



**OFFICE OF THE
DEPUTY PRIME MINISTER**

A Guide to Social
Rent Reforms
in the Local
Authority Sector

housing



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February 2003

Office of the Deputy Prime Minister

The Office of the Deputy Prime Minister
Eland House
Bressenden Place
London SW1E 5DU
Telephone 020 7944 4400
Web site www.odpm.gov.uk

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The Office of the Deputy Prime Minister
PO Box 236
Wetherby
West Yorkshire
LS23 7NB
Tel: 0870 1226 236
Fax: 0870 1226 237
Textphone: 0870 1207 405
E-mail: odpm@twoten.press.net

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INDEX

CHAPTER 1

| | |
|---------------------------------------|---|
| Introduction | 5 |
| 1.1 Rent Restructuring Policy | 5 |
| 1.2 Monitoring & Review of the Policy | 5 |
| 1.3 Purpose of this Guide | 5 |

CHAPTER 2

| | |
|--|----|
| Calculating Restructured Rents | 7 |
| 2.1 Extent of Rent Restructuring | 7 |
| 2.2 Rent Formula | 7 |
| 2.3 Property Valuations | 8 |
| 2.4 Example: Calculating a Formula Rent | 9 |
| 2.5 Limits on Rent Changes | 9 |
| 2.6 Rent Cap | 10 |
| 2.7 Calculating Actual Rents | 10 |
| 2.8 Example: Calculating the Actual Rent | 11 |
| 2.9 Averaged Change Approach | 13 |
| 2.10 Tenure Issues | 13 |
| 2.11 New Tenants | 13 |
| 2.12 5% Flexibility | 14 |

CHAPTER 3

| | |
|--|----|
| The Housing Revenue Account Subsidy System | 15 |
| 3.1 HRA Subsidy | 15 |
| 3.2 Adjustments to HRA Subsidy | 15 |
| 3.3 Making the Transition | 15 |
| 3.4 Adjustments for Caps and Limits | 15 |
| 3.5 Property Specific Rent Restructuring | 17 |
| 3.6 Property Specific Rent Rebate Subsidy Limitation | 17 |
| 3.7 Subsidiary Rules – Disproportionate Rent Increases (DRI) | 18 |

CHAPTER 4

| | |
|---|----|
| Service Charges | 19 |
| 4.1 Treatment of Service Charges under Rent Restructuring | 19 |
| 4.2 Phased Unpooling | 20 |
| 4.3 Keeping Charges Affordable | 20 |
| 4.4 Implications for HRA Subsidy | 21 |
| 4.5 Implications for Property Specific Rent Rebate Subsidy Limitation | 22 |

CHAPTER 5

| | |
|--|----|
| Implications for Tenants | 23 |
| 5.1 Implications for Tenants | 23 |
| 5.2 Implications for Local Authorities | 24 |
| 5.3 Rebasing of Management and Maintenance Allowances | 24 |
| 5.4 Review of Management and Maintenance Allocation Formulae | 25 |

CHAPTER 6

| | |
|---|----|
| Glossary of terms | 27 |
| Annex A: Information for the Restructuring Formula | 29 |
| Annex B: Calculating Formula Rents | 31 |
| Annex C: Making the Transition to Formula Rents | 34 |
| Annex D: Effect of Property Specific Limit Rents | 36 |
| Annex E: Separating Service Charges | 41 |

CHAPTER 1

Introduction

The Government's policy for social rents in England that are fair, affordable and less confusing for tenants was set out in the December 2000 policy statement, *The Way Forward for Housing* available at <http://www.housing.odpm.gov.uk/information/index18.htm>.

The Government is committed to keeping social rents at affordable levels. The changes that are being made are designed to keep rents in the social sector well below those in the private sector. These changes will help ensure that generally future rent increases stay well below those experienced in the last decade.

1.1 Rent Restructuring Policy

The Government believes that:

- social rents should remain affordable and well below those in the private sector;
- social rents should be fairer and less confusing for tenants;
- there should be a closer link between rents and the qualities which tenants value in properties; and,
- differences between the rents set by local authorities and Registered Social Landlords (RSL) should be removed.

1.2 Monitoring & Review of the Policy

Each social landlord is expected to produce an annual restructuring progress report covering issues such as calculation of formula rents, plans for implementation, and progress achieved. Local authority landlords should address these issues in their Housing Revenue Account (HRA) Business Plans.

ODPM will commission research into the impact of rent restructuring across the country, and Ministers will review the progress that has been made with the implementation of rent reforms after about three years. The review will consider the impact of the policy so far and whether any further refinement is needed to the details of the policy.

1.3 Purpose of this Guide

This guide explains, in detail, the basis on which local authorities are being encouraged to set their rents from 2002 onwards. In particular it provides:

- a full explanation of the central formula around which Ministers wish social rents to be set in future;
- details of associated changes to the HRA subsidy system, including the treatment of service charges;
- an analysis of implications for both tenants and local authorities;
- information on how implementation of the policy will be monitored and reviewed;
- worked examples, to illustrate the approach.

CHAPTER 2

Calculating Restructured Rents

This chapter explains how rents should be calculated under the reforms.

The key to achieving the policy objectives above is via a common formula for both local authority (LA) and RSL rents. Councils and RSLs are expected to move their rents as far as possible towards these '*formula rents*' over 10 years from April 2002.

2.1 Extent of Rent Restructuring

The Government expects local authorities to apply rent restructuring to all properties which are accounted for within their HRA.

In particular, HRA properties which have been leased to a RSL or other managing agent for 21 years or less are subject to the local authority rent restructuring regime. (A lease of more than 21 years would mean the property had been disposed of and would therefore be removed from the HRA). Ministers expect that local authorities which have entered into such agreements will work in partnership with managing agents to ensure that rents are moved towards the *formula rents* as outlined in 2.2 below.

2.2 Rent Formula

The Government wants social rents to reflect:

- condition and location of properties, and other qualities that tenants value;
- local earnings, so as to take account of affordability;
- property size.

Property values provide a simple and transparent way of reflecting the relative attractiveness of properties to tenants. Local earnings moderate the impact of property values on rent levels, ensuring that rents reflect local incomes and remain affordable. Property size helps to ensure a sensible pattern of rent differentials between properties with different numbers of bedrooms.

These aspects are reflected in the weekly *local authority formula rent*:

| |
|--|
| $\begin{aligned} \text{Weekly Formula Rent (April 2000)} = & \\ & 70\% \times \text{average LA rent (April 2000)} \times \text{relative county earnings} \times \text{bedroom weight} \\ & + \\ & 30\% \times \text{average LA rent (April 2000)} \times \text{relative property value} \end{aligned}$ |
|--|

Average LA rent means the national (England) average council rent at April 2000.

Relative county earnings mean average county-level manual earnings divided by national average manual earnings, both at 1999 levels.

Relative property value means an individual property's value divided by the national average value of a council property, at January 1999 prices.

Average *formula rents* for authorities will be uprated each year by inflation (currently the GDP deflator) and a real terms increase, as set in the relevant Spending Review, including a contribution towards closing the gap between average local authority and RSL rents.

The objective of removing differences between LA and RSL rents does not mean that their rents should be the same: there are objective differences between local authority and RSL stock. The aim is that social rents on similar houses in the same area should be the same, no matter who is the landlord.

2.3 Property Valuations

In order that rent restructuring generates a consistent and equitable pattern of rents between landlords, a common approach needs to be adopted. Open market values assuming vacant possession and continual residential use should be used. This is what valuers call Existing Use Value (EUV).

Valuations for rent restructuring purposes should be based on prices in January 1999. This was the date used for exemplifications in the original consultation on the Housing Green Paper, and remains the most suitable valuation base as it is more representative of average conditions in recent years.

NB: Authorities should not update the formula by using a different price base.

Local authorities were asked to value their stock following the introduction of resource accounting in the Housing Revenue Account in 1999. Property valuations for rent restructuring purposes may be derived from the beacon values obtained for this purpose through a desktop exercise. **However, authorities should note two important differences in these valuations.**

First, beacon values for resource accounting are based on an April 2000 price base, whereas rent restructuring uses a January 1999 price base. Second, for resource accounting purposes, authorities were required to make downward adjustments to the Existing Use Values to reflect the lower values of properties when used for social housing. **Downward adjustments should not be made for rent restructuring purposes.** It would add extra complications to the process, and would introduce circularity because the current pattern of rents would influence the pattern of restructured rents.

As the price base is constant, the valuation of any individual property for rent restructuring purposes should generally remain the same over time. Exceptions to this include where an authority has refined the accuracy of the method of valuation, or where it has carried out substantial major works which have materially affected the property value. Any revaluation must be backdated to January 1999 prices.

2.4 Example – Calculating a Formula Rent

Consider a 3-bedroom council house in Gloucestershire, with a capital value estimated at £60,000 in January 1999. Other information needed in the formula is given in **Annex A**.

| | |
|---|---------|
| average national LA rent in April 2000: | £45.60 |
| average earnings in Gloucestershire: | £308.00 |
| national average earnings: | £316.40 |
| bedroom weight: | 1.05 |
| national average LA property value in January 1999: | £41,350 |

Putting these figures into the formula:

| | |
|---|-----------------------|
| 70% x sector-average rent x relative county earnings x bedroom weight | |
| = 70% x £45.60 x £308.00/£316.40 x 1.05 | = £32.63 subtotal |
| 30% x sector-average rent x relative property value: | |
| = 30% x £45.60 x £60,000/£41,350 | = £19.85 subtotal |
| adding together the sub-totals, April 2000 Formula Rent | = £52.48 total |

This would be the **formula rent** for 2000/01. The real terms increases for 2001/02, 2002/03 and 2003/04 are as shown in Annex A. The **formula rent** for the example property above in those years is as follows:

| | |
|-----------------------------|--|
| Formula rent 2001/02 | = £52.48 x 4.5% (2% increase + 2.5% inflation) = £54.84 |
| Formula rent 2002/03 | = £54.84 x 3.5% (1% increase + 2.5% inflation) = £56.76 |
| Formula rent 2003/04 | = £56.76 x 3.25% (1% increase + 2.25% inflation) = £58.60 |

Further worked examples are given in **Annex B**, including for shared ownership dwellings and hostels.

2.5 Limits on Rent Changes

Ministers want councils to move the rent for each council property to the **formula rent** (or within 5%, subject to local circumstances), so far as possible by March 2012. However, protecting tenants from large annual rent rises takes precedence and so Ministers do not want anyone's rent to change by more than RPI + ½% +/-£2 in any year¹. That may mean that some authorities will require longer than 10 years to restructure all their rents.

¹ In this context, RPI means the 'all items' annual increase measured in the September prior to the start of the financial year: 1.7% in the case of caps and limits for 2003/04

This limit on changes applies not only to rent rises but also where rents need to fall. Where the actual rent is currently higher than the **formula rent**, the maximum rent change will be $RPI + \frac{1}{2}\% - £2$ per year. Where rents have been very high, $RPI + \frac{1}{2}\% - £2$ may actually be a positive value, i.e. the rent will rise a small amount in cash terms.

For example, if the rent before restructuring was £95, and needed to fall to a lower **formula rent**, then if RPI was 2%, the following year's rent should not be below $£95 + RPI + \frac{1}{2}\% - £2 = £95 \times 1.025 - £2 = £97.38 - £2 = £95.38$.

This is a rent increase of £0.38 per week. However, the rent has fallen in real terms, and because the **formula rent** is going up each year by a faster rate, the gap between the actual and **formula rent** will still close.

2.6 Rent Caps

In high property value areas, it is possible that the moderating effect of the relative earnings factor will not preclude **formula rents** at unacceptably high levels.

To protect tenants in high property value areas, Ministers therefore announced in November 2001 that there would be a maximum ceiling or 'cap' to the **formula rent** depending on property type. If the **formula rent** for a particular property is higher than the **rent cap**, then the **formula rent** will be replaced by the **rent cap**.

In introducing these caps, Ministers do not intend authorities to reduce rents to the caps instantly. If an authority has **actual rents** higher than the **rent caps**, the subsidy system will assume movement towards the **formula rent** in ten roughly equal steps, subject to the $RPI + \frac{1}{2}\% - £2$ limit on rent reductions.

The replacement formula **rent caps** for 2003/04 are:

| | |
|----------------------|---------|
| Bedsit | £87.30 |
| 1 bedroom | £87.30 |
| 2 bedroom | £92.43 |
| 3 bedroom | £97.57 |
| 4 bedroom and larger | £102.70 |

The caps will increase each year by $RPI + 1\%$.

2.7 Calculating Actual Rents

Ministers expect that authorities will be moving their individual property rents towards **formula rents** over the ten year transitional period from April 2002 to March 2012 (subject to the $RPI + \frac{1}{2}\% +/ - £2$ limit). Ideally the following approach to calculating individual property rents for 2002/2003 will be used for all years during the transitional period ('transitional rents').

- The starting point is the authority's **actual rent** for each property in 2001/02.
- To calculate the rent for 2002/03, that **actual rent** for each property is increased by 3.5% (2.5% GDP deflator plus 1% real increase in local authority average rents). This is referred to as the '**uprated**' rent.

- Move this value for each property by 1/10th of the way towards the 2002/03 **formula rent** for that property (but see below for later years).

Subject to the following paragraphs, that would give the 2002/03 **transitional rent** for the property.

However, the authority then needs to consider whether the **formula rent** for the property is above the **rent cap** described in paragraph 0 above. If so, then the calculation should be to move the uprated actual rent 1/10th of the distance towards the **rent cap**, instead of towards the higher **formula rent**.

But before settling on that as the rent, an authority needs to check that the change in the rent does not exceed the RPI + ½% +/-£2 per week limit. The authority should calculate the difference between the rent taking account of restructuring and caps (as obtained immediately above) and the 2001/02 rent increased by RPI + ½%.

If the difference is less than or equal to +/-£2 per week, then the **transitional rent** will be the rent taking account of restructuring and caps.

If the difference is more than +/-£2 per week, the **transitional rent** will be rent taking account of restructuring and caps, scaled back so that the change is equal to £2 per week.

For 2003/04 and following years, **transitional rents** should be calculated in a similar way except that the **uprated rent** will be moved 1/9th of the distance to **the formula rent** (or **rent cap**, if that is below **the formula rent**) in 2003/04, 1/8th in 2004/05, 1/7th in 2005/06, and so on. The RPI + ½% +/-£2 limit on rent changes should also be applied in the same way each year.

2.8 Example: Calculating the Actual Rent

Let's look again at the 3-bedroom house in Gloucestershire above. The **formula rent** was calculated to be £58.60 in 2003/04. Now imagine that the **actual rent** for this house in 2001/02 was set at £45.

EXAMPLE A

Calculating the actual rent for 2002/03

First, the 2001/02 **actual rent** needs to be uprated to 2002/03 levels by applying inflation (as measured by the GDP deflator) and the appropriate real terms increase.

Uprated 2001/02 **actual rent** = £45 x 3.5% = £46.58

Next the authority calculates the difference between the 2002/03 **formula rent** and the **uprated rent** above.

2002/03 **formula rent** – 2001/02 **uprated rent** = £56.76 – £46.58 = £10.18.

Then the 2001/02 **uprated rent** is moved 1/10th of this difference.

$$\begin{aligned}\text{Rent 2002/03} &= \text{2001/02 Uprated rent} + (\text{Formula rent 02/03} - \text{Uprated rent 01/02})/10 \\ &= £46.58 + £10.18/10 \\ &= £46.58 + £1.02 \\ &= £47.60\end{aligned}$$

In this case, the **formula rent** is below the cap, so the **rent caps** do not have an impact.

But, before setting the **actual rent** for 2002/03 as £47.60, the authority needs to check it has not exceeded the RPI + ½% +/-£2 limits. In setting 2002/03 rents, the September 2001 'all items' annual increase of 1.7% is used. Therefore 2001/02 rent x (RPI + ½%) = £45 x 1.022 = £45.99, and so the maximum rent for the property would be £47.99 while the minimum would be £43.99 per week.

The 2002/03 **transitional rent** as calculated above is £47.60, which is within £2 of £45.99. Therefore, the authority would set its rent in 2002/03 for this property at £47.60.

To calculate the **actual rent** for 2003/04, there is a similar process.

EXAMPLE B

Calculating the actual rent for 2003/04

First, the 2002/03 **actual rent** needs to be uprated to 2003/04 levels by applying inflation (as measured by the GDP deflator) and the appropriate real terms increase.

Uprated 2002/03 **actual rent** = £47.60 x 3.25% = £49.15

Next the authority calculates the difference between the 2003/04 **formula rent** and the **uprated rent** above.

2003/04 **formula rent** – 2002/03 **uprated rent** = £58.60 – £49.15 = £9.45.

Then the 2002/03 **uprated rent** is moved 1/9th of this difference.

$$\begin{aligned}\text{Rent 2003/04} &= \text{2002/03 Uprated rent} + (\text{Formula rent 03/04} - \text{Uprated rent 02/03})/9 \\ &= £49.15 + £9.45/9 \\ &= £49.15 + £1.05 \\ &= £50.20\end{aligned}$$

In this case, the **formula rent** is below the cap, so the rent caps do not have an impact.

But, before setting the **actual rent** for 2003/04 as £50.20, the authority needs to check it has not exceeded the RPI + ½% +/-£2 limits. In setting 2003/04 rents, the September 2002 'all items' annual increase of 1.7% is used. Therefore 2002/03 rent x (RPI + ½%) = £47.60 x 1.022 = £48.65, and so the maximum rent for the property would be £50.65 while the minimum would be £46.65 per week.

The 2003/04 **transitional rent** as calculated above is £50.20, which is within £2 of £48.65. Therefore, the authority would set its rent in 2003/04 for this property at £50.20.

Further examples of calculating transitional rents are given in Annex B.

2.9 Averaged Change Approach

Ideally authorities will follow the approach set out above throughout the transitional period. However, the Government has recognised that a number of authorities were unable to apply restructuring at the individual property level in the first year (2002/03), for instance due to IT system shortcomings. Therefore Ministers said that they were content for authorities in this situation to apply a single average percentage increase in 2002/03 to move their average rent level towards the average **formula rent** level.

Calculating 2002/03 rents by this approach uses the same calculation as outlined above, but putting in the average **actual rent** and average **formula rent** for the authority. This will produce the average **transitional rent** level for 2002/03.

The authority can then calculate the percentage difference between the average rent for 2001/02 and the average **transitional rent** for 2002/03. An authority applying the **averaged change approach** would uprate all 2001/02 rents by this percentage. Computer systems allowing, authorities applying this approach were also expected to implement the caps and limits as set out above.

Ministers have stated that no council will be penalised through the HRA subsidy system if it followed the averaged change approach in 2002/03.

However, Ministers have made clear that they expect authorities to have the computer and other necessary systems in place to implement property specific rent restructuring from April 2003. Authorities who followed the averaged change approach in 2002/03 will be expected to start moving individual rents towards formula levels from April 2003, following the approach outlined in paragraph 0 above, but taking the 2002/03 **actual rent** as the starting point and with a nine year transition. Those who do not move individual rents in this way from April 2003 may find they are affected by property specific rent rebate subsidy limitation when it is introduced from April 2004.

2.10 Tenure Issues

Ministers generally expect rents for all HRA property to be restructured using this approach. However, in certain tenures such as shared ownership, implementing rent restructuring could conflict with the legal contract between the authority and tenant. Authorities are encouraged to move the rents for such properties as far as legally possible in the direction of the **formula rent**. Annex B contains an example of how **formula rents** might be calculated for shared ownership properties.

2.11 New Tenants

When a property is re-let to a new tenant, an authority could use this opportunity to make a bigger step towards the **formula rent** than RPI + ½% +/-£2 without penalising any individual. However, this could result in neighbouring properties having very different rents during the transition period, temporarily defeating the aim of making rents fairer and less confusing to tenants. The subsidy system will assume that rents for all properties are being moved towards **formula rents** in ten broadly equal steps, regardless of re-lets. If an authority wished to follow a different policy for re-lets it should do so only after consultation with its tenants.

2.12 5% Flexibility

The rent restructuring policy recognises that landlords need an element of discretion over the rents set for individual properties, in order to take account of local factors and concerns, in consultation with tenants. But this should not outweigh the central aim of creating a more coherent pattern of rents once restructuring is complete. Ministers have therefore said that at the end of the transitional period (e.g. 10 years) they wish social landlords to set rents on individual properties within a band of up to 5% higher or lower than the ***formula rent***. Ministers expect local authorities to use the 5% flexibility in a balanced way and certainly not to set all rents at 5% above the ***formula rent***. The subsidy system will assume that, in aggregate, rents are set in line with ***formula rents***. (Please see Chapter 3, in particular 3.3 and 3.6 for further details of the assumptions being made in the subsidy system).

CHAPTER 3

The Housing Revenue Account Subsidy System

This section introduces the Housing Revenue Account (HRA) subsidy system, and outlines the changes which have been made to it to support rent restructuring.

3.1 HRA SUBSIDY

There are two parts to HRA subsidy:

- the **housing element** which either provides subsidy to those authorities which need it to help meet the costs of managing, maintaining and improving their council housing or effectively recoups assumed surpluses from those authorities that are deemed to have revenues which exceed costs; and,
- the **rent rebate subsidy** through which central government meets most of the costs incurred by authorities in giving rebates to those entitled to them.

THE HOUSING ELEMENT SUBSIDY

In order to calculate how much housing element subsidy an authority needs to run its council housing or how big a surplus it should make, the Government makes assumptions about the authority's costs and revenues. This is necessary as, if subsidy were paid on the basis of actual costs and revenues, authorities would have no incentive to control costs or set rents prudently as the extra costs or lost revenue would be met by increased Government subsidy.

A key part of the housing element subsidy calculation is the assumption made about income from rents. This is based on the number of properties held, an assumption about the proportion of properties that are vacant (2%), and an assumed average rent for the authority – the “**guideline rent**”. Immediately prior to rent restructuring, guideline rents bore little relation to reality. On average actual local authority rents were some 16% above **guideline rents**.

RENT REBATE SUBSIDY

Currently about 60% of local authority rental income is met by rent rebates. The Government reimburses local authorities for the cost of rent rebates – but only up to a “**limit rent**”. This is to discourage authorities from putting rents up excessively in the knowledge that most of the extra cost would be met by Government through rent rebate subsidy rather than by local people. Authorities are free to set rents above the limit rent, but if they do so they must bear the cost of rebates above the **limit rent**.

Rent rebate subsidy limitation was introduced in 1996-1997. **Limit rents** were based largely on the actual rents that were charged in March 1996. This means that authorities that happen to have had an unusually low rent at that time – perhaps due to a previous rent freeze – may have a lower **limit rent** than other comparable authorities.

3.2 Adjustments to HRA Subsidy

Following responses to consultation papers in July 2001 and June 2002, the HRA subsidy system has been adjusted to support the rent restructuring policy. Adjustments have been made with the aim of removing financial disincentives that would discourage authorities from applying the policy, and also to make the system fairer.

Over the period of rent restructuring, starting in 2002/03, both **guideline rents** and **limit rents** are to be gradually moved towards the average **formula rent**. Having set out a policy and a formula to determine the ‘right’ rent it is natural that this rent should ultimately act as both the guideline and limit rent. Should an authority choose to set a lower rent than it is foregoing rent that the Government believes it could fairly charge and it would have to bear the consequences in terms of having to make economies elsewhere within its housing revenue account. Should an authority choose to charge more than the **formula rent** it would have to justify this to tenants and meet the cost of rent rebates above the **formula rent**. Moreover, moving **limit rents** to **formula rents** would undo the distortion caused by some currently low **limit rents**.

3.3 Making the Transition

Guideline rents and **limit rents** will be moved in ten broadly equal annual steps from their current position to the **formula rent**. This will be done by moving both the **guideline and limit rents** by a tenth of the difference between themselves and the **formula rent** in the first year (2002/03), by a ninth of the remaining difference in the second year (2003/04), an eighth in the third year (2004-05), and so on. The steps will not be exactly equal as the **formula rent** will be uprated each year. This approach is designed to encourage authorities to restructure their rents and will not penalise those authorities which move **actual rents** towards the formula as outlined above, or who followed the averaged change approach in 2002/03.

3.4 Adjustments for Caps and Limits

The RPI + ½% +/-£2 per week limit to rent increases and decreases, and the caps to the formula rent, means that for some properties it will take longer than 10 years to move to the formula rent. Corrections will be made to the **guideline and limit rents** each year to adjust for the impact of the limits and caps. The adjustments will be based on the difference between the average **transitional rent** unconstrained by caps and limits, and the average **transitional rent** taking the caps and limits into account. The effect of the adjustments will be to ensure that authorities affected by caps and limits will be neither better nor worse off if they cannot move **to formula rents** within the same period as authorities not affected. A worked example showing the transition to **formula rents** is at Annex C.

3.5 Property Specific Rent Restructuring

The rent rebate limitation system up to now has been based on average rents. This would provide no incentive for authorities to move the rents for individual properties to the **formula rent**. An authority could, for example, get its full rent rebate bill reimbursed if it had a completely flat rent structure with all of its rents equal to the average **limit rent**. In achieving the aims of the rent restructuring policy, it is important that individual rents are set using the rent restructuring formula, as only if this is done will there be fair relativities both among council properties and between council and RSL properties. The Government will encourage this by applying rent rebate subsidy limitation on a property by property basis.

3.6 Property Specific Rent Rebate Subsidy Limitation

It is appreciated that authorities have needed time to adapt their computer systems to the challenges of the property specific approach, but Ministers expect all authorities to have the necessary systems in place by April 2003.

We propose to introduce property specific rent rebate subsidy limitation in 2004-05, and it will be based on the **transitional rents** for each property outlined in the previous chapter (paragraph 0). The **property specific limit rent** for each property will be the **transitional rent** plus 5%, to allow for the 5% local flexibility. Adjustments can then be made to the property specific limit rents to take account of limits and caps, in the same way as described in paragraph 0 above.

Once the transitional period is over, we propose that the maximum rent rebate subsidy any authority can receive would be the subsidy it would receive if all rents were set at the **formula rent**. An authority would get this level of subsidy if rents set above the formula (within the 5% band) were balanced by rents set below the **formula rent**. The authority would not gain additional subsidy if it set more rents above the formula than below.

Some authorities adopted the 'averaged change approach' in 2002/03 as described in paragraph 0 in Chapter 2. For some properties, this approach will mean a significant difference between the actual rent change in 2002/03 and the ideal first step to the formula rent. This discrepancy could mean that an authority could not avoid property specific rent rebate subsidy limitation without breaching the RPI + ½% +/-£2 limit. Ministers do not want to penalise authorities who followed an averaged change approach in 2002/03. Therefore, in these cases, in calculating subsidy for 2004/05 and onwards, we propose that the starting point for calculating a **transitional rent** will be the actual rent in 2002/03, and a nine-year transition will be assumed.

It is important to note that, as property specific rent restructuring is phased in, limitation will be applied using both the property specific and average limit rents. We propose that the subsidy will be the lower of the two methods. This is exemplified at **Annex D**.

3.7 Subsidiary Rules – Disproportionate Rent increases (DRI)

The DRI rules are designed to discourage authorities from selectively increasing the rents of tenants receiving rebates. Under the rent restructuring policy, there is a “right” rent for each property in an authority and a property specific limit rent would apply. It would be difficult, if not impossible, for any authority to gain by concentrating rent increases on those receiving rent rebates. Restructuring will, in any case, require significant changes in rents over the 10-year period and it is possible that in making the necessary changes an authority could, inadvertently, fall foul of the DRI rules. Ministers therefore have suspended the DRI rules from 2002/03, at least for the duration of the restructuring period.

CHAPTER 4

Service Charges

In addition to their rent, tenants may also pay service charges. Rents are generally taken to include all charges associated with the occupation of a dwelling, such as maintenance and general housing management services. Service charges usually reflect additional services which may not be provided to every tenant, or which may be connected with communal facilities rather than particular to occupation of a dwelling. Different tenants may receive different types of service reflecting their housing circumstances.

Ministers have decided that local authorities should retain discretion to decide what services to charge for separately, and what services should be included within the rent, within a broad framework.

4.1 Treatment of Service Charges under Rent Restructuring

Service charges are not governed by the same factors as the property charge or rent. Therefore it is not appropriate to apply the restructuring formula to these charges. However, Ministers do expect local authorities to set reasonable and transparent service charges which closely reflect what is being provided to tenants.

At present, some authorities identify service charges separately, some include the cost in the general rent charge to a tenant, and others pool the costs of services across all tenants. **Formula rents** take no account of service charges. Therefore Ministers have encouraged local authorities to move towards identifying service charges separately, based on the actual costs of services to individual properties. This would also allow tenants to see what they are getting for their money and to assess the reasonableness of charges.

If a local authority follows this approach then at the end of the rent restructuring period, the total charge to the tenant would comprise the **formula rent** plus a service charge based on the actual costs of additional services to that tenant. Where a property is subject to a cap on the **formula rent**, the service charge may be additional to the cap but should be strictly limited to the cost of the services provided.

Local authorities are expected to use their discretion on charging for services to avoid situations in which anomalies are created, e.g. it costs tenants much more to live in high rise flats than it would to live in street properties that they would find more attractive. In particular, Ministers do not think it appropriate to levy service charges on services such as lifts that are essential to high rise flats any more than it would be appropriate to charge tenants of certain system-built houses extra amounts to reflect the high costs of maintaining their homes. These are costs that are inevitable for the properties concerned: neither tenant nor landlord has any discretion over them. For some other services, drawing a clear line between those which should be explicitly charged for and those which should not is no easy matter. This is best left to local judgement.

4.2 Phased Unpooling

The Government acknowledges it may be difficult for authorities to unpool and separately identify all housing service charges at one time. Depending on local circumstances, a gradual, phased unpooling of charges may be more appropriate. Therefore Ministers have decided that authorities should also retain discretion about the timing of introducing new service charges, or unpooling existing charges.

NB: Phased unpooling is not possible for charges for services which will be included in the Supporting People regime from April 2003. These costs must be separately identified and notified to the Supporting People team at ODPM as previously requested.

4.3 Keeping Charges Affordable

Government policy is that no one's rent should increase by more than $RPI + \frac{1}{2}\%$ \pm £2 per week because of rent restructuring. Similarly, Ministers want to limit rises in overall bills due to separate identification of charges for existing services.

Therefore, in a year in which any service charge is unpooled, local authorities are encouraged not to increase the total charge to any individual tenant by more than $RPI + \frac{1}{2}\%$ \pm £2 per week. Within this constraint the authority has discretion to decide the split between rent and service charges, so long as the total service charge is not more than the cost of providing those services.

In years where there is no unpooling, service charges to an individual should not increase by more than $RPI + \frac{1}{2}\%$ per year, whilst rent should not change by more than $RPI + \frac{1}{2}\%$ \pm £2 per week in any year. If this approach is followed, the total charge to tenants would not increase by more than $RPI + \frac{1}{2}\%$ \pm £2.

There may be very rare occasions where an authority has to increase its service charge by more than $RPI + \frac{1}{2}\%$ due to increases in costs outside its control, such as increases in fuel costs.

NEW CHARGES

One exception to this is when new services are introduced, in which case an additional charge equal to the cost of the new service may be made. A new service may be something completely new, or an extension of an existing service. However, Ministers would expect authorities to consult appropriately with tenants before introducing new or extended services and associated charges.

EXAMPLE: UNPOOLING SERVICE CHARGES

Let us take an example authority with 3,000 dwellings.

Ambridge District Council provides a communal cleaning service to tenants in 300 of those dwellings. The cost of that service is £3,000 and up until now has been met from the general rental income from all tenants. In effect, all tenants have been contributing £1 per

week towards this cost. The authority has decided to charge the 300 tenants concerned a separate service charge for communal cleaning from 2003/04.

Ambridge could therefore charge up to £10 per dwelling on average as a service charge to those 300 tenants, without exceeding the cost of the service. It would be for the authority to decide whether to charge a flat rate charge of £10 per dwelling, whether to charge differing amounts across those 300 tenants (for instance based on dwelling sizes or varying cleaning schedules in different blocks), or indeed whether to charge less than £10.

As stated above, when unpooling, local authorities are encouraged not to change the total charge (i.e. rent plus service charges) to any individual tenant by more than $RPI + \frac{1}{2}\%$ \pm £2 per week.

To achieve this in this example, Ambridge might therefore need to reduce the rent element of the charge to the 300 tenants receiving the communal cleaning service by an appropriate amount.

Using the figures from the example in paragraph 0, imagine the rent for one of the recipient tenants in 2002/03 was £47.60, while the **formula rent** for 2003/04 was £58.60. Then $RPI + \frac{1}{2}\%$ would be $£47.60 \times 2.2\% = £1.05$. So the total charge to the tenant in 2003/04 should be no more than £50.65 (i.e. $£47.60 + £1.05 + £2$).

To unpool the communal cleaning charges by adding a service charge of £10 to this tenant's charges while keeping within the $RPI + \frac{1}{2}\% \pm £2$ limits, the authority would need to reduce the rent for this tenant in 2003/04 to £40.65 or less. Of course, if the **formula rent** had been below the actual rent, then the rent element could have been reduced further to a minimum of £36.65 (so that the total charges equalled $£47.60 + £1.05 - £2$).

In this example, as a result of unpooling this service charge the rent moves away from the **formula rent**. Although this may mean it takes longer than ten years to achieve restructuring, protecting tenants from large sudden increases must take priority.

The rent levels for the other 2,700 tenants do not need to be reduced as a result of unpooling. Rents for the other 2,700 tenants who do not receive this service would continue moving towards their **formula rent** levels, in the same way as described in paragraph 0.

4.4 Implications for HRA Subsidy

The calculation of housing element subsidy will continue to ignore service charges as assumed income. This is on the basis that the proceeds of service charges remain within the HRA, and meet the cost of the relevant services.

It would be wrong to allow local authorities to make a large windfall gain now as a result of re-classifying rental income. However, as part of the implementation of rent restructuring, **limit rents** need to move progressively towards **formula rents** irrespective of whether service charges have been separated out. Ministers have therefore adjusted policy on limitation and service charges so that where service charges have been pooled, authorities benefit progressively from separately identifying service charges. This supports the policy set out above.

In 2003/04, the actual rent of an authority which has separated out service charges will be deemed to be increased by 80% of the average unpooled service charge, for the purpose of comparisons with the **limit rent**. In 2004-05 the adjustment will be 70% of the average separated out charge; 60% in 2005/06; 50% in 2006/07 and so on. The same will apply in relation to property specific rent rebate subsidy limitation (see 4.5 below).

(Average service charges will be calculated over only those properties that attract a separate service charge.)

For any property, in 2003/04 a service charge will be deemed to have been separated out if the total service charge is greater than the service charged made in 2001/02 plus an allowance for inflation plus the cost of any new services introduced since 2001/02.

The effect of this is to give authorities a steadily growing incentive to separate out service charges. Ministers believe this to be appropriate given the benefits of greater transparency and convergence between council and RSL rents and charges. Worked examples showing how these systems operate are at **Annex E**.

4.5 Implications for Property Specific Rent Rebate Subsidy Limitation

In the same way, **property specific limit rents** when introduced (see paragraph 0) will not be changed by the unpooling of service charges.

Again, for purposes of comparison with **property specific limit rents**, the actual rent for each property where service charges are separated out will be deemed to be increased by a percentage of the unpooled service charge for that property. It is intended that when property specific rent rebate subsidy limitation is introduced in 2004/05, the same percentages will apply as in the general limitation formula, i.e. 70% of unpooled service charge in 2004/05, 60% in 2005/06 and so on. Please see Annex D for exemplification of property specific rent rebate subsidy limitation.

CHAPTER 5

Implications for Tenants and Local Authorities

5.1 Implications for tenants

The objective of rent restructuring is that rents should be fair and affordable.

The outcomes of the process should be that:

- Nationally, average council rents over the next ten years will rise at only half the rate than they have risen by over the last ten years.
- Council rents will generally remain below those charged by reputable private sector landlords.
- The rent for a house or flat should be linked to its size, location and condition so that tenants can make a proper choice between how much they pay and the size and quality of the property they live in.
- Rents will be linked to earnings in the area so that they remain affordable.

In 2000/01, about 60% of local authority tenants received rent rebates. For these tenants rent rebates will be adjusted to reflect changes in rents charged. Inevitably some rent increases will be higher than the average and others will be lower. Some rents will fall in real terms. The Government is concerned that where rents need to rise in order to create a fair system those tenants who pay their own rent should not face excessive increases. The proposals include a number of safeguards to help ensure that this does not happen:

- Where rents need to rise, authorities are encouraged to keep the annual increase within £2 a week of the inflation-linked increase of $RPI + \frac{1}{2}\%$. This limit will apply even where it means that the rent for a property cannot reach its **formula rent** within the ten year transitional period, as the Government believes that protecting vulnerable tenants must take priority.
- The housing benefit system will provide a safety net for those on low incomes, for whom even that level of increase is too much.
- Rent caps have been introduced on the **formula rent** to prevent properties with a high capital value from having an excessively high **rent**.
- The Government will monitor the implementation of rent restructuring closely. If there are unexpected and unintended consequences fine tuning adjustments will be made in the 3-year review of the implementation of the policy.

5.2 Implications for Local Authorities

The key consideration for local authorities will be the implications for the amount they have to spend per dwelling. This will depend not just on the changes made to **guideline and limit rents** but also on the adjustments made to management and maintenance allowances. The Government accepts that it would be unreasonable to increase **guideline rents** to bring them closer to actual levels (and thereby reducing subsidy) without also increasing management and maintenance allowances to bring these closer to actual levels as well (thereby increasing subsidy).

The precise financial effect on each authority will depend on the interaction of the four main factors affected by rent restructuring:

- **Actual rents** – increases in rents generally increases resources.
- **Limit rents** – increasing the limit rent could increase subsidy.
- **Guideline rents** – increasing guideline rents generally reduces subsidy.
- **Management and Maintenance Allowances** – increases will increase subsidy.

It should be noted that, subject to Parliamentary approval of the Local Government Bill, rent rebates will be removed from the HRA and subsidised separately by DWP in the General Fund. However, it is intended that ODPM and the National Assembly for Wales would continue to collect information from authorities and advise DWP on the operation of rent rebate subsidy limitation. It is proposed that, in England, where an authority is subject to either property specific or average limitation, then the cost of rebates above the limit rent should be met out of the HRA, as this is a consequence of a landlord decision.

5.3 Rebasing of Management and Maintenance Allowances

In paragraph 5.15 of Part 2 of the December 2001 White Paper ‘Strong Local Leadership – Quality Public Services’, a commitment was made that changes to guideline rents as a result of rent restructuring would not increase or reduce the aggregate level of resources available to councils nationally. Ministers decided that the national level of management and maintenance allowances should be increased to ensure that the changes to **guideline rents** would be resource neutral. These adjustments are known as ‘rebasing’.

In 2002/03 the adjustments were made on a more generous basis than that outlined above. For 2002/03 only, the rebasing adjustments were subsidy neutral.

In 2002/03, **formula rents** were increased by the 1% announced in the July 2000 Spending Review. However, moving **guideline rents** to **formula rents** in approximately annual equal steps resulted in an average real terms increase of about 2.7% in 2002/03. For 2002/03, we increased management and maintenance allowances by the cash equivalent of the national guideline rent increase of 2.7%, so that the total amount of subsidy being put into local authority housing remained at the level assumed in the Spending Review. This meant that nationally management allowances rose by 5.4% in real terms and maintenance allowances by 3.4% in real terms.

However, in 2003/04 rebasing adjustments ensure that authorities do not face any loss in resources as a result of rent restructuring, as promised in the December 2001 White Paper. This is done by first calculating the loss in subsidy due to the increase in guideline rents – made up of inflation, a real increase, and the move *to formula rents*. Then the gain in resources from increased rental income (due to inflation and the real increase) has been calculated. The overall loss in resources to authorities at a national level is the difference between these two calculations, and rebasing has been achieved by adding an equivalent cash amount to the management and maintenance allowances for 2003/04.

It is important to note that although rebasing will ensure that rent restructuring does not cause a loss of resources at a national level, this does not rule out redistribution of subsidy between authorities. There are two important factors which affect how an individual authority's resources will be impacted by rent restructuring:

- The extent to which average actual rent is above current rent guidelines. If the average actual rent is much higher than the guideline rent, then the authority's assumed rental income for subsidy purposes will grow much faster than the actual income as the rent is moved in line with the formula. This would reduce subsidy.
- The extent to which an authority is currently affected by rent rebate subsidy limitation, as a result of having had historically low rents when the system was introduced in 1996. Those in this position, who align their rents with the formula, would benefit from greater subsidy as they come out of limitation.

The object of the subsidy system is to distribute resources fairly between authorities in accordance with objective measures of need. One of the objectives of these proposals is to produce a fairer system for allocating subsidy. This will inevitably mean that some authorities receive more of the available subsidy whilst others get less. If, as we believe, the new system is indeed fairer it could be said that some authorities could be seen to have received rather more than their fair share of the subsidy pot in the past. It is only fair that stops. The 10-year transitional period should provide ample opportunity for authorities to adjust to such changes and offer a good quality of service within the revised subsidy allocation. Ministers do not therefore propose to make any additional transitional arrangements.

5.4 Review of Management and Maintenance Allocation Formulae

In addition to rebasing increases to management and maintenance (M&M) allowances, it is recognised that the current allocation formulae may no longer properly reflect the need to spend on M&M. For instance there are now increased expectations of a housing management service such as the need to tackle anti-social behaviour. Other new problems have arisen in particular areas such as housing market collapse, and associated higher void levels. Smaller authorities may experience diseconomies of scale which are not currently reflected in the formulae.

Therefore ODPM has commissioned a research project to refine the formulae to properly reflect the relative need to spend on M&M in different authorities. The Office expects to consult authorities about the outcomes of the research and proposals for M&M allowances in spring 2003, and to use the new allocation formulae in the 2004/05 HRA Subsidy Determination.

CHAPTER 6

Glossary of terms

| | |
|---|---|
| Caps | Upper limits on the formula rents for different sized properties. |
| Formula rent | A rent calculated in line with Ministerial policy on the structure of rents, as set out in the policy statement of December 2000. Usually expressed in pounds/week. |
| Guideline rent | The average rent assumed in the HRA subsidy calculation for the purpose of calculating the rental income assumed in the subsidy calculation for an authority. Usually expressed in pounds/week averaged over all properties in the authority's HRA. |
| HRA | Housing Revenue Account. The account, defined by statute, covering specified expenditure and income relating to the authority's own housing stock. |
| Limits | The RPI+/-½% limits on annual rent changes (up or down) which Ministers encourage authorities to adopt to protect tenants from prevent sudden large rent rises. |
| Limit rent | The average rent for each authority that is used to apply rent rebate subsidy limitation. Usually expressed in pounds/week averaged over all properties in the authority's HRA. |
| M&M | Management and Maintenance. |
| Management and maintenance (M&M) allowances | The assumptions made in the HRA subsidy calculation about the spending on M&M by the authority. Usually expressed as an amount per property per year. M&M allowances are sensitive to the types of property held by an authority, and to the relative costs of providing a service in that part of the country. |
| Property Specific Limit Rent | A rent level for each individual property to be used to apply property specific rent rebate subsidy limitation, expressed in pounds/week for each HRA property. |
| Rebasing | The process of adjusting guideline and limit rents and M&M allowances to bring them into line with rent restructuring. |
| Rent rebates | Housing Benefit for local authority tenants. |
| Restructuring | The process by which the rent levels, and rent structures of social landlord are brought into line with Ministerial policy on the structure of rents. |

| | |
|---------------------|---|
| RSL | Registered Social Landlord. |
| Service charge | Payments for services that may be separate from the rent. |
| Transitional Period | The 10 year period from 2002 – 2012 during which social landlords are expected to move rents as far as possible to formula rents. |
| Transitional Rent | The rent for a particular property during the transitional period based on the actual rent at the beginning of the period adding a step to close the gap to the formula rent each year. |

ANNEX A

Information for Restructuring Formula

A1 This annex provides the information, apart from property-specific details, that is needed to apply the rent restructuring formula.

RENTS

A2 National average rents, net of service charges, in April 2000 were estimated to be as follows:

| | |
|------------|-----------------|
| LA sector: | £45.60 per week |
|------------|-----------------|

A3 For local authorities, the real terms increases in rents assumed in the Spending Review announced in July 2000 are as follows²:

| | |
|----------|----|
| 2001/02: | 2% |
| 2002/03: | 1% |
| 2003/04: | 1% |

BEDROOM WEIGHTS

A4 The following bedroom weights are applied to the earnings term in the restructuring formula:

| Number of bedrooms | Bedroom weight |
|-----------------------|----------------|
| Bedsit | 0.80 |
| One bedroom | 0.90 |
| Two bedroom | 1.00 |
| Three bedroom | 1.05 |
| Four or more bedrooms | 1.10 |

A5 These weights are not derived from any single source, but are intended to provide a broad reflection of the way in which larger properties tend to be valued more highly by their inhabitants.

² Real terms increases in rents for 2004/05 and 2005/06 were assumed to be 1.5% in the Pre Budget Report of 27th November 2002.

EARNINGS

A6 Earnings data for the restructuring formula are given in the table below:

| County | Earnings £/week | County | Earnings £/week | County | Earnings £/week |
|-----------------|--------------------|--------------------|--------------------|------------------------|--------------------|
| Avon | 321.20 | Greater London | 354.10 | Nottinghamshire | 298.00 |
| Bedfordshire | 343.70 | Greater Manchester | 307.30 | Oxfordshire | 323.80 |
| Berkshire | 345.40 | Hampshire | 328.70 | Shropshire | 295.40 |
| Buckinghamshire | 328.30 | Hereford & Worcs. | 289.60 | Somerset | 299.70 |
| Cambridgeshire | 330.10 | Hertfordshire | 343.70 | South Yorkshire | 299.10 |
| Cheshire | 322.00 | Humberside | 318.40 | Staffordshire | 296.20 |
| Cleveland | 338.40 | Isle of Wight | 288.50 | Suffolk | 304.30 |
| Cornwall | 255.50 | Kent | 316.40 | Surrey | 333.20 |
| Cumbria | 323.70 | Lancashire | 302.70 | Tyne & Wear | 307.90 |
| Derbyshire | 321.10 | Leicestershire | 303.10 | Warwickshire | 326.10 |
| Devon | 278.00 | Lincolnshire | 286.70 | West Midlands | 320.60 |
| Dorset | 293.90 | Merseyside | 324.90 | West Sussex | 332.50 |
| Durham | 289.70 | Norfolk | 302.50 | West Yorkshire | 302.70 |
| East Sussex | 281.50 | North Yorkshire | 299.60 | Wiltshire | 313.90 |
| Essex | 325.90 | Northamptonshire | 328.50 | | |
| Gloucestershire | 308.00 | Northumberland | 276.10 | England average | 316.40 |

A7 These figures are derived from the New Earnings Survey (ONS) and represent the average gross weekly earnings of full-time male and female manual workers over the 1997 to 1999 period, uprated to 1999 prices. Pre-1996 counties are used, because of the problems of small sample sizes for some of the new counties, especially Unitary Authorities.

PROPERTY VALUES

A8 Individual property values for rent restructuring are based upon January 1999 vacant possession values, assuming continued residential use. A useful source of information about stock valuation is *A New Financial Framework for Local Authority Housing – Guidance on Stock Valuation*, May 2000, on our website at <http://www.housing.odpm.gov.uk/nff/index.htm>.

A9 As relative property values play a fairly modest role in the restructuring formula, small differences in individual property values do not greatly affect restructured rents. So landlords have not been expected to carry out an individual valuation for each property, but instead to focus on more generic valuations for particular types and sizes of properties in different locations.

A10 National average property values in January 1999 are estimated to be as follows:

| | |
|------------|---------|
| LA sector: | £41,350 |
|------------|---------|

ANNEX B

Calculating Formula Rents

EXAMPLE 1 – RENT CAPS

B1 Consider a three-bedroom local authority property in London, for which the capital value is estimated to be £160,000 in January 1999.

B2 From the information in Annex A:

| | |
|---|---------|
| average LA rent in April 2000: | £45.60 |
| average earnings in Greater London: | £354.10 |
| national average earnings: | £316.40 |
| bedroom weight: | 1.05 |
| national average LA property value in January 1999: | £41,350 |

B3 Putting these figures into the formula:

| | | |
|---|---------------------------|-----------------------|
| 70% of sector-average rent: | $70\% \times £45.60$ | = £31.92 |
| multiplied by relative county earnings: | $\times £354.10/£316.40$ | = £35.72 |
| multiplied by bedroom weight: | $\times 1.05$ | = 37.51 subtotal |
| 30% of sector-average rent: | $30\% \times £45.60$ | = £13.68 |
| multiplied by relative property value: | $\times £160,000/£41,350$ | = 52.93 subtotal |
| adding together the sub-totals: | $£37.51 + £52.93$ | = £90.44 total |

B4 So, the property has a formula rent in April 2000 of £90.44 per week.

B5 The formula rent for future years can be calculated in the same way as above:

| |
|--|
| Formula rent 2000/01 = £90.44 |
| Formula rent 2001/02 = £90.44 \times 4.5% = £94.51 |
| Formula rent 2002/03 = £94.51 \times 3.5% = £97.82 |
| Formula rent 2003/04 = £97.82 \times 3.25% = £101.00 |

B6 However, in this case the formula rent in 2002/03 exceeds the rent 'cap' for a 3 bedroom property, which is £95 (see Annex A). Therefore in this case, the formula rent for 2002/03 will be replaced by the cap of £95. In 2003/04, the formula rent will be replaced by the uprated cap of £97.57. Rent caps will rise by RPI + 1% annually.

EXAMPLE 2 – SHARED OWNERSHIP DWELLINGS

B7 Now consider a 2 bedroom local authority property in Bedfordshire, for which the capital value is estimated to be £80,000 in January 1999. The property is leased on a shared ownership basis, with the authority retaining a 40% share in the equity.

B8 From the information in Annex A:

| | |
|---|---------|
| average LA rent in April 2000: | £45.60 |
| average earnings in Bedfordshire: | £343.70 |
| national average earnings: | £316.40 |
| bedroom weight: | 1.00 |
| national average LA property value in January 1999: | £41,350 |

B9 Putting these figures into the formula:

| | | |
|---|--------------------------|-----------------------|
| 70% of sector-average rent: | $70\% \times £45.60$ | = £31.92 |
| multiplied by relative county earnings: | $\times £343.70/£316.40$ | = £34.67 |
| multiplied by bedroom weight: | $\times 1.00$ | = 34.67 subtotal |
| 30% of sector-average rent: | $30\% \times £45.60$ | = £13.68 |
| multiplied by relative property value: | $\times £80,000/£41,350$ | = 26.47 subtotal |
| adding together the sub-totals: | $£34.67 + £26.47$ | = £61.14 total |

B10 So, if the authority owned the whole property, the formula rent in April 2000 would be £61.14 per week.

B11 To obtain the formula rent for a shared ownership dwelling the formula rent based on the full capital value is multiplied by the authority's share in the equity. In this case the formula rent is $£61.14 \times 0.4 = £24.46$.

B12 The formula rent can then be uprated each year in the same way as in previous examples.

B13 The rent cap to be applied would be the appropriate pro rata share of the rent cap for that size of dwelling.

EXAMPLE 3 – HOSTELS & HMO'S

B14 Imagine a 4-bedroom hostel for homeless families. Room 1 is a single room. Rooms 2 & 3 contain a double bed and a single bed. Room 4 contains a double bed and a bunk bed. The hostel is in London and the capital value of the building is £200,000 in January 1999.

B15 For subsidy purposes, a hostel is defined in terms of dwelling equivalents. A group of bedspaces in a hostel is counted as one dwelling equivalent. A hostel with up to three bedspaces is counted as one group, and for a hostel with more than three bedspaces the number of groups is calculated by dividing the total number by three. Any balance counts as one group. This calculation is done separately for each hostel.

B16 In this example, the hostel contains a total of 11 bedspaces. (A bedspace is any space for one person in a bed: a double bed or bunk bed is therefore two bedspaces). Therefore there are four dwelling equivalents in this hostel.

B17 A formula rent can then be calculated for the four dwelling equivalents assuming each to have a capital value one quarter of the total value, a dwelling equivalent to have a bedroom weighting of 1.

B18 From the information in Annex A:

| | |
|---|---------|
| average LA rent in April 2000: | £45.60 |
| average earnings in Greater London: | £354.10 |
| national average earnings: | £316.40 |
| bedroom weight: | 1 |
| national average LA property value in January 1999: | £41,350 |

B19 Putting these figures into the formula, for each dwelling equivalent:

| | | |
|---|--------------------------|-----------------------|
| 70% of sector-average rent: | $70\% \times £45.60$ | = £31.92 |
| multiplied by relative county earnings: | $\times £354.10/£316.40$ | = £35.72 |
| multiplied by bedroom weight: | $\times 1$ | = £35.72 subtotal |
| 30% of sector-average rent: | $30\% \times £45.60$ | = £13.68 |
| multiplied by relative property value: | $\times £50,000/£41,350$ | = £16.54 subtotal |
| adding together the sub-totals: | $£35.72 + £16.54$ | = £52.26 total |

So, each dwelling equivalent has a formula rent in April 2000 of £52.26 per week.

B20 The formula rent for future years can be calculated in the same way as above:

| |
|--|
| Formula rent 2000/01 = £52.26 |
| Formula rent 2001/02 = $£52.26 \times 4.5\% = £54.61$ |
| Formula rent 2002/03 = $£54.61 \times 3.5\% = £56.52$ |
| Formula rent 2003/04 = $£56.52 \times 3.25\% = £58.36$ |

B21 To obtain the total formula rent for the hostel, the formula rent per dwelling equivalent is multiplied by the number of dwelling equivalents. In this example, the total formula rent in 2003/04 is $4 \times £58.36 = £233.44$ per week.

B22 The local authority could then decide an appropriate split resulting in what rent to charge per room. For instance, it might be decided to charge £40.44 per week for Room 1, £59 per week for Rooms 2 & 3, and £75 for Room 4.

B23 If a property of similar size and location instead contained six single rooms, this would result in two dwelling equivalents, each with a formula rent of £68.80 at April 2000, or £76.83 in 2003/04. In this case, the total formula rent for the building in 2003/04 would be £153.66, giving a rent per room of £25.61.

ANNEX C

Making the Transition to Formula Rents

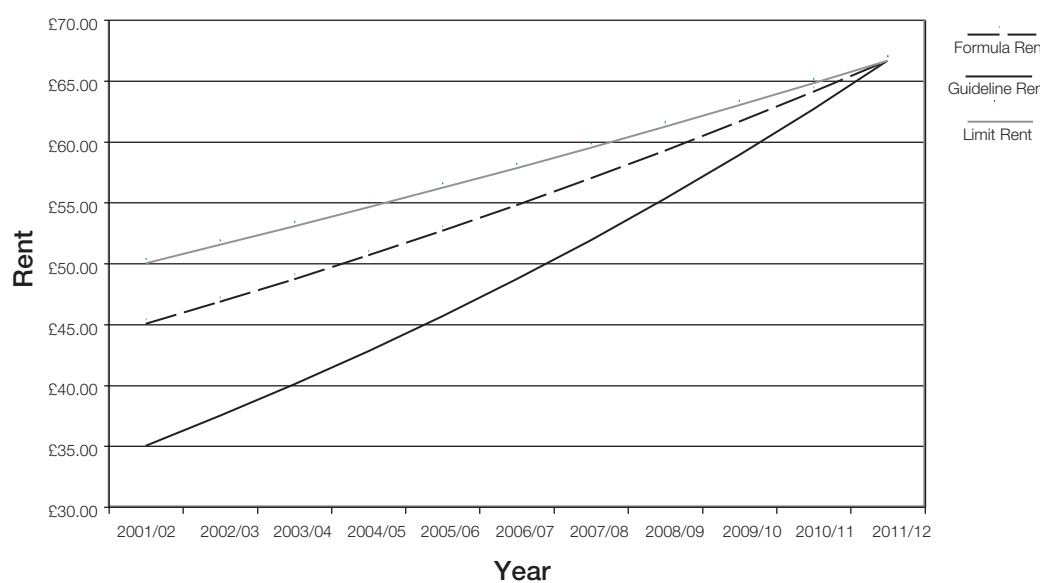
CHANGES IN GUIDELINE AND LIMIT RENTS

- C1 The guideline and limit rent for each authority in 2001/02 was re-calculated in the light of the re-basing of the subsidy system. That was done by increasing the current 2001/02 figures by 3.5% (representing 2.5% inflation plus 1% increase in local authority rents assumed in SR2000).
- C2 The new guideline rent for 2002/03 was this re-based guideline rent plus 1/10th of the difference between it and the formula rent for 2002/03. There was a similar calculation for the new limit rent.
- C3 Each subsequent year, an uprated guideline and limit rent will be calculated from the previous year's values by increasing them by the same uplift factor applied to the formula rent. The differences between the uprated guideline and limit rents and the formula rent will then be reduced each year. So:
- In 2003/04, the guideline rent will be the uprated 2002/03 guideline rent plus 1/9th of the difference between that and the formula rent for year 2003/04. There would be a similar calculation for the limit rent.
 - In 2004/05, the guideline rent would be the uprated 2003/04 guideline rent plus 1/8th of the difference between that and the formula rent for year 2004/05. There would be a similar calculation for the limit rent.

Similar calculations would be carried out in the further years until the guideline and limit rents equal the formula rent.

- C4 The effect of the proposed movement from present to future guideline and limit rents is shown below. The initial formula rent is £45/week, the initial guideline rent is £35, and the initial limit rent is £50. The graph and table below illustrates how guideline and limit rents move with 2.5%/ year inflation and an assumed 1.5%/ year real increase applied to the formula rent.

Moving towards the formula rent



| Year | Formula rent | Guideline rent | Limit rent |
|-----------|--------------|----------------|------------|
| 2001/02 | £45.00 | £35.00 | £50.00 |
| 2002/03 | £46.80 | £37.44 | £51.48 |
| 2003/04 | £48.67 | £40.02 | £53.00 |
| 2004/05 | £50.62 | £42.74 | £54.56 |
| 2005/06 | £52.64 | £45.62 | £56.15 |
| 2006/07 | £54.75 | £48.67 | £57.79 |
| 2007/08 | £56.94 | £51.88 | £59.47 |
| 2008/09 | £59.22 | £55.27 | £61.19 |
| 2009/2010 | £61.59 | £58.85 | £62.95 |
| 2010/2011 | £64.05 | £62.63 | £64.76 |
| 2011/2012 | £66.61 | £66.61 | £66.61 |

ANNEX D

Effect of Property Specific Limit Rents

- D1 As noted in paragraph 0 central government reimburses local authorities for the rent rebates they pay to council tenants – but only up to a “limit rent”. Councils are free to set rents above the limit rent but if they do so they must meet the cost of rebates above the limit rent.
- D2 The present rent rebate subsidy limitation (RRSL) system applies only to the *average* rent, plus a proportion of any unpooled service charges, levied by an authority. The rent together with the appropriate percentage of unpooled service charges is known as the ‘rent for RRSL purposes’. (Please refer to Annex E for further details on unpooling of service charges). Where the average rent for RRSL purposes is more than the limit rent, the amount of rent rebate subsidy paid is calculated as follows:

$$\text{rent rebate subsidy} = \text{rent rebates} \times \frac{\text{limit rent}}{\text{average rent for RRSL purposes}}$$

- D3 The effect of this formula is to take the cost to the authority of rent rebates and multiply it by a scaling factor so that the authority bears the cost of rebates above the limit rent.
- D4 So in a simple example with 4 properties and no unpooled service charges:

| | A | B | C | D | Total | Average |
|--------------|--------|--------|--------|--------|---------|---------|
| Actual Rent | £50.00 | £40.00 | £60.00 | £45.00 | £195.00 | £48.75 |
| Rent Rebates | £50.00 | £40.00 | – | – | £90.0 | |

The average rent is £48.75 and £90.00 is paid in rent rebates. If the limit rent is £48.00, rent rebate subsidy is £88.62:

$$\text{rent rebate subsidy (£88.62)} = \text{rent rebates (£90)} \times \frac{\text{limit rent (£48)}}{\text{average rent (£48.75)}}$$

PROPERTY SPECIFIC LIMIT RENTS

- D5 As the current rent rebate limitation system is based on average rents it provides no incentive for authorities to move the rents for individual properties to the formula rent. From 2004-05, we propose to change the system to provide this incentive by applying rent rebate subsidy limitation on a property by property basis.

- D6 We would adjust the current formula for calculating rent rebate subsidy so that it is no longer possible for authorities to offset rents that are above the formula rent against those that are below. The revised formula would be:

| |
|---|
| $\text{rent rebate subsidy} = \text{rent rebates} \times \frac{\text{sum of eligible rents}}{\text{total rental income}}$ |
|---|

where the eligible rent is the lower of the actual rent for RRSL purposes or the limit rent for a property.

- D7 The subsidy would also be subject to an overall limit calculated using the same formula used by the present system.

5% FLEXIBILITY

- D8 The rent restructuring policy recognises that there is a need for some flexibility to take account of local factors and allows landlords a 5% flexibility around the formula rent. This will be reflected in the way property specific rent rebate subsidy limitation is applied, as we propose to set the limit rent for individual properties at 5% above the formula rent. ODPM expects authorities to use the 5% flexibility in a balanced way and certainly not to set all rents at 5% above the formula rent. For this reason, once the transitional period is over (i.e. from 2012-2013), it is intended that the maximum rent rebate subsidy any authority could receive will be the subsidy it would receive if all rents were set at the formula rent. An authority would get this maximum level of subsidy if rents set above the formula (but within the 5% band) were balanced by rents set below the formula rent. It would not gain additional subsidy if it set more rents above the formula rent than below.
- D9 During the transitional period, it is intended that rent rebate subsidy limitation will be applied using both the property specific approach and on the basis of an average limit rent. The subsidy paid will be the lower of the property specific or average limit rent method.
- D10 The following worked example may help to illustrate how property specific rent rebate subsidy limitation would work once the new system has been fully implemented. Going back to the earlier example with 4 properties:

| | A | B | C | D | Total |
|--|--------|--------|--------|--------|---------|
| Actual rent for RRSL purposes | £50.00 | £40.00 | £60.00 | £45.00 | £195.00 |
| Rent Rebates | £50.00 | £40.00 | – | – | £90.00 |
| Formula rent | £55.00 | £45.00 | £52.00 | £48.00 | |
| Property specific limit rent i.e. Formula rent plus 5% | £57.75 | £47.25 | £54.60 | £50.40 | |
| Eligible rent i.e. lower of actual and limit rent | £50.00 | £40.00 | £54.60 | £45.00 | £189.60 |

The total of the rent rebates paid by the authority to its tenants is £90.00. The total rental income (for RRSL purposes) is £195.00. The sum of eligible rents is £189.60. Applying the formula:

| | |
|--------------------------------------|--|
| rent rebate subsidy = rent rebates x | $\frac{\text{sum eligible rents}}{\text{total rental income}}$ |
| = £90.00 x | $\frac{\text{£189.60}}{\text{£195.00}}$ |
| = £87.51 | |

The subsidy payable is therefore £87.51. This is less than the total rebates paid out by the authority as the rent on property C exceeds the property specific limit rent.

TRANSITION TO PROPERTY SPECIFIC LIMIT RENTS

- D11 ODPM proposes that the transitional value for a property in 2004/05 should be calculated from the April 2001 actual rent using much the same step process as is to be used to calculate annual changes to the guideline rent and to the limit rent – see Annex C.
- D12 Each year, an uprated property specific rent would be calculated from the previous year's values by increasing it by the same uplift factor applied to the formula rent. The difference between the uprated property specific rent and the formula rent would then be reduced by 1/10th in 2002/03, 1/9th in 2003/04, 1/8th in 2004-05 etc to give the transitional property specific rent.
- D13 The **property specific limit rent** (see paragraph 0) each year would be that year's transitional property specific rent plus 5%. In this way the system would be introduced in small, approximately equal steps – on the assumption that authorities have already moved part of the way toward formula rents by the time the system goes live in 2004/05.

EFFECT OF UNPOOLING OF SERVICE CHARGES

- D14 The general limitation formula has been changed from 2003/04 to support the policy of encouraging authorities to separate out service charges. (Please see paragraph 0 above).
- D15 In a similar way, if a service charge is unpooled from rent for a property, the actual rent for that property will be deemed to be increased by a percentage of the unpooled service charge, when making a comparison with the **property specific limit rent**. It is intended that property specific rent rebate subsidy limitation (PSRRSL) will be introduced from 2004/05, and in that year 70% of unpooled service charges would be included in the rent for PSRRSL purposes. Thereafter 60% of unpooled service charges would be included in 2005/06, 50% in 2006/07 and so on until none of the service charge is included in 2011/12.

EXEMPLIFICATION

- D16 The following section gives an example of how property specific rent rebate subsidy limitation might work in the transitional period. There is no inflation or real rent increase in this example, and the RPI + ½% +/-£2 limits are ignored. The average limit rent is moved to the formula rent in roughly equal steps using the methodology exemplified in Annex C.

| | A | B | C | D | Total | Average |
|---------------------|--------|--------|--------|--------|---------|---------|
| Actual rent 2001/02 | £50.00 | £40.00 | £60.00 | £45.00 | £195.00 | £48.75 |
| Formula rent | £55.00 | £45.00 | £52.00 | £48.00 | £200.00 | £50.00 |

- D17 In 2001/02 the authority is subject to rent rebate subsidy limitation because the average actual rent of £48.75 is above the limit rent of £48.00. Property specific limitation has not been introduced. £90.00 is paid as rent rebates. Subsidy paid is £88.62 (£90 times 48.00 divided by 48.75).

| | A | B | C | D | Total | Average |
|--|--------|--------|--------|--------|---------|---------|
| Rent for RRS� purposes 2004/05 | £51.50 | £41.50 | £60.00 | £45.90 | £198.90 | £49.73 |
| Rent rebates 2004/05 | £51.50 | £41.50 | – | – | £93.00 | |
| Transitional rent 2004/05 | £51.50 | £41.50 | £57.60 | £45.90 | | |
| Property limit rent 2004/05 i.e. transitional rent plus 5% | £54.08 | £43.58 | £60.48 | £48.20 | | |
| Eligible rent 2004/05 i.e. lower of actual and limit rent | £51.50 | £41.50 | £60.00 | £45.90 | £198.90 | £49.73 |

- D18 In 2004/05, £93.00 is paid as rent rebates. The average rent is £49.73 and the limit rent is £48.60 so on the average limit rent formula the amount paid in subsidy would be £90.89 (£93 times 48.60 divided by 49.73). The authority decides to keep the rent for property C at £60 per week, but is not affected by property specific limitation, as this is within 5% of the transitional rent for that property of £57.60.

| | A | B | C | D | Total | Average |
|--|--------|--------|--------|--------|---------|---------|
| Rent for RRS� purposes 2006/07 | £52.50 | £42.50 | £60.00 | £46.50 | £201.50 | £50.38 |
| Rent rebates 2006/07 | £52.50 | £42.50 | – | – | £95.00 | |
| Transitional rent 2006/07 | £52.50 | £42.50 | £56.00 | £46.50 | | |
| Property limit rent 2006/07 i.e. transitional rent plus 5% | £55.13 | £44.63 | £58.80 | £48.83 | | |
| Eligible rent 2006/07 i.e. lower of actual and limit rent | £52.50 | £42.50 | £58.80 | £46.50 | £200.30 | £50.08 |

- D19 In 2006/07, £95.00 is paid as rent rebates. The average rent is £50.38 and the limit rent is £49.00 so on the average limit rent formula the amount paid in subsidy would be £92.40 (95 times 49.00 divided by 50.38). The authority has again decided to leave the rent for Property C at £60. This time property specific limitation could affect the outcome, because the rent of £60 is higher than the property specific limit rent of £58.80. The sum of eligible rents is £200.30 and the total rental income is £201.50 so under property specific limitation, rent rebate subsidy would be £94.43 (£95 times 200.30 divided by 201.50). The subsidy paid would be the lower of the two limitation rules, in this case £92.40.

| | A | B | C | D | Total | Average |
|--|--------|--------|--------|--------|---------|---------|
| Rent for RRSLS purposes 2008/09 | £53.50 | £43.50 | £60.00 | £47.10 | £204.10 | £51.03 |
| Rent rebates 2008/09 | £53.50 | £43.50 | | | £97.00 | |
| Transitional rent 2008/09 | £53.50 | £43.50 | £54.40 | £47.10 | | |
| Property limit rent 2008/09 i.e. transitional rent plus 5% | £56.18 | £45.68 | £57.12 | £49.46 | | |
| Eligible rent 2008/09 i.e. lower of actual and limit rent | £53.50 | £43.50 | £57.12 | £47.10 | £201.22 | £50.31 |

- D20 In 2008/09, £97.00 is paid as rent rebates. The average rent is £51.03 and the limit rent is £49.40 so on the average limit rent formula the amount paid in subsidy would be £93.90 (£97 times 49.40 divided by 51.03). Property specific limitation could also affect the outcome. The sum of eligible rents is £201.22 and the total rental income is £204.10 so under property specific limitation, rent rebate subsidy would be £95.63 (£97 times 201.22 divided by 204.10). The subsidy paid would be the lower of the two limitation rules, in this case £93.90.

| | A | B | C | D | Total | Average |
|---|--------|--------|--------|--------|---------|---------|
| Actual rent 2011/2012 | £55.00 | £45.00 | £60.00 | £48.00 | £208.00 | £52.00 |
| Rent Rebates | £55.00 | £45.00 | | | £100.00 | |
| Formula rent | £55.00 | £45.00 | £52.00 | £48.00 | £200.00 | £50.00 |
| Property limit rent 2011/2012 i.e. Formula rent + 5% | £57.75 | £47.25 | £54.60 | £50.40 | | |
| Eligible rent 2011/12 i.e. lower of actual and limit rent | £55.00 | £45.00 | £54.60 | £48.00 | £202.60 | £50.65 |

- D21 In 2011/12 both the limitation formulae use the actual rent again. The percentage of unpooled service charges to be added back has reduced to zero. The actual rent for properties A, B and D equals the formula rent. The actual rent for property C remains £60 per week.
- D22 The average rent is £52.00 and the limit rent now equals the average formula rent or £50, so using the average limit rent formulae, the amount paid in subsidy would be £96.15 (£100 times 50 divided by 52). The sum of the eligible rents is £202.60, and the total rental income is £208.00, so under property specific limitation, rent rebate subsidy would be £97.40 (£100 times 202.60 divided by 208.00). Subsidy paid would be the lower of the two rules, in this case £96.15.

ANNEX E

Separating Service Charges

- E1 As stated in Chapter 4 above, for rent rebate subsidy limitation purposes, in 2003/04, the actual rent of an authority which is deemed to have separated out service charges will be increased by 80% of the separated out service charge, averaged over the dwellings attracting a service charge. We propose that in 2004-05 the adjustment will be 70% of the average separated out service charge; 60% in 2005/06; 50% in 2006/07 and so on. The same will apply in relation to property specific rent rebate subsidy limitation. This will give authorities a growing incentive to separate out service charges.
- E2 At the end of the rent restructuring period, the rent element would be expected to be within 5% of the formula rent, or rent 'cap' if applicable. The service charge would be additional to this but should not be more than the actual cost of providing services.
- E3 Ministers are concerned that the separation of service charges does not lead to sudden, large rises in charges to individual tenants. Therefore the limits on rent rises under rent restructuring have been extended to cover service charges. The total of rent plus service charge in any year should not change by more than $RPI + \frac{1}{2}\%$ \pm £2. In any year following unpooling, service charges should not rise by more than $RPI + \frac{1}{2}\%$.
- E4 The following table gives an example of how rent rebate subsidy limitation might apply to an authority which unpools charges for existing services. The example authority has an average actual rent in 2002/03 of £50 per week. The average formula rent in the same year is £45 per week and the limit rent is £48 per week. Inflation is assumed to be 2.5% throughout, and the real terms increase in local authority rents is assumed to be 1% in 2002/03, and 1.5% each year thereafter. Please note that these are only assumptions, and actual increases may be slightly different in some cases.
- E5 By 2012, this authority has moved the average actual rent to the formula rent, and introduced a service charge. They stay within the limits on rent and service charge rises, and move out of rent rebate subsidy limitation in 2008-09, when the total rent for RRSL purposes moves below the average limit rent for the first time.

| Year | Average Formula Rent | Average Limit Rent | Average Actual Rent | Average Unpooled Service Charge | Percentage of Service Charge added to rent for RRSL purposes | Total rent for RRSL purposes | Total Rent plus Service Charge |
|---------|----------------------------|--------------------------|---------------------------|--|---|------------------------------------|---|
| | (1) | (2) | (3) | (4) | (5) | (6)=(3)+[(5) *(4)] | (7)=(3)+(4) |
| 2002/03 | 45.00 | 48.00 | 50.00 | 50.00 | 50.00 | | |
| 2003/04 | 46.58 | 49.34 | 51.18 | 80% | 51.18 | 51.18 | |
| 2004/05 | 48.44 | 50.95 | 49.40 | 4.00 | 70% | 52.20 | 53.40 |
| 2005/06 | 50.38 | 52.61 | 51.02 | 4.12 | 60% | 53.49 | 55.14 |
| 2006/07 | 52.39 | 54.33 | 52.74 | 4.24 | 50% | 54.86 | 56.98 |
| 2007/08 | 54.49 | 56.10 | 54.56 | 4.37 | 40% | 56.31 | 58.93 |
| 2008/09 | 56.67 | 57.92 | 56.52 | 4.50 | 30% | 57.87 | 61.02 |
| 2009/10 | 58.93 | 59.81 | 58.64 | 4.64 | 20% | 59.57 | 63.28 |
| 2010/11 | 61.29 | 61.74 | 60.99 | 4.78 | 10% | 61.47 | 65.77 |
| 2011/12 | 63.74 | 63.74 | 63.74 | 4.92 | 0% | 63.74 | 68.66 |

- E6 For any property, a service charge will be deemed to have been separated out if the total service charge is greater than the service charge made in 2001/02 plus an allowance for inflation plus the cost of any new services introduced since 2001/02. In a year when service charges are unpooled, the total of rent plus service charge that any individual is required to pay should not increase by more than $RPI + \frac{1}{2}\% + £2$. This is exemplified below.
- E7 Consider a local authority property that currently attracts a rent of £50 per week. The property is located in a block and the authority provides various communal services such as exterior window cleaning, grounds maintenance, and cleaning of the communal areas. The authority does not currently charge a separate service charge even though the actual cost of providing these existing services to that property is £10 per week. The cost of providing services is met from the general rents collected from all tenants.
- E8 Following the guidelines set out in Chapter 4, this authority may decide to unpool the service charges and charge £43.10 per week rent plus a service charge of £10, giving a total charge to the tenant of £53.10 ($£53.10 = £50 \times 1.022 + £2$, assuming RPI to be 1.7%). Alternatively the authority could charge £48.10 rent and a service charge of £5. However, the authority could not charge rent of £50 plus a service charge of £10 without exceeding the $RPI + \frac{1}{2}\% +/£2$ per week limit.
- E9 Of course, if the authority is applying rent restructuring in line with the policy then they would not apply the full $RPI + \frac{1}{2}\% +/£2$ increase if a lower level of increase is required to move towards the formula rent in ten roughly equal steps.

