mind the gap – housing supply in a cold climate

A Discussion Paper by David Pretty CBE and Paul Hackett for the Smith Institute, the Town and Country Planning Association, and PricewaterhouseCoopers
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A steady supply of good-quality, affordable housing in well designed, sustainable communities is the hallmark of a civilised society. A balanced housing market with sufficient supply and choice of housing is fundamental to our economic and social well-being. However – as this report makes abundantly clear – we are still falling well short of achieving that objective.

As Kate Barker said in her Review of Housing Supply back in 2004: ‘I do not believe that continuing at the current rate of housebuilding is a realistic option, unless we are prepared to accept increasing problems of homelessness, affordability and social division, decline in standards of public service delivery and increasing the costs of doing business in the UK – hampering our economic success.’ Five years later the situation is worse. The housing market has suffered a sudden decline owing to the banking crisis and recession, with supply set to fall steeply. Indeed, with an uncertain outlook and a tightening fiscal position impacting on housing output, the omens for the future are not encouraging unless action is taken on a wide front.

We need to tackle not only the recessionary challenges, but also a range of important issues which pre-existed the downturn. Unless we can effectively do this and develop a cohesive policy response, including a wider range of delivery models and mix of tenure, then housing supply is likely to be seriously constrained for many years to come. Few would now argue that the prospect of a large and growing shortfall in housing supply can be ignored any longer. To look away is not a realistic option. The evidence of a widening gap between housing production and demand is undeniable. Moreover, as the supply backlog grows and household formation increases, the problems we face get bigger, more difficult, and more costly to solve.

Since the 1980s all governments have failed to frame policies that have incentivised the delivery of enough housing of the right type in the right places. Private housing production has been operating below its potential for some time, while the resource-constrained public sector has been ill-equipped to compensate (with social housing supply decreasing significantly). At the same time demand for new homes has increased at an ever faster rate, not least due to the growing and ageing population – particularly single-person households.

It is the sheer scale and urgency of the housing challenge – and the serious social and economic consequences that follow – that we highlight in this report. Mortgage finance and development funding is in very short supply, and we are now facing the lowest levels of housing production in living memory.

We don’t pretend to have all the answers, and we hope that our report will be read alongside recent publications on housing supply by Shelter, the Home Builders Federation, the Government’s National Housing and Planning Advice Unit and others. What we have tried to do is explain the problem and offer some constructive advice and potential solutions.

Our aim is to inform government thinking and to help shape the policy debate on housing supply in England. We have built our findings and recommendations on current data and the views and experiences of a wide range of senior housing practitioners.
We held seven roundtables, organised by the Smith Institute and the TCPA, on housing supply during the spring and summer of 2009 (four in London and three in the regions). These involved over 100 people from across the housing sector, including senior representatives from housing associations, housebuilders, local authorities, ALMOs, banks and funders, commercial developers, planners, campaign organisations, academia, and civil servants. The debates were often heated, but always informative and of a very high quality. Everyone accepted that there are no easy solutions, but there was a general consensus on the key issues and agreement on many of the solutions highlighted in this report. Of course, the observations and conclusions we reached do not necessarily represent the views of everyone we spoke to.

We are most grateful to everyone who attended the roundtables and to all those who have submitted their thoughts. We would also like to give special thanks to PricewaterhouseCoopers for supporting the project and to Gideon Amos OBE, Chief Executive of the TCPA, and Richard Parker, Partner, PricewaterhouseCoopers.

David Pretty CBE
Paul Hackett
An adequate supply and choice of good-quality housing is vital for our economic and social well-being. However, in recent decades we have fallen well short of providing anywhere near the number of new homes needed. Indeed, the gap between housing demand and housing supply in England has widened, especially for affordable homes. The shortfall is now set to get much worse. With housing production at an 80-year low, the housing supply backlog is likely to approach 1 million by the end of 2010.

This unprecedented level of under-supply has serious social and economic consequences, not least in pushing up housing waiting lists and overcrowding to record levels. The lack of new homes will hamper economic prosperity, exert considerable upward price pressure, exacerbate wealth inequalities, constrain public service delivery, and thwart homeownership.

As a result of the mortgage famine and the economic downturn, housing completions in 2009 are likely to be under 100,000, a 40% drop from the recent peak. While housing supply has fallen, demand has increased. We now need to build at the rate of at least 250,000 new homes a year to match annual population growth, and at an even higher rate to replace our ageing housing stock and meet the accumulated backlog. The supply-demand shortfall for 2009 alone (excluding the backlog) is likely to be around 150,000 homes – equivalent to the size of Nottingham.

The housing market is showing early signs of recovery, and house prices could return to 2007 levels within five years. But, because capacity in the housing sector has been dramatically reduced, it could (without sustained public intervention) take at least seven years for housing production to get back to pre-slump levels, let alone match housing needs.

The Government has reacted quickly to the housing crisis, and its emergency ‘Kickstart’ programme is helping. But more action is needed to help boost supply and ensure that we continue to build more sustainable homes in mixed communities, not the mono-tenure housing of the past.

While there are no quick fixes, the Government (and its main delivery agency, the Homes and Communities Agency) should consider the following measures:

- Maintain public intervention and investment in both private and affordable housing at current levels. Cuts in the total housing budget (which support new supply) risk creating a major housing crisis at a time when the economy is starting to recover.

- Take more action to boost mortgage availability and help for creditworthy buyers (especially first-time buyers), including a new ‘National Home Deposit Savings Scheme’ and the extension of Stamp Duty thresholds for first-time buyers only.

- Ensure that more land is released and that land supply is better managed to increase the supply and variety of new homes and to reduce the percentage of apartments in future output. It is important to protect green belt and maintain brownfield targets, but there will be a need for the release of more greenfield sites – especially in high-demand areas.
Accelerate the release of public land and make more land available for the creation of new public-private housing delivery vehicles.

Give greater support for local authority land deals (where councils offer land at low cost or in lieu of a share of a development) and help with establishing new Local Housing Companies and other joint ventures.

Improve the planning applications process, along the lines of the recent Killian Pretty review, including extending the period for existing planning consents. Avoid any major planning reforms which would create uncertainty and disrupt supply.

Ease the impact of regulation through support for rescheduling Section 106 agreements and adjusting the housing tenure mix to improve viability. Also review ways of easing the impact of future regulations on new housing supply.

Give further support to grow the private rented sector, including new tax incentives to increase institutional investment and support for alternative new housing models, such as Community Land Trusts.

Ensure that councils have the skills and expertise they need for new council building, and that production of council homes is additional and not at the expense of housing associations or private output.

Enable councils to secure rental incomes from new build (and future sales to private buyers) to support the use of new funding models, such as Accelerated Development Zones and other tax incremental financial schemes.

Recent proposals on dismantling the Housing Revenue Account could provide extra funding for new build, although much depends on the scope of the reforms and how housing debt is reallocated.

Strengthen the role of the Homes and Communities Agency in risk-sharing partnerships and co-funding of new financial tools to support housing-led growth.

Encourage new entrants to the sector through tax incentives or special land deals, including extra help for the emerging self-build sector.

Resource a major campaign to inform and raise awareness about the need for major new settlements and more new housing generally.

The analysis, commentary and recommendations in this report are predicated on a series of discussions with over 100 senior representatives from across the housing sector.
Section 1

Introduction

“We conclude that the only policy lever available that both moderates long term house price growth and improves housing accessibility, is housing supply.”

Housing Requirements and the Impact of Recent Economic and Demographic Change. National Housing and Planning Advice Unit, 2009

All the mainstream political parties have stated that they want to increase the supply of housing. They offer different policy approaches, but share a commitment to creating a more flexible and sustainable housing market. Our politicians also share a belief in the merits of homeownership and understand the need to provide an adequate supply (and mix) of affordable housing, while protecting the countryside and open spaces. Moreover, there is a general acknowledgement that housing supply directly influences economic development and labour mobility, and is a critical factor in underpinning investment confidence and tackling deprivation and wealth inequalities.

However, since the 1960s and 1970s (when housebuilding in England regularly exceeded 300,000 annually) production has steadily declined, and most notably for council housing – which witnessed a dramatic reduction in subsequent decades. The growth of housing associations has been unable to offset this shortfall in the provision of social housing. All governments since the early 1980s have failed to meet new housing need, let alone replace our ageing stock. There has been a significant investment (mainly through the Decent Homes programme) in refurbishment and improvements in housing welfare, but levels of new supply have consistently fallen well short of meeting demand and need.

Housebuilders and housing associations have consistently struggled to meet government’s overall housing targets. Private housebuilding completions in England have been relatively static over the past 30 years, averaging about 130,000 per annum. This is below the peak averages of 180,000 per annum seen in the 1960s and well below potential. Private output (completions) did increase from 2003, with a steady improvement to 153,000 in 2007, but is likely to fall to around 70,000 in 2009 owing to the credit crunch and mortgage famine.

In contrast, new affordable homes produced by local councils and housing associations, which averaged over 130,000 per annum in the 1950s and 1960s, have seen a steep downward trend since the 1970s. Production has averaged less than 30,000 per annum since the mid-1980s, slumping to 13,000 in 2003. However, there has been a good improvement since then, with new completions at 26,000 in 2008 and more expected in 2009. These official figures for affordable housing, however, do appear to have some overlap with social homes built by housebuilders for Registered Social Landlords (RSLs) (mostly through Section 106 agreements). The degree of that overlap is possibly around 10,000 units, including conversions. Nevertheless, the overall supply trend is significantly down over recent decades.

The quality of housebuilding has undoubtedly improved since the high-rise ‘ghetto blocks’ of the 1960s and 1970s, but policy-makers have failed to find solutions to significantly increase long-run supply – which has consistently fallen short. Housing development, particularly brownfield development, has become more complex, more
demanding and much more costly. The national picture has also become complicated by regional variations, with some parts of the North and Midlands showing over-supply and high-demand areas in the South suffering chronic under-supply.

According to the Audit Commission ‘none of the national targets for building new market and affordable housing set in 2007 will be met, and council housing services will come under increasing pressure’ (Building Better Lives: Getting the Best from Strategic Housing – Local Government. Audit Commission, 2009). On a more positive note, there is now a wider recognition that we need to move the supply debate beyond simple targets and numbers to encompass place-making and creating sustainable, mixed communities that people want to live in.

Nevertheless, new housing has become much more controversial, with local opposition to new developments prevalent in high-demand areas – the National Housing and Planning Advice Unit (NHPAU) reports, for example, that 51% of homeowners and 31% of non-homeowners would oppose more homes being built in their area (Public Attitudes to Housing 2009. NHPAU, 2009). A similar public view was evident in a YouGov poll in 2007 for the New Homes Marketing Board: 80% of those polled felt that action was needed to address the housing shortage, but over 40% were not in favour of new housing in their area. Inevitably, such attitudes and the political sensitivities surrounding them complicate housing supply solutions.

Following the groundbreaking Review of Housing Supply by Kate Barker in 2004 the Government introduced a package of reforms, including changes to the planning system, new regulations, new funding systems and various tax breaks and incentives to build (especially in dedicated housing ‘Growth Areas’). These measures have helped to boost capacity and output of both private and affordable housing.

Unfortunately, since 2007 and the onset of the credit crunch the trend has been reversed. This year the construction of all new homes is likely to be under 100,000 – the lowest level since 1924. Moreover, this position may well become the supply-side norm as government funding falls away (constraining the supply of affordable homes) and lenders continue their more cautious and risk-averse lending strategies (constraining both demand and supply of new private development).

Although annual new supply normally accounts for only between 1% and 2% of the nation’s total housing stock, it does make a very significant contribution to meeting housing need and helps to improve choice, increase mobility and improve affordability. It also employs over a quarter of million people (in the housing sector and its supply chain) and can create better and more prosperous places. Moreover, failure to address the growing shortfall in supply will inevitably cause significant economic and social problems.


Latest projections issued by the Department for Communities and Local Government (CLG) (Household Projections to 2031, England. CLG, 2009) suggest that the number of households in England will increase from 21.1 million in 2004 to 26.6 million in 2026 and over 27 million by the end of the decade (with population growth as the main driver and one-person households accounting for much of the growth).

These projections suggest an annual rate of household growth in England from 2006 to 2031 of 252,000, with the largest concentrations of households in London and the South East and high annual average household growth elsewhere, particularly in parts of the North and Midlands.

The latest projections would, according to analysis from the TCPA based on population projections (‘New and higher projections of future population in England – a first look at their implications for households and housing’. TCPA, 2008, and ‘Weighing up the official household projections’. TCPA, 2009), imply that we will need to produce 275,000-280,000 new homes each year. According to the NHPAU, still higher levels – over 300,000 – would be necessary to restrain the projected long-term rise in house prices.

While the supply of publicly subsidised housing has dramatically reduced since its peak in the 1950s, the actual demand for all housing, and especially affordable housing, continues to increase. This is not least because of the growing (and ageing)

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of households thousands</th>
<th>Change 2006-2031</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
<td>2016</td>
</tr>
<tr>
<td>North East</td>
<td>1,110</td>
<td>1,201</td>
</tr>
<tr>
<td>North West</td>
<td>2,931</td>
<td>3,221</td>
</tr>
<tr>
<td>Yorkshire &amp; the Humber</td>
<td>2,181</td>
<td>2,494</td>
</tr>
<tr>
<td>East Midlands</td>
<td>1,849</td>
<td>2,138</td>
</tr>
<tr>
<td>West Midlands</td>
<td>2,237</td>
<td>2,454</td>
</tr>
<tr>
<td>East</td>
<td>2,371</td>
<td>2,715</td>
</tr>
<tr>
<td>London</td>
<td>3,178</td>
<td>3,516</td>
</tr>
<tr>
<td>South East</td>
<td>3,447</td>
<td>3,838</td>
</tr>
<tr>
<td>South West</td>
<td>2,211</td>
<td>2,529</td>
</tr>
<tr>
<td>England</td>
<td>21,515</td>
<td>24,107</td>
</tr>
</tbody>
</table>

population, the growth in single-person households and higher net immigration; but it is also due to rising prices keeping traditional homeownership out of the reach of increasing numbers of people. This need will also intensify in the short term as a result of the credit crunch and rising unemployment.

Even if the population projections are revised downwards (if, for example, net inward migration rates turn out lower), the figures still suggest an increase in the number of new homes needed of around 245,000 per annum – above the Government’s 2020 target of 3 million new homes (214,000 per annum).

The demand for private (market) housing is, in the main, shaped by the level of economic activity, the relationship of earnings to house prices and, today crucially, the availability, cost and terms of mortgage finance. Nevertheless, under-supply adds more pressure on demand, especially in areas where the backlog has significantly increased.

Table 2
Household projections by household type

<table>
<thead>
<tr>
<th>Household type</th>
<th>Number of households</th>
<th>Change 2006-2031</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
<td>2016</td>
<td>2026</td>
<td>2031</td>
</tr>
<tr>
<td>Marital status</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Married couple</td>
<td>9,395</td>
<td>9,115</td>
<td>9,129</td>
<td>9,179</td>
</tr>
<tr>
<td>Cohabiting couple</td>
<td>2,188</td>
<td>3,031</td>
<td>3,574</td>
<td>3,804</td>
</tr>
<tr>
<td>Lone parent</td>
<td>1,663</td>
<td>1,852</td>
<td>1,976</td>
<td>2,021</td>
</tr>
<tr>
<td>Other multi-person</td>
<td>1,446</td>
<td>1,648</td>
<td>1,816</td>
<td>1,914</td>
</tr>
<tr>
<td>One person</td>
<td>6,822</td>
<td>8,460</td>
<td>10,178</td>
<td>10,899</td>
</tr>
<tr>
<td>All households</td>
<td>21,515</td>
<td>24,107</td>
<td>26,674</td>
<td>27,818</td>
</tr>
</tbody>
</table>

Private household population

| Average household size        | 2.32     | 2.23     | 2.16     | 2.13     |
| persons/household             |          |          |          |          |

The fall in supply is not new. National housing production has been on a declining trend since the late 1970s, notably for social housing, which once accounted for over 50% of total housing output. The collapse in new build council housing was particularly dramatic, and the shortage was exacerbated later by the Right to Buy. The growth in housing associations (supported by housing grant) has partly offset the loss of council housing, but has never been able to make up for the large historic shortfall.

Five years on from the Barker Review of Housing Supply (HM Treasury, 2004) we are entering a period of low volume for the entire housing sector. Private housing development has shrunk to its lowest levels for over 80 years. Although the Government’s emergency housing measures have helped to sustain production of affordable housing at pre-slump levels, the rate of private completions has fallen drastically.

Annual completions in England peaked at 168,000 in 2007/08, after a period of slow but steady increases since 2001/02 (especially in London and the South East). Since the credit crunch and the dramatic reduction in mortgage availability, total housing production has slumped dramatically, with completions possibly as low as 100,000 in 2008/09 when those figures are finalised – well down on anything recorded in previous decades.

All regions have experienced a fall in completions, with the largest declines in the North and the Midlands. The rate of decline has not been so marked in the high-demand areas (London, the South East and the South West), which account for nearly half the total output, but are still well behind their pre-slump peaks. According to CLG statistics, private housing starts in London, for example, fell from a peak of 20,000 in 2005/06, to a provisional 12,000 in 2008/09, while in Yorkshire & the Humber for the same period the fall was from 17,000 to 6,000; in the North West from 23,000 to 6,000; and in the East Midlands from 18,000 down to 5,000.

Given the shake-out in the housebuilding industry and its supply chain, the rate of growth is unlikely to be higher than 10% per annum for the next few years. It may be unduly pessimistic, but according to modelling analysis by the NHPAU, if the housebuilding sector is unable to increase output by more than 5% a year, it would take until 2025 before more than 200,000 homes a year were again added to the housing stock: ‘This will result in a massive under delivery of housing, further amplifying the structural long term under supply in terms of pent up demand and market volatility.’ (Housing Requirements and the Impact of Recent Economic and Demographic Change. NHPAU, 2009)

Whatever the rate of improvement, few housebuilders and RSLs believe the sector can quickly resume delivery at pre-slump volumes, not least because of the lack of finance, continuing lack of mortgages and reduced capacity. On a best-case scenario at 10% growth each and every year it would take seven years to get back to the 2007 completions level. Of course, this ignores the accumulating backlog, which could well reach 1 million by the end of 2010.

Some of the most important factors causing the chronic under-supply of housing pre-existed the recession and mortgage famine, such as the significant reduction in
social housing, the failure of most local authorities put in place their Local Development Framework (LDF), the slow planning application process, and outright local opposition to planned housing numbers by many local communities and some local authorities.

Before the financial crisis the housing market was steadily cooling in response to interest rate rises. This changed dramatically with the onset of the banking crisis. The sudden and severe lack of mortgage finance for private buyers led to a collapse in the housing market, with lending falling steeply to record lows. This was probably the single most important factor in constraining short-term supply. It has had the effect of pushing housing sales well below current demand, and arguably has increased the depths of the recession.

### Table 3
Permanent dwellings completed in England

<table>
<thead>
<tr>
<th>Financial year</th>
<th>All dwellings</th>
<th>Private enterprise</th>
<th>Registered Social Landlords</th>
<th>Local authorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990/91</td>
<td>160,030</td>
<td>132,500</td>
<td>14,580</td>
<td>12,960</td>
</tr>
<tr>
<td>1991/92</td>
<td>155,130</td>
<td>132,050</td>
<td>15,970</td>
<td>7,110</td>
</tr>
<tr>
<td>1992/93</td>
<td>142,460</td>
<td>115,910</td>
<td>23,970</td>
<td>2,580</td>
</tr>
<tr>
<td>1993/94</td>
<td>147,710</td>
<td>116,050</td>
<td>30,210</td>
<td>1,450</td>
</tr>
<tr>
<td>1994/95</td>
<td>157,970</td>
<td>125,740</td>
<td>31,380</td>
<td>850</td>
</tr>
<tr>
<td>1995/96</td>
<td>154,600</td>
<td>123,620</td>
<td>30,230</td>
<td>760</td>
</tr>
<tr>
<td>1996/97</td>
<td>146,250</td>
<td>121,170</td>
<td>24,630</td>
<td>450</td>
</tr>
<tr>
<td>1997/98</td>
<td>149,560</td>
<td>127,840</td>
<td>21,400</td>
<td>320</td>
</tr>
<tr>
<td>1998/99</td>
<td>140,260</td>
<td>121,190</td>
<td>18,890</td>
<td>180</td>
</tr>
<tr>
<td>1999/00</td>
<td>141,800</td>
<td>124,470</td>
<td>17,270</td>
<td>60</td>
</tr>
<tr>
<td>2000/01</td>
<td>133,260</td>
<td>116,640</td>
<td>16,430</td>
<td>180</td>
</tr>
<tr>
<td>2001/02</td>
<td>129,870</td>
<td>115,700</td>
<td>14,100</td>
<td>60</td>
</tr>
<tr>
<td>2002/03</td>
<td>137,740</td>
<td>124,460</td>
<td>13,080</td>
<td>200</td>
</tr>
<tr>
<td>2003/04</td>
<td>143,960</td>
<td>130,100</td>
<td>13,670</td>
<td>190</td>
</tr>
<tr>
<td>2004/05</td>
<td>155,890</td>
<td>139,130</td>
<td>16,660</td>
<td>100</td>
</tr>
<tr>
<td>2005/06</td>
<td>163,400</td>
<td>144,940</td>
<td>18,160</td>
<td>300</td>
</tr>
<tr>
<td>2006/07</td>
<td>167,680</td>
<td>145,680</td>
<td>21,750</td>
<td>250</td>
</tr>
<tr>
<td>2007/08</td>
<td>168,140</td>
<td>144,740</td>
<td>23,100</td>
<td>300</td>
</tr>
</tbody>
</table>

Totals may not equal the sum of component parts owing to rounding to the nearest 10

*Source:* From ‘House building: permanent dwellings completed, by tenure and country’. Live Table 209. CLG. www.communities.gov.uk/documents/housing/xls/323495.xls
The mortgage famine not only impacted seriously on housebuilders, but also on housing associations. Liquidity is slowly starting to improve owing to Government action, but is likely to be constrained for the medium term as lenders work to repair their depleted balance sheets, reduce loan-to-value ratios and increase the price of lending.

The other main causes of the current collapse in supply are:

- **Reduced consumer confidence**: The recession, fear of unemployment and falling house prices directly impact on consumers’ willingness to buy, even if they can afford to do so. With continuing economic uncertainty and the likelihood that any recovery will be gradual, the level of transaction activity in the housing market is unlikely to fully recover very quickly.

- **Reduced productive capacity of the private and social housebuilding sector and supply chain**: The sudden mortgage famine dramatically reduced housing sales, and reduced production well below even current demand. Because of this and the uncertain outlook, housebuilders, and housing associations, have had to severely cut back production and lay off staff. This in turn has seriously impacted on the supply chain. Even when the market improves, it will inevitably take time to increase investment and recover production momentum.

- **High debt levels**: Such has been the speed and scale of the banking crisis and recession that even the most efficient housing providers have seen their debt levels and gearing rising sharply. For many this has meant renegotiating financial covenants and cash availability with their funders, who themselves are under financial strain. Even where unsold stock has now been reduced to manageable proportions, the ability to restart building is often constrained by these high debt levels. Priority is then given to managing the cash position, and simply increasing output inevitably becomes a lower priority until debt levels have been reduced. To some degree this problem has been mitigated by historically low rates of interest, but any rise in rates could present further problems.

- **Fall in the viability of developing land**: The significant fall in house prices has inevitably led to an even larger reduction in land values. This leads to many landowners withdrawing housing land from the market to await an improvement in future values. The current collapse in land values has virtually eliminated the funding available from previously agreed or for future Section 106 agreements (which combined were worth around £4 billion per annum – around half of which was for affordable housing). Reduced income from planning gain to part-fund housing-related infrastructure also undermines new developments. The impact of increased regulatory costs, which has coincided with recessionary pressures, has also significantly affected the viability of development (see the later Section on ‘Impact of regulation’).
Housing is fundamental to the nation’s well-being. A persistently weak supply of housing undermines economic prosperity, exacerbates wealth inequalities, creates social division, constrains public service delivery, and thwarts homeownership. As the Prime Minister said at the time he announced plans to build 3 million new homes back in mid-2007, ‘putting affordable housing within the reach not just of the few but the many is vital both to meeting individual aspirations and a better future for our country’.

A low-volume outlook will inevitably exacerbate the nation’s housing shortage and, despite the current drop in house prices, hamper efforts to make housing more affordable in the future. As Shelter points out, ‘the hiatus in housing delivery during the downturn is likely to constrain further the ability of people to access a decent, affordable home’ (Ground Breaking – New Ideas on Housing Delivery. Shelter, 2009). Government (and local government) will need to ration social housing and face higher costs of placing more people in temporary accommodation.

In 2004 the underlying backlog of homes was around 450,000. By the end of 2010 (on current supply trends and projected levels of household formation) it will be approaching 1 million, and will grow each year until housing production gets close to matching new household formation. Such a widening gap will push up housing waiting lists and overcrowding to record levels. The National Housing Federation (NHF) predicts that housing waiting lists in England will increase by 200,000 over the next two years to over 2 million households (around 5 million people – or half the total of all social tenants). The fall in new build also makes it harder to find homes for vital key workers and makes it much more difficult to create mixed-tenure communities. According to the pressure group Compass’ report Don’t Bet the House on it: No Turning Back to Housing Boom and Bust (Compass, 2009), low supply will severely undermine the

![Real house price trend](source: Nationwide)

**Fig. 1**

**Boom and bust cycles in the housing market – the long-term trend in UK real house prices**
Nominal house prices are converted into current (Q1 2009) prices using the RPI
Government’s targets to reduce homelessness and end child poverty by 2020. The under-supply of housing also has important implications for the housing stock, around 20% of which was constructed over 100 years ago. At current rates of replacement every new home would have to last many hundreds of years.

Some commentators fear that initiatives which are mainly focused on social rented housing, as a way of helping to mitigate the current slump in private housing, could lead to the creation of new mono-tenure estates where the majority of tenants are out of paid work and reliant on housing benefit. Certainly any policy shift away from supporting mixed-income, mixed-tenure communities could widen the housing divide between those with property and those without.

For the time being, the fear of negative equity and repossession continues to hang over the housing market. A YouGov survey for the Chartered Institute of Housing (CIH) published in June 2009 indicated that nearly 12 million people expect to face financial difficulties paying their housing costs over the coming 12 months. The survey also indicates that the recession and credit crunch has caused over 8 million people to delay or cancel their housing plans to move over the past 12 months.

Over the next few years housing development is expected to be smaller scale, and to primarily focus on land that is less complicated to develop and where infrastructure costs are minimal, or where there is little need for government gap-funding or subsidy. This may well adversely impact on those places that have become dependent on housing as a lever for regeneration.

Increasing the supply of homes is a key priority for the Government. The recent revised Public Services Agreement 20 (‘Increase long term housing supply and
affordability’) states that by March 2011 ‘there will be an increase in housing supply in England across all tenures, including increased provision of social rented and other affordable homes as well as market housing, representing good progress towards meeting the government’s ambition of at least 240,000 net additional homes per year by 2016’ (HM Government, 2009).

However, Ministers are now acutely aware of the impact of the downturn on housing supply and accept that CLG will be unlikely to meet its target of delivering 70,000 new affordable homes in 2010/11, including 45,000 social rented homes. It is nevertheless vital that the housing budget for the next three-year spending envelope (20011-14) is at a minimum maintained at current levels. Cuts in the housing budget for new build risk creating a major housing crisis at a time when the economy is starting to recover.

The Government is also aware that the key to a recovery in the private market largely depends on the revitalisation of mortgage availability. It now has such clout within the banking sector, owning significant portions of major lenders, that it could demand a rapid easing of mortgage availability to credit-worthy buyers. It could also speed up the implementation of the credit guarantee scheme recommended in November 2008 by Sir James Crosby (Mortgage Finance: Final Report and Recommendations. HM Treasury, 2008).

Government housing initiatives since 2008

- **National Affordable Housing Programme** – £8.4 billion to increase the supply of all affordable homes (2008-11).
- **Housing Pledge** – £1.5 billion to support existing programmes, including £350 million to buy unsold stock and £400 million brought forward for affordable housing.
- **Kickstart** – £1.06 billion package to deliver 22,000 homes over two years, of which 8,600 will be directly supported affordable homes. 270 bids shortlisted.
- **Community Infrastructure Fund** – £100 million for the Thames Gateway and £200 million for the Growth Areas and Growth Points to support housing developments.
- **HomeBuy Direct** – £300 million shared-equity scheme to help first-time buyers purchase their newly built properties.
- **Housing Private Finance Initiative (Round 6)** – £1.7 billion PFI credits for ten councils to deliver 4,500 new or improved council homes as well as 1,600 new affordable rented homes.
- **Housing Market Renewal Pathfinder Areas** – £35 million extra funding.
- **Eco-towns** – four new settlements to provide 10,000 new homes by 2016, of which 30% are to be affordable homes.
- **Mortgage support** – includes the £44 million Homeowners Mortgage Support scheme and the £280 million Mortgage Rescue Scheme.
- **Stamp Duty holiday** – on properties costing less than £175,000 (until the end of 2009).
Despite falling prices and the recession, the desire to own one’s own home remains strong. Indeed, according to a YouGov survey for the New Homes Marketing Board in 2009, 88% of those polled felt that owning their own home was still a good investment in their future. However, the number of first-time buyers (FTBs) in the total housing market has fallen sharply (from an average of around 500,000 a year between 1998 and 2004, to under 200,000 last year). Their average age has meanwhile increased from 25 a generation ago to 37 years old today.

FTBs now need very much bigger deposits and pay significantly higher interest rates than other buyers. Ironically, despite price falls, many are worse off today than before the recession. They are considered a high-risk group by lenders and, in reality, are low on their priorities. However, no housing market can be sustainable without a healthy FTB catchment. It is in our national interest to help FTBs, many of whom are key workers.

As part of a package to directly assist FTBs, the Government could quickly introduce a ‘National Home Deposit Savings Scheme’, which would reward young people who make consistent and sustained monthly savings towards a deposit on their first home with a tax-free 25% bonus when they reach their saving target. Such a scheme would not only help to re-establish longer-term savings habits (quite apart from increasing lenders’ funding for mortgages), but would also bring obvious benefits to the market. Whatever the mechanics or the level of incentive, such a savings scheme should be a permanent part of the housing finance landscape for the future.

Government should also give urgent consideration to raising the Stamp Duty threshold, for FTBs only, to £250,000.

Some councils (such as Liverpool and London Borough of Lambeth) are focusing more on the housing demand side and are aiming to stimulate market activity by offering low-cost mortgages to local FTBs. The Government is supporting the idea by cutting the minimum interest rate that councils can charge, although it is unclear how extensive the scheme might be.
A continued and acute under-supply of new homes will eventually feed through into upward pressure on house prices and land values. Indeed, along with low interest rates, it was a key ingredient in the excessive house price rises seen up to 2007. As a result, as the general market improves, prices (which have fallen 15-20% since 2007) could well return to those pre-recession peaks within five years.

A resurgence in house prices might be welcomed as good news by existing homeowners and landowners and might also offer short-term relief to the housing sector (helping to repair the balance sheets of the housebuilders and RSLs), but it would be bad news for aspiring FTBs and low-income households, who could be worse off than ever. It would also be bad news for a housing sector looking for a steady and sustainable return to increased output. The NHF speculates that the average house price in England will rise by 20% to £227,800 by 2014 – with the average price at the end of the period being £38,000 higher than the forecast average of £189,800 for 2009. There are widely differing views on this subject, but it is clear that, with severely constrained supply, all the ingredients are there for a strong house price resurgence once the market starts to pick up.

House price rises would also further widen the wealth and social divide between homeowners and others. As Professor John Hills highlights in his report *Ends and Means: The Future Roles of Social Housing in England* (Centre for Analysis of Social Exclusion, LSE, 2007), social tenants are at a disadvantage and cannot compete to buy private housing. People whose parents and grandparents are social tenants will continue to lose out, as housing wealth cascades from generation to generation of owners.

But rising house prices will not affect only those on lower incomes who traditionally have lived in social housing. Buying a home could become increasingly difficult for many of those on higher than average earnings. As a result, worsening affordability of market housing due to rising rates of house price increases and deposit and lending constraints will lead to higher demand for all forms of rented (and intermediate) housing. The challenge will be translating that demand into new supply.

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**Fig. 3**

UK annual house price rates of change (all dwellings), 2007-09

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18 Mind the Gap – Housing Supply in a Cold Climate
Investor confidence in the housebuilding industry remains low, although many commentators believe that it is now at the bottom of the cycle. The sector has benefited from Government initiatives, such as HomeBuy Direct and the Kickstart programme, but most housebuilders are still recovering from an unprecedented 90% drop in their share price. Many are still, for the time being at least, preoccupied with reducing debt and cash management. Supply chains have also been seriously affected, and the banks remain cautious about lending for any new development.

The sudden market collapse, coupled with an uncertain outlook, has led to a serious contraction in the residential housebuilding sector (which comprises around 6,000 housebuilders – although the top six account for 40% of total completions). Housebuilders, large and small, have been forced to lay off more than half of their workforce. Therefore, even when economic recovery begins, it will take some considerable time for the staffing levels, skills and production capacity to recover. This, together with land value write-downs, will inevitably hold back efforts to boost production.

Some of the larger housebuilders look as if they will recover more quickly, but life will be difficult for those which remain highly geared with few forward sales. In any event, most housebuilders are, for the foreseeable future, likely to concentrate on improving profit margins and debt reduction, rather than simply maximising production as a route to recovering profitability and financial strength.

Any further consolidation in the sector is likely, in the short term, to reduce capacity and therefore add another constraint on supply.

There are some concerns that the traditional ‘short-term trader’ business model (whereby the housebuilder buys land, obtains planning permission, develops, and then sells the homes) cannot be reworked – even with a substantial rise in land values. The post-recession market will be certainly be different, but it is perhaps still too early to tell if the sector needs to embrace completely new ‘asset-owning investor’ models (where housebuilders own stock post-construction for rented or shared ownership tenures).

The more likely scenario is that the existing model is not permanently ‘broken’. It will recover, but needs to be supplemented by additional delivery models, some of which – like holding newly built stock for long-term private rental or shared ownership – could be provided by new entrants into the sector, such as property companies. However, the key commercial challenges facing the whole sector will need to be overcome if building all forms of housing is to be profitable and become more attractive to investors.

The current reluctance of banks to lend, and the general uncertainty of the housing market, is, nevertheless, encouraging more housebuilders to look at other ways of working. These include new partnerships or joint ventures where risk and reward are shared with landowners, housing associations and local authorities (such as Local Housing Companies and special-purpose housing delivery vehicles) as well as commercial developers. There will be increasing focus on developing new models of tenure, such as rent-to-buy and build-to-let, or other forms of shared ownership, all of
which demand a longer-term commitment and will help to reduce risk and spread returns over a longer time frame. According to Richard Simmons, Chief Executive of the Commission for Architecture and the Built Environment (CABE), ‘This might even give builders the chance to remedy one of their own complaints: their inability to capitalise on growth in house prices once they have sold to the first buyer… Long-term ownership isn’t always a guarantee of quality, although it does improve the odds.’ (No More Toxic Assets: Fresh Thinking on Housing Quality. CABE, 2009)

The Homes and Communities Agency (HCA), with its extended remit and extra resources, is in a good position to encourage and support these new delivery models. However, there are difficult commercial and administrative barriers in the way. These include the limited powers of the HCA to participate in equity vehicles, and uncertainty regarding the treatment of dividends and capital receipts. Some of the models that have emerged (the Local Housing Company model, for example, which requires private partners to at least match the land value invested by local authorities) have so far proved difficult to deliver in a market of falling land values, increased development risk and a shortage of balance sheet finance.

Few new companies have emerged to challenge the major housebuilders over the past 40 years. The financial returns have arguably not been high enough, or too erratic, to attract long-term investment by new players or institutional investors who view the sector as cash intensive, cyclical and relatively high risk. However, in view of the low-volume outlook, there is a real need to consider ways in which models can be developed and new entrants encouraged, perhaps by offering tax incentives and land deals. Most importantly, however, government (local and central) will need to provide much greater certainty for all housing providers, not least in regard to land availability, planning policies and approvals and regulatory compliance, in order to entice any serious new players into what is, and always has been, a challenging and risky business.

The Government could also offer more support (perhaps in the form of tax breaks and subsidised land) to the self-build market, which is much less developed than in earlier decades or in Northern Europe. The average loan-to-value ratio for self-builders is low and there are few defaults, which should make the sector attractive to lenders. Self-build production has steadily risen, according to unofficial estimates, to around 10% of the UK housing market, with the strongest growth in rural areas. Although the recession has reduced activity, organisations like the National Self Build Association believe that, with the right mix of incentives, production of self-build could be increased to over 40,000 homes (mostly detached).
Many of the large housing associations have their own independent development programmes. However, when considering the wider role of RSLs it is important to remember that around 50% of all affordable social housing is actually built by private housebuilders under Section 106 agreements, for housing association partners. Thus many have well developed public-private working relationships, and their fortunes are often inter-connected.

Housing associations have been hit hard by the credit crunch. Many of the larger associations raised extra debt to acquire land for development at the top of the market and have been damaged by the collapse in their own private sales and falling land values. Faced with difficult cash flow and sales problems, many housing associations have become more reliant on public subsidy (the HCA, for example, has offered some cash-strapped associations 50% of land purchase costs if they guarantee to build more).

However, the RSL sector has recently increased completions and has continued to expand its range of housing types. After a period of zero growth (between 1999 and 2004), output of all types of affordable housing then rose steadily to around 40,000 last year. According to the NHF, housing associations accounted for 38,000 homes last year, of which an estimated 23,000 units were new build.

From the mid-1990s onwards, around 33% of all affordable (and social rented) housing was provided by RSL acquisitions of existing homes. In the following period up until the housing slump, the trend was towards more new build, rather than acquisitions. For example, in 2007/08 new build accounted for 81% of all affordable housing, its highest proportion in 20 years. This pattern may change if more of the emergency housing funding from the HCA is used by RSLs for acquisitions in the second-hand market, rather than new build. Thus it could have a negative effect on the new affordable housing supply.

Additional Government funding for new affordable homes has been welcomed by the NHF, which claims that housing associations could deliver up to 50,000 homes by next June. However, there are real concerns that production of publicly subsidised affordable housing will begin to fall back sharply after 2011 owing to anticipated and significant capital spending cuts. This is quite apart from the impact on projects where previously agreed Section 106 agreements are no longer viable owing to the collapse in land values. Many will have to be renegotiated and new sources of funding found.

Although there is considerable caution in the sector and nervousness about the levels of future grant funding, some housing associations see the current crisis as an opportunity to develop a differentiated business model which is less reliant on grant funding, planning gain and sales of market homes. New risk and reward-sharing partnerships with local authorities and housebuilders are beginning to emerge, seeking to develop a wider range of more flexible tenures for those now likely to be excluded from current social housing and traditional homeownership.

Tighter loan-to-value ratios for aspiring homebuyers have in recent years boosted demand for housing associations’ new shared-ownership homes, which for many aspiring first-time buyers is now the only way to get a foot on the housing ladder. The new HomeBuy Direct scheme (which provides FTBs with an equity loan worth up to 30% of the value of the property) is expected to boost sales of equity share housing.
It is hard to imagine now that less than 50 years ago local authorities in England were building over 150,000 homes each year, often equivalent to over half of all new supply. Since then, the annual rate of council housebuilding has dramatically fallen to under 500 units. This demise in council housebuilding has had a severe effect on the supply of social housing, particularly since the housing association movement has been unable to make up the shortfall.

While few would advocate a return to the low-quality, high-rise, mono-tenure council housing of the 1960s and 1970s, policy-makers are now looking to local authorities to play a much bigger (and more interventionist) role in helping to increase the supply of new affordable homes. According to a survey by the Audit Commission, ‘80% of chief executives cite providing affordable homes as an objective of their housing strategy. This is the most common objective across all types of council. Objectives such as improving health and well-being, tackling worklessness and improving energy efficiency achieved relatively few mentions.’ (Building Better Lives: Getting the Best from Strategic Housing – Local Government. Audit Commission, 2009)

Support for ‘new housing localism’ complements the strategic role of local authorities as ‘place-makers’ and providers of more mixed-tenure communities. It is also more in keeping with the pro-active developer role of councils in Northern Europe, particularly in the Netherlands, France, Sweden and Germany. According to the Local Government Association (LGA), ‘Increasing the stock of council houses would shift the balance of low-income tenants towards lower-rent council housing, reducing the housing benefits payable to them without impacting negatively on their spending power. It would also allow councils to house homeless families more quickly, reducing the need to provide expensive temporary accommodation for extended periods.’ (Local Housing – Local Solutions: The Case for Self-Determination. LGA, 2009)

The Government (and the HCA) is encouraging local authorities (and ALMOs – Arm’s Length Management Organisations) to establish local housing partnerships, and has set an initial target of 13,500 council-built homes for rent by 2010/11. Although less than a third of the total target for social renting and under a quarter of all planned affordable homes, this is still a high level to achieve from a flat base.

There are a number of obstacles in the way to delivering a step-change in council housebuilding. For example, not only are housing resources likely to become very tight, but most local authorities are short of funding (owing to the recession and the collapse in Section 106 incomes) and are limited in the scale of prudential borrowing they could access to fund the non-grant funded element of construction costs. They also lack the necessary development expertise, and there is some nervousness about councils taking on the financial risk of providing housing (and in particular for market and intermediate housing, necessary for creating mixed communities) and concern about adequate funding of housing-related social and physical infrastructure.

According to Anna Turley of the New Local Government Network (NLGN), ‘At first glance [a return to housebuilding by local authorities] seems an inviting proposal: they have land to build on; [they] are a safe and stable investment vehicle and can invoke their prudential borrowing powers to secure the necessary finance... However, substantial barriers remain and unless central government is bold enough to undertake

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serious and substantial reform as a matter of urgency, this could simply be a good opportunity to ensure a multiplicity of provision that will never get off the ground.’ (‘Back to the future?’, in Ground Breaking – New Ideas on Housing Delivery, Shelter, 2009)

In order to support new build, some local authorities (with HCA support) are also seeking to buy up land banks and offer land at below market rates as part of their contribution to Local Housing Companies (LHCs) or housing delivery vehicles. LHCs offer, in theory, an alternative funding model, but it is unclear whether councils are best placed to bear the financial risks as master-developer. The current model was conceived in a market of rising land values and often assumes a level of equity in the market and an appetite for development that have both been eroded by the downturn. While these types of model do contain the ingredients that can support development that would otherwise not have taken place, it is likely that the model will need some further development and the ability to attract grant funding if it is to remain attractive to local authorities and attract private sector funds.

It will take time for local authorities that embark on new build programmes to develop their capacity and capability as commissioners – let alone as developers and housebuilders. According to the Audit Commission’s recent review of the strategic housing functions of councils, a third of all councils still lack the skills to understand and influence housing markets. Furthermore, even in areas of high housing need not all councils are willing to prioritise new housing (often due to strong local opposition to new developments), and there is often a reluctance to specify within local plans where housing will go.

Local authorities (and ALMOs) cannot compensate for the huge shortfall in local private housebuilding, but they can help by offering land at nil cost (in lieu of a share in the development) and can help to reduce project costs and the levels of grant needed to support affordable housing.

Even for small-scale development, councils will need extra help to ensure that they have the necessary skills and expertise for new council building. However, it is essential that any production of council homes is additional, and not at the expense of housing associations or private output.

To encourage more activity, councils are seeking:

● More housing investment: As part of its response to the housing supply crisis, the Government is allocating more of its housing capital programme to local authorities. This has helped to unlock some key mothballed sites. However, there is real and understandable concern that funding will be significantly reduced as the Government cuts back on its capital spend after 2011. In addition, it is unclear to what extent local authorities will be able to secure additional funding from new CLG proposals that allow councils to retain (and borrow against) the rental incomes from any new homes they build and from the total receipts from the Right To Buy scheme (possibly worth around £1.5 billion) and from future house sales. Securing rental incomes from new build (and future sales to private buyers) could support the use of new funding models, such as Accelerated Development Zones and other tax incremental financial
schemes which rely on ring-fencing future revenue streams from development activity to service debt raised to fund housing costs and upfront enabling infrastructure.

- **Reform of the Housing Revenue Account:** Recent proposals on dismantling the Housing Revenue Account (HRA) could provide extra funding for new build, although much depends on the scope of the reforms and how housing debt is reallocated. According to the NLGN, if councils keep the money for all rents through the HRA they would have an additional £450 million per annum to invest in new build. The process will take time to implement (perhaps two years or more if primarily legislation is required), and it could take another two to three years before it has any impact on supply at a local level. In order to effectively reform the housing subsidy system and enable councils to use their rental stream and asset base (which across the country is only 17% geared) to support more investment, there are also calls to cancel all HRA ‘notional’ debts (around £15.5 billion). While such calls are unlikely to be met, there would need to be floors and ceilings to any HRA reform package to compensate for winners and losers, and alignment of new funding with local housing investment. However, the LGA claims that ‘over a ten-year period, enabling councils to use the additional revenue stream from rental incomes would allow an extra 139,000 social houses to be provided. If councils were also released from the historic debt and allowed to borrow against their assets this figure could increase to 309,000, providing an enormous boost, not only to the housing sector, but also to the wider economy.’ (Local Housing – Local Solutions: The Case for Self-Determination. LGA, 2009)

- **Rewards for supporting housing growth:** Increased population (and demand for new housing) impacts not just on the capital stock of a locality – in transport, schools, health centres etc. – but also on current spending through the need to employ more teachers, nurses, police officers etc. The current system of funding to support such spending actually creates disincentives to embrace development. Data on demographics and housing demand feed into grant decisions long after the changes they record have happened. Furthermore, changes in grant allocation are ‘damped’ to avoid councils suffering sudden changes in income. Therefore, even when increased population has fed through into an initial grant calculation, it will be subject to dampening – which means funding for current spending takes even longer to adjust. The system could be changed so that councils facing housing demand receive much speedier and fuller recognition of the costs that will arise from that demand. The NLGN, for example, is calling for a higher Comprehensive Area Assessment score for councils who undertake large housing developments.

The Conservative Party, in its Green Paper *Control Shift: Returning Power to Local Communities* (Conservative Party, 2009), has pledged to ‘match the additional council tax raised by each council for each new house built for each of the six years after that house is built’. The details of this scheme have still to be worked out. However, given that Council Tax generally accounts for only a quarter of local authority income, the funding raised may be relatively small. In addition, fears have been raised that relying entirely on financial incentives to allow unwanted development could prejudice planning decisions and regeneration initiatives. For example, some areas which urgently need regeneration may disproportionately suffer under such an arrangement.
Increased investment in social and physical infrastructure is vital to the success of the Government’s housing building programme, and is acknowledged as such in the HCA’s concept of a ‘single conversation’ or more joined-up approach to housing growth. According to the OECD, improving investment in infrastructure is a key challenge if the UK’s economic performance is to improve (Global Infrastructure Needs: Prospects and Implications for Public and Private Actors. OECD, 2007). A PricewaterhouseCoopers (PwC) opinion poll in 2007 showed that 81% of public and private leaders in English cities believed that there was an urgent need for increased investment in local infrastructure (Talking Points. PwC, 2007).

However, for many decades the UK’s record on linking development with the funding and delivery of infrastructure (which costs more than housing to build) has been lamentable. Comparative studies on the costs, levels and quality of housing-related infrastructure (see Regeneration in a Downturn: What Needs to Change? Smith Institute, 2009) suggest that the UK lags far behind its Continental counterparts. In addition, much local opposition to new housing is due to the lack of local infrastructure to support it, rather than simple ‘nimbyism’.

The credit collapse and planned cuts in public sector capital spending leave a large infrastructure funding deficit. As the All Party Urban Development Group stressed in its recent report (Regeneration and the Recession: Unlocking the Money. All Party Urban Development Group, 2009), ‘public sector actors will be less able to fund the infrastructure investment that is often crucial to the viability of development sites, particularly marginal sites in deprived areas’. Most of the funding tools to support housing-related development – Section 106, ‘roof taxes’ and local asset-backed vehicles – are now operating well below their potential. In the current climate, revenues from the Community Infrastructure Levy (and Supplementary Business Rates) are also likely to be well below previous expectations.

Recent Government proposals for piloting alternative funding tools, such as Accelerated Development Zones (ADZs) and Regional Infrastructure Funds and other local variants on tax increment financing, are being developed to help bridge the funding gap (and complement other reforms – see the discussion of the reform of HRA in the ‘Council housing’ section above). However, it may take two years (depending on the legislation) to roll out a national scheme. While primarily focused on the financing of enabling infrastructure that will draw in development and increase the tax base from which the upfront financing will be repaid, ADZs do have the potential to create opportunities for housing growth.

In order to support development in these difficult times, local authorities and agencies are having to consider taking on more of the upfront housing-related infrastructure costs. This would be a considerable task, but the pressure to undertake it is unlikely to change in the short to medium term, although greater priority will have to be given to finding different ways of sharing (and minimising) risk – such as bond financing and co-investment to better align capital spending on transport, schools and hospitals with new housing development.
Of course, any set of initiatives aimed at increasing housing output would fail unless there is an adequate supply of land suitable for development, particularly in areas of greater housing need. It is of added concern that much of the new housing in recent years has been achieved through higher densities and more flats rather than increased land release.

The majority of the nation’s new homes can be built on brownfield land. It is important to protect green belt and maintain brownfield targets, but there will be a need for the release of more greenfield sites – especially in high-demand areas. More land release and better management of land supply is absolutely crucial to increasing the supply and variety of new homes, particularly to reduce the percentage of apartments in future output.

However, even when there are available sites, it is difficult when land values have fallen to encourage the release of development land. It is also much harder in a depressed market to encourage building on brownfield sites, or on large greenfield sites, which are more complex and costly to develop.

Compulsory purchase of more suitable sites would be one option, but would be highly controversial, protracted and very costly. Simpler routes need to be explored, including making greater use of some of those which already exist. More use could certainly be made of surplus public land for new homes, although the sites need to be in the right locations and will involve some possible transfer costs (government departments do not normally release land for free). In a bid to de-risk and improve the viability of projects, the HCA also intends to give contractors the chance to build homes on public land in exchange for an equity share in the development. Such innovative approaches, offering companies the land upfront with more security, but lower rates of return, are still in their infancy, but could have merits well beyond the recession.

However, public attitudes towards releasing more land (particularly greenfield land) for housing remain ambiguous and often hostile. A YouGov poll conducted for the New Homes Marketing Board in November 2007 highlighted unfounded fears about land usage. When asked to estimate what percentage of land would be taken up in South East England if 120,000 new homes were built there every year for the next ten years (four times the recent rate), only a tiny proportion of respondents came up with the correct answer, which is less than 2% of the land area. Most respondents thought that number of new homes would take up anything between 3% and 20% of the land area.

Recent public hostility towards the proposed eco-towns reinforces the view that gaining local support is crucial to winning heart and minds for new large-scale housing developments or for even smaller-scale development. While the idea of government zoning large sites around the country for new homes under the auspices of a powerful delivery body (like the New Town Development Corporations – which compulsorily purchased land and were backed by long-term public loans to be paid back by renting out properties) might be attractive on paper, it would probably be extremely difficult to implement in high-demand areas. Nevertheless, government should consider embarking on a major campaign to inform and raise awareness about the need for major new settlements, and the need for housing generally.
In the current recessionary climate, many housebuilders and housing associations have understandably held back from commencing new projects. As a result, existing planning approvals could expire and will need to be renegotiated with local planning authorities (LPAs). Any staffing cut-backs in LPAs (predicated on lower housebuilding) could create delays in processing such new agreements and the expansion of future housing output.

Nevertheless, apart from these short-term issues, there has been a steady deterioration in the performance of the planning application process over recent decades. This has frustrated both users and planning officers and remains a major constraint on all new housing production.

According to the Killian Pretty Review (Planning Applications: A Faster and More Responsive System. Final Report. CLG, 2008), the planning system is already over-burdened and under-resourced, and 97% of all applications were found to be for minor or domestic proposals. This obviously diverts resources from more significant decisions – as highlighted in the TCPA and PwC Permission to Plan report (TCPA/PwC, 2006). Furthermore, planning applications for new housing are now taking four times longer than 25 years ago. After wide stakeholder consensus, Killian Pretty put forward 17 recommendations to improve and speed up the processing of planning applications, the vast majority of which were accepted by the Government.

Clearly, further planning reforms such as these are needed, not least to improve the lengthy pre-applications process, the excessive information requirements and the current unsatisfactory target regime. It should be emphasised that the Killian Pretty Review had a narrow remit and, as such, the proposed changes are to the applications process and are not aimed at producing a wholesale reform of the planning system. Some, however, may prefer a more radical reform of the whole system; but it should be emphasised that any major restructuring of the system in the foreseeable future could create upheaval and even further delays, which could damage the ability to increase housing production.

The possibility of changes to strategic planning (for example the abolition of Regional Spatial Strategies) and removal of housing data collection and target-setting could create extra uncertainty and confusion. Coupled with this, there appears to be a loss of political will in some areas to plan for the homes needed, which also contributes to a slow-down in application decisions. It is important to ensure that the planning and supply arrangements are fit for purpose, with clear objectives against which to measure performance. Housebuilders, RSLs and any new entrants need to have some certainty that national policies and local plans will be in place which allocate sufficient land for housing – particularly as the lead-in times to any development are so long.
Even before the current recession, many housebuilders and RSLs were concerned that their sites would become unviable unless there was some relaxation (or deferment) in local and national housing policy requirements – such as affordable housing, eco-standards, new building regulations, housing density provision, Lifetime Homes, housing-related infrastructure etc. The cost of meeting many of these requirements relied on ever-increasing house prices and land values. Of course, the current housing slump and the collapse in house prices and land values has caused many housing projects to become unviable. The fear is that the increased burden on landowners and housing providers will mean that they have little or no incentive to release land or build new homes on the scale necessary.

Recent estimates from the Home Builders Federation suggest that the growing range of requirements could add as much as £65,000-80,000 to the price of a new home (including £30,000 a unit for affordable housing; £30,000 for low- to zero-carbon housing; and £5,000-20,000 for other regulations), with little or no chance of recovering the cost on the selling price or the rent. This is a key concern now that the recession has impacted so badly on the sector. The counter-argument is that regulatory compliance costs should fall as economies of scale are reached, and that there are equally high negative costs to consumers and society in not pushing for higher standards. Organisations like CABE, the Government’s advisor on architecture and the built environment, believe that the HCA and councils should use their market power to insist that nothing ‘poor’ is built with public money or on publicly owned land. They also argue for much higher space standards before giving developments the go-ahead.

However, there is a growing realisation that these very challenging times require some easing of the burden, if only temporarily, in order to stimulate critical housing production and achieve the scale of housing needed – and to generate the necessary economies of scale. For example, among some local authorities part-way solutions on funding can be found – such as renegotiating and rescheduling Section 106 agreements. Some councils (such as Milton Keynes) are also negotiating claw-back arrangements for when the market recovers. Other options for local authorities (supported by the HCA) include adjustment of the affordable housing tenure mix to improve viability, granting planning consent for an initial period longer than three years, and extending the life of existing consents.
Increasing institutional investment in the private rented sector (PRS) would help to boost supply (particularly in London and other large cities) and bring a better balance and stability to the nation’s housing stock. It would also help to combat the speculative nature of much housebuilding, take some of the pressure off social housing landlords, and encourage greater labour mobility and more professional management.

The demand for private rented homes is increasing (owing to the rise in single-person households and the mortgage famine), but are the large pension funds and insurance companies really willing to invest in large-scale build-to-lets, and what barriers may be holding them back?

Private rented housing appears to be the sleeping giant in housing finance. The sector accounts for less than 5% of new supply – significantly below levels in the USA and much of the EU. During the property boom it was homeowners and private buy-to-let investors who entered the market. At the top of the market buy-to-let (BTL) accounted for nearly two-thirds of all new market homes sales in London, rather than institutional and corporate landlords.

Recent studies of the PRS – such as the Rugg Review, The Private Rented Sector: Its Contribution and Potential (Centre for Housing Policy, University of York, 2008), The Future of the Private Rented Sector (Smith Institute, 2008), and papers from the Joseph Rowntree Foundation, Shelter and the British Property Federation – have concluded that the reasons behind low levels of institutional investment are: the tax burden; ‘costly’ regulation (including the costs of planning gain that funds social housing); low rental yields and much higher and stable returns from commercial property; high reputational risk; high management costs; and lack of scale. According to the HCA, ‘in the current market, on paper, sufficiently high net yields could now be achieved from rental streams without reliance on capital growth’ (‘Appetite for new investment opportunity confirmed by expressions of interest’. HCA, 2009).

The falls in house prices due to the current housing slump, and the resultant higher rental yields, could provide a window of opportunity for more institutions (rather than individual owner-occupiers) to enter the market. The trend is starting to change, notably in London. According to Invista, the property management group, residential investments such as student accommodation and retirement homes are now showing many of the characteristics of commercial property investments – longer leases, strong covenants and fixed uplifts.

New incentives to support investment in the PRS could include:

- **Real Estate Investment Trusts (REITs):** There are currently no residential REITs in the UK. The regime could be reformed (with tax breaks and allowances) to attract institutional investors.

- **Planning:** Introduce a new designated PRS planning use class or licence (through Section 106 agreements) whereby a development would be licensed for a set period to be privately rented. This would aim to create another tenure like social housing.
- **Capital allowances**: Grant PRS owners 100% capital allowances on their tax bills to offset the cost of repairs.

- **Pooling**: Incentivise (through regulation and tax breaks) private investors (BTLs) to join pooled institutional investment arrangements.

The HCA’s new PRS Initiative is aimed at both UK and overseas institutional investors who would acquire homes for rent purely as a long-term investment. According Richard Capie of the Chartered Institute of Housing, the initiative could ‘create scope for a new approach to pricing within schemes and could potentially support a different approach to securing mixed-tenure communities… it could also potentially unlock much needed delivery of new housing’. Investor responses have so far been positive, although it is unclear how new investment in the PRS fits with a social rented tenure (which offers sub-market rents and tenancy in perpetuity). Again according to Richard Capie, ‘We need to be clear about what the different rented products offer consumers and how movement between the tenures (in both directions) could be supported better.’ (‘Cinderella comes to the ball’, in Ground Breaking – New Ideas on Housing Delivery. Shelter, 2009)

There is also considerable scope for institutional investors to fund alternative models of intermediate market housing, such as co-operative affordable housing schemes built on land owned by a community trust (a Community Land Trust – CLT). These hybrid homeownership schemes (supported by the Co-operative movement) would be structured to guarantee long-term returns. The land would be held in perpetuity by the CLT, which would grant a mutual homeownership group the right to build, occupy and manage homes on the land. Members would be lease-holders and would have an equity stake in the entire property portfolio, rather than in individual properties. The homes would be funded by a corporate mortgage loan serviced by members, who would also pay a small deposit and would be able to sell their equity shares when they leave. The HCA is supporting these mutual property unit trust schemes, although CDS Co-operatives acknowledges that structuring these investments remains a challenge (CDS recommends creating a new breed of financial intermediaries for the co-operative housing sector).
Section 15

Conclusion

It may take a long time before the market is able to deliver anything near the quantity of housing we need. The reasons for the market failure go beyond the reach of housebuilders, housing associations, public agencies, planning authorities and landowners. Other factors have played their part, such as decades of uneven regional economic growth, financial deregulation, and changing attitudes to social housing, homeownership and new development. And under-supply of development land with planning permission has been a fundamental obstacle, as has, more recently, a chronic shortage of mortgage availability. However, the uncomfortable truth is that levels of supply are falling, while demand and need are rising.

Without the release and relaxation of credit and further increases in spending on both housing and housing-related infrastructure, it may take a decade or more to get back to pre-credit crunch production levels – which, nevertheless, would still be well below the levels we need. There may be an increase in house prices in the foreseeable future, but this is unlikely – even in the medium term – to feed through into significant and speedy increases in new supply.

The Government has responded to the crisis and acted to help maintain and stimulate housing supply in some areas, but production (especially of private housing) has decreased dramatically. National plans to increase production to over 200,000 new homes each year in England, which looked achievable in previous market conditions, now look extremely over-ambitious. It will take time to replace lost capacity and recapitalise, and it is unlikely that housing associations and local authorities will be able to do more than maintain the flow of affordable homes. There is no indication that they can compensate for the fall in market housing. Meanwhile, investors will continue to be wary of the housebuilding sector, and finance (both public and private) will be in short supply.

The traditional housebuilding business model may be damaged, rather than completely broken, but few expect a sudden return to ‘business as usual’. The focus – among both the public and private sectors – should be on forming new partnerships and creating alternative delivery models which reduce development risk for all and offer a wider tenure mix. These joint ventures (many supported by the HCA) complement past practices and should help to create a more flexible and diverse supply market.

Although the market is still adjusting to the downturn, there are areas of growth. Prospects for the private rented sector, for example, have greatly improved, and new incentives could attract substantial investment in larger-scale residential letting. Although this type of private renting is less suitable for low-income households, it does provide a way of maintaining housebuilding capacity and could, over time, help to deliver the much needed mixed economy in housing supply. Encouragement for the small self-build sector should not be overlooked either.

The HCA has a vital role to play in supporting new partnerships for all forms of new build, but no single organisation – private or public – has the resources, finances or expertise to tackle the huge challenges alone. But Ministers have the power to change policies and regulations, and government departments, public agencies and local authorities have supplies of land suitable for development. Councils and housing associations often have assets that are under-utilised, and housebuilders, RSLs and
contractors have the development and construction expertise. Working effectively together, in partnership, these organisations have the potential to reshape the sector and create a more sustainable and varied market and much greater supply.

In the short term, central government will have to plan for a low-build scenario and accept that more intervention and assistance will be needed if we are to maintain a reasonable level of housing output until market conditions improve. At least for the next few years, policy-makers must assume that a recovering private sector will not build anywhere near enough homes to meet current demand, let alone make up for the growing shortfall. Funding constraints will prevent housing associations from making up for much of the backlog. There is some concern that all this will mean that quality standards will be rolled back and that the much needed emphasis on place-making, rather than housebuilding, will be lost. This need not be the case.

The backdrop of tight public spending and restricted private finance is, of course, hardly conducive to a fast recovery. To a great extent, any revival will ultimately be determined by the continued easing of the mortgage famine and rebuilding consumer confidence. Nevertheless, housebuilders, housing associations and local authorities are willing to deliver, and capable of delivering, the homes we need at higher quality – but only if government continues to make housing supply and related infrastructure investment major policy priorities.

It is a sobering thought that, whatever short-term action is taken, housing supply is likely to be significantly constrained by many factors over the foreseeable future. It seems to us that the key is to take the necessary short-term action to prevent housing production from falling further, but, in parallel, put in place a range of measures which will boost and sustain housing supply as the economy recovers – and enable it to push on and achieve national housing targets which, so far, have proved elusive.
Mind the Gap -
Housing Supply in a Cold Climate

A Discussion Paper by David Pretty CBE and Paul Hackett
for the Smith Institute, the Town and Country Planning
Association, and PricewaterhouseCoopers

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