UK Residential – Autumn 2018

SPOTLIGHT
Savills Research

Affordable Housing: Building through cycles

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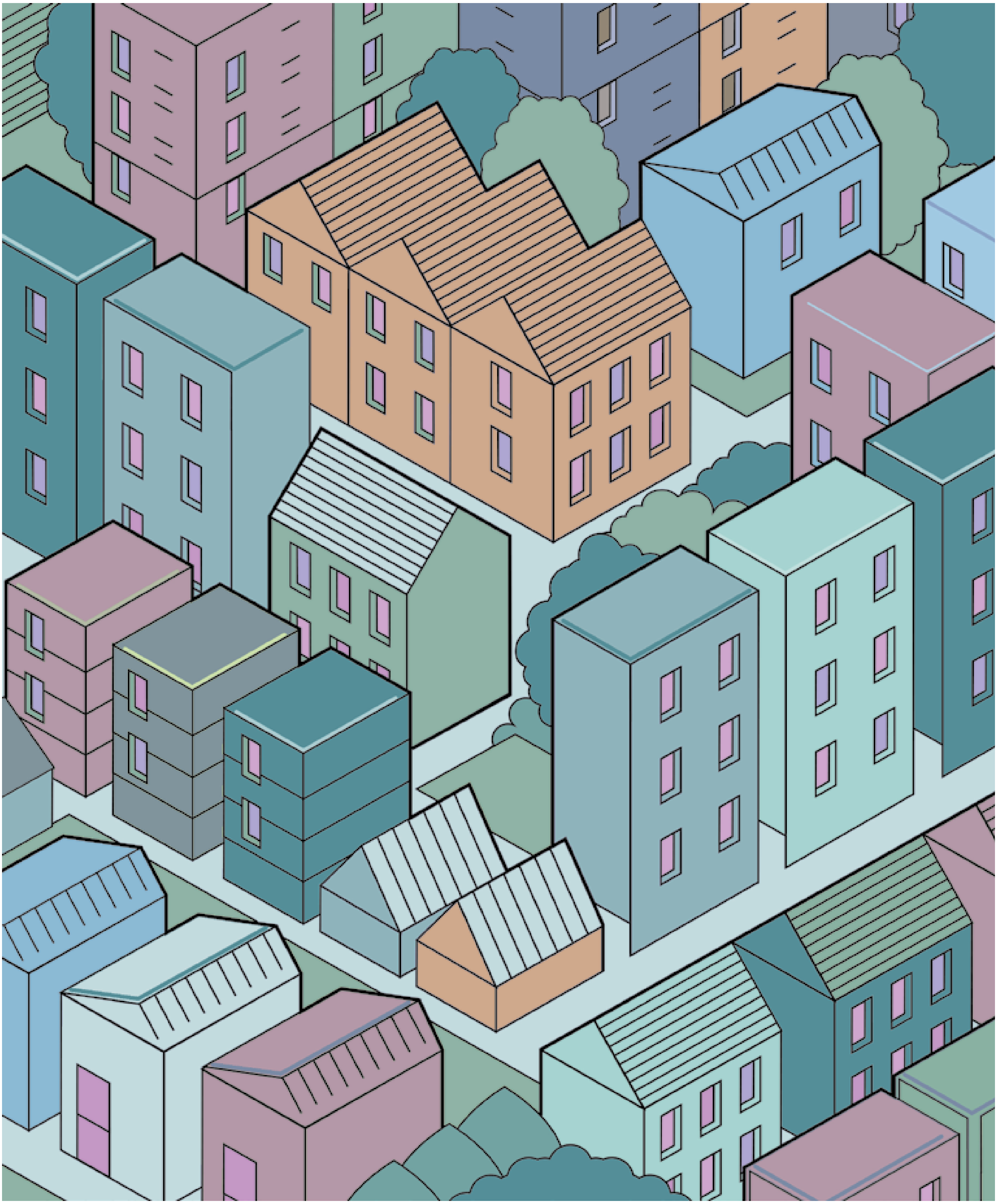


Market risks ● Benefits of grant ● Sourcing the land

In an increasingly favourable policy environment, housing associations and local authorities have great opportunities to help meet the Government housebuilding target of 300,000 homes per year in England by the mid-2020s. 100,000 of these need to be priced at sub-market levels, according to our 2017 calculations published in *Spotlight: Investing to Solve the Housing Crisis*. But plugging the gap is getting tougher. New approaches to development are needed to combat the unfolding housing market challenges.

Risks and opportunities

Risks

- The number of homes built for market sale by housing associations increased by 24% between 2016/17 and 2017/18. The sector has never been more exposed to a cyclical housing market slowdown. And Brexit may bring risks around cost and availability of resources.

- Reliance on Section 106 to fulfil development aspirations is risky. After the new high of 18,000 additional Section 106 affordable homes in 2016/17, there is little capacity for further increases. But a downturn could cut delivery by 50%.

- House price growth, particularly in London and the South, has generated a high level of cross-subsidy from market sales to fund affordable housing. But forecast growth is much lower for the next five years in these regions. New approaches to delivery are desperately needed if the huge gap in affordable housing supply is to be filled.

Opportunities

- Grant funding can take some of the sales risk out of the cross-subsidy housing delivery model. The more grant, the more countercyclical sub-market rented homes can be built within a development programme.

- Longer term grant funding gives housing associations the opportunity to take a more proactive approach to the land market. Building up a pipeline of land would give the sector more control of future affordable housing supply.

- Local authorities have a growing role to play in affordable housing delivery. The Housing Revenue Account (HRA) debt cap has gone. The number of local authority housing companies continues to grow. More partnerships and collaborations with local authorities may be needed in order to link up development capacity in housing associations and the private sector with the funding and land controlled by local authorities.

Market impact on affordable supply

Three ways in which the housing market cycle will have an impact on affordable supply

1. The housing market is slowing down

Low levels of grant funding, by historical standards, have led housing associations to develop a cross-subsidy model in recent years. The number of homes built for market sale by housing associations grew 24% between 2016/17 and 2017/18. Housing associations are increasingly reliant on proceeds from market development to fund affordable housing through the cross-subsidy model. They have never been more exposed to a cyclical slowdown in the housing market.

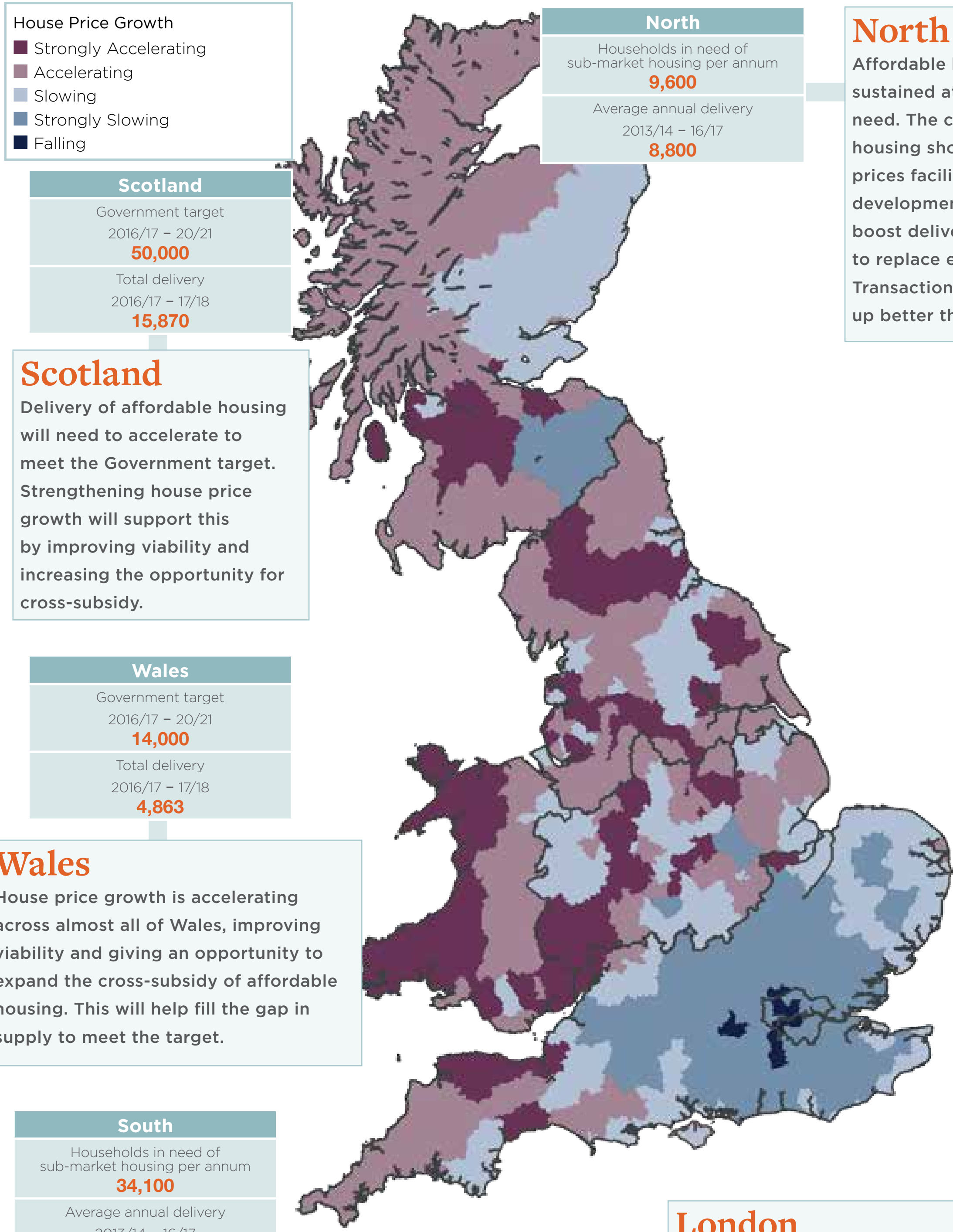
Particularly in London and the South, the cross-subsidy model has benefitted from strong house price growth, boosting the level of cross-subsidy generated. But the housing market is slowing down: price growth is decelerating and transaction volumes are falling, albeit that many new home sales are supported by Help to Buy.

This makes selling new homes on the open market more challenging. Housing association activity is likely to become constrained by a tightening housing market as the generation of cross-subsidy will slow. This cyclical slowdown in house prices is concentrated in London and the South, the areas with the greatest need for affordable housing.

The slowdown in new homes sales rates has created opportunities for housing associations to acquire market sale homes from housebuilders to switch into shared ownership.

Market sale by housing associations increased by 24% (2016/17 – 17/18)

Figure 1 House price growth



Scotland
Government target 2016/17 – 20/21 **50,000**
Total delivery 2016/17 – 17/18 **15,870**

Scotland

Delivery of affordable housing will need to accelerate to meet the Government target. Strengthening house price growth will support this by improving viability and increasing the opportunity for cross-subsidy.

Wales
Government target 2016/17 – 20/21 **14,000**
Total delivery 2016/17 – 17/18 **4,863**

Wales

House price growth is accelerating across almost all of Wales, improving viability and giving an opportunity to expand the cross-subsidy of affordable housing. This will help fill the gap in supply to meet the target.

South
Households in need of sub-market housing per annum **34,100**
Average annual delivery 2013/14 – 16/17 **15,500**

South

As in London, there is a scarcity of affordable housing in the South. In future years, there will be less of an increase in cross-subsidy available. House price growth is decelerating across the South, except in the far south west, and transaction volumes are slowing. New approaches will be required to fill the gap.

North
Households in need of sub-market housing per annum **9,600**
Average annual delivery 2013/14 – 16/17 **8,800**

North

Affordable housing delivery needs to be sustained at around the current level to meet need. The challenge of delivering affordable housing should ease as accelerating house prices facilitate the viability of mixed tenure development. This improved viability should boost delivery beyond meeting net need to replace existing poor quality stock. Transaction volumes in the North have held up better than those in the South.

Midlands
Households in need of sub-market housing per annum **10,200**
Average annual delivery 2013/14 – 16/17 **7,500**

Midlands

House price growth is still accelerating across much of the Midlands, giving an opportunity to expand the cross-subsidy of affordable housing to fill the gap between affordable supply and need.

London
Households in need of sub-market housing per annum **42,500**
Average annual delivery 2013/14 – 16/17 **8,800**

London

Parts of the London market have peaked and house price growth is slowing in the rest. Rising house prices have generated high levels of cross-subsidy from market sales for affordable homes, but this will be harder over the next few years. Lower land prices may generate some opportunities. Affordability remains stretched and transaction volumes continue to fall. In London, an extensive lack of affordable housing supply persists. Radical new measures are needed if this gap is to be filled.

Source Savills Research using Land Registry

2. The role of grant as sales slow

Sir Oliver Letwin noted in his review that there is “virtually limitless” demand for affordable housing. This is where the housing association cross-subsidy model, supported by grant, has the most potential to contribute to housing delivery.

Grant funding can support the cross-subsidy model, helping to reduce sales risk. Figure 2 illustrates a sector-wide cross-tenure delivery programme based on £5 billion of working capital. It shows the greater the amount of grant, the more new homes can be built.

More importantly, it shows that increased grant helps rebalance the cross-subsidy model: it shifts the balance of tenures away from market sale to more counter-cyclical sub-market rented tenures.

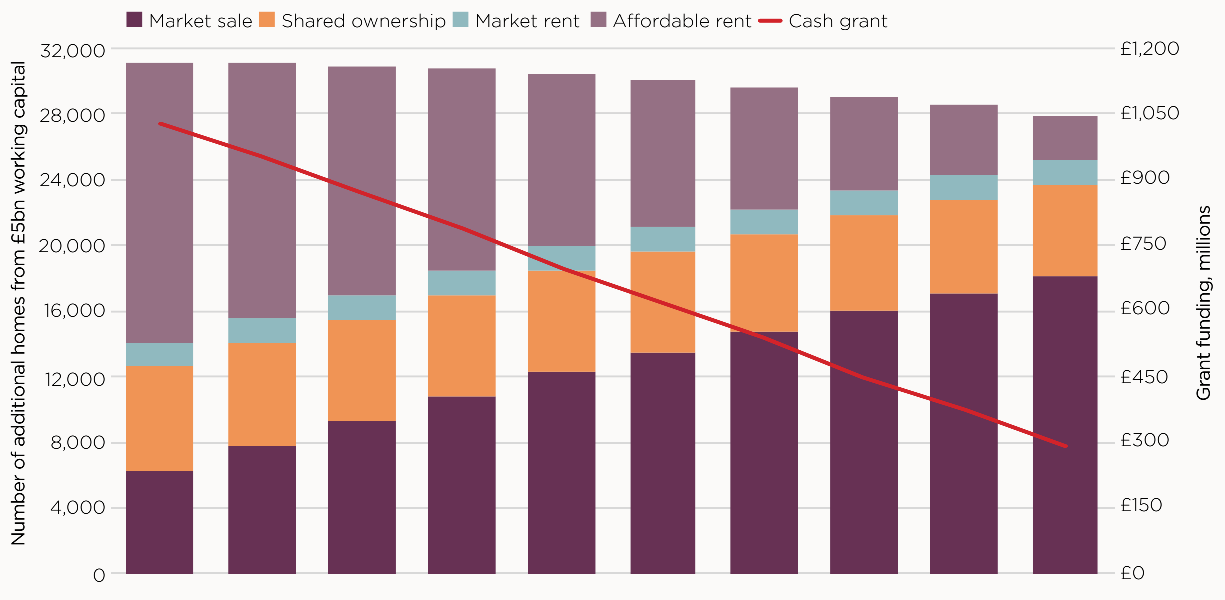
Help to Buy

New market housing completions are closely related to underlying market activity: over the last 40 years, there has been approximately one new market home built for every 10 homes sales.

But currently, the number of new homes being built is increasing, while the total number of homes being sold is falling. This deviation from the long-term trend is due to the competitive advantage given to new build by Help to Buy and the growing number of Build to Rent schemes.

The Chancellor confirmed in the 2018 Budget that the phasing out of Help to Buy in its current form will start in 2021. To keep new housing delivery on track to meet the Government’s target of 300,000 per year by the mid-2020s, the additional sales supported by Help to Buy will need to be replaced. This could be achieved through increasing the use of higher loan to value mortgage products, which are increasingly available, and through a greater diversity of tenure, including shared ownership.

Figure 2 Grant can rebalance a development program away from sales



Source Savills Research

Assumptions: Based on a high-level appraisal of standard greenfield development in a market like Milton Keynes. Assumes nil land value for up to 17.5% of the affordable housing; grant paid at £28k per unit of shared ownership, £50k per unit of affordable rent. This excludes social rent, which would require more grant per unit in higher value markets. In 2016, we calculated that the housing association sector could, in theory, increase gearing supported by existing cashflow to raise £7.4bn of working capital (see *Spotlight: Housing Association Financial Capacity*).

3. Section 106 has limits

The amount of nil grant Section 106 delivery has moved to a new level since 2013. It has increased to over 8% of all housing delivery, up from under 4% in 2012/13 and in the previous peak years of 2006 to 2008.

This has been enabled through stronger sales rates, following the introduction of Help to Buy, and rising house prices and land values. The number of social rented homes delivered by Section 106 has remained broadly constant, but there have been big increases in tenures that require less capital subsidy, affordable rent and shared ownership.

Section 106 is an important source of new affordable homes for housing associations, particularly for those with limited development and construction capacity. But competition is increasing.

New entrants to the market, such as for-profit providers Sage Housing and Heylo have added to demand for Section 106 units. Sage Housing has committed to buying 20,000 Section 106 units over 4.5 years; the number of nil grant Section 106 homes reached a new peak in 2016/17 at c.18,000 homes.

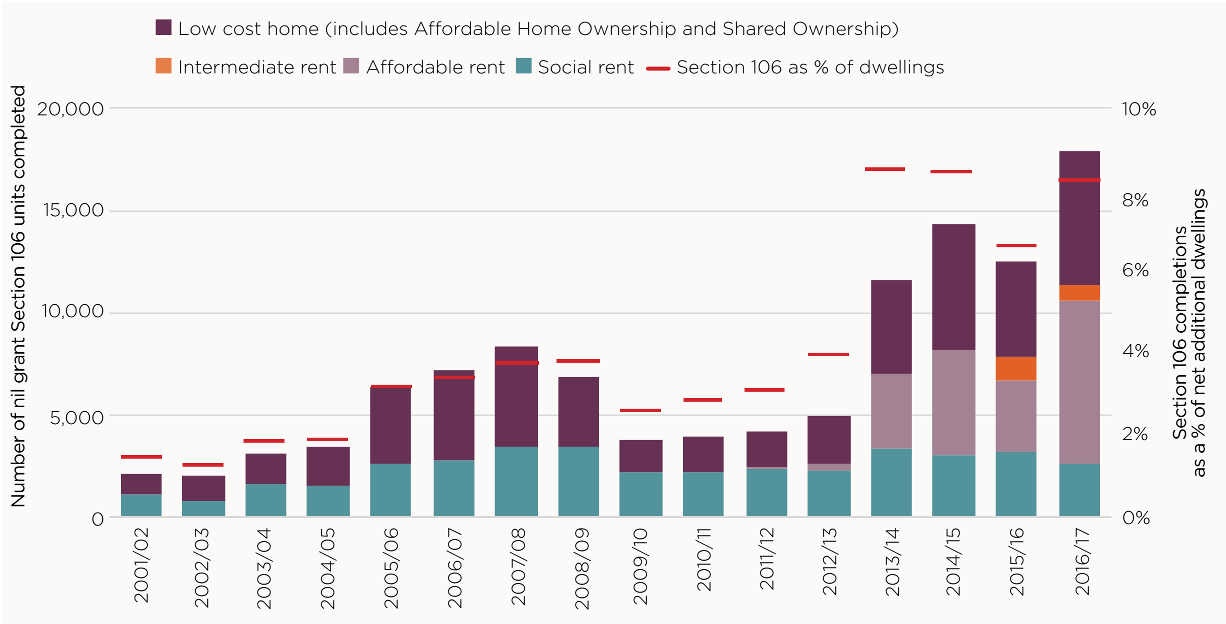
Section 106 is also vulnerable to market cycles. Annual completions fell 50% between 2006–09 and 2009/10. The same fall from current levels would cut delivery to c.9,000 homes per year. This is a major risk for housing associations reliant on Section 106 to meet their development targets, unless grant funding were increased.

In its current form, Section 106 can only be a small proportion of affordable housing supply. Affordable housing delivered through Section 106 has averaged around 8% of total delivery in recent years.

Assuming this level remains constant and the Government housing target of 300,000 homes is met by the mid 2020s, there would be c.24,000 Section 106 completions per year.

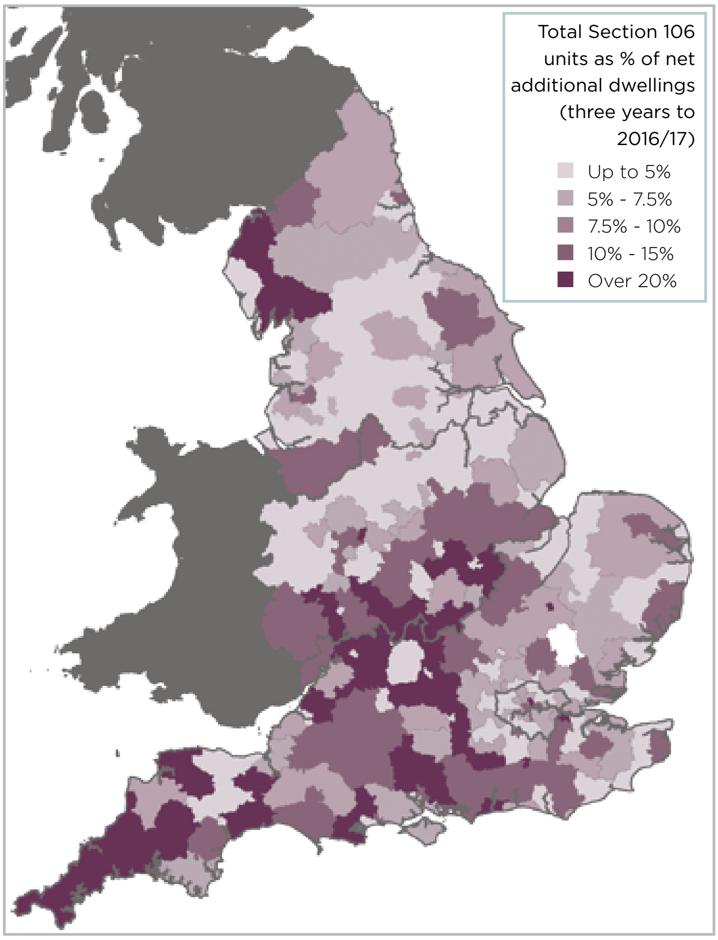
Figure 4 shows the pattern of Section 106 delivery over the last three years. There have been many homes delivered via Section 106 in the middle belt of the country, particularly parts of the southern Midlands where greenfield development dominates.

Figure 3 Section 106 has reached a new high



Source MHCLG

Figure 4 Local variation in Section 106



Source MHCLG

In London and the South East, there has been a huge lack of Section 106 despite high house prices. But high existing use values for residential development land and a scarcity of greenfield land supply limits the capacity for land value capture. Many of the local authorities in London's greenbelt do not have up-to-date Local Plans (Spotlight on *Planning: New Measures To Increase Delivery*), so lack modern policy requirements for affordable housing.

This is beginning to change in parts of London. Residential land values have fallen by 4.9% in central London, as a result of decelerating house price growth and increasingly complex policy requirements (*Market In Minutes: Residential Development Land*, October 2018). Falling residential land values sounds like a good thing for developers, but if they fall below the land values for other uses, then less land will come forward for housing.

Late cycle price growth in the North will create some opportunity for further affordable housing delivery via Section 106 capture of land value. But with lower house price growth forecast over the next five years (*Residential Property Forecasts*) and continued build cost inflation, the trend of an expanding pool of land value uplift is unlikely to continue (*Spotlight: What Next For Housebuilding?*).

What if... Section 106 as a proportion of total delivery remains constant and the Government housing target is met?

Total Section 106 (2016/17) 17,900

Total housing delivery (2016/17) 217,000

= 8% × Government housing target 300,000 = Potential Section 106 completions 24,000

Where's the land?

Longer term funding gives housing associations an opportunity to increase control over their land pipeline

The risks unfolding in the housing market and the scale of ambition required to fill the supply gap mean that housing associations and local authorities need to be more in control of affordable housing delivery if development aspirations are to be met. A crucial part of this is control of a land pipeline for affordable housing. Not surprisingly then in *Savills Housing Sector Survey 2018*, access to land was identified as the biggest constraint restricting development capacity for 85% of housing associations.

Housing associations have tended to enter the land market towards the later stages of development, although there are well known exceptions. This is highlighted in Figure 5, which presents a snapshot of the residential development land pipeline in October 2018.

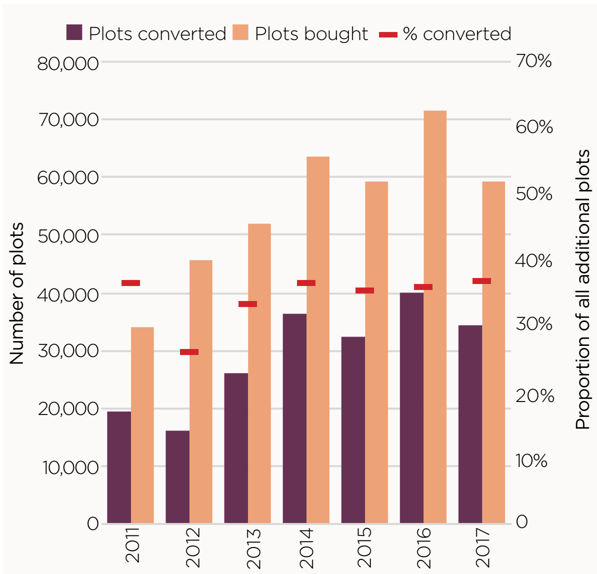
The short-term nature of government funding programmes and policy initiatives has, in the past, limited the capacity of the sector to employ a long-term strategic approach towards land. But the additional £2 billion of funding for affordable housing between 2021 and 2029 provides a new opportunity for the more widespread involvement of housing associations at earlier stages of the planning system, adopting a more land-led approach towards development by building up significant strategic pipelines.

Housebuilders are involved at all stages of the planning process and have a much longer-term pipeline of development land. They have taken a more active role promoting land and control significant land holdings at all stages of development. We have explored the model used by seven of the top ten housebuilders to acquire land between 2011 and 2017.

These housebuilders used a mix of plots purchased with detailed planning permission and plots converted from their strategic pipelines. Converted plots are those that have been transferred from strategic land banks (without planning consent) into immediate land banks (with full planning consent). Their development activity relies upon a balance between strategic land and purchased consented land. 36% of the immediate land pipeline was sourced through conversions from their strategic pipeline during the last three years.

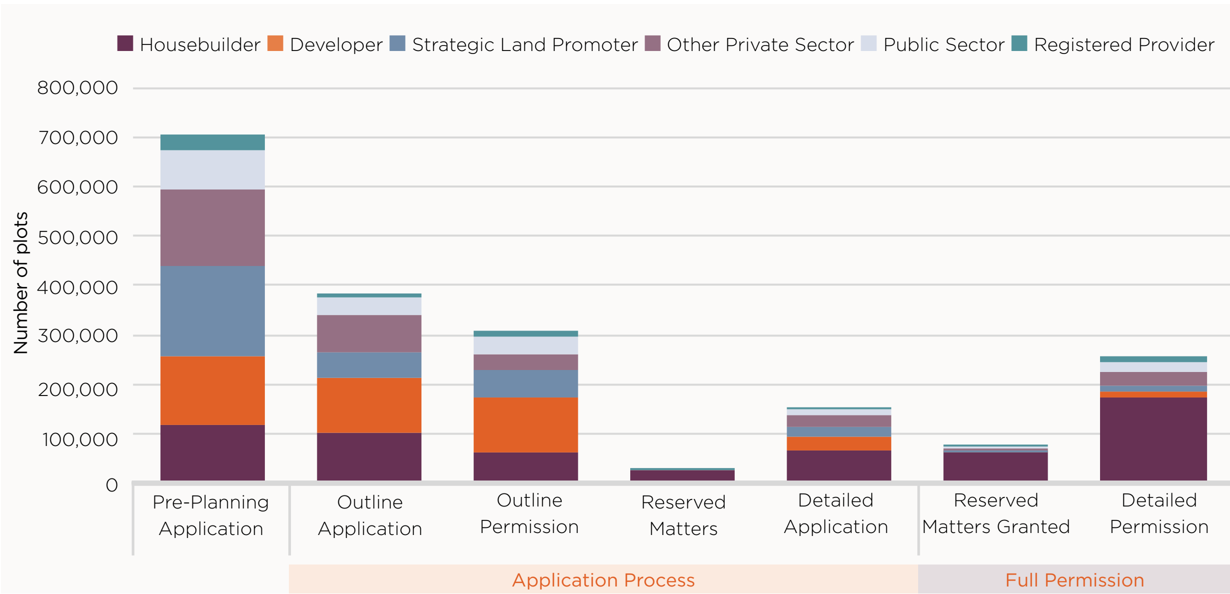
This strategy is intended to provide a buffer against the rollercoaster of the housing market. It also enhances the control housebuilders have over their future development volumes. Housing associations will need to gain more of this control if affordable housing delivery is going to be sustained through tougher housing market conditions.

Figure 6 Housebuilder pipeline management



Source Housebuilder reports: Barratt, Bellway, Bovis, Crest Nicholson, Persimmon, Redrow, Taylor Wimpey

Figure 5 Who controls the development pipeline?



Source Savills Development Database

Local authorities could now build 15,000 homes a year

Local authority opportunities

Is this the start of a new generation of council housebuilding?

In October, the Prime Minister announced that the Housing Revenue Account (HRA) borrowing cap for local authorities will be abolished with immediate effect in England. This removes one of the biggest constraints on council housebuilding.

Local authorities will now be able to borrow more money to invest in larger scale development and contribute significantly to the delivery of new affordable housing. We have estimated that councils could build at least 15,000 homes a year in the long term.

Lifting the debt cap only affects those local authorities with housing revenue accounts, about half of all councils. But there are different routes opening up for local authorities to increase their housebuilding programmes. Over 150 local housing companies have been created, for example.

The next challenge is raising sufficient capacity to fill the gap in development and construction skills. Local authorities need collaborations, joint ventures and partnerships, including with housing associations with whom they share the common interest of increasing affordable housing supply.

Local authorities are significant landowners with major land holdings in their own districts, including land with existing housing on it. The tables show the top ten biggest local authority landowners, categorised by whether they have a HRA or not. Most are active in building up their development capacity.

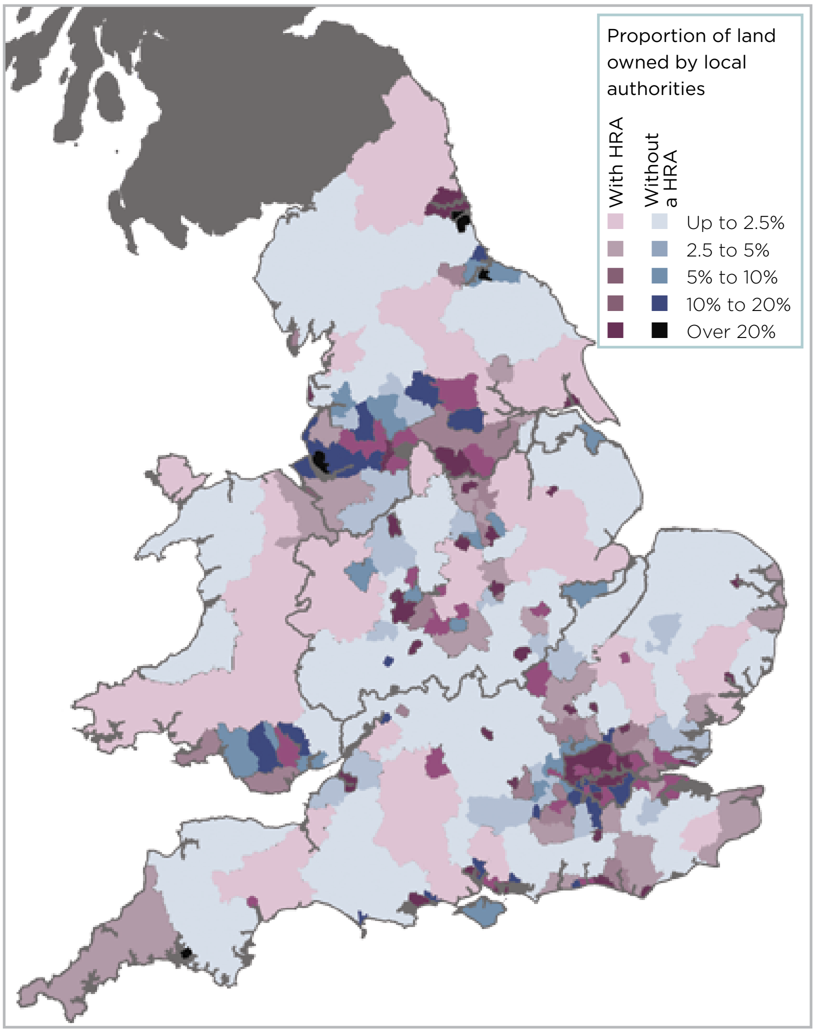
Many questions remain. How much local authority land is developable? Which tenures and types of housing are most needed to support economic growth? What role could estate regeneration play? But a new era of council house building could be just beginning.

Top 10 local authorities
With a HRA
Leeds
Sheffield
Brighton and Hove
Milton Keynes
Manchester
Bristol
Wigan
Hillingdon
Gateshead
Leicester

Without a HRA
Sunderland
Sefton
Liverpool
Bromley
Bolton
Torbay
Blaenau Gwent
Plymouth
Halton
Knowsley

Top 10 based on amount of land owned, selected from local authorities owning more than 15% of their district

Figure 7 Local authority land ownership



Source Savills Research using HM Land Registry

Savills Research
We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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