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Briefing:

Rent reductions

Supporting implementation

Summary of key points:

This briefing sets out Housing Associations can practically implement the 1% rent cut in the Welfare Reform and Work Bill.

- The rent cut will, in principle, apply to all tenancies that are currently subject to the Rent Standard (although for supported housing it has been deferred to 2017).
- Commencing from 2016/17, landlords are required to reduce the rent due from the tenant by 1% each year until (and including) 2019/20.
- The Bill assumes that an April rent review date is the norm, but contains special (and complex) provisions for cases where rents are normally reviewed at other times.
- Social rent for new general needs properties must be charged at the formula rent, with no 5% tolerance.
- Where a social rent property is relet to a new tenant, the association may retain the 5% tolerance to the extent that it was already in use as at 8 July 2015.
- There is no statutory or other official mechanism for reducing the rent. Tenants should receive formal notice of the change but in most cases the statutory form should not be used.

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1. Background

At the summer Budget in July 2015, the Government announced plans to reduce rents in the social housing sector by 1% for each of the next four years from April 2016, breaking the 10-year rent settlement of CPI + 1%.

Provisions for the rent reduction are being brought forward through the Welfare Reform and Work Bill which has already passed through the House of Commons and is currently being scrutinised in the House of Lords. The Government is aiming for the Bill to receive Royal Assent, the point at which the legal authority for the rent reduction will be established by the end of March 2016 (although, even if the Bill is delayed, it is still likely to be prudent (for reasons explained in section 4 below) for most associations to reduce their rents in April 2016).

This briefing note sets out the practical implications of implementing the rent cut and is based on the information available to the Federation as of 4 February 2016. It does not include details on the changes to the Local Housing Allowance, more details on this change can be found on our website. The Welfare Reform and Work Bill is still under debate and this briefing will be updated as further information becomes available. For more information about the Federation's response to the rent reduction and current influencing work to seek mitigations, please see section 5.

2. Implementing the rent cut – to which homes and services does it apply?

To which housing does the rent cut apply?

Our understanding is that the rent cut will, in principle, although subject to a delay in respect of supported housing, apply to all tenancies that are currently subject to the Rent Standard:

- Social rented housing in general where the landlord is a registered provider of social housing (whether they are local authorities, housing associations, or for-profit providers). This includes registered providers who manage tenancies on behalf of private sector landlords, or who lease their properties.
- Affordable rented housing where the landlord is a registered provider.

It will not apply to properties that are outside the Rent Standard, such as specialised supported housing, market rent, intermediate rent, and shared ownership. This policy is evolving, and we would strongly encourage associations to take their own advice in addition to the information included in their briefing where they have queries concerning the scope and impact of the policy. Properties managed by unregistered providers will also not be subject to the rent reduction.

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Although, in principle, the rent cut covers supported housing (except specialised supported housing), the Government announced on 27 January that its application will be delayed for one year, i.e. until April 2017. For more details, see section 3 below.

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The one-year deferment also applies to

- co-operatives (which is likely to be defined to mean fully-mutual co-operatives)
- almshouses
- community land trusts.

What about formula rent, also known as 'target rent'?

Just as actual rents are to be reduced by 1% annually, so the formula rent will also be reduced. As such, when this briefing refers to 'formula rents' we are referring formula rent as decreased by 1% annually from 2016 until 2020.

Are service charges included?

The Government has indicated the clear policy intent that, for social rents, the 'rent' for the purposes of the rent reduction excludes the service charge. This applies whether the service charge is fixed or variable.

By contrast, the 'rent' for affordable rents includes the service element – again, whether fixed or variable (most associations operate a fixed service charge in affordable rent properties).

How does it all work when it comes to relets?

Where a property is relet to the same tenant (for instance, if a fixed-term tenancy comes to an end and the landlord renews it), this is regarded as a continuation of the same tenancy and the rent should continue to fall by 1% annually. This applies to both social rents and affordable rents.

Where a social rent property is relet to a new tenant, the rent may be either:

- (a) the formula rent (as reduced by 1% each year), termed in the Bill the 'social rent rate', or
- (b) the rent charged as at (in most cases) 8 Jul 2015. This is the 'assumed rent rate'.

The overall effect of this is that the property can be relet above formula rent only if (and then to the extent that) it was above the formula rent on 8 July 2015.

The following cases illustrate the point. In each case, it is assumed that the property is let as general needs, that the landlord's first 'relevant year' begins on 1 April 2016, and that the rent was not increased between 8 July 2015 and 31 March 2016.

CASE 1

The formula rent for a property on 8 Jul 2015 is £100 and the actual rent is £105 (i.e. at the top of the 5% tolerance). In Apr 2016, with the same tenant still *in situ*, the landlord reduces the rent to £103.95 (a 1% cut) and

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the formula goes down to £99.00. (However, the actual rent continues to be 5% above formula, albeit both have been reduced.) In Apr 2017 the rent is further reduced to £102.91, while formula falls to £98.01. At some point during 2017/18 (i.e. the second relevant year), the property becomes vacant and falls to be relet. The maximum rent on relet is the higher of the social rent rate (i.e. 98.01) and the assumed rent rate (i.e. £102.91).

CASE 2

If, on the other hand, the same property had been let on 8 Jul 2015 at £95 (i.e. at the bottom of the 5% tolerance), then by 2017/18 the formula would have fallen to £98.01 (as in Case 1) and the actual rent would have fallen to £93.10 (i.e. two years' 1% cut). In this case, the property falls vacant the landlord may relet it at the higher of these two figures, namely the (reduced) formula rent of £98.01.

CASE 3

If the same property had been let on 8 Jul 2015 at £100, i.e. exactly at formula, then the social rent rate and assumed rent rate would be identical and would both reduce in step during the rent reduction exercise, so in 2017/18 the maximum rent on relet would be £98.01.

For supported housing, however, the 10% tolerance is retained even if it not in use as of 8 July 2015 (see section 3).

Where an affordable rent property is let to a new tenant, including conversions of social rent properties, the rent can be set at 80% of the market in the usual way.

... And for new lets?

New lets for social rent properties can be at formula rent. The 5% tolerance no longer applies for new lets of general needs housing.

New lets for affordable rent can be set at 80% of the market in the usual way.

How will waivers work?

The Welfare Reform and Work Bill includes a provision for the regulator to grant an organisation either a whole or partial waiver from the obligation to reduce rents by 1% per year.

The Bill sets out the power of the Regulator, the Homes and Communities Agency (HCA), to issue a direction in respect of a registered provider exempting it from the requirements to reduce rents if one of the following conditions is satisfied. The conditions are:

- the Regulator considers that complying with the rent reduction would jeopardise the financial viability of the provider, or
- the circumstances of the private registered provider satisfy requirements prescribed in regulations.

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The HCA will publish a document on what measures it considers could be taken by a housing provider to avoid jeopardising its financial viability. The Government has yet to clarify how the second condition will be framed in the regulations but the provision does open up a possible opportunity for housing providers to argue for a waiver for reasons unrelated to the overall financial health of the organisation. The detail framing this condition will be set out in regulations.

This waiver could be partial or complete and the Regulator will have the power to impose an alternative rent settlement appropriate to the organisation. The wording of the Bill leaves this power very open and a partial waiver could apply to particular stock and/or a fixed period of time. The Federation is continuing dialogue with the Department of Communities and Local Government (CLG) and the HCA on both the process to apply for a waiver and the criteria, and will update members as soon as more detail is confirmed.

3. Supported housing

How will the rent reduction apply to supported and sheltered housing?

During the debate on the Welfare Reform and Work Bill in the House of Lords on Wednesday 27 January Lord Freud confirmed that the Government will put in place a year-long exception for all supported housing from the 1% rent reduction in the social rented sector. For these properties social landlords will be able to raise rents by CPI plus 1% in line with the rent standard. CLG has further clarified this policy as set out below:

The Government's intention on the definition of supported and sheltered housing 'is that this be a wide definition. All supported housing as currently set out in the rent standard guidance will be excepted from the rent reduction for a period of 1 year and providers should use this as a guide as they set rents for 2016-17. The exact definition will be defined in regulations. For the purposes of clarity we intend that the exception will include though not necessarily be limited to:

- domestic violence refuges and other specialist accommodation based support for domestic violence victims
- hostels and other accommodation for the homeless
- sheltered accommodation for older people
- supported accommodation for young people
- extra care housing,
- accommodation for people with mental health or drug/alcohol problems,
- accommodation for people with disabilities
- accommodation for ex-offenders and people at risk of offending.'

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What will happen 2017/18 and beyond?

The exception for supported and sheltered housing is for one year. Government is considering the future funding system for people living in supported and sheltered housing sector in the light of the decision in 2013 for housing costs for these schemes not to go into Universal Credit. The Government has stated that it wants to take into account the results of the review of the scope and cost of the sector before making any longer term decision about rent policy for these homes.

Does the 10% tolerance still apply?

During the course of the Bill, Ministers have announced that providers of supported housing would be able to set rents for new and relet supported housing at 10% above the social rent rate (i.e. formula less the appropriate reduction). During the exception period the intention is that providers will be able to set new rents at 10% above the 2015/16 formula rate uprated by CPI+1.

What about schemes that are outside the rent standard?

Rents in 'specialist supported housing' are outside the HCA Rent Standard. These homes will be excepted from the rent reductions completely and for the entire 4 year period. The full definition of 'specialist supported housing' is in the [Rent Standard](#). A summary of the definition is given below:

- Where a scheme offers a high level of support and/or care for people who as an alternative might live in a care homes, and
- Where no, or negligible, public subsidy has been received by the scheme, whether in the form of capital grant or free land, and
- Where the scheme has been commissioned in line with local health, social services or Supporting People strategies and priorities

4. Implementing the rent cut – the process for reducing rents and serving notice

What statutory process do I need to go through to reduce rents for assured tenancies?

There is no statutory or other official mechanism for reducing the rent. The existing statutory mechanisms, specifically sections 13 and 14 of the Housing Act 1988, which apply to almost every periodic assured tenancy (whether shorthold or 'lifetime'), apply only to rent increases.

Accordingly, the familiar statutory form should not be used when it comes to implementing the 1% annual rent reduction. Crucially, this means the 12-month (or 52-week) rule has no application (because this is a rule about the interval between rent increases), and the tenant has no statutory right of appeal.

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In the unlikely event that the tenancy agreement itself sets out a rent reduction mechanism, the Welfare Reform and Work Bill provides that a registered provider may nonetheless reduce rents without giving prior notice.

So when does the rent reduction need to take place?

The Government's policy intent is that the rent cut should take place at the start of the landlord's 'relevant year'.

The 'relevant year', for each association, depends on when it normally increases its rents. Thus, for an association that normally increases its rents at the beginning of April, its first 'relevant year' will run from April 2016 to March 2017. The majority of associations will be in this position.

Associations that increase the rent of a majority of their tenants at a date other than April should adjust their 'relevant year' accordingly. For an association with an October increase date, for instance, the first 'relevant year' will run from October 2016 until September 2017.

The central requirement of the legislation is that, for each tenant, the rent due in respect of the first 'relevant year' should be 1% less than the rent due from that tenant in the last full year before the first 'relevant year'. This should normally be calculated on the basis that the rent charged on 8 July 2015 had applied throughout the last full year before the first 'relevant year' (but note that the Secretary of State has power to allow reference to another date if the rent was (or is to be) increased in accordance with the Rent Standard between 8 July 2015 and 31 March 2016 – see notes below on increase dates other than April).

In respect of each successive 'relevant year', the rent due from the tenant should fall by a further 1% until, and including, the fourth and final 'relevant year', which, for an association with an April increase date, will run from April 2019 to March 2020.

Where an association has a standard rent review date for the majority of its tenant, therefore, the practical effect of the Bill is to require a rent cut of 1% each year, at the same time as the rent would otherwise have increased.

The reason that the bill refers to 8 July 2015 is that this is the date of the summer budget at which the rent reduction policy was announced. These references, therefore, are designed to prevent artificial rent increases that would allow the landlord to effect the 1% reduction from a higher level of rent. It does, however, create a problem for associations whose normal rent increase date falls after 8 July. These associations will quite legitimately have increased their rents since that date, not as an avoidance device but simply in compliance with the Rent Standard. These associations should note that the Secretary of State has power under the Bill to vary the 'permitted review day' and we anticipate that this power will be exercised to specify, for these associations, a 'review day' that legitimates rent increases taking place between 8 July 2015 and 31 March 2016, provided that the rent would normally have been increased at that time and the percentage increase was in accordance with the Rent Standard (i.e. CPI+1%).

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Assumed rent rates may be calculated as follows:

1. Where the property was occupied on that date, the rent charged as at 8 July 2015
2. Where:
 - a. Landlords have increased their rents in accordance with the Rent Standard at a date between 8 July 2015 and 31 March 2016, and
 - b. the Secretary of State agrees, and
 - c. there was a tenant in the property on the alternative date, the rent charged on an alternative date.
3. Where a tenant was not in situ on the alternative date, the rent that was payable by the tenant who was in the property on 8 July
4. Where a tenant was not in situ on either the alternative date, nor on 8 July, the rent that is likely to have been payable on the 8 July.

What about landlords with a number of different rent review dates?

Where a landlord has a number of different rent review dates during the year, its first 'relevant year' will begin at some point between April 2016 and March 2017:

- a. if there is a particular date that applies to a majority of its tenants, on that date; or
- b. if there is no date that applies to a majority of tenants (e.g. if the association increases rents on the anniversary of the start of the tenancy, so that dates are scattered throughout the year), on 1 April 2016.

This means that an association with a variety of increase dates will inevitably have some tenants whose normal rent review date does not coincide with the start of the association's 'relevant year'.

For these tenants, the requirement will nevertheless apply that the rent due in respect of the first 'relevant year' must be 1% less than it was previously. The previous rent is normally calculated as it was on 8 July 2015, but, as mentioned above, it is expected that the Secretary of State will allow the use of a later date if the rent was increased in accordance with the Rent Standard between 8 July 2015 and 31 March 2016. However, this will not alter the timing of the first 'relevant year', which will begin when the association normally increases the rent of the majority of its tenants or, if there is no such majority date, in April 2016.

In short, the practical effect is that the landlord will still need to cut its tenants' rent by 1% at the start of the first 'relevant year' even for tenants whose rents would normally have been increased at some other time. It is understandable that associations might be tempted to defer the reduction until the normal rent increase date, but the effect of such a delay is that the reduction will apply for only part of the 'relevant year' so it will have to be greater than 1% in

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order to produce the required reduction across the 'relevant year' as a whole. It is assumed that most associations will prefer to avoid such an outcome.

Are there any other legal requirements about the timing of rent reductions?

Although there is no statutory restriction on when rents may be reduced, for periodic tenancies the reduction must comply with the common law requirement that the rent can be changed only at the beginning of a tenancy period.

For fixed-term tenancies, there is no such requirement but it has been normal practice to increase the rent with effect from the point at which a payment becomes due and it makes sense to apply the same approach to a reduction.

How and when do I give my tenants notice of the rent reduction?

While there is no standard format for notifying the tenant of a rent reduction, it would be advisable to do this in writing with your organisation's letterhead.

Where there is a fixed service charge, the notification should state:

- The existing gross rent (and how much of this is service charge)
- The new gross rent (and how much of this is service charge)
- The date on which the new rent will take effect.

Where the service charge is variable, the notification should state:

- The existing net rent (and how much service charge is being levied in addition to this)
- The new net rent (and how much service charge will be levied in addition to this)
- The date on which the new rent will take effect.

The tenant should be given reasonable notice of the change in rent. This should certainly be long enough to allow the tenant to make any necessary arrangements, such as informing the local authority, or altering bank mandates. It is suggested that one month would be reasonable notice.

It is possible that a few tenancy agreements may specify a notice period for a rent cut, but any such term is set aside by the Bill so that a rent cut for the purposes of the Bill may be implemented without notice.

My organisation's tenancy agreements have ouster clauses. Does that make any difference?

Some associations may have clauses in their tenancy agreements that operate so as to oust the statutory rent mechanism in assured periodic tenancies. These associations will be accustomed to use their own mechanisms for increasing the rent, in accordance with the tenancy agreement.

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Associations in this position should carefully study the rent clause in their tenancy agreement. Because clauses of this kind are bespoke to the association concerned, it is not possible for the Federation to give general advice except to say that it is essential to check whether the clause applies to any change in the rent (up or down) or only to increases.

If the rent clause covers reductions, the association should give effect to the rent cut in accordance with the clause (although any notice period in such a clause is set aside by the Bill). If the clause covers increases only, then the association should simply give reasonable notice as outlined in the previous section.

A handful of associations may have included 'upward-only' rent clauses in the tenancy agreement. Such a clause is common in commercial leases but it is unusual in residential tenancies. It is likely that the legislation will have the effect of overriding the upward-only clause, but associations in this position may wish to seek their own legal advice on the point.

How does this all apply to fixed-term assured tenancies?

Since 2011 associations have been able to grant fixed-term assured tenancies (i.e. 'flexible' tenancies as opposed to 'lifetime' tenancies). Fixed-term tenancies are excluded from the statutory rent increase mechanism and consequently the tenancy will include its own mechanism for varying the rent. It is likely that this mechanism will apply to increases only. A reduction can, therefore, be effected by serving reasonable notice as outlined in the previous sections.

What happens if the service charges increase by an amount greater than the 1% rent reduction?

Associations should also note the possibility that, in some cases, it is possible that the service charge might increase by a sum that outweighs the reduction in rent.

This is likelier in supported housing than in general needs, because the service charge is likely to be larger in proportion to the net rent, but even in general needs housing, it may happen occasionally, for instance if expenditure on services in the coming year is expected to be much higher than usual.

In certain circumstances, this will make an important difference to the way the change is notified to tenants. This is because, for the purposes of the rent increase mechanism in sections 13 and 14 of the Housing Act 1988, a fixed service charge (unlike a variable charge) counts as part of the rent. If the charge has increased by more than the net rent has fallen, therefore, a rent increase has occurred and the statutory rent notice should be used in the usual way. But it is stressed that this will be an unusual situation, because it requires all of the following to apply:

- The tenancy must be assured periodic without an ouster clause.
- The service charge must be fixed.

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- The service charge must increase by a larger amount, in cash terms, than the 1% reduction in the net rent.

What does this all mean for fair rent tenancies?

The Bill makes no special provision for fair rent tenancies and consequently they will need to be treated in the same way as other tenancies: the rent due in respect of the first 'relevant year' must be 1% less than previously.

What happens if the Welfare Reform and Work Bill does not pass through Parliament by the end of March 2016?

In the normal course of events, rent notices for an increase at the beginning of April 2016 would go out before the end of February. Several members have asked about what happens if the Bill has yet to become law in time for April 2016, when the rent reduction is due to come into force.

While the Bill will have no legal authority until it receives Royal Assent, we recommend members proceed with the necessary action on the basis of a 1% rent cut in the year beginning 1 April 2016.

This is because the legislation, once passed, will require the landlord to collect 1% less rent from each tenant during the first year of rent reductions than it did during the previous year. If, therefore, a landlord were to increase rents in April 2016, presumably by CPI+1%, its only way of collecting 1% less rent during the year as a whole would be to introduce a more drastic rent cut part-way through the year.

5. Federation's views - impact and our activity

The Federation has been working with members to highlight the impact of the rent reduction on housing associations. Our estimates are that the rent cut will equate to a £3.85bn loss to housing associations over the period.

In August 2015 we also commissioned research by Savills to explore the financial impact on housing associations of all the measures set out in the summer Budget, including the rent cut (but not the LHA cap, which had not then been announced). This research, which will be published shortly, finds that:

- The impact on individual associations was dependent on the proportion of their income derived from rents and the scale of any cross subsidy activity. As such, detrimental impacts were felt mostly by associations with fewer than 10,000 homes, those in the Midlands and North of England, and LSVTs.
- The cuts reduced associations' appetite and ability to continue to cross subsidise supported housing costs. This additional pressure was driving many associations to focus

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supported housing activities away from services for vulnerable working people towards older people's services.

We have provided briefings on the impact of the rent reduction at each stage of the parliamentary process, as well as in our submissions to the CLG Committee inquiry into housing associations and the Right to Buy, and the House of Lords Economic Affairs Committee inquiry into the economics of housing.

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