Policy Response
The impact of new housing measures on development
February 2016

SUMMARY

Markets served by Help to Buy, Starter Homes and shared ownership are likely to overlap

- **Housing delivery:** Help to Buy, Starter Homes and shared ownership will largely serve the same parts of the market. As a result of the overlap, there is a risk that the schemes may not deliver additional homes. p.2

- **Affordable Housing:** these schemes are unlikely to help low income households. The shift in policy drive from Affordable Rent to one of the other tenures, and in particular the classification of Starter Homes as a form of Affordable Housing, is likely to leave a gap in housing provision for those on lower incomes. p.3

- **Starter Homes:** there is a risk that the Starter Homes policy could distort the new homes sales market, without significantly increasing the number of new homes delivered overall. p.4

- **Help to Buy:** increasing the size of the equity loan in London will open up more parts of the market to working middle income households. p.5

- **Rental demand:** the private rented sector will still expand by more than one million households over the next five years, despite the drive to boost homeownership. We expect to see opportunities for large scale investors to provide rental stock and enable developers to de-risk schemes through forward-funding structures. p.6

- **Land values:** uncertainty surrounding the details of these schemes, including future Affordable Housing requirements alongside Starter Homes, makes the appraisal of land values a challenge. p.7
In last year’s Autumn Statement, George Osborne announced proposals for 400,000 affordable new homes focused on low-cost homeownership over the term of this parliament.

The drive to reverse the falls in homeownership, which has been in decline since the start of the century, particularly among younger households, is set against wider Government ambition to build one million new homes by 2020.

We are still building well below the numbers required, with only 155,000 new homes completions recorded in England in 2014/15, compared with the need for 312,000 per year over the next five years, according to the latest assessment from the TCPA.

Measures to instigate the construction of new homes aimed at homeowners include 200,000 Starter Homes, access to bigger equity loans through Help to Buy in London and a broader eligibility criteria for 135k new shared ownership homes.

For buyers, the main effect of each scheme is to reduce the deposit required and therefore lower the barrier to homeownership.

However, the combination of these polices and their interaction with other forms of tenure, including Affordable Housing, raises a number of issues and challenges for those engaged in delivery of new homes.

Housing provision
As it currently stands, the biggest concern is that the Starter Homes policy, under which homes are sold at a 20% discount to first time buyers under 40, could distort the new homes sales market without significantly increasing the number of new homes delivered overall.

As we explain in greater detail below, there is a risk that Starter Homes could cannibalise Help to Buy sales as well as existing open market sales aimed at first time buyers (see Figure 1).

Furthermore, the classification of Starter Homes as a form of Affordable Housing under planning rules and the duty on local authorities to promote the supply of Starter Homes, is likely to result in fewer homes delivered for what is currently classified as an affordable tenure. We can therefore expect to see fewer homes delivered for Affordable Rent. However, given the lack of detail released, it is not clear what the interaction will be between shared ownership and Starter Homes.

Our previous analysis (see ‘The Future of Sub-Market Housing’, Autumn 2015) shows that there is a clear overlap between parts of the market likely to be served by Help to Buy, Starter Homes and shared ownership, particularly in London.
In a typical inner London borough, this is likely to be households with annual incomes of between £45,000 and £90,000. Under current delivery models, Affordable Rent tends to help the poorest households, those that reach the top of local authority waiting lists and often reliant on housing benefit. The shift in policy drive from Affordable Rent to one of the other tenures is therefore likely to leave a gap in housing provision for those on lower incomes.

Moreover, simply replacing homes which would have been delivered anyway through existing routes, namely in the open market via Help to Buy or as Affordable Housing through section 106 agreements, will not provide additional homes. In fact, by narrowing the focus of housebuilding to first time buyers, we risk creating the reverse effect and reducing the number of new homes built.

**Development and land**

The challenge to developers is to find a way of differentiating various products from one another and to prevent them from overlapping. As we have argued in the past (see ‘Who will build the homes we need?’, 2015), the best way to increase building numbers is to encourage building for a diversity of tenure delivered by a range of developers. Current policy takes us in the opposite direction.

These changes will also impact on the land values. It is possible that Starter Homes may generate no more land value than that of traditional affordable tenures (see p.7).

Crucial details of how the Starter Homes scheme will work in practice have yet to emerge. However, as the Housing and Planning Bill winds its way through parliament, this paper outlines what we know so far and examines the likely effect of these measures on the market and the consequences for housing delivery.

“Replacing homes which would have been delivered anyway through existing routes will not provide additional homes”

![Housing delivery chart](chart.png)

**FIGURE 2**

**Housing delivery**

Narrowing the focus of housebuilding to first time buyers may limit supply

The best way to boost supply is to encourage building across tenures

Changes in current policy will also impact on the land values

Source: Savills using DCLG data

*Excluding PDR and other conversions*
NEW HOMES FOR SALE

The Starter Homes scheme and the expansion of Help to Buy may help some first time buyers but could distort the market

The Government has confirmed its ambition to deliver 200,000 Starter Homes over the course of the parliament. Details of this flagship scheme, which has evolved significantly since it was first announced under the Coalition Government, are still being fleshed out by the DCLG. However, basic provision for Starter Homes is included in the Housing and Planning Bill which is expected to gain Royal Assent by summer 2016.

As it currently stands, Starter Homes will be new build homes available to first time buyers under 40 at a minimum discount of 20% to full market value. The exact process for determining the open market value is still being discussed between Government, housebuilders and lenders. However, the maximum discounted market price will be capped at £450,000 in Greater London and £250,000 elsewhere – the equivalent of £562,500 and £312,500 respectively in the open market.

To meet the delivery target for this ambitious scheme, the Government has determined that a proportion of all “reasonably-sized housing sites” are set aside to deliver Starter Homes. The precise requirement is still to be defined and could vary across the country.

Planning reforms
It appears that the bulk of the numbers are to be delivered through the reform of the planning system with Starter Homes treated as a form of Affordable Housing. This would mean developers will be obliged to deliver Starter Homes as a percentage of an overall site or a commuted sum to enable the building of Starter Homes elsewhere. Precise numbers will therefore be subject to viability assessments on a site-by-site basis.

In addition to those delivered through the reform of the planning system, the Government has allocated a £2.3 billion fund to support the delivery of 60,000 Starter Homes. From this, the first tranche of £1.2 billion is to be spent preparing 500 brownfield sites for 30,000 new homes by 2020.

A portion of these Starter Homes will be delivered as part of the Government’s plans to directly commission 13,000 new homes, up to 40% of which will be Starter Homes, on publicly owned land. The pilot will run in Connaught Barracks in Dover, Northstowe in Cambridgeshire, Lower Graylingwell in Chichester, Daedalus in Gosport and Old Oak Common in London.

There are also proposals to allow housebuilding on previously developed brownfield sites on the Green Belt, provided the properties are Starter Homes.

Market impact
Timings are tight. With so many details yet to be decided, developers are unlikely to start delivering Starter Homes much before 2017. The pressure to meet targets is likely to prompt developers to seek the most straightforward routes to delivering Starter Homes.

As a result we are likely to see the bulk of Starter Homes delivered as a replacement for other forms of Affordable Housing on sites that are already allocated, rather than via the more time-consuming and difficult route of finding exception sites.

However, unlike existing forms of affordable tenures, eligibility for Starter Homes is not linked to income but age – under 40. Furthermore, as proposals currently stand, the discount for Starter Homes is effectively passed on to the purchaser after five years which contrasts with other Affordable Housing in which the subsidy remains in the tenure in perpetuity.

“Schemes with large numbers of Starter Homes may have an impact on saleability and values of competing homes nearby”
Hence, there is risk that Starter Homes will distort the local market and cannibalise market sales. Schemes where there are a large number of Starter Homes for sale may have an impact on the saleability and therefore values of competing entry level homes for sale nearby.

The biggest impact is likely to be felt on sites offering new homes via Help to Buy equity loan schemes. With 80% of Help to Buy deals taken up by first time buyers, both schemes are essentially competing for the same tranche of the market. Depending on the size of the scheme, it could even have an effect on the wider second hand market.

**Help to Buy Equity Loan**

Help to Buy equity loan has supported more than 62,000 sales of new homes since its launch in April 2013, making it by far the most effective Government support scheme for new builds to date. Among the major housebuilders, approximately a third of sales are supported by the scheme. Across the country it has had the biggest impact in mid to lower value markets but has made little difference in most parts of London where values are either above first time buyers. After securing a 20% discount to the open market price, buyers would have access to a 40% equity loan on the remaining amount.

We expect that buyers would still need to have a deposit covering 5% of the full price, as is the case under current Help to Buy rules. However, combining both schemes means that a buyer would only require a mortgage for 44% of the value of the property.

With many of the details yet to emerge, it is difficult to gauge at this stage how the two schemes will interact, complement each other or overlap. Given that both schemes target a similar demographic, there is a strong chance that there will be stronger demand for Starter Homes, which potentially offer a better deal to the buyer assuming the quality of housing is the same.

**London boroughs**

Our analysis shows that the increase in the size of the loan from 20% to 40% would enable a household with an income of £50,000 and a 5% deposit to buy a lower quartile new home in 20 of London’s 33 boroughs. This compares with the previous position where the same household would only be able to access a lower quartile new home in eight boroughs with a 20% equity loan.

Since the Autumn Statement, Brandon Lewis has been quoted saying that Help to Buy Equity Loan will be available on Starter Homes, although no further details or formal confirmation is available.

Combining the two schemes would have a significant impact in London for first time buyers. After securing a 20% discount to the open market price, buyers would have access to a 40% equity loan on the remaining amount.

“Raising the Help to Buy equity loan to 40% in London will increase market access for middle income working households”

**FIGURE 3**

**Help to Buy Equity Loan in London**

<table>
<thead>
<tr>
<th>KEY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where can a household with an annual income of £50,000 afford a lower quartile new home (pricing from 12 months to November 2015)?</td>
</tr>
<tr>
<td>■ Affordable with 5% deposit and 4x LTI</td>
</tr>
<tr>
<td>■ Affordable with 5% deposit and 4x LTI + 20% equity loan</td>
</tr>
<tr>
<td>■ Affordable with 5% deposit and 4x LTI + 40% equity loan</td>
</tr>
<tr>
<td>■ Not affordable with either HTB scheme</td>
</tr>
</tbody>
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Source: Savills using HM Land Registry
Sub-market housing
Before the Autumn Statement, we found that there were 70,000 potential new households each year in need of some form of sub-market housing. The most affordable shared ownership products, if they can be viably delivered, will help some of the more affluent of these people. However, many will be unable to access homeownership, even with the new schemes, due to either deposit or income requirements, or both. There is provision for 10,000 rent to buy homes, but this volume will not have a significant impact.

Shared ownership
The announcement of funding for a huge expansion of shared ownership is likely to have a substantial impact on housing associations, bringing them back into the market for Section 106 land and, if all 135,000 shared ownership units announced by the Chancellor are to be delivered, bringing them back into the wider land market as well.

This is likely to reverse, at least in part, the decline in Section 106 land value that followed the Budget announcement of a 1% annual fall in social rent levels, down from a CPI +1% rise. It will also go some way to counter the fall in Affordable Housing starts seen since the Budget.

The intention is to allow shared ownership to be delivered by a range of providers, not just housing associations. There may be an incentive for housebuilders and developers to deliver shared ownership themselves, to maintain control and ensure differentiation from other products. The management responsibility is likely to be passed on, probably to a housing association. The income stream from the unsold share is relatively risk free and therefore attractive to investors. Housing associations that have developed shared ownership have rarely sold the income stream, indicating how highly they value it.

BUY-TO-LET AND RENTAL DEMAND
The private rented sector (PRS) will still expand by more than one million households over the next five years despite the Government’s drive to boost homeownership. Without policy interventions, we forecast that the PRS would grow by an average rate of 260,000 households a year in the UK.

We calculate that even if the Government were to achieve its target of building 400,000 Affordable Homes for sale, enabling 80,000 new households a year to access homeownership over the next five years, 40,000 would come out of the private rented sector with the balance shifting out of other sub-market tenures. This would reduce the growth of the PRS by 15% to 220,000 new households a year.

However, separate measures aimed at residential property investors are likely to put further pressure on the already constrained supply of rental homes. From April 2016, purchases of residential properties over £40,000 for investment will attract an additional surcharge of three percentage points above the current rate of SDLT. Hence a buy-to-let investor acquiring a property worth £500,000 would pay an additional cost of £15,000.

This stamp duty increase follows a restriction of tax relief on mortgage interest payments for buy-to-let investors with debt set against their property. Together both measures could discourage private investors. This would therefore have a knock-on effect on sales price and sales rate of development schemes that rely heavily on off-plan sales to buy-to-let investors. In London, limits on investor demand are likely to be exacerbated by changes to the tax treatment of overseas investors and exchange rate shifts.

As a result, we expect to see big opportunities for large-scale investors to provide rental stock and enable developers to de-risk schemes through forward-funding structures. (See ‘Rental Britain’, February 2016)
Conclusion

THE EFFECT ON LAND VALUE

Uncertainty surrounding the details on new policies to boost homeownership makes the appraisal of land values a challenge.

There are still many unknowns surrounding how these products will interact. Future land values will depend on the mix of tenures on site. Here are some issues which will impact on appraisals:

- Affordable Housing requirements: one of the biggest factors affecting land value is the amount of Affordable Housing that the local planning authority will require the developer to deliver alongside open market homes and Starter Homes.

- Risk and viability: another consideration is how the broadening of shared ownership provision could impact on viability. The level of risk to the developer, and consequently the profit margins required, depends on whether shared ownership units are sold in bulk to a housing association or the developer undertakes the sales themselves. The latter route carries greater risk.

- Starter homes: while developers can secure their cash flow by selling shared ownership units in bulk early to a housing association, this is unlikely to happen with Starter Homes. As a consequence, land allocated to Starter Homes may return a lower value than sites allocated for shared ownership.

This potentially opens up wider questions around how promotion and development of large sites are funded.

- Securing a cash flow: if a developer decides to retain control of all sales on a site, whether Starter Homes, Help to Buy or shared ownership, they would not secure the cash flow that they can currently receive through the sale of Affordable Housing to a housing association. Housebuilders and developers may be increasingly willing to forward sell units at a discount to institutional PRS investors as one of the few options left to them in securing early cash flow.

- Private developers that retain control of shared ownership may also consider selling the income stream, something housing associations have rarely done, creating a larger market for this form of investment.

- Higher value markets: the graph assumes that Starter Homes will achieve 80% of market value. But 20% is the minimum discount and, across high value markets in the south of the country, the maximum value caps (£450k in London, £250k everywhere else) will have a much greater impact. In these high value markets, the discount will need to be much higher to get below these caps and it is possible that Starter Homes may generate no more land value than that of traditional affordable tenures.

All of this will have a profound effect on viability testing, not only of development schemes but also of Local Plans, including the policy level of Affordable Housing requirement and CIL. This adds to the burden on local authorities, who may want to amend their plans, and may derail plans that are currently on target to be adopted before the Government's 2017 deadline. Such a review would need to balance the Westminster requirement to provide Starter Homes with the duty to house people in need, at the same time as ensuring development can take place on a financially viable basis.

FIGURE 5
The impact on land values

- Similar return required – both involve developer sales risk
- Lower land value if developer takes sales risk
- Higher land value if bulk sale to HA
- Market Sale (inc. Help to Buy)
- Starter Homes
- Shared ownership
- GDV = 80% of market sale
- GDV = 70% of market sales

Source: Savills Research

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