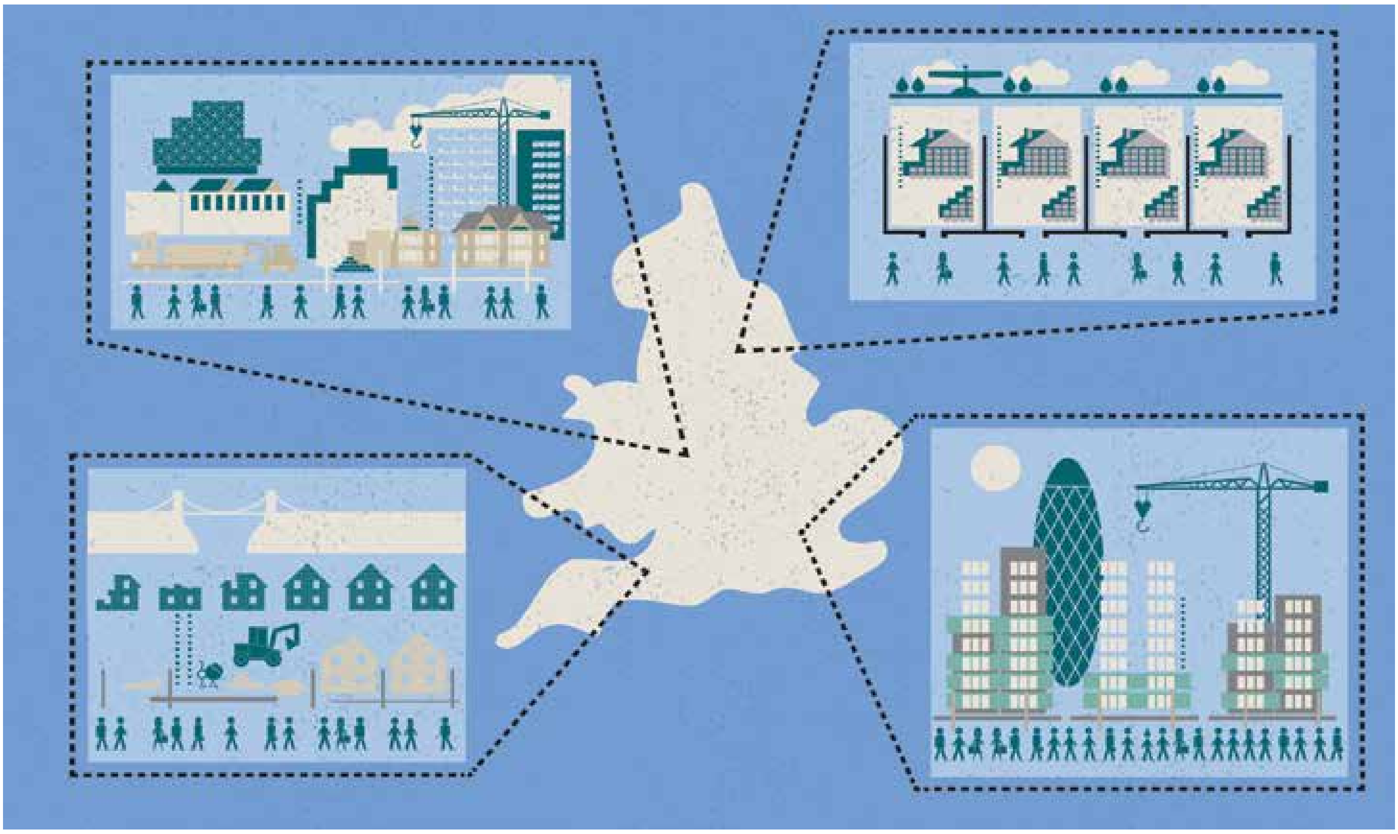
Spotlight | 2017

Investing to solve the housing crisis



Summary The impact of grant funding should be judged on how well it solves the full range of local housing issues, including affordability, quality and undersupply

- **Nearly 100,000 households are in need of sub-market housing each year.** The incomes of these households, and therefore the housing they can afford, vary hugely. Housing policy should allow tenure flexibility to reflect local housing needs and ensure value for money from grant. See p.2-3

- **Against this need we have delivered an average of 45,000 sub-market homes annually since 2013.** 93% of the shortfall is in London and the South, whilst affordable delivery gets close to meeting need in the North and Midlands. See p.2-3

- **It would take £7bn each year to provide social rented homes to all of those in need of sub-market housing.** In the most expensive parts of the country this could offer a significant benefit saving compared to housing these households in market rented homes, because social rent is at such a discount. See p.4-5

- **Instead of just aiming to build the maximum number of homes, funding packages should give housing associations the opportunity to tackle local housing issues.** This may be addressing housing quality in areas where affordability is less of a constraint. See p.4-5

- **For most housing associations, the profit generated through market sale is equivalent to less than 20% of their total surplus, but for some this rises to over 60%.** Yet only 24% of board members told us a market downturn was a risk to them delivering more homes in our June 2017 survey. See p.6-7

Doing more with less

Maximising value for money means using housing funding flexibly to help deliver the right homes in the right places, regardless of tenure

Across the UK we need to deliver 300,000 homes a year to have any impact on the crisis of housing affordability. At current pricing nearly 100,000 of these homes need to be sub-market, and the scale and nature of this need varies greatly between regions. The 2016-21 Shared Ownership and Affordable Homes Programme fails to acknowledge the different needs of local markets and isn't necessarily delivering the most cost effective housing across the country. Directing grant to the areas where it returns the most value in terms of benefit bill savings, ensuring it delivers the most appropriate tenures and plays a role in improving housing quality, is essential to solving the housing crisis.

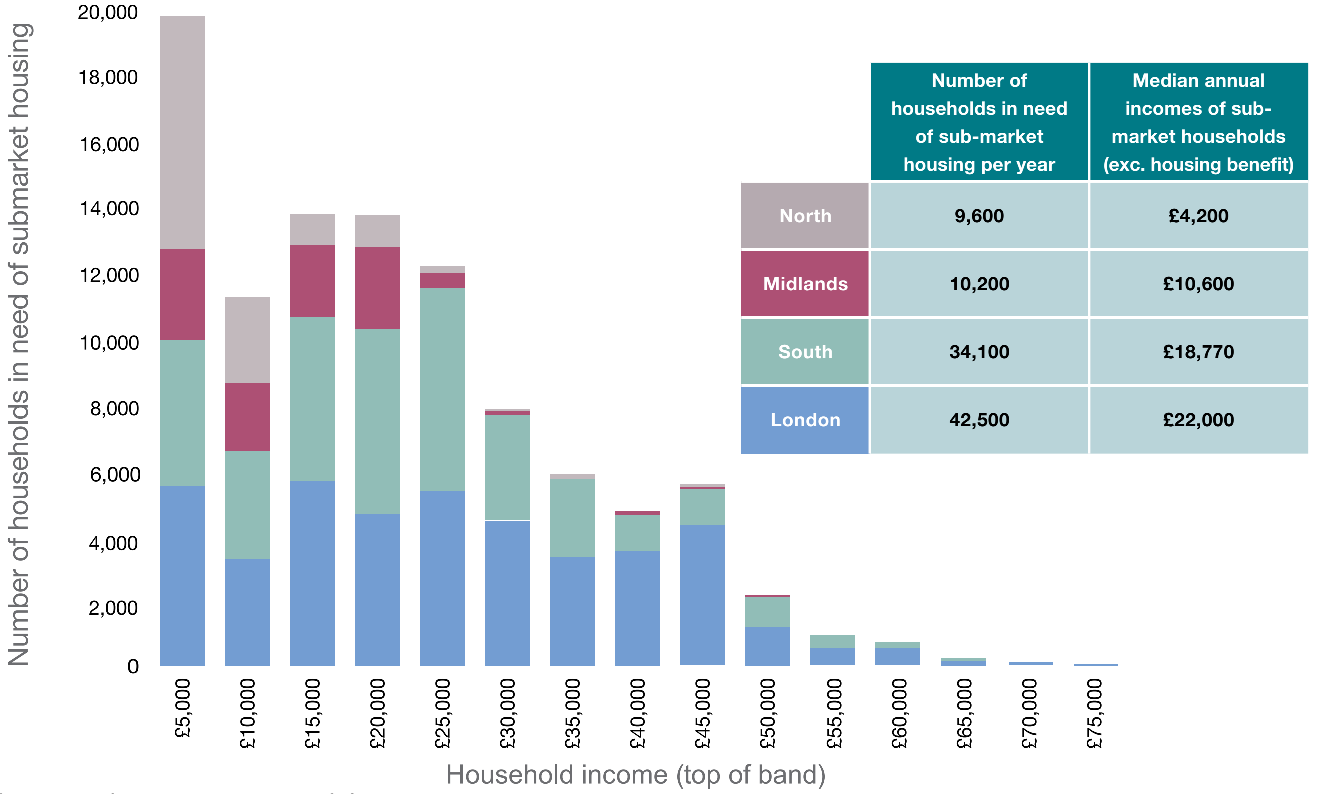
In 2015 we reported that 70,000 households could be in need of sub-market housing each year. Using our modified version of the Government's proposed standard approach to housing need (1), and house price growth that has outpaced wage growth, this figure is now 96,000 per year. These are households who don't have enough income to access their local market and their incomes vary hugely in different parts of the country. In London, 20% of these households have incomes over £35,000, and 20% have incomes under £10,000. In the North, 80% have incomes under £10,000 and none have incomes over £30,000. These income levels exclude housing benefit.

Right homes. Right places

A one size fits all housing policy fails to address the variety of issues faced in different regions. In markets where affordability is the most pressing issue, a range of tenures is needed to meet the varied needs of local households unable to access the market. In other areas, housing quality is a key issue, including a need to renew poor quality private rented housing.

In more affordable markets the income range of households unable to access the market is concentrated in the lowest income bands. Low cost rental housing is essential in these areas whilst intermediate products and shared ownership don't necessarily address the needs of the local community. Understanding the differences in sub-market housing need is crucial to getting the right affordable homes in the right places.

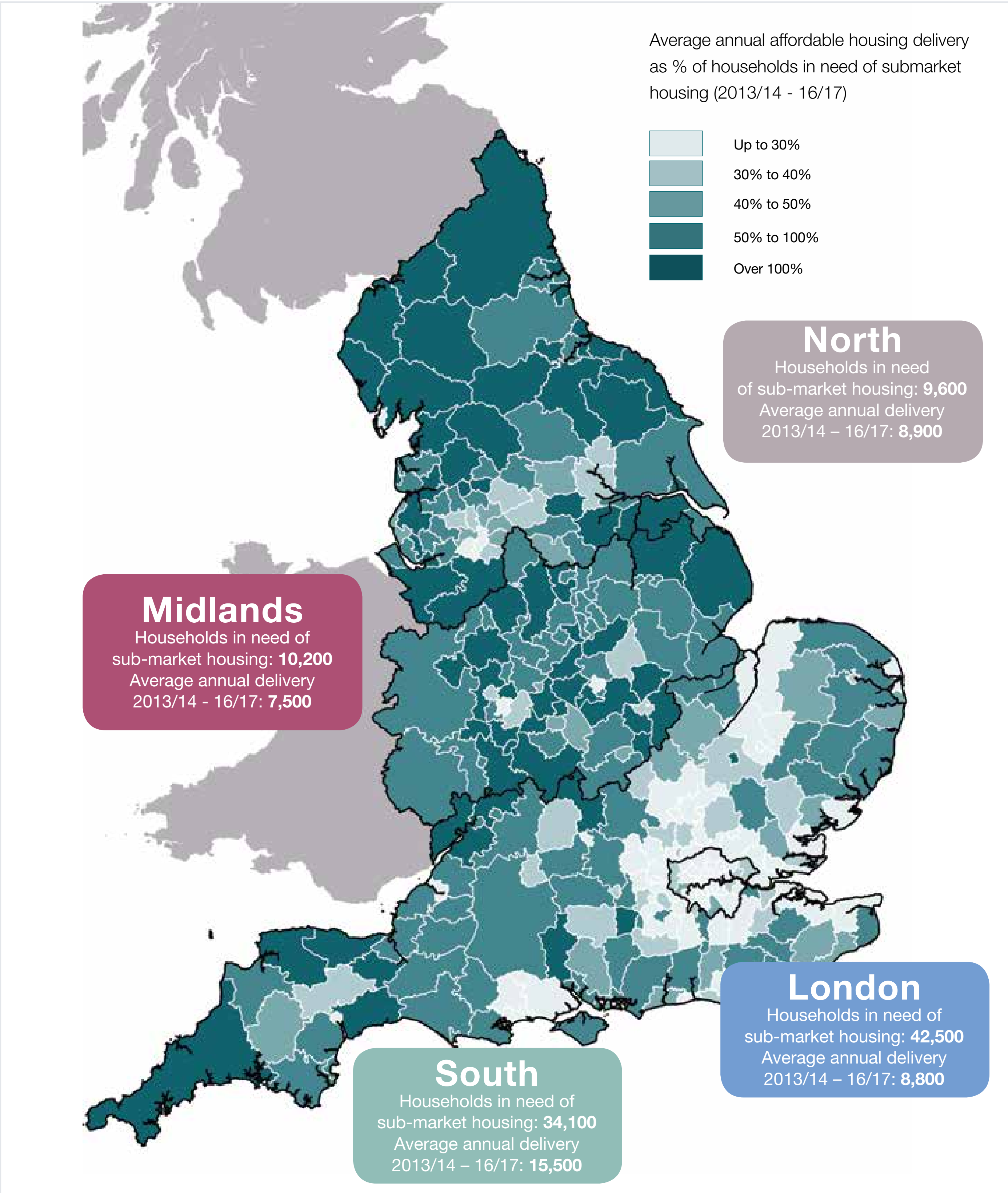
Figure 1 The need for sub-market housing in London and the South is acute, and spans a wide range of incomes. In the Midlands and North very low incomes highlight the essential role of sub-market housing



	Number of households in need of sub-market housing per year	Median annual incomes of sub-market households (exc. housing benefit)
North	9,600	£4,200
Midlands	10,200	£10,600
South	34,100	£18,770
London	42,500	£22,000

Source: Savills using EHS, Land Registry, Rightmove, DCLG

Figure 2 In some of the cheaper parts of the country affordable housing delivery has been able to meet the majority of sub-market need, 93% of the shortfall is in London and the South



Source: Savills using EHS, Land Registry, Rightmove, DCLG

Footnote (1) See our policy response note: Planning for the right homes in the right places

Flexible funding to meet local needs

The market can't and won't solve the growing problem of priced-out households. If subsidies are going to take the strain, they should be administered in a more flexible and targeted way

Grant funding of affordable housing could be considered an investment where it can deliver long term savings on the housing benefit bill. But in practice, affordable housing grant also fulfils many other roles, including bringing viability to development in lower value areas and improving housing quality.

A more flexible and holistic funding regime – directing funding at issues like stock renewal, infrastructure and unlocking difficult sites – could be a more effective way of solving local problems in the housing market.

Priced out

Our analysis on p2-3 identifies a large and growing problem: more and more emerging households priced out of the housing market due to low incomes and rising costs. If we assume that all these households will form, how would you go about housing them all, and what would it cost?

Two scenarios are shown on the page opposite. The first assumes that all of the 100,000 households are housed in hypothetical market rented housing, supported by housing benefit. The second assumes that we build enough social rented housing to accommodate all 100,000 households.

New generation of social housing

In her party conference speech the Prime Minister announced an extra £2bn of funding over four years, some of which would be available for social rent. But to house 100,000 emerging households in this tenure would need funds of a different magnitude: £7bn each year.

Adopting this scenario would reduce the hypothetical housing benefit for the 100,000 households by £430m per year, with rents more aligned to the low incomes of those excluded from the market. And you get something tangible for your upfront subsidy in the form of new housing assets.

The housing benefit savings generated are much greater in London and the South, where the difference between prevailing levels of social and market rents is largest.

Local solutions for local problems

Grant from affordable housing programmes also helps make development viable in markets where the balance between build costs and sales values would otherwise preclude it. Clearly there are benefits to using grant in this way too.

Major development programmes can often be a good way of boosting the local economy in deprived areas, providing jobs and training, and supporting local supply chains. But it's hard to make the case for an affordable homes programme where market, Affordable, and social rents overlap.

The Homes and Communities Agency (HCA) is in the process of consolidating its various pots of funding and taking a more active role in delivery. In future, housing associations should have the opportunity to bid for a wider range of funding packages and move away from the current restrictions of grant funding. This could help the sector to address local housing issues more effectively.

Political will

More flexibility would allow funding to be targeted at specific housing problems, with less of a focus on delivering maximum numbers of affordable homes. The political will to move to a more targeted approach seems to be growing.

The Prime Minister's party conference speech alluded to a shift in government thinking, saying: "In those parts of the country where the need is greatest [the government will] allow homes to be built for social rent".

A flexible approach would complement wider economic rebalancing policies, helping to remove the perception of poor quality housing options that is often cited as a barrier to relocating workers outside the south east. Treating housing as infrastructure, alongside transport improvements and investment in employment space would mean measuring the overall economic impact of funding or policy interventions against a range of indicators.

Building more homes should be a priority, but so should improving the quality of existing homes. Money spent should be judged on whether it's delivering the right housing solutions in the right places.

Figure 3 Scenarios for housing the 100,000 households in need of sub-market homes

	London	South	Midlands	North	Total
Number of households in need of submarket housing p/a	42,500	34,100	10,200	9,600	96,400
Scenario A	In Scenario A we assume the private rented sector (PRS) has suddenly acquired dramatically more capacity, enough to house the 100,000 households in need of submarket housing. Housing benefit is required to pay a large proportion of the rent.				
Benefit Bill	£510m	£225m	£52m	£62m	£849m
Scenario B	In Scenario B we assume that 100,000 social rented homes are built each year to accommodate households in need of submarket housing. This would cost £7bn in grant funding each year.				
Grant needed	£3.4bn	£2.4bn	£0.6bn	£0.5bn	£6.8bn
Benefit Bill	£199m	£132m	£40m	£47m	£418m
Outcomes	The advantage of Scenario B over Scenario A would be a long term hypothetical saving to the housing benefit bill, £431m per year across the country. The equivalent value of this saving in perpetuity is £24bn, at current long term interest rates.				
Hypothetical saving to Benefit Bill	£310m	£94m	£12m	£16m	£431m
Value of saving	£17.2bn	£5.2bn	£0.7bn	£0.9bn	£23.9bn

Source: EHS, CACI, Land Registry, Rightmove, HCA SDR, 2011 Census, CIH (note that totals may not sum due to rounding)

Footnote on assumptions
To assess the scale of sub-market need we've looked at local incomes, local prices, and DCLG's new need figures following the standardised approach. We've assumed that households are in need of sub-market housing if there is no market provision accessible when they spend 25% of their gross income on housing costs. The potential housing benefit bill is estimated based on current two bed LHA rates. The varying amount of rent covered by housing benefit by different income groups in different regions has been accounted for. The value of the saving in perpetuity has been calculated using current 30-year gilt rate of 1.8%.

Understanding market risk

A housing market downturn remains low on the risk radar of many housing associations, despite their increasing focus on developing homes for market sale

Only 24% of housing association chief executives saw a housing market downturn as something that might prevent their organisation from delivering more homes according to the Housing Sector Survey we published earlier this year. And only a third saw a downturn as a risk to their organisation's expansion. But with the sector increasingly exposed to the market the associated risks need more attention.

The Government has made available £7.1bn to deliver new affordable homes. Over time more flexibility has been introduced from an initial focus on shared ownership. This has created more opportunities to deliver affordable homes for rent. This shift has been complemented with the announcement of a further £2bn pot of grant allowing for social rent delivery.

In order to deliver the social rent that is central to their charitable purpose housing associations are venturing into market sale delivery to cross-subsidise their sub-market programmes. Just over a quarter of our sample of 189 housing associations made some income from non-social housing sales activity in 2015/16. Increasingly the structure of grant has pushed housing associations towards more pro-cyclical tenures.

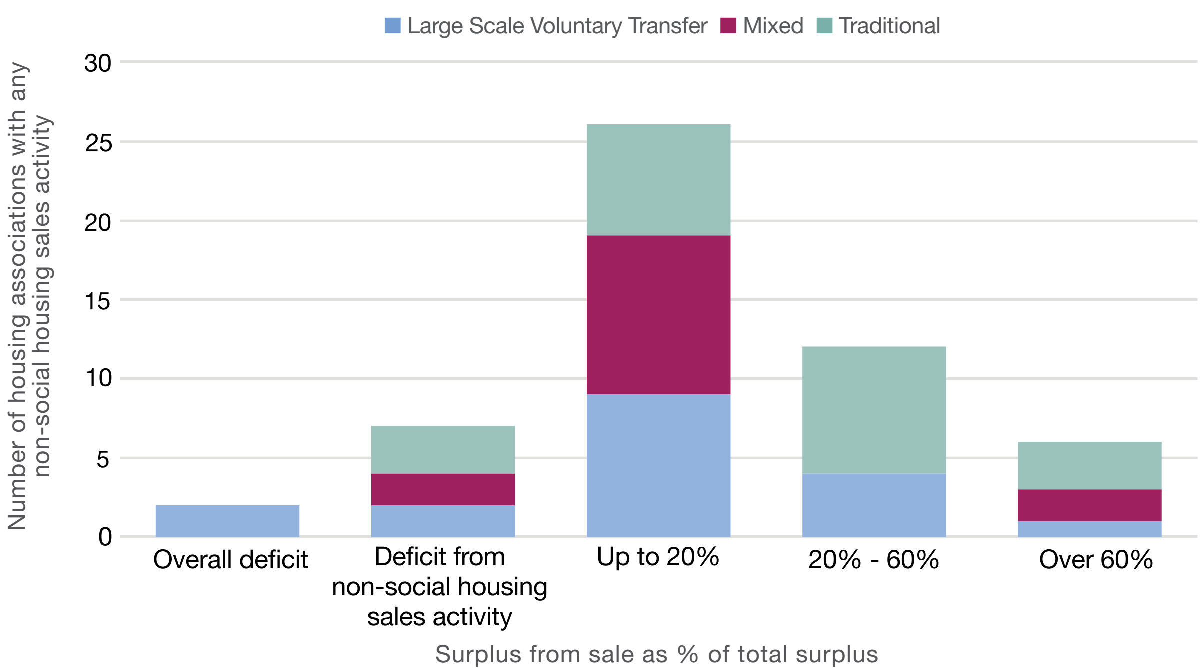
For most of them the profit made from these sales was equivalent to less than 20% of the organisation's total surplus. Some associations actually made a loss from this sales activity. But for others it was equivalent to more than 60% of their total surplus.

So currently most developing associations have only modest exposure to market risk. But the sector's intention is to grow their development portfolios towards pro-cyclical tenures, with 66% in our survey saying they will build market sale in the next five years. This is positive and reflects the maturing role of housing associations in housing supply across all tenures.

Risk awareness

However, with more of their turnover and development aspirations exposed to the market, an awareness of the risks of downturn is key. Following the financial crisis in 2008 operating margins for the eight largest listed housebuilders fell sharply into negative territory. They were also hard hit by the rapid fall in land values. Greenfield land values fell 45% in 2009, and urban land values fell over 50%. It was only in 2016 that the average operating margin recovered to 20%, consistent with target returns required 'across the cycle'.

Figure 4 Whilst most housing associations only have modest exposure to the market in their surplus, some are making a loss from their non-social housing sales activity



Source: Savills analysis of the 2016 published financial reports for over 189 of the largest housing associations owning 93% of general needs housing stock

Whilst working to deliver new homes using grant, housing associations are increasingly delivering market sale homes alongside shared ownership, to cross-subsidise sub-market tenures. But despite their experience of developing and managing rented stock only 37% are planning to deliver market rent, reflecting viability challenges and also the capital lock-up compared to open market sale and grant funded tenures.

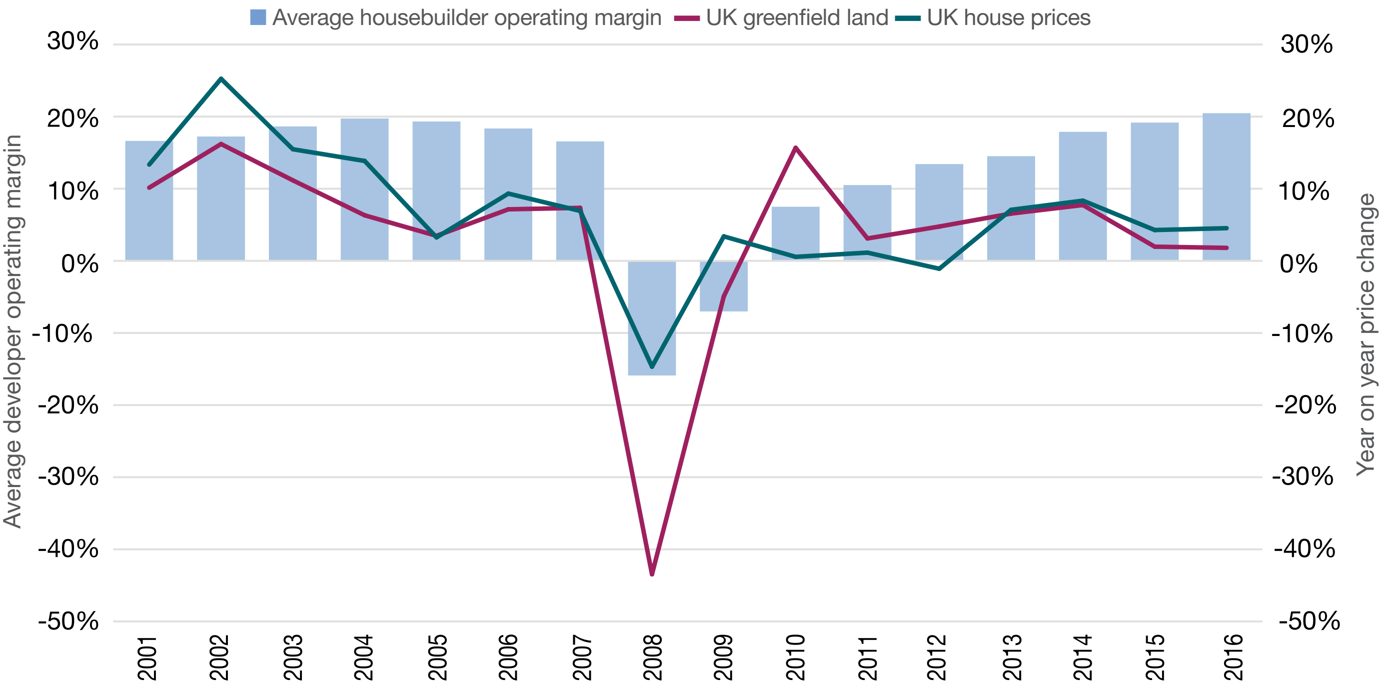
For sale schemes provide an ability to recycle cash more quickly but this must be offset against the increased risks. Market development programmes with a balance of sale and rental homes offer a lower risk option, providing a long term income stream along with an asset to borrow against. But as we've shown in this paper in some parts of the country market rent may also fulfil the charitable purpose of housing associations improving access to housing for households on the lowest income whilst improving the quality of local housing stock.

Flexible use of government funding would allow housing associations to respond to local housing issues, whether it's affordability, quality, or simply undersupply.

37% of housing associations plan to deliver market rent in the next five years

33% of housing association board members saw a market downturn as a risk to expansion

Figure 5 Average developer operating margins fell to -16% in 2009 following the downturn, as land prices fell dramatically. The risks of downturns to market developers are potentially severe



Source: Savills Research, Nationwide, Housebuilder Annual Reports savills.com

Contact

SAVILLS RESEARCH TEAM

Chris Buckle
020 7016 3881
cbuckle@savills.com

Nick Gregori
020 7409 5907
ngregori@savills.com

Holly Titford
020 7229 3077
holly.titford@savills.com

SAVILLS HOUSING TEAM

Robert Grundy
Head of Housing
020 7409 5995
rgrundy@savills.com

Helen Collins
Housing Consultancy
020 7409 8154
hcollins@savills.com

Dave Eastgate
Housing Consultancy
020 7299 3020
deastgate@savills.com

Robert Pert
Development & Regeneration
020 3107 5498
rpert@savills.com

Terry Frain
Savills Financial Consultants
020 7299 3070
tfrain@savills.com