The Case for Boosting the Supply of Sub-Market Housing

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Following the referendum result there are reports that the construction industry and developers are cutting back on investment and there is renewed uncertainty in the housing market. Savills recently reported that it is likely that Brexit will produce weaker buyer sentiment and a fall in housing market transactions, at least in the short term[1]. The most recent RICS Residential Market Survey[2] showed that Brexit has been followed by an immediate decline in inquiries from new buyers and of the supply of new properties for sale coming onto the market. This has been matched by a reduction in agreed sales, all early signs that there is a risk of a weakening housing market. In addition new research commissioned by the National Housing Federation from the Centre for Business and Economic Research (CEBR)[3] also suggests that there is a risk of construction slowdown given the uncertainty created by the referendum result.

While it is not yet clear what the effects will be in the longer term, the government has already decided to suspend its fiscal targets and there is discussion of measures by the Bank of England and the Treasury to respond to the threat of recession.

In these new circumstances there is a strong case for reconfiguring current government housing programmes, which are dependent on an uncertain homeownership market, to boost the supply of sub-market housing, utilise potential spare capacity in the building industry and stimulate the wider economy.

This paper makes the case for such a stimulus and outlines some potential options, and their costs.

How housing investment can boost the economy

The beneficial impact on the economy of extra housing investment is well-established. For example, each additional pound of investment in construction is estimated to stimulate an extra £2.84 of economic output in supply chains and, through the higher spending of employees, and an extra 56p of tax revenues for the Exchequer.[4]

While a significant investment programme requires government grant spending and hence public borrowing, if it results in new homes at sub-market rents then there are long-term savings in public borrowing via lower rents and reduced housing benefit spending.[5]

Compared with other forms of counter-cyclical investment, new housing construction can be 'shovel ready' more rapidly (than, say, new transport infrastructure) and adds more quickly to GDP. It is also an investment area which is less reliant on imported materials, which are now more costly given the weaker pound.[6]

How counter-cyclical investment has been used in the past

Past governments have responded to earlier economic downturns by intervening in the housing market in different ways. For example, in response to the 2008 financial crisis the government increased the HCA's investment programme by £1.7 billion in 2009/10 compared with the previous year, as a deliberate stimulus to construction after the 2007/08 crisis. The bulk of the extra spending was via a 'Housing Pledge' of £1.5 billion over 2009/10-2010/11, of which half was directed towards housing association rented homes, some £240 million to new LA building and the remainder to 'kickstart' stalled building schemes. An important point to note is that two-thirds of the total came from underspending in other departments and one-third from reallocating DCLG spending.[7] Counter-cyclical investment programmes do not by definition require new borrowing. Affordable housing construction output rose to over 56,000 units in 2010/11, partly as a consequence.

Earlier, the Conservative government responded to the housing market recession of the early 1990s with a 'Housing Market Package' administered by the then Housing Corporation, which spent over £500 million in a short timeframe to purchase over 18,000 homes on the open market, almost half being unsold homes acquired from developers. This and other counter-cyclical measures produced the Corporation's biggest ever investment programme in 1992/93.[8] The Housing Market Package helped to place a "floor" under declining house prices and boosted the size of the affordable housing sector just as need for affordable housing increased due to the problems in the home ownership market.

Why more sub-market rented housing is needed now

Government has a target to build 200,000 homes per year. This is at the lower end of a range of estimates of how many houses England needs to build annually, with indications that 250,000 could be needed to meet new needs and as many as 300,000 to address the backlog.[9] There is also a consensus that around one-third of new provision should be non-market housing, given the substantial problems for low-income households of affordability in the private rented sector (PRS) and of access to homeownership, and that this proportion is, if anything, likely to grow as access to the PRS becomes more difficult with the tightening of Local Housing Allowance rates, the benefit cap and other welfare reform measures.[10]

> *'Reduced development of sub-market rental housing will leave a gap of at least 70,000 potential new households each year being unable to access the housing market. That's 350,000 over the term of a parliament. This shows a clear and continuing role for sub-market housing.' Savills (2015).*

Affordability problems (and hence need for sub-market rented housing) are most acute in London. Overall, 55% of new supply is required in London and the East/South-East; but of total demand for sub-market rented housing, 65% is required in these three regions.

Various studies have shown that boosting the supply of affordable homes for rent, in particular, would be popular with the public. A 2014 study found that 57% strongly support more social housing provision and only 15% object to it.[11] A new survey for CIH shows that 80% of people think that renting must be part of the housing mix and 79% believe that young people will have a hard time getting good housing.[12]

Do current government programmes provide the right balance of investment if construction output falls?

As CIH analysis has shown, of total government investment in housing up to 2020/21 of just under £45 billion over five years, only about £2 billion is directed to sub-market rented output. About £6 billion is aimed at shared ownership and Starter Homes, and the bulk at other measures to stimulate the private market.[13] However, even this level of intervention is relatively small in relation to the market as a whole, given that normal new mortgage lending exceeds £200 billion each year. There is therefore a real risk that, post-referendum, market conditions might change and shared ownership, Starter Homes and other elements of the current programme might no longer be deliverable at the scale originally intended. This did of course occur after the 2007/08 crisis when private new-build starts, mortgage advances and transactions all fell.

There is therefore a real risk that the current investment programme will be unbalanced if there is a dip in the housing market, and spending aimed at homeownership products for first-time buyers, in particular, will be far less attractive. In this context it would be sensible to boost supply by redirecting investment priorities towards sub-market rented housing.

What are the options to boost supply?

Broadly speaking, the government deploys three types of direct financial support for new housing supply: grants, loans and guarantees. Grants account for slightly less than one-third of the current programme, loans and guarantees for slightly more than one-third each. In addition, supply can be boosted via social landlords' own resources (capital and revenue) and through planning gain. Government policy (e.g. on rents and welfare reform) also has a potential part to play in facilitating investment.

Alongside investment government is also able to use public sector land resources, owned by both central government departments and local authorities, to facilitate the delivery of new homes. Government has already been working to identify more innovative ways to do this and it is important that this work continues in parallel with a revised approach to investment.

The rest of this paper looks briefly at a range of different approaches to boosting the supply of sub-market rented homes that might now be considered and implemented.

Reshaped Affordable Homes Programme

The new four-year Shared Ownership and Affordable Homes Programme allocates £4.1 billion mainly to shared ownership (S/O) products but also to rent to buy. Part of this will of course by now be committed, although some committed schemes may prove no longer viable as the market responds to Brexit. There is a case for adopting a different approach to the management of this programme to allow a more varied output of homes, including a larger number of rented homes, including some homes at social rents. This could be achieved by offering housing associations more flexibility over the design and mix of their development programmes.

In practice there may be little difference in the cost in grant per home: the current programme has an average forecast grant rate of just over £30,000, whereas the recently ended 2015-2018 AHP had an average grant rate for affordable rented homes of around £24,000 outside London and £37,000 in London. A change in programme mix may not therefore reduce the total output.

At the same time, it would be sensible to encourage part of the revised output to be built at social rents, given that homes at affordable rents put more pressure on HB costs and lower rents assist those in low-paid jobs. Some 1.3 million households on low or middle incomes are spending more than 35% of their income on housing costs, many being dependent on HB. Studies have shown that building for social rent repays its extra capital cost via savings to the HB budget after 20 years.[14] This would require a higher level of grant per home. Recent work by Savills for the JRF and NHF suggested grant rates for what they call 'living rents' at £76,000 per unit in London and £46,000 per unit elsewhere in England – equivalent to approximately 30% (35% in London) of the assumed total cost of each home.[15] Such grant levels are higher than those for homes at affordable rents but carry the strong advantages of long-term savings in HB costs and in providing more affordable housing for those in low-paid work.

Restarted Affordable Homes Guarantee

The Affordable Homes Guarantee (AHG) ran for three years until March 2016 and allocated £2.5 billion towards building 27,000 new homes. The programme was popular, involved a guarantee rather than direct spending and would have been further subscribed if it had been extended. Given that it is a tried and tested product, there is a case for reopening the AHG. Sourcing the finance for a guarantee scheme is obviously less problematic than for a grant or loan scheme, but possible sources might be underspend on either the PRS guarantee scheme (£3.5 billion to 2017/18) or the Help to Buy mortgage guarantee (£12 billion to 2016/17) if they are undersubscribed.

Reshaped HRA Borrowing Programme

In 2017 the £300 million extra borrowing programme for local authorities is due to end. It represents extra borrowing power rather than direct spending, but of course potentially increases overall public borrowing. It is believed to be undersubscribed. In addition to the programme having some criteria that are unpopular with some LAs, they are now much more cautious about taking on extra borrowing. This is because of adverse changes in their forecasts of costs and incomes since the 2012 self-financing settlement, and more recently because changes in government rent policies have drastically affected their capacity to borrow (so that borrowing caps are no longer the constraint they were in 2012).

There is considerable potential in an extended and reshaped HRA Borrowing Programme, combining increases in borrowing caps for individual LAs with exemption from the remaining stages of the DCLG scheme to cut local authority rents, in return for commitments to extra investment in rented homes. Given the headroom within the borrowing cap limits, such a programme could be kept within the Treasury's assumed envelope for LA borrowing.

Projections by CIH suggest that the rent reduction policy which started in April 2016 could reduce to zero the sector's development capacity from their HRA income over the period 2017/18-2028/29. This occurs because the self-financing model generates insufficient cashflow to repay the self-financing debt between those years, and so there is no additional cash to invest. Restoring HRA income to the levels expected before the rent reduction policy would bring capacity back to about 3,800 units per year, assuming that all spare investment capacity went into new build. An offer to LAs to halt the rent reduction policy (so the cuts in April 2017, 2018 and 2019 would not go ahead in those LAs) might therefore generate extra new build output for affordable or social rent of, possibly, 2,000 units per year

at no capital cost to government. It would, however, somewhat reduce the expected savings in the HB budget.

Changes would also be required in the detailed criteria for the programme, and it is suggested that these be reviewed by DCLG with local government representatives so as to produce a revised package that is attractive to those LAs who wish to build but currently cannot do so, and makes maximum use of local resources such as land and capital receipts.

Investment in homes for older people

The scheme for specialist homes for older, disabled and vulnerable people currently aims to spend almost £400 million over the period to 2020/21. There is a strong case for boosting this fund, both to meet growing demand for more appropriate accommodation from older households and also to free-up accommodation for new buyers and renters created by attracting older people to down size or right size.

Research for the APPG on Housing and Care for older people by Demos (2014) highlighted the potential appetite amongst older people for moving to a smaller, more practically and financially manageable homes, including specialist options. However, the ability to do so is hampered by availability of suitable options in the neighbourhoods and localities in which they live (maintaining support networks etc.). In the 1980s around 30,000 retirement homes were developed each year; this has reduced to approximately 8,000 in 2014, in spite of the substantial and growing number of older person households.

Affordable housing and planning policy

The coalition government responded to the need to boost a sluggish market by relaxing planning gain requirements. However, heading into a possible slow-down in the market the requirements to make a proportion of output available to housing associations to buy and let at social or affordable rents is actually an advantage to builders, as they can guarantee selling stock that might otherwise be unsold. It is therefore worth pausing the current moves to switch the emphasis of planning gain requirements to Starter Homes, as of course these might not be saleable in a housing-market recession. Continuing to require social or Affordable Rent output, via housing associations, would help underpin building projects in the near-term. Affordable housing provided via planning gain, with no grant, exceeded 14,000 units in 2014/15, and sustaining this source of new sub-market housing is important even though output is obviously dependent on changing market conditions.

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[1] *Savills World Research (2016) The impact on the mainstream market: Brexit briefing. London: Savills*

[2] *RICS (2016) June 2016: UK Residential Market Survey. London: RICS*

[3] *CEBR (2016) A role for housebuilding in times of economic uncertainty. How investment in housing can help stabilise a turbulent post-Brexit economy. London: CEBR*

[4] *UK Contractors Group (2011) Making the economic case for construction: An examination of the economic impacts of the construction sector on the English regions, Scotland, Wales and Northern Ireland. London: UK Contractors Group*

[5] *Capital Economics (2015) Building New Social Rent Homes: An economic appraisal. London: SHOUT and NFA.*

[6] *Perry, J. (2013) Let's Get Building. Coventry: NFA, CIH, LGA, ARCH and CWAG.*

[7] *CLG (2010) Annual Report 2009. London: HoC Communities and Local Government Committee.*

[8] *Murie, A. (2008) Moving Homes: The Housing Corporation 1964-2008. London: Politico's.*

[9] *See the summary of recent evidence in Commentary Chapter 2 of the UK Housing Review 2016.*

[10] *See both Holmans, A. (2013) New estimates of housing demand and need in England, 2011 to 2031. London: TCPA, and Savills (2015) The Future of Sub-Market Housing. London: Savills.*

[11] *Doron, N. and Tinker, R. (2014) Silent Majority: How the public will support a new wave of social housing. Newcastle: Home Group and Fabian Society.*

[12] *Ipsos Mori poll for CIH, June 2016 (see www.cih.org/news-article/display/vpathDCR/templatedata/cih/news-article/data/Suitable_housing_out_of_reach_for_ambitious_young_people_says_CIH).*

[13] *CIH (2016) UK Housing Review 2016 Briefing Paper. Coventry: CIH, p.11.*

[14] *See for example Capital Economics (2015) op.cit. and Healey, J. (2015) High Aspirations, Solid Foundations. London: The Smith Institute.*

[15] *Lupton, M. and Collins, H. (2015) Living Rents – a new development framework for affordable housing. London: Savills for JRF and NHF.*