Pre-conditions for Increasing Housing Supply

Paper by Highbury Group on Housing and the Credit Crunch

Key messages

- A strong sale housing market is essential to deliver increased housing supply. Consumer demand is present but first time buyer difficulties in accessing mortgages are preventing the market operating effectively. Improved access to mortgage finance is essential and if quantitative easing is not encouraging the banks to provide mortgage funding then local authorities should do so either using their own reserves or through setting up Local Housing Funds and taking money from private investors to provide mortgages for first time buyers and low cost home owners.

- Public funding should be concentrated where it can do most good. HCA funds should be concentrated on schemes which demonstrably meet need and can demonstrate a requirement for subsidy.

  Local authorities (and Growth Area Delivery Vehicles) should be pro-active in the land market, assembling sites and undertaking joint ventures with developers, sharing risk and reward in order to deliver a product which meets community need. This will require more effective masterplanning by the public sector and may require use of compulsory purchase

1. The mortgage market

The supply of mortgages remains at historically low levels and access to mortgages is particularly difficult for first time buyers and low cost home owners. (The FSA's proposed new regulatory framework will make this worse rather than better). Without a strong first time buyer market the overall housing market remains weak and demand for affordable housing is increased because people who could otherwise afford to buy cannot access a mortgage without raising a 25% deposit which is prohibitive for young people who do not have rich parents to help them out.

At the same time the return on savings to private investors is now minimal. Local authorities, working alone or in partnership with a bank or local building society, should set up a Local Housing Fund which would use savings from private investors to forward fund infrastructure provision and provide mortgages to first time buyers, low cost home owners, self builders and housing co-ops.

2. Cross subsidy and mixed tenure communities

Mixed tenure development is a proven mechanism for creating sustainable communities. The use of affordable housing targets on privately developed sites has enabled local authorities to increase the supply of affordable housing and to utilise land value subsidy in order to minimise demands on public sector funding. This model is not "broken" as some media commentators have suggested. Falling house prices have meant that the land market needs to stabilise at new levels and have brought problems for speculative developers who bought land at the peak of the market and now cannot sell/develop it without crystallising their loss, but land values are no lower now than they were in 2002 –a point at which the GLA was setting targets for 50% affordable housing.

In London, the South East and East of England where residential land values remain over £2m per hectare[1], housing land in most locations is still more highly valued than any competing use, even with the inclusion of affordable housing, as values for non-residential land have also generally fallen.. As the example below shows, such markets can still support the provision of affordable housing, but to do so will depress land values.

THE LOCAL HOUSING BOND
Forward funding infrastructure and supporting affordable housing provision in an outer London borough or a South East market town

A 500 unit mixed tenure scheme: 325 market units and 175 affordable units (split equally between social rent and intermediate housing)
Development takes place over 2 years

Upfront infrastructure funding of £15m is required. This is provided as short term finance by the Local Housing Bond with payment through a levy on the market housing set so as to provide a return of 6% over two years. A sum of £52,000 per dwelling would be required. If viability appraisal showed that this sum rendered the development unviable then a contribution of "gap funding" from the public purse would be required. The developers do not have to pay interest costs over the two years or raise finance on the open market, although this option is always available to them if they can do so on competitive terms.

£16m is made available from the Local Housing Bond as a source of private finance to the providers of affordable housing. It could be used for conventional affordable housing provision through an RSL or to support the provision of private rented housing for intermediate rent or to fund self-build, co-housing or other alternative forms of affordable housing. As with conventional RSL funding the amount borrowed would be paid back through rental payments.

£76m of mortgage finance would be available to purchasers of market or low cost home ownership housing to provide 90% mortgages through the Local Housing Mortgage, though they would also be able to access mortgage finance on the open market.

Viability appraisal using the Three Dragons toolkit suggests that in a typical Outer London borough such a development would generate a residual land value of between £1.5m and £2m without any input of public funding.

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[1] Property Market Report July 2009 Valuation Office

Outside these regions, where housing land is typically valued at between £1m and £2m per hectare, agricultural land is currently valued at less than £20,000 per hectare suggesting that there is still ample scope to bring forward greenfield sites for housing.

But it will require strong action by the public sector to ensure that any recovery in house prices and housing output is not frittered away in rising land prices and is captured to maximise the benefit for local communities:

- Local authorities should set clear and costed affordable housing targets which allow a land value above existing/alternative use and be pro-active in identifying sites where landowners and developers are willing to work with them to deliver. This may require them to reduce reliance on windfalls (back garden development) and to look to identify sustainable greenfield sites but it will not increase the overall quantum of development and it will retain the quality and diversity of the environment in urban areas.

- The HCA should be very clear that public subsidy will not be used to support inflated land values for greenfield development, but will be targeted at inner urban sites, where housing land values can be negative with (or even without) affordable housing and to ensure the provision of necessary infrastructure so that new homes are not provided without the schools, surgeries and sustainable transport networks to go with them. .

3. Making best use of public funding

The first component is the establishment of a funding regime for social rented, shared ownership and sub-market rented provision which recognises when it is and is not appropriate to rely on market value appreciation or cross subsidy from disposal of existing affordable housing assets. Where affordable housing provision is not viable without public subsidy the simplest approach is to make grant available for affordable housing to meet the capital cost not met by revenue streams, which are capitalised rental income – *at target rents for social rented housing, fixed sub-market rents (maximum of 75% of market rent) for sub-market rented provision- and receipts from initial equity purchases for shared ownership provision.* In effect this means the re-establishment of the Total Cost Indicator (TCI) based grant system that was the basis of the mixed funding regime regime that operated up to 2003 when the Housing Corporation moved to a fully competitive bidding system. The land value component would need to relate to existing use value with a factor to incentivise the release of land for housing provision, but not support inflated values .

In order to reduce the need for public subsidy it is important to reduce total build cost through the provision of land on a discounted basis. In high value areas, land cost can be as much as 75% of the cost of providing a home – in lower value areas it remains at least 25% of cost.

Public sector bodies – local authorities, central government departments, regeneration agencies and the HCA itself should make land available for development, both market and affordable provision, on the basis of taking an equity stake in the appreciation of the market and shared ownership homes. This joint venture approach reduces the cost of providing affordable homes while the public sector retains the long- term benefit of value appreciation in the market component. In some cases it may be more effective for a local authority to develop directly on its own land and only sell market units on completion. Or enter into an arrangement for a housebuilder to build under license. This reduces the developer profit component of cost.

Where land is not owned by the public sector and development is being undertaken by a private developer, a local authority should be able to take an equity stake in the development through planning powers, as an alternative to seeking an initial planning obligation contribution.

4. Estate regeneration

The third component is the need for a new approach to the regeneration of council estates. Estate regeneration schemes which presume high density high value market housing within an estate to generate cross-subsidy to replacement of council housing will generally not be viable in the medium term.

Public sector funding should be made available to regeneration schemes based on grant necessary to meet costs not met by future income streams without reliance on cross subsidy from market components. However equity stakes as set out above would apply to any market components so any value appreciation would be to the benefit of the estate as a whole, in that increases in private residential value would contribute to the costs of environmental and social infrastructure provision, including maintenance as well as initial capital costs. This could be operated through payments into a resident controlled estate regeneration fund.

In some cases a mix of infill redevelopment and modernisation may be the best option rather than comprehensive demolition and rebuild, especially where buildings are both structurally sound and provide adequate space standards. It may also be more cost-effective for a local authority to undertake a renewal programme directly rather than transferring ownership and development functions to a private developer who requires a financial return.

5. Strategic Sites

Large vacant strategic sites offer the possibility of delivering housing of a high standard in quantity, and after a lead in period, quickly. If the land values are held down, and with advantage of scale, developments are more likely to be financially viable (see European examples below). The Government's housing strategy prepared before the credit crunch (Homes for the Future, July 2007) projected the need for 240,000 new homes a year, and targeted 60% of this to brown field sites. In other words, 96,000 new homes a year could be built on Greenfield sites. There is a case for moving ahead on new large sites quickly. Four major growth areas have been identified and 29 local authorities and partnerships covering 45 towns and cities have been named as New Growth Points. These large sites need to be socially sustainable, green and financially viable. This requires specific approaches to masterplanning.

6. Masterplanning

The masterplan will describe the specific uses on the site by tenure and use, the social profile of residents, the design, programme and business plan. A private sector client will naturally place major emphasis on the financial outturn and treat the social objectives as something to be met, leading often to poor results. A public sector client starts with a menu of social objectives with the financial outturn being regarded as important but not paramount. Experience shows this leads to better developments and is the process by which all the post war new towns were built. Private sector lead approaches tend to allow greater land prices to prevail.

A contrast between typically British approaches and European approaches illustrates some of the issues. The land at Kings Cross was in Public Ownership but was given to London and Continental Railways as a financial contribution to the Channel Tunnel connection, denying the local authority the opportunity to control one of the biggest developments in London for many years. Camden Council had to negotiate over a long and extended period to achieve a satisfactory plan, and would have preferred to have had more influence. The approach to the Eco Towns is similar in that all comers were asked to submit bids. Many were shortlisted in the face of local opposition. Because of private sector leadership, social objectives are likely be compromised in the face of financial pressures. At the Greenwich Millennium village a private sector lead scheme, on the site of a previously publicly owned gas works, about 500 sustainable homes have been built in 10 years, while at Hammarby Sjostad in Stockholm 5,000 homes have been built on a similar waterside site over the same period achieving much higher green standards. The government policy of requiring public bodies to sell land to raise cash is partly at the root of the leadership that is now ceded to the private sector.

At *Hammarby*, the Town Council initially bought up the derelict industrial land and conceived the masterplan. They developed the individual sites in phases working closely with developers at each stage to ensure that their social and design objectives were met. Only after the design was complete and the house values identified was the land value agreed. Although the local authority had to cash flow the early design stages, the eventual land receipt reduced the subsidy to minimal values. In *Hamburg*, where the old docks are being redeveloped, the Town Council has made sure that it controls all the land and has adopted a similar approach. Individual sites are tendered with the use defined and the land price set, developers have to compete on quality! This is the basis on which the former New Towns undertook development and it resulted in a mix of speed of development, innovation and quality which has not been matched since.

At *Ammersfoort* in Holland the public authorities capped land (which was not all in their ownership) values at approximately 30% of total value during the development of three new settlements which has already provided over 10,000 new homes (see, Eco-Towns: Leaning from International Experience, PRP and others. Details on a number of European case studies are in the appendices available on the PRP web site). A lesson from Europe is that developing successful new settlements is a long complex process best lead by influential local politicians and chief officers with active government support and with active community engagement only once the basic parameters have been set.

7. Sustainability

To achieve social sustainability it is necessary to make new developments attractive and successful from the start, so that the market in new housing is buoyant. Success breeds success and this will attract new businesses and stimulate private investment and pride in the community. Two considerations are paramount. One is connectivity and the other is achieving a social balance between different tenures and groups of residents and providing for their needs.

Places that are an extension of existing conurbations or are close to them, offer an easier route to connectivity. The possibility of employment is close by, and the existing infrastructure can be added to at relatively lower cost, rather than having to be built from scratch. In the early days when the reputation of the settlement is being created, residents can use existing schools, libraries, shopping and other facilities in the adjoining areas until their own facilities have been built. Good public transport connections at reasonable prices, and both cycle and road access are essential.

The European study found that in the six successful developments social housing was kept to below about a fifth to avoid "residualisation" and to provide cross subsidy from sales. However there was a much greater range of tenures, major private landlords and housing associations provided market rented accommodation and in some cases co-ops were offered sites. By controlling land disposal site by site the local authorities were able to ensure a diversity of developers and avoided the British practise whereby one developer is able monopolise sales and avoid price competition. It inevitably leads low rates of production in order to keep values high. In Milton Keynes all grid squares were expected to provide 25% affordable housing (including both social rent and low cost home ownership) and 10% "alternative" housing options such as self-build and housing co-ops.

Where public authorities market land with planning permission and infrastructure in place, lessening risk, developers are ready to accept profits of around 6-15%, rather than the typical British practice, which is to aim for 25% because of the large planning risks they have to take.

8. Cause for optimism

The goal of housing policy should be to increase housing output not house prices. There is no reason why a fall in house prices should be accompanied by a fall in housing output. In the 1930s although house prices remained below their 1931 peak for the rest of the decade but housing completions rose from just over 200,000 pa to over 350,000 pa. This was achieved through a mix of public investment and private sector initiative, supplemented by a supportive planning system.

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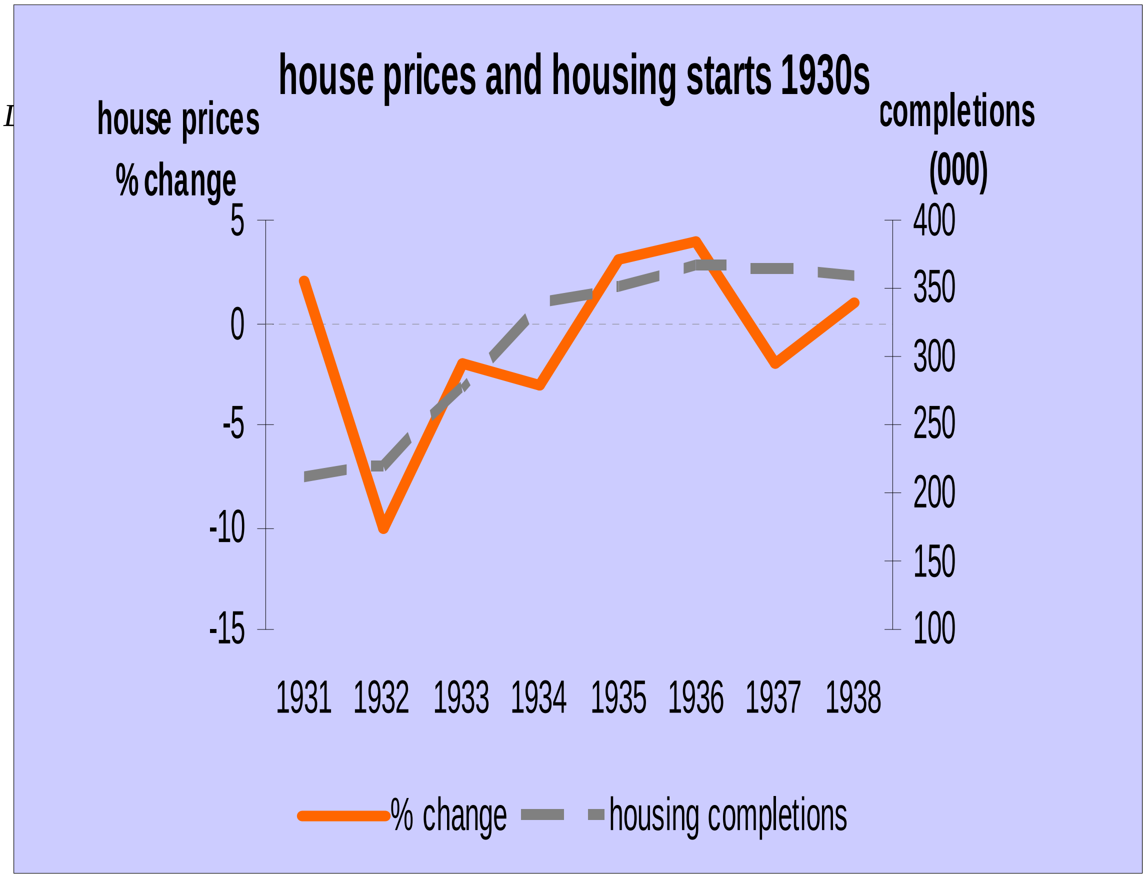
Note. The authors write as members of the Highbury Group but the views expressed are their own and not necessarily those of the group as a whole.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