A MECHANISM FOR MAINTAINING HOUSING TRAJECTORIES AND SECURING IMPROVED QUALITY OF DEVELOPMENT DURING THE CREDIT CRUNCH

SUBMISSION BY

THE HIGHBURY GROUP

TO

THE HOMES AND COMMUNITIES AGENCY

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The Highbury Group

Members

Duncan Bowie,	**London Metropolitan University (chair)**
Kathleen Dunmore,	**Three Dragons (secretary)**
Steve Ongeri,	**Consultant**
Tony McBrearty,	**Consultant**
Angela Housham	**Consultant**
Jo Lavis,	**Commission for Rural Communities**
Kelvin McDonald,	**Consultant to SHELTER**
Peter Studdert	**Cambridgeshire Horizons**
Roy Hinde,	**Bedfordshire Pilgrims HA**
Sarah Ireland	**Bedfordshire Pilgrims HA**
Roger Humber	**House Builders Association/ Circle Anglia Housing Group**
Simon Kaplinsky	**PRP Architects**
Terry Fuller	**Taylor Wimpey**
Julia Atkins,	**London Metropolitan University**

Members of the Highbury Group serve in a personal capacity. The views expressed are those of the individual members of the group and not necessarily of the organisations who employ them. The group is independent and receives no sponsorship.

1. Introduction:

The Highbury Group is an independent group of housing planning and development experts from public, private and academic organisations who have drawn up a proposal to ensure housing and affordable housing output is maintained in the current market context. Many members have experience of the last downturn in the 1989-1992.
This is the first of a series of papers the group is submitting to the HCA. The paper has been prepared in consultation with a wider range of individuals including individuals working for the HCA and its predecessor organisations.

The paper focuses on how the HCA can make most effective use of the full range of its powers and assets.

Against a background of falling housing starts, uncertainty in the mortgage market and almost complete seizure of the housing land market, this paper makes proposals for how the Homes and Communities Agency can work with RSLs and other affordable housing providers to buy land and

- Increase provision of affordable housing
- Improve quality of development
- Maintain housing trajectories
- Help support the construction industry

Now is an appropriate time for RSLs to buy land because the slowdown in activity in the private housing market has reduced the flow of affordable housing coming through cross subsidised S106 schemes. If RSLs are to maintain development programmes they need to find other mechanisms for securing access to land.

Developers have surplus land in their landbanks some of which they need to release in order to maintain cash-flow. Some developers, including the major players, are also interested in moving back into the contractor role in order to reduce risk and maintain workload.

There is an opportunity to acquire land on competitive terms for immediate development to help meet Government targets and for the longer term build a landbank to enable RSLs to maintain a future development programme. It will also help RSLs to respond to the programme approach to investment, which will be pursued by the Homes and Communities Agency.

The Highbury Group therefore proposes a time-limited period during which the HCA would make available an allocated pot of loan funding which would enable affordable housing providers to buy land from developers and landowners. Such land should either have planning consent already or the reasonable expectation of gaining planning consent for housing. Schemes would be expected to be able to demonstrate that they offered better value to the public purse than if the scheme had proceeded as a straightforward mixed tenure developer led scheme or where they resulted in affordable housing becoming part of a development which previously would have been solely market housing because it was smaller than the S106 site threshold. This could be done through

- Provision of additional affordable housing above the plan policy target
- Provision of affordable housing above that agreed in the initial planning permission
- Provision of an improved mix of housing (eg more family housing)
- Improved build quality (eg higher Code for Sustainable Homes standards, increased provision of Lifetime Homes)
- Contribution to development of a sustainable community (eg provision of additional community facilities)

Discussion with local authorities and developers has identified the following types of sites which might be expected to come forward

- Urban brownfield sites which are no longer look viable for speculative development (particularly if the existing planning consent includes a large proportion of flats)
- Small rural sites which were either originally intended as exceptions sites or had an allocation for market housing which is unlikely to sell in the present market
- Edge of town serviced greenfield sites bought by developers for speculative development and now considered unlikely to proceed until the market recovers

This initiative will be of particular value to growth area authorities seeking to maintain housing trajectories, to urban authorities looking for development of prominent sites which would otherwise stand vacant and to predominantly rural authorities seeking to maximise development of affordable housing in villages and market towns.

Although we anticipate that our proposals could bring forward smaller sites within the Greater London area and encourage the development of more family friendly housing we believe that there are special problems with mixed use high density developments which have led housing supply in the capital and we propose to address these in a follow-up paper.

Example: market town in the East of England.

The site was owned by a national developer and had planning permission to provide 58 units of accommodation. The site was first offered to the RSL for £2 m, then several months later for £1.7m. Agreement has now been reached for the site to be sold to the RSL for £761,500 (a 62% reduction in land value).

Previously the development provided 58 units solely as flats on a town centre site. It will now be developed at a lower density providing 37 units, 27% as houses and 73% as flats. The RSL will act as developer and the developer will carry out the works under a Design and Build contract.

Tenure mix will be	27% social rent, 27% intermediate rent (80% of open market rent) 46% Homebuy (at 35% share) .

Given the change in tenure and mix a new planning permission is being sought, but has been favourably received by the local authority.

Example: village site in the East of England

The site is held by a developer through an option which would have provided a land value of £25,000 per unit (or £450,000 for a site of approximately half a hectare).

It is being made available to the RSL at a land value of £20,000 a unit (ie £360,000) and will provide 18 (2-4 bed) units of which 50% will be for social rent and 50% for Homebuy.

The arrangement is that this will form a back to back deal with the builder undertaking the development under license. Such an arrangement levers in a site for affordable housing and enables the developer to stay in business.

Currently the site does not have planning permission and the option had been agreed in the ‘hope’ that it would in time be released for either 100% or predominantly market housing. The landowner and builder recognise that under current conditions this is unlikely to be realised and wish to release the site. As the site will now provide 100% affordable housing in an area where it is in short supply and meets the requirements of a rural exception site the planning authority have responded positively to the proposal.

Example: a portfolio of sites in an Urban Midland location

There are 5 sites in all. There are 250 units in total on 6.45 hectares. All the land has been allocated for housing.

The local plan target is for 30% of the homes to be developed as affordable housing which could include low cost home ownership or intermediate rent.

The house price of a 2 bed terrace was £175,000 but is now £148,000 (a 15% reduction). Book value of the land is £1.25m per hectare (£8m)

An RSL develops the first 1 hectare site for mixed tenure with the developer carrying out the development on a Build under Licence basis. The land value for this site is £800,000 per hectare (a 36% reduction)

The above examples are illustrative only.

2. Meeting the objectives of the HCA

The HCA has wider objectives than either of its predecessor organisations, English Partnerships and the Housing Corporation. It is able to take a holistic approach to development seeking to:

- Support the delivery of new homes
- Secure the delivery of affordable homes
- Accelerate regeneration of under-performing towns and cities
- Improve the quality of existing stock and transform deprived neighbourhoods
- Ensure delivery is economically, socially and environmentally sustainable with good design

It is an approach focused on the needs of communities and people, which seeks to establish long term programmes of activity rather than funding individual projects. It recognizes the importance of place and the need to capture the passion and commitment of individuals within both local authorities and the development sector. Part of the remit of the HCA is to build sustainable development programmes and establish robust communities.

As the Government's lead housing delivery agency the HCA is well placed to take immediate steps to address the very serious effects of the credit crunch upon both the housebuilding industry and new housing provision.

Private housing starts in the first half of 2008 were 27% down on the same period in 2007[1] and are not expected to top 100,000 this year compared with 150,000 in 2007.

A loss in housing output of 50,000 private sector new homes would lead to an estimated loss of over 60,000 jobs in construction and related activities this year with possible further job losses in 2009 and 2010 if output does not recover. Once lost to the industry essential skills are hard to bring back, making it much more difficult (and costly) for output to recover when housing demand picks up.

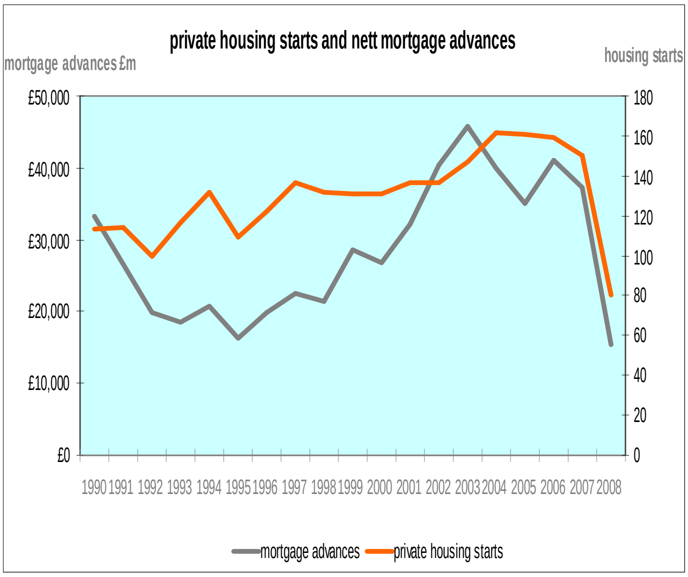

Chart 1 Source CLG live tables

Unlike its predecessor bodies the HCA has a remit to intervene in the national land market and not just in specific locations or with regard to public sector land.

[1] CLG live tables

Land assembly and site procurement/ disposal and compulsory purchase are all part of the HCA toolkit and elements, which are of critical importance at the present time.

This proposal seeks to draw on the powers of the HCA to intervene in the land market, stimulate housebuilding, support the construction industry and provide a mix of affordable and market housing which is geared to housing need.

It will require the commitment of RSLs, developers and local authorities to establish a virtuous circle of development at prices, which reflect current realities and meet local needs. In so doing it should help break the toxic mix of sub-prime mortgages, nervous funders and weakened wholesale funding markets that has had such a grievous effect on both the national economy and the housing aspirations of young people seeking to obtain their first home.

3. Our proposal

The HCA should make loan funding available to RSLs (and other affordable housing providers) to buy land for immediate and long-term development. There is a pool of land available from developers, which could be bought by RSLs and developed to provide a mix of market and affordable housing. RSL controlled development would facilitate the provision of more affordable housing and/or higher quality provision than is specified in current planning consents. It would stimulate the construction industry and help maintain housing trajectories as well as meeting housing need.

The HCA will need to be sure that land purchased is bought at prices, which reflect its value in the current market. One possible mechanism for doing this would be to work from published house price data and to use residual valuation to establish a norm land value for particular house prices assuming a standard proportion of affordable housing based on the target set in the Regional Spatial Strategy or adopted local plan policy framework. (eg 35%). This would provide a regional, sub-regional or local authority based benchmark which would help frame expectations of land values at which the HCA was prepared to support acquisition by RSLs. Alternatively such a calculation could inform the assessment of regional budgets but affordable housing providers would be encouraged to reach the best deal they could with developers and landowners.

The tables below illustrate two approaches to residual valuation and show how norm land values can be calculated.

Table 1: Land Value Calculation scheme of 10 x 2 bed terrace houses, 7 for sale, 2 for social rent, 1 for intermediate rent

	House price £175,000	**House price £150,000**	**House price £125,000**
Revenue	£1,381,000	£1,206,000	£1,031,000
Devt Cost (ex land)	£1,095,000	£1,063,000	£1,032,000
Site value	£286,000	£143,000	-£1,000
Land value per hectare	**£1.1m**	**£0.6m**	**nil**

Notes: Developer takes developer return (15%) on market housing and contractors profit (6%) on affordable units

In the example shown there is little incentive to the house builder to bring land forward for sale by an RSL at a house price of £125,000 because the revenue is insufficient to yield a land value. However housebuilders are also interested in pursuing workload. Table 2 below models the same scheme but with an RSL as developer. The housebuilder sells the land then goes on to carry out a Design and Build contract for the RSL

Table 3: Design and Build – impact on land value
Scheme of 10 x 2 bed terrace houses, 7 for sale, 2 for social rent, 1 for intermediate rent

	House price £175,000 a	House price £150,000 b	House price £125,000 c
Revenue	£1,381,000	£1,206,000	£1,031,000
Devt Cost (ex land)	£882,000	£882,000	£882,000
Site value	£499,000.	£324,000	£149,000
Land value per hectare	**£2m**	**£1.3m**	**£0.6m**

Notes: Developer takes contractors profit (6%) on all units

In this example there is enough money in the scheme even in the lowest house price area to generate over £1m of revenue to the house builder whilst still providing 30% affordable housing with no call on public subsidy. In this example the RSL is acting as developer and would need to finance the land purchase and fund the development process. However, provided funding is available for RSLs to act in this way and the housing achieves the sales values estimated the scheme breaks even after the provision of affordable housing.

Our basic proposal is therefore that the HCA facilitates RSLs acting as developer by making finance available for the purchase of land and, if necessary, assisting in securing development finance. Thus housing construction and affordable housing development is maintained.

Where either additional affordable housing, above the local or regional target was considered desirable or the weakness of the market meant that there was no possibility of developing the market housing then further SHG funding could be made available to increase the proportion of affordable housing. Table 3 below shows the financial implications of doing this: Column 1 of Table 3 is the same as Column b in Table 2 above and does not require SHG. Further columns indicate the SHG required to deliver different proportions of Social Rented housing. It should be noted that the SHG required to increase the proportion of affordable housing is a grant and is not repaid, whereas the loan made available for initial land purchase based on the plan requirement for affordable housing would be repayable.

Table3 Subsidy requirements for varying the proportion of affordable housing in a 10 unit scheme with units priced at £150,000***

	30% affordable housing ***	30% social rented housing	50% social rented housing	80% social rented housing	100% social rented housing
Revenue	£1,206,000	£1,148,000	£913,000	£561,000	£326,000
Land value required £1.3m per hectare	£324,000	£324,000	£324,000	£324,00	£324,000
Devt Cost (ex land)	£882,000	£882,000	£882,000	£882,000	£882,000

Total Cost	£1,206,000	£1,206,000	£1,206,000	£1,206,000	£1,206,000
SHG required	Nil	£59,000	£294,000	£646,000	£881,000
SHG per rental unit	**Nil**	**£19,666**	**£58,800**	**£80,750**	**£88,100**
surplus	£86,500	Nil	Nil	Nil	Nil

Notes

* *10 x 2 bed terraced houses on ¼ hectare*

** *Developer takes contractors profit (6%) on all units*

*** *2 social rented units, 1 intermediate rented unit*

An input of SHG ranging from £19,666 per unit to £88,100 per unit would deliver a higher proportion of affordable housing. Similar calculations could be applied to the delivery of wider community benefits or to the delivery of housing at higher levels of the Code for Sustainable Homes (this scheme was modelled at level 3).

Alternatively the site could be developed for a mix of social and intermediate housing plus an element of private rented housing which could ultimately be sold outright or transferred to the social sector. Many local authorities have highlighted the potential role of good quality private rented housing in helping them respond to repossessions and reduce waiting times for homeless households.

The ability to provide market housing – and benefit from any potential cross-subsidy – can be enhanced by careful selection of sites and pricing of completed units at prices which reflect current values (made possible by buying the land on this basis) and would be greatly increased were the local authority (or the HCA using its powers under Chapter 19 of the Housing and Regeneration Act) to provide a mortgage guarantee to purchasers of market and shared ownership housing who meet specific criteria.. The guarantee would be accompanied by a requirement that the parties enter a shared equity arrangement should the guarantee have to be employed. Any debt repayment made through this facility would be to the lender, not the occupier. This would give comfort to funders and ensure a supply of competitively priced mortgages for the development and would reassure individual residents that they were joining a reasonably stable community, which would not be subject to a wave of repossessions

We recognise that the housing market as a whole is not likely to recover until the mortgage markets have been placed on a sounder footing and we will return to this subject in a further paper, but the present proposals, which we are actively exploring with funders, should help RSL schemes capture what limited mortgage funding is likely to be available in 2009 and 2010.

Funding the programme: We suggest a budget of £380m with up to £280m made available for land purchase by RSLs and other affordable housing providers in 2009, with a further £100m in 2010,..

The £380m is arrived at as follows

We assume that in each of the 8 English regions (excluding London where land prices and densities are higher) HCA sets up a loan fund which RSLs and other affordable housing providers can draw on to buy land for 1,250 units (10,000 units in total split between market and affordable housing) or around 1/5 of the projected fall in housing output)

At current average densities of 45 dwellings per hectare[2] this will require 222 hectares.

If densities were reduced to 35 dph to reflect the exclusion of London and the provision of an increased proportion of family sized units this would require 286 hectares.

We have taken an average between these two densities and assumed development at 40 dph, requiring 254 hectares (or 32 hectares per region)

We postulate a land value of £1.5m per hectare (ie 40% lower than residential land values as recorded in the July edition of Property Market Report[3])

The overall budget is therefore:

254 x £1.5m = £380m

Chart 2 below illustrates how are proposals would operate..

[2] Land Use Change Statistics 2007, CLG Statistical Release May 2008).

[3] http://www.voa.gov.uk/publications/property_market_report/pmr-Jul-08/residential.htm

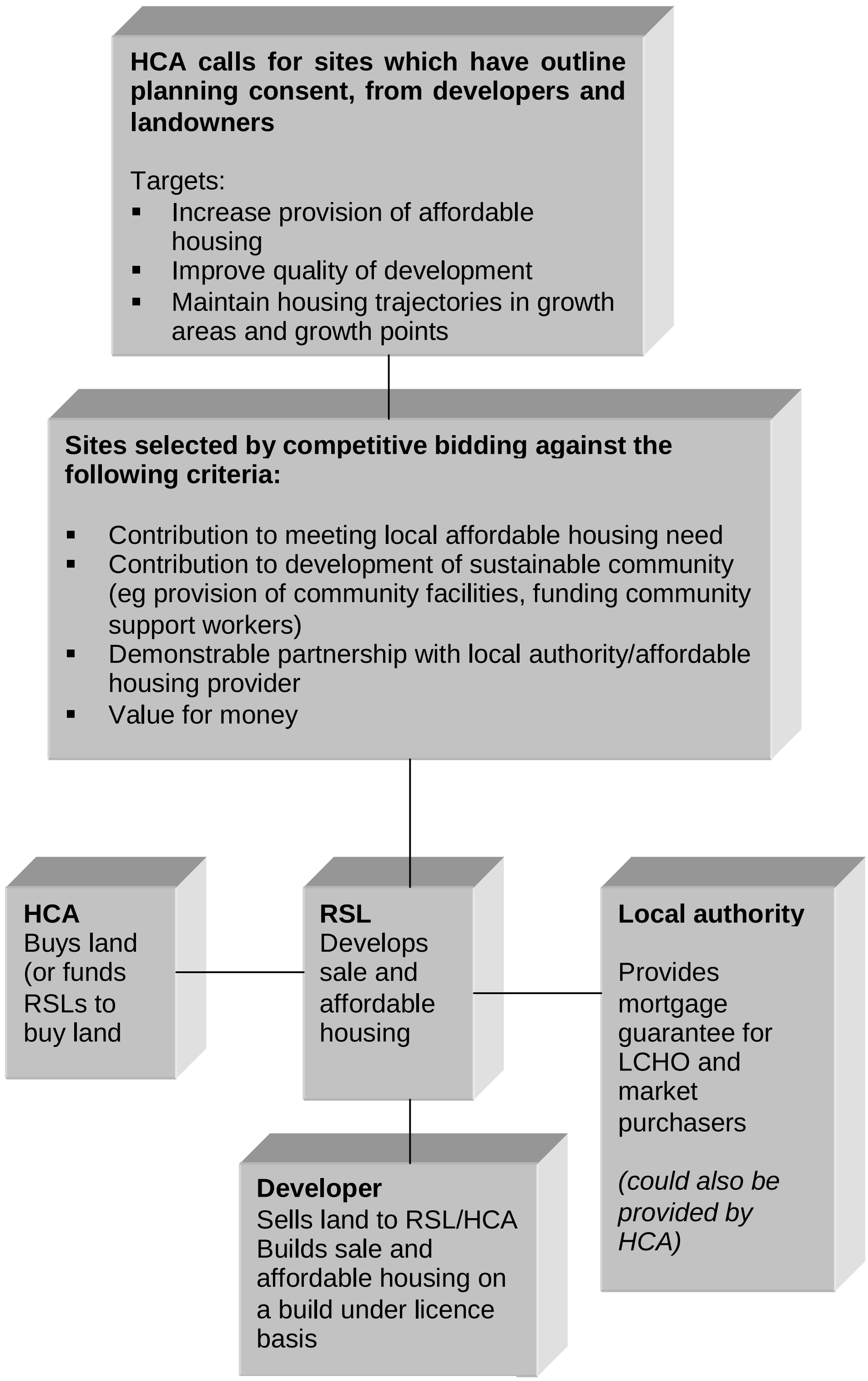

Chart 2: The scheme in operation

4. Major greenfield sites

In the growth areas (eg Thames Gateway, MKSM, East of England Growth Corridors) as well as in the proposed Eco-towns a substantial element of planned new housing provision is expected to take place on major greenfield sites. Experience has shown that these sites incur abnormal planning obligations and substantial infrastructure costs.

Consideration would need to be given to the additional planning obligations which typically apply on major greenfield sites. In the examples above planning obligations were modelled at £5,000 per unit. However on substantial greenfield developments planning obligations of £20-35,000 per unit are not uncommon. Table 4 below explores the impact of planning obligations of £25,000 per unit and infrastructure costs of £20,000 per unit on a scheme of 500 units in a major greenfield development.

Table 4: A major greenfield site – impact on land value
10 hectare site, scheme of 500 x 2 bed terrace houses, 70% for sale, 20% for social rent, 10% for intermediate rent, density 50 dph

	House price £175,000 a	**House price £150,000 b**	**House price £125,000 c**
Revenue	£69,050,000	£60,300,000	£51,550,000
Devt Cost (ex land)	£44,100,000	£44,100,000	£44,100,000
Additional planning obligations	£10,000,000	£10,000,000	£10,000,000
Infrastructure costs	£10,000,000	£10,000,000	£10,000,000
Total cost	£64,100,000	£64,100,000	£64,100,000
Site value	£4,950,000	-£380,000	-£12,550,000
Land value per hectare	**£495,000**	**-£38,000**	**-£1,255,000**

Notes: Developer takes contractors profit (6%) on all units

Here funding is needed not to support 30% affordable housing, which on a site with lower planning obligations and infrastructure costs would be self-financing, but to gap fund the provision of suitable infrastructure and facilities to enable major development to take place. We suggest that the HCA should consider three possible options for facilitating major greenfield developments of this kind.

- Making a straight grant via an RSL to defray early upfront infrastructure costs
- Giving a soft loan up front, repayable later as the market improves
- Taking an equity stake in the development via upfront investment in infrastructure and so sharing risks and future profits

The option chosen should be selected in close consultation with the planning authority as it might affect (and would be affected by) the S106 agreement. Provision of funding of this kind is entirely compatible with the proposed role of the HCA in facilitating development of major sites and should result in higher quality of development.

We recognise that there are many complex issues surrounding the development of major greenfield sites, including relationship with CIL, the financial impact of long-term development and how to set standards for long-term sustainable development. We shall return to these issues in a future paper.

5. Developing a rural programme

Rural RSLs and developers are already starting to do deals where land is transferred from predominantly market to predominantly affordable housing and the landowner takes a corresponding reduction in land value. More such schemes could come forward if there was funding available to help RSLs develop and landbank rural sites.

In the short to medium term there could be a specific rural allocation, from the £380m that we are proposing should support this approach, to encourage sites in rural areas to come forward and help meet the Government's rural delivery target. This could be vired back into either rural investment or the general affordable housing programme if was not spent within a given time period, depending on the source of the site funding programme.

The fund would be available to support the purchase of sites that either have planning permission or where there is a good prospect of this being given. This flexibility is necessary in rural areas where there are few site allocations and currently there is considerable reliance on windfall sites to provide housing, including affordable homes. It would have the added benefit of increasing the supply of affordable housing by closing the gap which has arisen where local authorities are using outdated policies with low affordable housing requirements because there is no adopted Core Strategy or Development Plan Document.

To meet housing needs in the longer term funding could be made available for RSLs or other public, charitable and social enterprise bodies to landbank sites in rural areas.. Initially this could take advantage of the opportunities that are becoming available as result of the market downturn.

Where it is envisaged that the site will form part of a landbank the release of the funding would be triggered

- where there is evidence of affordable housing need within the community and surrounding settlements;
- where the site is considered suitable as part of the Strategic Housing Land Availability Assessment process and the local authority would be in favour of its inclusion in its 5 year site supply either as an allocated mixed tenure site or an allocated rural exception site providing 100% affordable housing

Example: The Highlands Housing Alliance

To avoid local disputes about which affordable housing provider should develop a scheme one option would be to provide funding for rural landbanking as a revolving fund through a one off '*soft interest'* loan to an appropriately constituted body.

Such an approach has proved to be successful in Scotland run through the Highlands Housing Alliance (HHA) which can acquire land and bring it forward for development by a third party (either an RSL or a developer). HHA received a £10m loan from the Scottish Government and Highlands Council, which provides a revolving fund to purchase appropriate sites and bring them to a point where they will deliver housing. It has provided 837 new homes in the Highlands in development and 450 under negotiation. They provide a mix of market and affordable housing on sites, which range from 5 – 300 units. A start-up grant of £300K paid on a sliding scale was made available through funding from the local authority, RSLs and Communities Scotland. The organisation is now self financing and employs 5 members of staff

Under this approach the risk of site servicing and securing planning consent is taken by the HHA. Any return is used to support the work of the HHA and may be used to fund further investment in housing, including where necessary reducing the cost of low cost home ownership.

6. Development in London

London has sought to achieve high housing numbers by high density development of complex brownfield sites. This type of development is typically associated with high construction costs and complex development mixes, often incorporating substantial planning obligations and major infrastructure costs. Land values in London have also become hugely inflated compared with those in the rest of England and Wales and are now starting to fall (see chart 3 below). For all these reasons there are particular risks and rewards associated with development in London, which warrant further consideration. We shall return to the issue of development in London in a future paper.

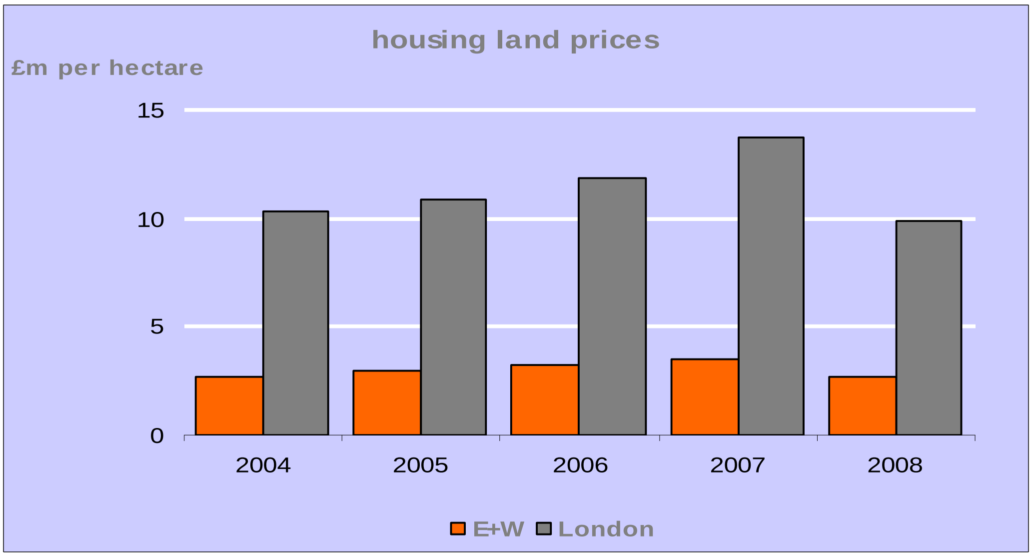

Chart 3 Source Property Market Report

7. Conclusions

- There is a need for the HCA to take action to maintain housing trajectories and support employment in construction and related industries

- Developers are keen to release land and, if purchased by RSLs, it could be developed to provide additional affordable housing and/or higher quality development than is specified in current planning consents

- RSL led development where the developer takes a Design and Build role offers better value for money than S106 schemes where the developer is in the lead and takes a speculative profit.

- A loan fund of £380m over two years could fund provision of 10,000 homes split between market and affordable housing.

- The scheme is applicable in both urban and rural areas and there would be merit in having a special allocation for rural areas in order to bring forward exceptions sites in villages and market towns which are likely to offer particularly good value for money.

- The scheme could help support development of major sites in the growth areas but additional upfront public funding may be required to finance essential infrastructure provision. This could be in the form of a grant, a loan or an equity stake in the development.

- Viability of housing development is ultimately dependent on the strength of the housing market and ease of access to mortgage funding. There is a potential role for the HCA to use its powers to guarantee loans to facilitate the development of market housing within schemes financed through the loan fund in order to maximize scope for cross subsidy, reduce the call on grant funding and help maintain housing trajectories.

- Special issues apply in London and we will return to these in a future paper.

8. Proposed follow-up papers

We propose to submit additional follow-up papers dealing with

- Development of major greenfield sites in growth areas and eco-towns
- The situation in London
- Possible measures to support the mortgage market