available to assist the process. The five steps are:

1. analysis of internal rent levels and structures;
2. comparison of the RSL's own rent levels and structures with those of other RSLs;
3. comparison of the RSL's own rent levels and structures with rents in other tenures;
4. assessment of income and other information about households; and
5. application of formal measures of affordability.

These five steps are exemplified in the next section. In applying this approach it is important for RSLs to compare like with like in terms of stock profile and the rent elements included. Here we suggest that **rents should normally be defined as gross rents, i.e. including service charges eligible for housing benefit**. This is recommended for two reasons. First, this approach removes any variation between what is included in the net rent and housing benefit eligible service charge. Secondly, the gross rent provides a better comparison with rents charged by local authorities which often include charges for services in the net rent. However, it should be noted that there is an anomaly in relation to gross rents when looking at RSLs with sheltered accommodation because care costs are also included.

## 4. Five Step Approach to Assessing the Affordability of Rents

### Step One Analysis of Internal Rent Levels

As a starting point of any assessment of affordability, RSLs need to be aware of their own rent levels and structures by property type, size and location.

*RSLs should be aware of:*

- Overall average rent levels by property size and by local authority area.
- Differentials in rent levels between property sizes (the rent structure, type and location).
- Other differentials, notably between areas.

The rent structure is important for Step Two. Whether the structure is steep or flat is also important because different household types may benefit from either a steepening or flattening of rent differentials. The analysis may also include comparisons between new, improved and unimproved dwellings.

Where stock is owned in more than one local authority area, this assessment should be done for each area. This is because local housing markets may vary significantly between areas, as may local incomes, both of which will impact on the affordability of rents.

#### **Data Sources Step One**

- RSL's own management information systems.
- For RSLs with more than 250 units in management – the Housing Corporation's Regulatory and Statistical Return data.
- Relet and new let data for all dwellings let in any given quarter at local authority and lower levels for specific property and household types are available from CORE. Information may be obtained from the NHF Data Advisory Service (DAS).

### Step Two Comparison of Rent Levels and Structures with Those of Other RSLs

- *RSLs should first determine with which rents a comparison is most appropriate.*
- *Again, it is likely to be important to compare both average rents by property size and locality and rents on new lettings.*

Although, like Step One, a comparison with the rents of other RSLs does not in itself provide an assessment of the actual affordability of rents, it is an indicative measure that is useful for a number of reasons. It is valuable in simple market terms to attract and retain tenants. It is relevant to equity considerations and to the government's objectives of coherence and consistency between providers. It raises awareness of rent levels in general. Finally, it helps to ensure that rents are not outliers within the regulatory framework.



## ***Data Sources      Step Two***

- Average rents for large RSLs with more than 250 units in management are published in the *Guide to Local Rents: Part II* by the Housing Corporation. This includes average assured and fair rents separately and combined. Average rents for local authority districts, as well as stock data, are also included but there is no distinction between fair and assured rents here.
- CORE collects rents for all new lets and relets at the time of letting and distinguishes between assured and fair rents. The CORE annual report gives only national data on rent levels but the CORE DAS can provide bespoke data analysis. These data are particularly useful for developing RSLs that are competing for SHG.
- **Dataspring** can provide bespoke analysis.
- RSLs can be approached directly, individually or as a result of formal or informal symposia, benchmarking and other groupings.

## **Step Three Comparison of an RSL's own Rent Levels with Rents in Other Tenures**

This comparison raises general awareness of local rent levels and helps RSLs understand how they are positioned in the housing market with respect to the local authority, private rented and owner occupied sectors.

- *In this assessment, **private sector rents** refer to unfurnished dwellings where tenants are in receipt of housing benefit.*
- *A **user cost** is used when making comparisons with owner occupation. This represents the out of pocket expenditure of an owner-occupier at the lower end of the mortgage market and includes the mortgage, buildings and life insurance and a mortgage indemnity guarantee.*

*NB. It is important in this comparison to be aware of the relative stock sizes and thus the relative accessibility of the different sectors.*

The comparison between an RSL's rents and local authority rents is important. If RSL rents are significantly higher than local authority rents there is evidence that households not eligible for housing benefit may leave the RSL sector in favour of lower rents. Reducing the gap reduces the risk of losing working tenants. Also, convergence between local authority and RSL rents is a government goal stated in the Housing Green Paper, *Quality and Choice: A Decent Home for All* (DETR, 2000).

In areas where private rents and owner occupation costs are low and RSL rents are high in comparison, tenants may choose to enter or move to other sectors. Equally, where private rents and costs are high, it is important for RSLs to know how wide the gap is as it implies that those with incomes who would normally bypass the social sector may not be able to access private sectors in these conditions. As a result, changes to allocation procedures may be desirable to include this group as 'in need'. This could result in a better mixed and balanced community of tenants, another aim of the proposals of the Housing Green Paper. The governments definition of social housing is to provide accommodation at sub-market rents, so affordable rent setting needs to take private market levels into account.

### ***Data Sources      Step Three***

All data are available from **Dataspring** back to 1989/1990 following the 1988 Housing Act. Alternatively:

- **Local Authority Rents** are available from the Chartered Institute of Public Finance Administration (CIPFA) at the district level with average rents by property size and type.
- **Private Rented Sector Rents** are available from two main sources:
  - a) Rent Officer Statistics give assured and secure shorthold tenancy rents from referrals by the Housing Benefit Service - so the rent data refer to the housing benefit sub sector of the market. This source also provides the **local reference rent** for each locality by property size, which is an estimate of the average private sector rent made by the Rent Officer.
  - b) University of York Index of Private Rents and Yields.
- **User Costs of Owner Occupation.** Simple house prices can be obtained from a number of sources. A number of assumptions about the cost profile of an owner occupier have to be made to determine the user cost, which is the relevant comparison to rents. The components included in the user cost vary from time to time. At the time of writing, **Dataspring** calculated these costs by using the following factors:
  - a) House price data for the lower quartile, not the average (Halifax data are used by Dataspring, although their market share has fallen in recent years). This represents the lower end of the market, which is the realistic alternative for social housing tenants. Because this is stock that can be mortgaged, it may exclude the lowest quality stock. Furthermore, if there are low numbers of property types in some local authorities they may not appear in the Halifax house price data.
  - b) Principal and interest on a 25 year repayment mortgage, given the average base mortgage rate for the year.
  - c) Loan to value ratios of 95% (the usual maximum proportion that can be borrowed).
  - d) Buildings insurance (average rates from the Nationwide).

- e) Life assurance (average rates from the Nationwide).
- f) Mortgage indemnity guarantee, given the high loan to value ratio (average rates from the Nationwide).

NB. If comparing data from different sources independently, an RSL needs to be aware that there may be some variation in how local authority boundary changes have been treated.

## **Step Four Income and Other Information about Households**

In measuring affordability, the other side of the coin to rents is to assess household characteristics, chiefly income. Also, to put household incomes in context and evaluate affordability measures, it is necessary to have an idea of the household structure of both the total and RSL tenant population. This provides an understanding of the balance between families and all adult households, pensioners, non-pensioners, single parent and two parent families, etc. The following categories should be considered within the relationship between tenants and income:

1. income characteristics of the total population;
2. where the RSL's own tenants are placed within this overall income distribution;
3. variation of tenants' incomes around the average tenant income; and
4. variation of tenants' incomes by household type.

These four aspects of household incomes are important. Each should ideally be made available by household type because affordability depends on household spending commitments.

### ***Data Sources Step Four***

#### **1. National Surveys**

National and regional data on household incomes and structures can be obtained from:

- a) Family Expenditure Survey – household structure and incomes.
- b) General Household Survey - household structure and incomes.
- c) Family Resources Survey – household incomes by income source, household structure and tenure.
- d) Survey of English Housing – household structure by tenure.
- e) Existing Tenants Survey (1995 and 2000) – household structure and incomes for RSL tenant population.

#### **2. District Level Data**

##### **• Total Population**

- a) **Household Structures** available from DETR / Dataspring.
- b) **Earnings** available from New Earnings Survey (Department of Employment), NOMIS (University of Durham) and Dataspring.

NB. These data are based on place of employment and only cover earned income.

- c) **Incomes** are available from the Inland Revenue or Dataspring. This is residence based data that only excludes tax free income.

- ***The RSL Tenant Population***

- a) **Household structures** are available from CORE for new tenants but do not include data for existing tenants for whom the existing tenants survey is the only source.
- b) **Household Incomes.** Dataspring can provide average incomes at the district level by household type. Net household incomes of new tenants are available from CORE. Individual household data do exist so data on averages and variations of incomes about the averages are available via NHF CORE DAS.

With some effort, data about **existing tenant's incomes** may also be extracted from the following sources: Housing Benefit records; commercial data taken from household market research surveys; and household surveys undertaken by RSLs or groups of RSLs within a district (the NHF provides a service to support this activity).

## **Step Five Formal Assessments of Affordability**

The core objective of affordability is to ensure that households achieve adequate housing and still have enough income for other goods and services so that they also have an adequate standard of living. A second objective is to help households into work and off welfare support.

Whichever measure of affordability is used, the difference in household circumstances of particular household types needs to be taken into account. As stated in the introduction, there are three main ways of calculating how affordable rents are to any given household type. **All of the data discussed on rents and incomes in Steps One to Four, together with contextual information, have to be assembled before the affordability of rents can be directly calculated with these measures.** The main report provides much more technical detail and information about performing these measures, including worked examples. Using the three measures together gives different perspectives on the question of affordability with respect to an RSL's range of goods. Ratios reflect a view of equity across households and over time, residual incomes reflect the extent to which housing costs differentially affect poverty and income levels, while freedom from Housing Benefit dependency takes account of the number of households housed by RSLs that are caught in poverty and employment traps.

### **Measure One Rent to Income Ratio**

Most RSLs and others use a single rent to income ratio either for the total tenant population or for a defined group. However, it is more appropriate to provide a series of benchmark rent to income ratios with each benchmark relating to a particular household type and reflecting differences in other commitments. For example, the benchmark ratio defining an affordable rent for a two parent family in a two bed property may be 21 percent whilst the benchmark ratio defining an affordable rent for a childless couple in the same property may be 23 percent. The result is that, for different household types, the definition of the affordable rent for the same dwelling will vary. This is necessary if the household is to be able to purchase other necessities.

This measure is particularly useful for measuring the affordability of rents over time – as rents rise the ratio will increase. Equally, as income from any source increases, the weight of housing costs will decline.

The landlord should determine for which household type(s) they want to make rents affordable as they are not likely to charge different rents for the same dwelling based on household composition. For example, the NHF's affordability measure focuses on working households but an RSL may wish to focus on pensioners instead.

### ***Definition of the Rent to Income Ratio Measure***

*The measure uses a series of benchmark rent to income ratios for different household types to set affordable rents. It is calculated in three steps:*

- 1. Take the existing average RSL tenant incomes of a household type in a district, county or region as the starting point;*
- 2. Calculate the rent at which the household would be paying the benchmark proportion of income on rent; and then*
- 3. calculate the ratio, i.e. the proportion of a rent expressed as a percentage:*

$$\text{Ratio} = \text{rent} \div (\text{income} + \text{housing benefit}) \times 100$$

*NB. Because this involves net incomes, a model of the benefit and tax system is necessary to perform the calculation.*

## **Measure Two      Residual Income**

This measure clarifies how much income is left over for other purchases after paying housing costs. It therefore relates directly both to the underlying concept of affordability and to the general approach of the social security system. The measure is complementary to the ratio approach. To determine residual income benchmarks it is appropriate to use multiples of the household's income support applicable amount - 120 percent or 140 percent of the applicable amount, for example. This is because, under the existing social security framework, a residual income benchmark cannot be operationalised unless it is set at or above the point at which the household comes off housing benefit. A full discussion of this measure can be found in 'The Ready Reckoner (2000/01)', S Wilcox (2000).

### ***Definition of the Residual Income Measure***

*The measure uses a series of income benchmarks for different household types to define what rent level is regarded as affordable. Residual income equals the income that is left after the rent and other essential costs have been paid:*

$$\text{Residual income} = \text{income} - \text{rent} - \text{income support} + \text{housing benefit}$$

*The measure is useful for showing the impact of changing rents as a household moves from one sector to another. The higher the residual income, the more affordable the accommodation becomes in as much as there is disposable income left over to purchase other goods.*

### **Measure Three    The Point at Which Housing Benefit is Zero**

The income levels resulting from this calculation show the incomes that tenants of particular household types in particular dwelling sizes would require to avoid dependence on benefits.

### ***Definition of the Welfare Dependency Measure***

*The rent levels at which different household types come off housing benefit can be calculated using average incomes for each household type in the locality as the starting point.*

***The results will show the maximum rents which different household types can afford without needing housing benefit to pay for them.***

*In this calculation landlords should choose the income data that relate to the most relevant household group given their affordability goals.*

*The income data need to be individual household incomes, or at least at district level, so that the proportion of actual working households with incomes in excess of the target income can be assessed for different household types in particular dwelling sizes.*

If the rent levels at which households come off housing benefit are lower than can be achieved, given other objectives, landlords must ask whether they can make rents relatively more affordable for some households at the expense of others given the constraints of housing benefit and their required rental income. This is done by looking at alternative rent schedules within the required gross rental income constraints. It must be remembered, however, when using the three measures that the extent to which rents of one dwelling size can be raised or lowered depends on the number of dwellings by dwelling size as a proportion of all dwellings.

### **Other Tools for Assessing Affordability:**

There are ‘tools’ available that can perform these calculations and are easily accessible or available. Examples include:

- the ‘*Ready Reckoner: Rents, Benefits and Affordability (2000/01)*’ by Steve Wilcox available from the Housing Corporation;
- Bob Line’s ‘*Affordability Spreadsheet*’ is available on the internet: <http://homepages.stayfree.co.uk/bline>;
- Bespoke analysis can be purchased from Dataspring: [www.landecon.cam.ac.uk/dataspring](http://www.landecon.cam.ac.uk/dataspring); and
- Bespoke analysis can also be purchased from CORE: [www.core.ac.uk](http://www.core.ac.uk).

In addition to the main report ‘*Getting Rents Right? The place of affordability in the rent setting process*’ (Marshall et al, 2000), there are also a number of texts that RSLs can read which address the principles and measures of affordability in more detail. Therefore RSLs can expand on their understanding of the process. Examples include:

- *Affordability: Definitions, Measures and Implications for Lenders*, Discussion Paper 45, Department of Land Economy, (1994), Cambridge.
- *A Review of International Literature on Rental Affordability*, Discussion Paper 88, Department of Land Economy, (1997), Cambridge.
- *Evaluating Housing Affordability*, LGA Publications (1999), London.
- *Evaluating Housing Affordability: Policy Options and New Directions*, LGA Publications (1999), London.

## 5. Conclusions and Recommendations

This project sought to assist RSLs in assessing rental affordability, first by finding out what current practice is amongst RSLs and then by clarifying some of the ways in which they might use CORE and other data sources to assess affordability as one element of their rent policies.

### Current Practice

Most RSLs state that affordability is an important goal in their rent policies. Because there is no robust workable definition of affordability with a single straightforward measure for RSLs to adopt, it is difficult for them to measure the affordability of their rents directly. The more compelling and readily measurable constraints of the Housing Corporation’s financial requirements, the RPI + 1% cap on rent increases and the rule about outlying rents, often have a greater impact on RSLs’ rent policies.

Most RSLs do not use affordability measures per se to find out whether their rents are affordable or not. Instead they may look at their peers' rents or look to tenant feedback to gauge market response. There are problems with RSLs relying on one another's rents to ensure that they are affordable. This approach is circular and relative. Where a group of RSLs operating in a locality each looks at the others' rent levels they are relying on one another to determine what is acceptable. Whether, in absolute terms, rents are affordable is not directly addressed. Implicit in this practice is the assumption that someone else has determined what is affordable. This is, however, not, at least formally, the case. To an extent the blind are following the blind, especially at local level.

There is a feeling among landlords that, because there is no single measure of affordability, they need not take steps to assess it. Yet, affordability is about the complex interplay between rents, incomes, the benefit system and housing quality. It cannot be fully summarised in one measure but requires an understanding of this interplay, the fundamentals of the local housing markets in which they operate and the characteristics of the households they are housing. RSLs need to be prepared to do more than wait for a single measure that will give them a single answer. This research outlines some steps that can help them address the issue for themselves.

On the government's part it is not enough to make general national statements as in the Housing Green Paper (DETR, 2000). What is needed is to evaluate how affordability operates on the ground. The implication is that, if they want RSLs to take affordability seriously, there needs to be a clearer measurable definition of affordability in the sector's Performance Standards.

## **Measuring the Affordability of Rents**

The approach outlined suggests that RSLs look to external circumstances in the local housing markets where they operate to get a more realistic idea of whether their rents are affordable or not before evaluating their position with respect to specific measures. The approach starts where they are already, by looking at their own rent levels and structures and then by looking at other RSLs in the locality. It then goes on to propose that RSLs should compare their rents to rents in other tenures. Next the approach suggests that RSLs should look at household characteristics, chiefly income, to clarify the impact of rents on affordability. Finally the report demonstrates three ways of determining what an affordable rent might be – the rent to income ratio, residual income and housing benefit dependency – each of which provides a different perspective on affordability.

## **Recommendations**

Affordability is important and more can be done by RSLs to work out whether their rents are affordable or not. Even if the Housing Green Paper's recommendations are fully implemented, removing RSLs' capacity to set individual rents, it will remain important to monitor affordability both with respect to local markets and RSL management practices.

Based on the findings of this research, some of our recommendations are set out below:

- The government and the Housing Corporation should agree a definition of affordability which can be applied at the individual level, although not necessarily a specific measure.



- Measures to facilitate affordability assessments should be introduced, particularly to help small and specialised RSLs that are less resource rich.
- RSLs should be aware of exactly what CORE provides both in the standard NHF reports and through specially commissioned analysis. They should make full use of the data available to them in their assessments of affordability.
- Implementing a more effective approach to affordability includes making more appropriate data available, particularly at the local level. In this context one way forward is to develop local authority data packages.
- Good practice, including the formation of peer groupings at the local level, should be encouraged. This would facilitate the cost effective use of more detailed CORE analysis and other products.

The full report, **Source Working Paper 5. Getting Rents Right? The place of affordability in the rent setting process**, can be obtained from the Housing Corporation Publications Unit, 149 Tottenham Court Road, London W1P 0BN, telephone 0207 393 2228.

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Office for National Statistics (1998)	<i>Housing in England 1997/98</i> , Survey of English Housing, Office for National Statistics, London
Office for National Statistics (1999)	<i>New Earnings Survey</i> , Office for National Statistics, London
Office for National Statistics (1999)	<i>Family Expenditure Survey 1998/99</i> , Office for National Statistics, London

## Data Sources

Data Source	Coverage	Available from
Dataspring	District level data for rents in the RSL, local authority and the private rented sectors; weekly owner-occupation costs; House prices; council tax bands; tenure structure; house completions; population; household characteristics; incomes and earnings; employment and unemployment. Bespoke analysis service available and standard statistical reports provided for members	Property Research Unit (Cambridge Housing & Planning Research) University of Cambridge Department of Land Economy 19 Silver Street Cambridge CB3 9EP
CORE Statistics	Quarterly (General Needs) and six monthly (Sales & Supported Housing) bulletins and annual reports. Wide range of data on new tenants and properties they occupy. Tailored reports can be ordered.	Joint Centre for Scottish Housing Research Purdie Buildings North Hall University of St Andrews Fife KY16 9ST
Bob Line's Affordability Spreadsheet	Calculating tax, national insurance, Working Families Tax Credit and housing benefit for different household types and rents. Comparison of rents between registered social landlords, local authorities and private rented sector using database analysis of RSR, CORE, Rent Officer statistics and other sources.	<a href="http://homepages.stayfree.co.uk/bline">http://homepages.stayfree.co.uk/bline</a>
The Ready Reckoner: Rents, Benefits and Measures of Affordability	Calculating tax and benefit liabilities and net household incomes before and after housing costs and provides eight alternative affordability measures for each household type, rent and earnings level.	Housing Corporation Publications Department 149 Tottenham Court Road London W1P 0BN
Family Expenditure Survey	Yearly sample of 6,000 household. Breakdown by standard region and tenure but not both.	The Stationery Office The Publications Centre P O Box 276 London SW8 5DT

<b>Data Source</b>	<b>Coverage</b>	<b>Available from</b>
Family Resources Survey	Yearly sample of the income and circumstances of 25,000 households. Breakdown by standard region and tenure but not both.	The Stationery Office The Publications Centre P O Box 276 London SW8 5DT
Housing in England	Sample of the housing tenure, satisfaction, condition and intentions of 20,000 households. Limited information by tenure	The Stationery Office The Publications Centre P O Box 276 London SW8 5DT
New Earnings Survey	Sample of 30 - 40,000 working people. Earnings and hours of work of employees by sex, standard region, type of work. Not by tenure	Office for National Statistics ONS Sales Office Room 64a/3 Government Offices Great George Street London SW1P 3AQ
Housing Association Tenants in 1995	Sample of 10,000 tenants in 1995.	Housing Corporation Publications Department 149 Tottenham Court Road London W1P 0BN
Index of Private Rents and Yields	Valuations and transactions data to local authority level	Centre for Housing Policy University of York York YO10 5DD
Source 32: Guide to Local Rents	Part I: Cross tenure rents. Average RSL and private sector rents (referred to Rent Officer) by property size and local authority. Average local authority rent by property size and region. Part II: Social landlord rents. Average rent and service charge by property size, local authority and RSL. Rent increase by RSL.	Housing Corporation Publications Department 149 Tottenham Court Road London W1P 0BN