Preliminary findings

A tale of two regions

Can low and middle income earners afford to live in the South East?

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moat

About the author

Andrew Heywood is a consultant specialising in research and analysis of housing and mortgage markets. He is editor of the journal *Housing Finance International* and a visiting fellow of the Land Economy Unit of the University of Cambridge as well as a visiting fellow of the Smith Institute. Andrew is currently an advisor to the Treasury Committee of Bromford Housing Group.

In his former role as Deputy Head of Policy at the Council of Mortgage Lenders [CML], Andrew had specific responsibility for leading on social housing issues and on the private rented sector, and also co-ordinated groundbreaking work between the CML and the Building Research Establishment [BRE] on certification standards for Modern Methods of Construction [MMC]. Andrew was on the Governing Body of BRE Global from 2003 until 2009 and on the board of Chelmer Housing Partnership from 2008 to 2011.

Andrew's recent publications in the public domain include *Housing and planning: what makes the difference?* (Smith Institute 2014), *Reselling shared ownership properties after improvements* (CCHPR 2013) and *The Case for a Property Speculation Tax* (Smith Institute 2013). His report for Future of London, *The Affordable Rent Model in London; delivery, viability, potential* has received significant publicity since its launch in June 2013.

About Moat

Moat is a housing association providing affordable homes in thriving communities for people in the South East of England. For over forty years we have delivered high quality general needs homes for social rent, Affordable Rent, retirement and independent living. We also have a strong low cost home ownership offer, with an excellent track record of helping people into home ownership. We are one of the Homes and Communities Agency's development partners and currently develop over 500 new homes per year.

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A tale of two regions is a study of housing affordability in the South East of England. Although housing affordability across the South East is often cited as a serious concern among policymakers, this study has been commissioned by Moat to quantify the extent of the problem. We are pleased to deliver the preliminary findings of this work, with the full report to be made available in November 2014.

The emerging picture...

In spite of high average per-capita incomes, low unemployment and other visible signs of affluence, the South East [SE] region has an undercurrent of real deprivation, poverty and homelessness. Preliminary findings suggest that we are on a trajectory to see these problems become more acute over the next decade.

Untill now, poverty has mostly been restricted to unemployed people and households on low incomes. However, the rising cost of housing is now causing financial difficulties for people on median incomes.

The picture that is emerging from this study reveals that across the SE we are seeing the following shifts:

- A rapidly expanding private rented sector [PRS], that is housing an increasing proportion of poor and benefit-dependent households, without always the resources or expertise.
- An affordable housing sector constrained in terms of new supply as a result of reduced capital grant, further downward pressure on Housing Benefit, and a regulatory system that is unduly restrictive.
- A reduction in development under the 2015-18 Affordable Homes Programme. The programme is underbid nationally compared to the 2011-15 programme, and preliminary analysis suggests that the reduction may be significantly more severe in the SE – by approximately a third.
- Increasingly unaffordable homes for 'Affordable' Rent, which as a tenure, is struggling to balance higher rents with some of the impacts of welfare reform, such as the benefit cap.
- Falling home ownership rates and acute problems of affordability for would-be home owners.
- A significant and rising level of homelessness and acute housing need that is becoming more concentrated in the parts of the region where prices and rents are lowest, as some local authorities discharge their obligations outside their own areas.

Spatial distribution of people on lower incomes

The study analyses the spatial distribution of lower income households, benefit-dependent and economically inactive households, and those suffering both multiple and housing-related deprivation. There are signs that the income levels are becoming more polarised across the region – a trend that was confirmed via interviews with local authorities [LAs] and housing associations [HAs].

There are a number of LAs where even those on median earnings would find it hard to access home ownership or, worryingly, suitable accommodation in the PRS. This tends to coincide with areas where the supply of social housing is relatively poor. Spatial polarisation raises a number of issues:

- The Index of Multiple Deprivation suggests that many of those living in cheaper areas are relatively deprived in terms of general amenities and housing-related standards, which reinforces the cycle of deprivation.
- Interviews with LAs indicate acute pressure on services in the most deprived areas, where employment opportunities and access to transport are often more limited. Again, this reinforces the cycle of deprivation.
- Despite the gradual shift of low income earners to more deprived areas, LAs do not appear to be properly resourced to tackle the problems of those on low incomes.
- It is a concern that the spatial polarisation of households may lead to less sustainable communities.
- Social cohesion may be threatened in the longer term by the spatial segregation of those on higher and lower incomes.

Recommendation 1

HAs are increasingly investing in market activities to cross-subsidise social activities, but are doing so within a heavily constrained regulatory environment. HAs must be given broader control over cross-subsidy, allowing the development of additional social and affordable stock in areas where the greatest need exists. This would also encourage social landlords to develop products aimed at low income earners to take pressure off the PRS, and for higher income earners to promote cross-subsidy. The necessary control could be achieved through changes to the regulatory system to ensure that it does not unduly restrict measured and properly-managed risk taken by HAs to support the delivery of additional stock.

The South East: changing housing markets

The balance of tenures in the SE is shifting away from home ownership as it is nationally. The PRS is growing rapidly at the expense of home ownership but also at the expense of the affordable sector.

Within the affordable sector there has been a major shift in the balance of stock between LAs and HAs, mostly as a result of voluntary stock transfers. However, in spite of an upturn in the level of new LA development in the past two to three years, an upsurge in Right to Buy [RtB] sales following the introduction of enhanced discounts in 2012 means that LAs remain net losers of housing stock – despite Government assurances over one-for-one replacement. Further increases in the discount and a reduction in the qualifying period for RtB (which are in the pipeline) will aggravate the situation. The main problem here is that the loss of affordable stock forces LAs to make increased use of PRS stock to house low income earners. This effectively places the poorest in the most expensive homes (in terms of tenure). This has an obvious impact on the benefit bill.

LAs have also expressed concern at ex RtB stock being transferred into the PRS. This was felt to be exacerbating the problem in that the same properties were being rented out at higher rents and were attracting higher levels of Housing Benefit.

Recommendation 2

There is an urgent need for the Government to reconsider its current policy of expanding RtB. It is clear that RtB sales have always exceeded the rate of replacement in the SE region, and the shortfall appears to be worsening in spite of a commitment to one-for-one replacement. Our view is that funds should be diverted away from RtB and into an expanded programme of shared ownership. Shared ownership can be used to assist households into home ownership, but has proven to be a far more cost effective use of taxpayers' money. Shared ownership allows for the recycling of grant at the point of staircasing and at eventual full sale.

Household projections and housing supply

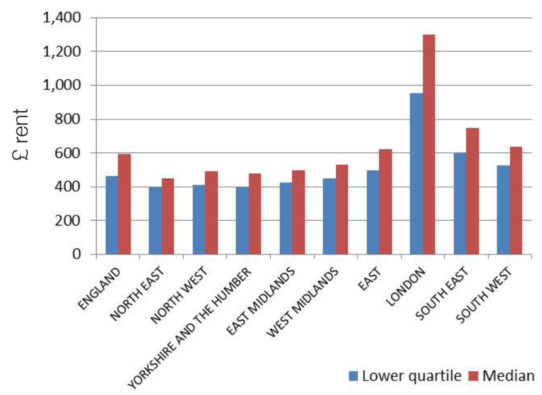
According to household projections, the SE region requires 67,000 new homes to be completed each year over the next decade simply to keep up with demand. The shortfall in the SE is significantly worse than for England as a whole with completions across all tenures totaling only 19,130 homes in 2013-14. This represents just 29% of the homes the region actually needs every year.

Overall, there has been a downward trend in completions across both the private and affordable sectors since 2007-08.

At present it appears that affordable completions are more concentrated in areas of lower prices and rents, but it is not clear whether this will continue. The imperative to focus on viability and to develop more ‘commercial product’ becomes stronger amongst HAs as a response to the low grant environment. This may skew the geographical spread of future affordable development.

With such a dramatic level of under-supply in the region, it is likely that prices and rents will continue to rise rapidly and this will have a knock on effect on the costs of gaining access to Affordable Rent [AR][1] and shared ownership. Homelessness has been rising in the region and there must be a risk of increased overcrowding and even outward migration from the region as the formation of new households is inhibited by constrained access to housing.

Median and lower quartile monthly rents, England and regions (2013-14)[2]



Recommendation 3

The housing shortfall in new supply is worse in the SE than across the country as a whole. The Homes and Communities Agency [HCA] should consider the position of the SE in making decisions about grant allocation and other support to promote affordable housing. In particular, homelessness and overcrowding are areas that will need specific support in the short-term, in order to prevent more serious consequences in the long-term.

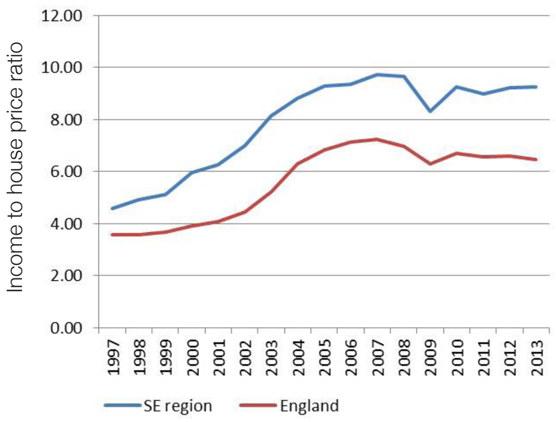
[1] Homes developed under the Affordable Homes Programme, and let at up to 80% of market rent.
[2] Source: VOA.

Home ownership: a receding future for lower income households?

Nationally it has been calculated that approximately 54% of the poor are home owners. Around 60% of low-to-middle earner households are home owners, and around a quarter of those are in the bottom income quintile.

In the SE, home ownership remains a significant tenure for those on below median incomes, but as ownership rates continue to fall, this picture is likely to change over time. The overall trend is away from ownership and into the PRS. Deteriorating affordability is the principal reason for this shift and the relative expense of the SE compared to the rest of the country can be seen in the chart below.

Trend of lower quartile house prices compared to median incomes (1997-2013)[3]



The chart makes concerning reading for a prospective buyer on a median income; on average, they can expect to pay over nine times of their income to purchase a house priced at the bottom quartile in the SE.

In this context, the study shows that the areas closest to London are already unaffordable, even for those on median incomes – in terms of monthly housing costs and the challenge of saving for a deposit.

Mortgaged home owners who are already financially stretched will struggle if interest rates rise. It is likely that a high proportion of people who cannot service their mortgages will drift into the PRS and accelerate the overall trend towards the PRS over the medium term.

Recommendation 4

An urgent expansion of shared ownership across the SE is needed, not only to boost supply, but also to take pressure off other housing tenures. The Department for Communities and Local Government [DCLG] and the HCA should also encourage the investigation and development of alternative tenures, including intermediate tenures and other forms of low cost home ownership.

[3] Source: DCLG, SE region figure, author's computation.

Growth and diversity: the private rented sector

The PRS has expanded to around 700,000 homes in the SE region. Overall, it offers lower entry costs than home ownership and greater flexibility to stay or leave one's home. While the profile of a typical tenant household is that of a younger working household, it is clear from interviews with both private landlords and LAs that a greater proportion of benefit-dependent and vulnerable households are finding a home in the PRS. The quality and stability of private accommodation, especially for low earners, has been a major talking point in recent years.

One particular group looking at PRS accommodation in increasing numbers, are single people looking for a single room. This appears to be in part because of the Government's restriction of Housing Benefit for under 35s to the single room rate, and partly due to an increase in student numbers.

Affordability

Single room accommodation for those on median earnings is reasonably affordable across the region, and households seeking two bedroom accommodation on one income (equivalent to median earnings) would find accommodation in most areas. However, for those on lower quartile incomes, the position is more difficult as lower quartile rents are easily outstripping wage growth.

Households earning lower quartile earnings would find themselves requiring Housing Benefit in many parts of the region, particularly when seeking two bedroom accommodation with one income. LAs and private landlords offered anecdotal evidence of movement of lower income households to cheaper areas where there was less certainty about access to employment and transport.

Impact of welfare reform and the LHA on the PRS

Private landlords have indicated an increase in demand from former social tenants as a result of under-occupation rule changes, especially for smaller homes (one bedroom) of which there is a critical shortage in the affordable sector. However, there is no reliable estimate of the numbers moving from one sector to another as a result of under-occupation.

It appears that the benefit cap is affecting some households in the PRS although private landlords believed that the numbers were modest and that problems for such households were being alleviated by Discretionary Housing Payments [DHPs] by LAs. When, and if such payments are withdrawn, landlords may well become increasingly wary of letting to households likely to be affected by the cap. There is a strong case for liaison between LAs and private landlords over this issue so that future problems can be avoided, or at least anticipated.

Universal Credit was seen as a serious future threat to private landlords. Although landlords have some experience of direct payment to tenants via the LHA, it appears that problem cases in many instances are circumvented by payment direct to the landlord. In addition to concern that tenants would fall into arrears, private landlords were also worried that the DWP would prove an inflexible administrator. There was a strong suggestion that private landlords would become more wary of letting to benefit-dependent households as a result of the introduction of Universal Credit.

Less frequent re-assessment and lower annual rent rises under the LHA have weakened the commitment of landlords to let to households in receipt of Housing Benefit.

If there is a significant shift by landlords away from low income households, the consequences (in terms of availability and choice of accommodation) could be very serious given the growing importance of the PRS for this group. Increases in overcrowding, illegal or covert subletting by rogue landlords, and homelessness would be the most likely consequences.

Meeting needs: standards and regulation

Overall, the picture that emerged from the PRS and LA interviews was one of a sector meeting reasonable standards for the majority of tenants, but struggling to provide the level of support that would be required by many of the poorest and most vulnerable households who have traditionally been housed by the social rented sector. It was also clear that for some landlords maintaining their commitment to these groups was a matter of balancing their personal commitment against viability considerations, exacerbated by high property prices and the benefit system.

Planning orders have restricted the conversion of family homes into HMOs (houses in multiple occupation – eg. shared houses) across much of the SE. Despite the intention of protecting the ‘family’ character of local areas, LAs are potentially restricting the provision of accommodation for which there is a genuine need.

All interviewed LAs operated an HMO licensing scheme. Some also operated additional or selective schemes. While all LAs reported themselves as satisfied with their HMO and other licensing schemes, they offered no detailed assessment of how they were effective in raising standards. In contrast, private landlords expressed themselves as critical of licensing. While not all were opposed to licensing in principle, there was a belief that only law-abiding or compliant landlords were actually ‘caught’ by licensing while the bad landlords simply avoided the schemes.

Institutional investment?

The chimera of institutional investment has hovered over the PRS at least since 2009. In spite of initiatives by Government, the prospect of large-scale investment still appears elusive outside of the student sector.

Private landlords interviewed for this study were aware of corporate/institutional investment in the student sector but did not believe that rental returns were high enough to attract such investment across the sector as a whole. Overall, the study has found little evidence that there might be sufficient institutional investment in the PRS in the medium term to change its strong reliance on individual landlords using buy-to-let or other loan finance.

Additional security

A common plea from LAs was that tenants in the PRS should have greater security of tenure and that there should be a legal framework to moderate excessive rent increases (without putting off potential investors). There was support for the concept of a three year tenancy, and private landlords were not against greater tenant security in principle. Landlords were keen to stress that tenants who stayed for longer periods were usually more profitable to the landlord. However, in practice landlords wanted the ability to end a tenancy that had broken down. Landlords also pointed out that mortgage lenders currently insist on assured shorthold tenancies being used as a condition for granting a loan.

On rent increases, landlords did not object to ‘built in’ increases along the lines of the continental model but were worried about red tape. Overall, there seemed to be room for compromise on these issues.

Recommendation 5

The PRS is providing homes for an increasing number of very low income and vulnerable households. Private landlords do not, in a significant number of cases, have the resources to support such households. To date, little new funding has been made available to provide support for this group in the PRS, which has the potential to discourage landlords from housing these people in future. We therefore call for:

- A comprehensive review of housing and welfare policies that may result in benefit recipients having their choice of landlord unduly restricted in the future.

- A full revision of the support system for vulnerable residents, keeping in mind that larger landlords (both HA and PRS landlords) are better placed to scale-up support, leading to greater efficiencies. Government must investigate whether such households should be offered additional support via LAs and to ascertain the cost-benefit ratio of such intervention.

Recommendation 6

There are concerns amongst landlords over the implementation of HMO and other licensing schemes by some LAs. Increased dialogue between LAs, HAs and private landlords to explore the future of HMO licensing would be mutually beneficial to reconcile the promotion of standards with the avoidance of red tape. In addition, there should be dialogue to resolve differences over the use of planning orders to restrict the conversion of family accommodation to provide smaller units.

Recommendation 7

Preliminary analysis suggests a willingness amongst private landlords to look at longer term tenancies and more predictable rent rises. However, it is likely that certain assurances will be necessary to avoid putting off future investment. We therefore call for dialogue between DCLG, LAs, national and regional landlord associations, and lenders to:

- Extend greater security of tenure for tenants, resolving concerns about terminating failing and failed tenancies.
- Investigate whether a framework for predictable annual rent increases could be introduced into the PRS as already happens in a number of European countries and in the affordable sector in England.

The affordable sector

Social rent and the Affordable Rent model

HAs have not depressed AR levels in more expensive areas of the SE in response to the benefit cap, as they have in London. It appears that rents for larger properties are lower as a percentage of a market rent across the region, suggesting that these rents have been held down to ease affordability and to avoid the effects of the cap on benefit-dependent households. The inability to charge higher rents has been a significant factor in inhibiting the development of larger homes. As the level of the cap is not linked to inflation, its effects on development will become more pronounced over time, and this is clearly a concern for HAs and investors.

While the proportion of working households in traditional social and AR homes is rising year on year, traditional social renting still has a majority of benefit-dependent households. Income levels for working households in traditional social and AR homes are broadly similar, but remain significantly lower than single full-time earnings at the lower quartile.

It appears that the shift towards placing a higher proportion of working households in social housing is largely a result of LAs changing their allocations policies during the past two years to give higher priority to working households and reduce waiting lists. While these changes may meet local political imperatives they raise a serious question as to where workless benefit-dependent households will live. PRS landlords have indicated that they may become more reluctant to take these households due to the impact of welfare reform and the problems of offering adequate support. If this proves to be the case, the range of choices available to these benefit-dependent households will diminish progressively as more LAs change their allocation policies. This can only lead to more households becoming homeless or residing in temporary accommodation, and higher rates of overcrowding. There may also be a negative impact on the opportunities for households to move in order to seek work or for other valid reasons, particularly as LAs' allocations policies frequently give higher priority to local households.

While traditional social renting remains affordable for most (although not all) lower income households in the SE, the picture of AR is rather different. One and two bedroom AR homes are broadly affordable for people on median full-time earnings. While rents for single person households on lower quartile earnings tend to be affordable also, the high rent-to-income ratio presents a strong incentive to move to a cheaper area; which is not something that every household is in a position to do. The situation for households on the equivalent of a single lower quartile income looking for a two bedroom home is much more challenging, as median AR levels in 27 areas are above the 35% affordability threshold.[4]

[4] The 35% threshold is a commonly used measure for determining excessive household expenditure relative to income. In this case, it refers to 35% or more of gross earnings used on housing costs.

Sadly it appears that for many working households 'Affordable Rent' is not affordable without recourse to Housing Benefit. There are negative implications here for work incentives and for the exchequer. Nevertheless, the recourse to Housing Benefit goes to the heart of the AR development policy, involving as it does a move from capital subsidy to revenue subsidy in the form of Housing Benefit.

Welfare reform

The low financial risk profile of the social housing sector is critical to ensuring the delivery of the Government's Affordable Homes Programme. The risk created by aspects of welfare reform – whether perceived or actual – has therefore created concern among investors in social housing. This has been reflected by Moody's downgrades of the sector's risk profile in recent years.

Under-occupation rules continue to pose a threat to HA income streams through higher arrears as well as hardship for many tenants who would be willing to move, but cannot be found suitable accommodation.

Unlike the majority of the English regions, the benefit cap does have a significant impact on a minority of AR households in the SE region. However, perhaps the most important effect of the cap is the strong disincentive it creates to develop larger AR homes in the region. The impact is likely to be significant, particularly for the 2015-18 AHP.

Universal Credit continues to cause concern amongst HAs as a potential threat to cash flow and as an additional cost, as tenants are supported in preparing for the change to direct payments. Its most important effect is to potentially encourage a reduction in build capacity as a response to the more challenging operating environment which involves higher arrears levels and bad debt.

Shared ownership: an intermediate option

There were 33,199 shared ownership homes in the SE region in 2012-13. This represents around 10% of the total affordable housing stock in the region. There were 2,155 sales of shared ownership properties in 2012-13. The average value of a shared ownership home is £170,000; this is higher than for any region outside London and reflects higher house prices in the SE. The large majority of shared owners are, unsurprisingly, working households.

A positive factor is that, at present, shared ownership appears to be helping households on below median incomes into home ownership. The median head of household income is around £23,000 and a high proportion of shared ownership is financed on one income, suggesting that many households with an income equivalent to lower quartile full-time earnings are gaining access to shared ownership. Analysis of monthly costs confirms that shared ownership is widely affordable for households in the bottom 20% of earnings and that it is cheaper than buying an equivalent home in full. However, saving for a typical deposit would be a formidable obstacle for many, and the emerging picture from the SE suggests that this will become more difficult over the next decade. It may be that schemes could be developed to make deposits easier to fund, although care would have to be taken to ensure that such demand-side intervention did not simply put upward pressure on prices. Preliminary findings suggest that the biggest drawback attached to shared ownership as a valuable contributor to the affordable housing mix is that there is not enough of it.

Affordable development: at the crossroads

Nationally, the 2015-18 AHP programme is underbid, and the number of proposed new homes is down by over a third compared to the current round. In the SE region, a partial analysis and discussion with HAs suggests that the reduction may be significantly more severe with a significant shift away from AR development. This may be counterbalanced with a shift towards shared ownership with some additional development for outright sale and market renting; although the full extent of this shift is unclear.

It would seem that for the SE region, the additional risks posed by development in an area of high land values and rents may have been partly responsible for a severe downturn in planned development and made AR in particular less attractive. The impact of the benefit cap (particularly in respect of larger homes) and fears about other aspects of welfare reform may also have played their part. In relation to 2015-18 bids, HCA inflexibility in insisting on 80% market rent, regardless of circumstances, may also have contributed to a reluctance to continue development on the same scale as before. It also appears that there may be a progressive overall shift in the distribution of affordable development from poorer to more expensive areas, where higher land values can enhance the opportunity for cross-subsidy.

The implications of a reduced AHP in the SE region will be significant for those on lower incomes. While the impact may not be so severe for those able to gain access to shared ownership, the lowest income and workless households will be worst hit by the reduction in AR development as they look to join the PRS.

Recommendation 8

The Secretary of State for Communities and Local Government should index the benefit cap for inflation. Failure to do so will result in development across the SE region becoming more constrained over time, particularly in relation to larger homes. There may also be a strong case for monitoring the effects of the cap in different regions, to determine whether future levels of the cap should vary according to regional factors such as rents and land values.

Recommendation 9

Although sympathetic to the political imperatives of prioritising working households, there is evidence to suggest that it is leaving vulnerable and benefit-dependent households at risk of deprivation and homelessness. In the cases where these households are accommodated in the PRS, there is every likelihood that the rent to be covered by Housing Benefit is greater – meaning a higher cost to the exchequer overall. Allocation policies are most effective when housing need takes precedence, with other imperatives following thereafter. There is a strong case for DCLG to review its direction to LAs on this issue, reversing the unintended consequences of the policy.

Recommendation 10

As significant numbers of working households across the SE require Housing Benefit in order to sustain AR tenancies, there is a need for a review of the appropriate balance between capital and revenue subsidy to develop new homes. We support the CBI's stance[5] that there is a strong case for spending more on capital grant for new homes, resulting in lower rents for those households that need them, and reducing reliance on Housing Benefit.

[5] CBI, Housing Britain: Building New Homes for Growth, September 2014, p.24.

Homelessness: compounding the crisis?

Homelessness can be viewed as the most serious symptom of a lack of affordable housing. Homelessness is on the rise in the SE region and LAs are increasingly using the PRS to discharge their homelessness obligations. This is therefore another conduit through which vulnerable and very low income households are finding their way into the PRS and another example of how the poorest in society are being housed in inappropriate tenures. Interviews with private landlords suggest that they are aware of lacking the resources and expertise to provide adequate support for this group, which may lead to higher care costs down the line. Welfare reform is also making some private landlords less willing to house those who depend on benefits.

A further disturbing development is that many LAs are 'shipping out' households in priority housing need to cheaper areas, sometimes long distances from family and community and not always to areas where job prospects and transport are adequate. It also appears from interviews with LAs that it may be common practice to fail to inform the LA whose area is the recipient of these households (and who will have to provide additional resources/support in consequence).

Recommendation 11

DCLG must collect comprehensive data on the incidence of 'shipping out' and should then move to place a binding obligation on local authorities to adequately support households who are moved to cheaper areas. The obligation must include:

- The creation of a standard that places the onus on the outbound LA to measure the impact of the move in relation to job prospects, access to transport, family and community.
- The obligation that LAs who dispatch households must inform receiving LAs of the move, giving those councils the authority to charge compensation for the provision of an appropriate level of support.