Additionality of Affordable Housing

Final Report

Contents

Key Findings

- We need an expansion of affordable housing supply to reach the Government's target of building 300,000 new homes per annum in England by the mid 2020s. This requires additional grant funding.

- Private sector housebuilding for market sale has underpinned the rapid expansion in housing supply since 2013, including affordable housing delivery through Section 106, but that growth is slowing, against market headwinds. The tapering and potential withdrawal of Help to Buy represents a significant downside risk to speed and scale of development for the majority of developers, including housing associations, unless there is a major shift in mortgage market conditions to support buyer demand.

- We are expecting continued rapid expansion of the Build to Rent sector and a big increase in local authority development of homes, but that will not be enough in itself to fill the supply gap. Both of these assume continuation of a supportive policy environment.

- In a lower house price inflation and slower transaction environment, continuing build cost inflation puts an additional squeeze on the amount of cross subsidy available to fund affordable housing, from both Section 106 planning obligations on private sector development and the housing association cross-subsidy model.

- There is a major shortfall in the supply of affordable housing. Based on affordability alone, the annual need for additional affordable housing in England is 2.6 times greater than supply, rising to a multiple of 7.6 in London.

- Widening the range of new homes that are available, by type and tenure, will increase the number of occupiers who can and want to live in those homes, accelerating the speed of market absorption and the build out of sites.

- In these circumstances, grant funding of affordable housing will add to (and not displace) private sector development of new homes, provided that the grant is used in a way that does not crowd out the private sector from land and construction capacity. This points to the need for:

    - More joint venture agreements between housing associations and private sector developers, particularly where the scale and complexity of a project or market uncertainty incentivises the sharing of risk and financial commitment.

    - Long term funding agreements, building on the early experiences of the strategic partnerships being rolled out by Homes England and GLA. This will allow forward planning to build construction and development management capacity, along with a measured programme of land acquisition and building up strategic land pipelines.

- Housing associations have become more exposed to market conditions. In the event of a downturn, grant funding for affordable housing would allow housing associations development to continue, building capacity towards meeting the 300,000 homes annual target. It also provides a valuable contra-cyclical outlet for absorption of housebuilder stock built for market sale, when rates of sale are under pressure, as demonstrated by activity in the current market.

Executive Summary

This report investigates the additionality of affordable housing to housing supply in England. This is the extent to which an increase in affordable housing leads to an increase in overall housing supply, towards the Government target of increasing housing supply to 300,000 additional homes per annum by the mid 2020s. The report recognises but does not review the very significant social and economic roles played by affordable housing, including its role in the regeneration of failing places.

The key question addressed in this report is the extent to which overall housing supply would be increased by additional grant funding to increase the supply of new affordable housing, to include social rent, affordable rent and shared ownership homes. MHCLG guidance is that the highest levels of additionality on such a supply side intervention are likely to be where there are weak market conditions, such that private sector developer activity is not crowded out.

The focus of the analysis is on limits to market capacity to deliver the 300,000 new homes. However, it also references sites where grant funding of affordable housing can make unviable sites deliverable, alongside other funding programmes, where this makes local regeneration policy objectives realisable.

Current Affordable Housing Supply

The delivery of affordable housing in England has been c.46,000 homes per annum since 2013, including 41,000 newly built homes, representing 18% of total supply, comparable to the 2006-08 pre-downturn period. The current £9bn programme of grant funding for affordable housing is intended to fund 225,000 homes over 5 years, being an average of 45000 per annum, using housing association mixed tenure development to stretch that funding to deliver as many new affordable homes as possible.

Section 106 planning obligations have been providing some 18,000 homes per annum in recent years, representing more than 47% of total new build affordable delivery and, more recently, 10% of all housing supply. The reliance on Section 106 and the housing association cross-subsidy model makes affordable housing supply more reliant on the underlying strength of the housing market.

Affordable Housing Need

There is a consensus amongst numerous studies, including those completed by Savills, that a significant and growing number of households are not able to afford the market price of suitable housing, simply as a result of declining affordability within the market. Savills estimates that 100,000 new homes per year need to be priced at sub-market levels. The Herriot Watt university study published in 2018 further reinforces the shortfall in affordable housing delivery, reporting that the affordable housing need is 145,000 homes per year.

This leaves an annual shortfall of at least 60,000 affordable homes per annum. Based on affordability alone, the annual need for additional affordable housing in England is 2.6 times greater than supply, rising to a multiple of 7.6 in London, according to Savills analysis.

This is before considering the wide range of other socio-economic reasons for households being unable to access a suitable home in the market. These wider reasons contribute to the 1.1 million households who were on local authority waiting lists in England in April 2018.

As a consequence, when new affordable housing for rent is released to the market, the take up from households is immediate, in contrast to market housing where the rate of sale or letting up is dependent on the local strength of market demand. Shared ownership homes fall between these two cases, as there is a purchase element which has some demand factors in common with outright sale. This is consistent with the significant fall in shared ownership sales in Inner London in the year to March 2018, compared with increases across the rest of England. The high demand for affordable housing was recognised in the final report of the Letwin review, which concluded that there is "virtually unlimited" demand for affordable housing, offering the potential to accelerate build out rates beyond market capacity.

Housing Supply relative to the Government Target

Annual new housing supply has increased by more than 78% since its low point of 125,000 homes in 2013, moving towards the government's target of 300,000 homes. Delivery reached 220,000 in the year to March 2018, with the number of Energy Performance Certificates on new homes providing a leading indicator that around 240,000 homes were added to stock in the 2018 calendar year. This includes a bounce back in London supply, of which around 40% appears to be expansion of mixed tenure development by housing associations.

As housing supply has continued to rise, the rate of annual increase has been falling, from an average of 14% during the 2014 to 2017 period, to around 5% per annum since then. During that period, the annual growth rates in total completions of the nine major housebuilders, who account for some 40% of total new build completions, have been declining from 11% in 2014 to 3% in 2018.

To reach the 300,000 homes target by 2025 requires further growth of 26% over seven years, being 3.4% per annum.

Analysis published by Savills in October 2018 indicates that annual housing supply will rise from around 220,000 to 260,000 homes in 2021, assuming:

- 6% growth pa from larger and medium sized housebuilders.
- 10% growth pa from small housebuilders, as the availability of finance and land opportunities grow.
- Housing associations expanding from 35,000 to 50,000 homes per annum, in line with stated plans.
- Build to rent increasing its rapid expansion, going from 7,000 to 15,000 per annum, noting that much of this will support continued expansion of output by housebuilders and housing associations, so is partially included within the other assumptions.
- Local authorities increasing annual development to 5,000 homes, making use of new borrowing capacity within the HRA.
- Other completions, primarily those via Permitted Development Rights, falling from 34,000 to 20,000 per annum.

These projections build in the current £9bn affordable housing grant programme that runs to 2021 and expanded levels of funding thereafter.

There is downside risk to the growth assumed for larger housebuilders, given that recent growth for the largest nine housebuilders has been at around half that level. Housebuilder expansion at all sizes has been facilitated by attractive operating margins which depend on buoyant market conditions. Those housebuilders that have stated their future growth intentions are planning for annual growth of between 3 and 5%. Our supply projections did not look beyond the end of the current Help to Buy programme in 2021 and we now know that the subsequent two year scheme to 2023 will be tapered and that Government does not currently intend to run an equity loan scheme thereafter.

Help to Buy

As 33% of new homes sales per annum are supported by Help to Buy, the tapering of the Help to Buy scheme from 2021, with the potential for no committed scheme from 2023, represents a significant downside risk to market capacity. The overall impact on new homes sales will depend on a wide range of factors, including the extent to which mortgage markets improve, the impact of any other schemes put in place by Government, and the ways in which housebuilders adjust their product to retain buyers in the new homes market.

If, say, two thirds of would-be Help to Buy purchasers are retained within the new homes market via these factors, then there would be a reduction in all new homes sales of around 10%. This downside risk scenario of a 10% reduction in overall new homes sales in 2023/25, should there be a complete withdrawal of Help to Buy (with a worst case scenario of, say, a 20% reduction), would be consistent with assumptions made by some equity analysts. This is before considering any mitigating policy options.

Market Capacity

Across London and the South, house prices have peaked in some areas and are slowing in others as growth ripples to the Midlands and the North. Total market transaction volumes have also flattened, with the greatest falls concentrated in those markets experiencing a slowdown in house prices. As part of this, mortgaged buy to let levels have dropped off, especially in higher value (lower investment income yield) markets.

More widely, Brexit uncertainty has led to lower buyer confidence in the second hand market and, more recently the new homes market. Political clarity on Brexit should support a return of confidence to the market, but the other factors, in particular affordability, are longer lasting. Beyond 2021, with the tapering and then potential removal of Help to Buy support, it is difficult to see expansion of the current mix of new housing supply at the rates required to hit the 300,000 target.

The scenario of a 10% to 20% cut in new homes sales and the associated Section 106 affordable housing represents a significant downside risk to completions after 2023, of between 17,000 and, in the worst case, 34,000 homes per annum. Tapering of Help to Buy in the 2021-23 period represents a much smaller but notable downside risk to completions.

The consequence of these downside risk scenarios would be that all other supply would have to expand by between 23% and, in the worst case, 33% between 2021 and 2025 to meet the 300,000 homes target, probably in more challenging market conditions.

Policy Response

As noted above, the Government can put in place new measures to support housebuilding of all tenures after 2023. It is possible that the Government will implement a further form of tapered Help to Buy, albeit that the Government's stated intention is not to run a further equity loan scheme.

Potential policy responses include working with local planning authorities to build more homes in high value, relatively unaffordable, markets with low levels of housing supply, within the constraints of the principles of sustainable development, including selected Green Belt release. This would increase the number of new homes sales outlets across the country, off-setting the downward pressure on sales rate per outlet described above. However, there are political limits to the scale of additional supply that can be unlocked via this route.

Part of the solution is to promote productivity, growth and job opportunities across cities, rebalancing growth across the UK. This requires integrated strategies for housing, employment and transport, to allow cities to grow and people to live and work where they want, prioritising major upgrades for cities with the most growth potential and capacity constraints and major additional investment in urban transport.

The Letwin Review recommended more diversity of the type and tenure of new homes, to accelerate market absorption and the build out rate of large sites.

The rapid expansion of Build to Rent is evidence of its capacity to add to overall housing supply, diversifying routes to market and providing a high quality accessible alternative to home ownership. Our supply projections builds in continued rapid expansion of Build to Rent volumes to 15,000 homes by 2021, over and above housebuilder completions that are acquired by Build to Rent operators. This assumes a supportive policy environment, in particular that the positive provisions in the NPPF are embraced by local and strategic planning authorities and that there is no new regulation that stifles investor appetite.

The new flexibilities in local authority finance will unlock significant development capacity; we assume that local authorities will be completing 5,000 homes per annum by 2021, filling part of the supply gap.

The evidence set out in this report indicates that the supply gap would be readily filled by an expansion of affordable housing supply, funded by a larger affordable housing programme. As part of this, shared ownership can potentially play a valuable role in supporting demand for new homes, should Help to Buy be withdrawn. If this is to be the case, it will need to be made readily available in new homes sales offices.

It is clearly important that expansion of affordable housing development does not crowd out private sector market focused delivery by restricting access to land and construction capacity.

Availability of Construction Capacity

In recent years, the BCIS private housing construction price index suggests declining build cost inflation in real, inflation adjusted terms. This indicates that the construction sector has adjusted to the extra demand for development of new homes, albeit that there have been peaks of excess demand which are most evident in tender price inflation, which includes a main contractor margin that will vary in response to market conditions. This indicates that if expansion of affordable housing is phased over a period that allows forward planning at rates consistent with past expansion, then there should not be crowding out of private sector construction capacity.

Clearly there are caveats to this view, with the availability of skilled labour continuing to be a limiting factor, closely linked to the impact of any external factors such as a change in immigration policy that would reduce the availability of skilled construction workers. The Letwin Review identified the number of skilled bricklayers as a relatively hard constraint on development capacity, recommending a major programme of investment in training of additional bricklayers. Successful expansion of reliable methods of offsite construction looks set to be part of the expanded construction capacity in the medium to long term.

A further point to consider is that, in a lower house price inflation environment, build cost inflation squeezes either: operating margin and the associated incentive to expand development volumes; or residual land value and the associated viability of cross subsidy and Section 106 funding of affordable housing.

Availability of Land

Across most of the UK, the high supply of land with planning consent has provided developers with a readily available supply of land on which to expand their development programmes. This availability of land is reflected in the limited rates of land value inflation which have left the value of UK greenfield land, on average, 13% below its previous peak in 2007/08, compared with house prices which are 17% above the previous peak level at that time. In central London, where land supply is more constrained relative to demand, there is more competition for land, with land values some 10% above their previous cycle peak in 2007/08, albeit that there is still a gap with house prices which across prime London markets are some 20% above the previous cycle peak in 2007/08.

However, according to our 2018 survey of housing association chief executives, the availability of land is regarded as a constraint on development capacity by 86% of housing associations. As development plans evolve and land pipelines grow, this may become less of a constraint. The key issue is whether land can be acquired at a price to allow housing associations to develop at policy compliant levels, before expanding affordable housing delivery beyond that level, using grant funding.

Additionality Conclusions

MHCLG appraisal guidance indicates that supply focused interventions are likely to have medium to high additionality of between 50% and 100%, with weaker market conditions making it more likely that additionality will be in the upper parts of this range. The guidance gives the example of affordable housing “where there is strong evidence to suggest housing of this type is unlikely to be built by private developers in the absence of policy and very little crowding out of private development occurs in practice”.

There are limits to market capacity to deliver 300,000 homes annually by the mid 2020s. This also constrains housing associations from expanding the number of affordable homes that are cross-subsidised from mixed tenure development. These limits to market capacity have the same impact as the weaker market conditions referenced in the appraisal guidance, in which additionality of a supply focussed intervention rises towards 100%.

If there is adequate land, development management and construction capacity, then grant funding to enable the viable development of more affordable housing will have high additionality of close to 100%. The availability of land, development management and construction capacity is important. Grant funding needs to be accompanied by measures to ensure that higher levels of affordable housing development do not crowd out private sector development of market housing by displacing these factors of production.

Joint ventures with private sector developers are an important part of the solution, particularly where either the scale and complexity of a project or market uncertainty creates the incentive to share risk and financial commitment.

The longer term funding arrangements being rolled out through the Homes England and GLA strategic partnerships should allow for sufficient forward planning of construction capacity to avoid displacement; and a measured programme of land acquisition at values consistent with policy compliant development without grant. Long term planning will allow a strategic land pipeline to be built up, to contribute to business capacity and resilience.

Additionality on Unviable Sites

Our 2013 report[1] reviewed evidence of capital grant being invested in costly regeneration sites where:

- the investment would deliver affordable homes that would not otherwise have been built; and
- development of the affordable homes would unlock a mixed tenure site, providing additionality to housing supply in excess of 100%. In this case, grant funding of affordable housing acts as a supply catalyst.

This remains the case where a site would be unviable without capital grant. There is clearly an overlap here with the objectives of the Housing Infrastructure Fund, which provides grant funding for new infrastructure that will unlock new homes in the areas of greatest housing demand. It is one of a number of funds where 80% of the fund is aimed at the 50% least affordable local authorities.

Housing Association Resilience in a Downturn

The current housing association development model is, by its nature, exposed to a market downturn. In the event of a downturn, grant funding for affordable housing would allow housing associations development to continue, building capacity towards meeting the 300,000 homes annual target.

[1] Savills 2013, Additionality of Affordable Housing, Report to G15

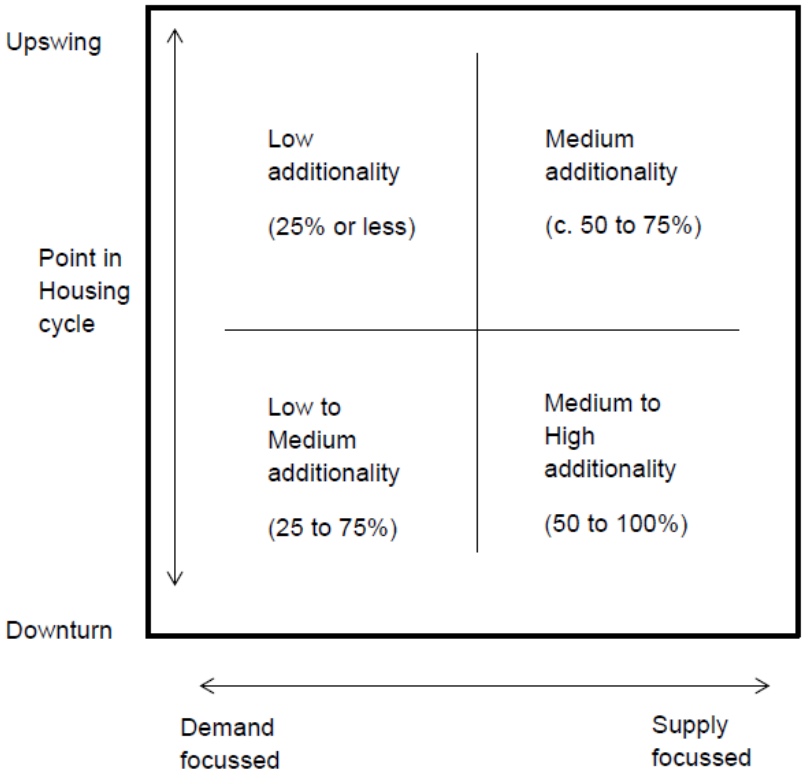
1. Introduction

This report investigates the additionality of affordable housing to housing supply in England, within the context of the Government's target of increasing housing supply to 300,000 additional homes per annum by the mid 2020s. The report recognises but does not review the very significant social and economic roles played by affordable housing, including its role in the regeneration of failing places.

The key question addressed in this report is the extent to which overall housing supply would be increased by additional grant funding to increase the supply of new affordable housing, to include social rent, affordable rent and shared ownership homes. The focus of the analysis is on limits to market capacity to deliver the 300,000 new homes. However, it also references sites where grant funding of affordable housing can make unviable sites deliverable, alongside other funding programmes, where this makes local regeneration policy objectives realisable.

MHCLG appraisal guidance[2] sets out a framework for assessing the additionality of property related policy interventions. This indicates that supply focused interventions are more likely to have medium to high additionality of between 50% and 100%, with weaker market conditions making it more likely that additionality will be in the upper parts of this range. The guidance gives the example of affordable housing "where there is strong evidence to suggest housing of this type is unlikely to be built by private developers in the absence of policy and very little crowding out of private development occurs in practice".

Figure 1 – Framework for assessing additionality



Source: The DCLG Appraisal Guide

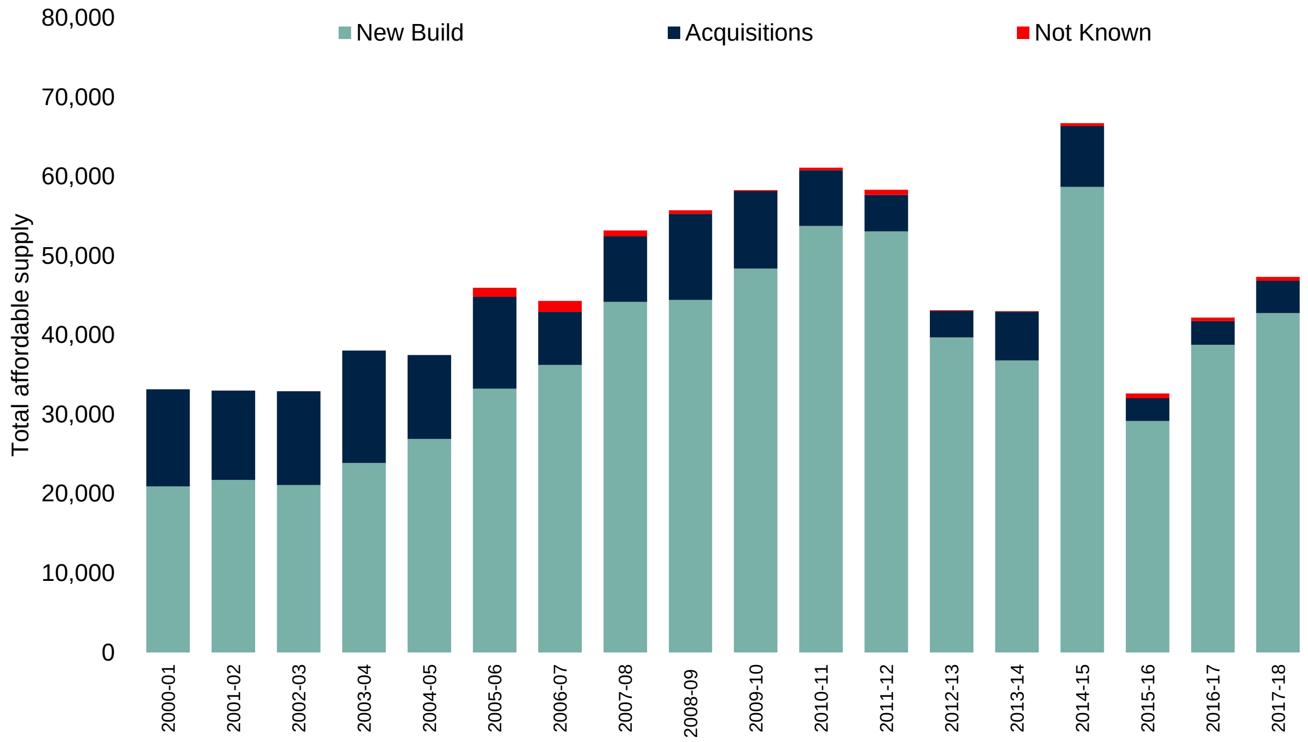
[2] DCLG 2016. *The DCLG Appraisal Guide*. Department for Communities and Local Government, December 2016.

2. Current affordable housing supply

2.1. Affordable housing completions

The delivery of affordable housing in England has been c.46,000 homes per annum since 2013, including 41,000 newly built homes. Between 2016/17 and 2017/18, the number of affordable homes delivered increased by 10%. New build affordable homes comprised over 90% of total affordable housing delivery in 2017/18. In the last three years, new build affordable housing completions have increased by 47%.

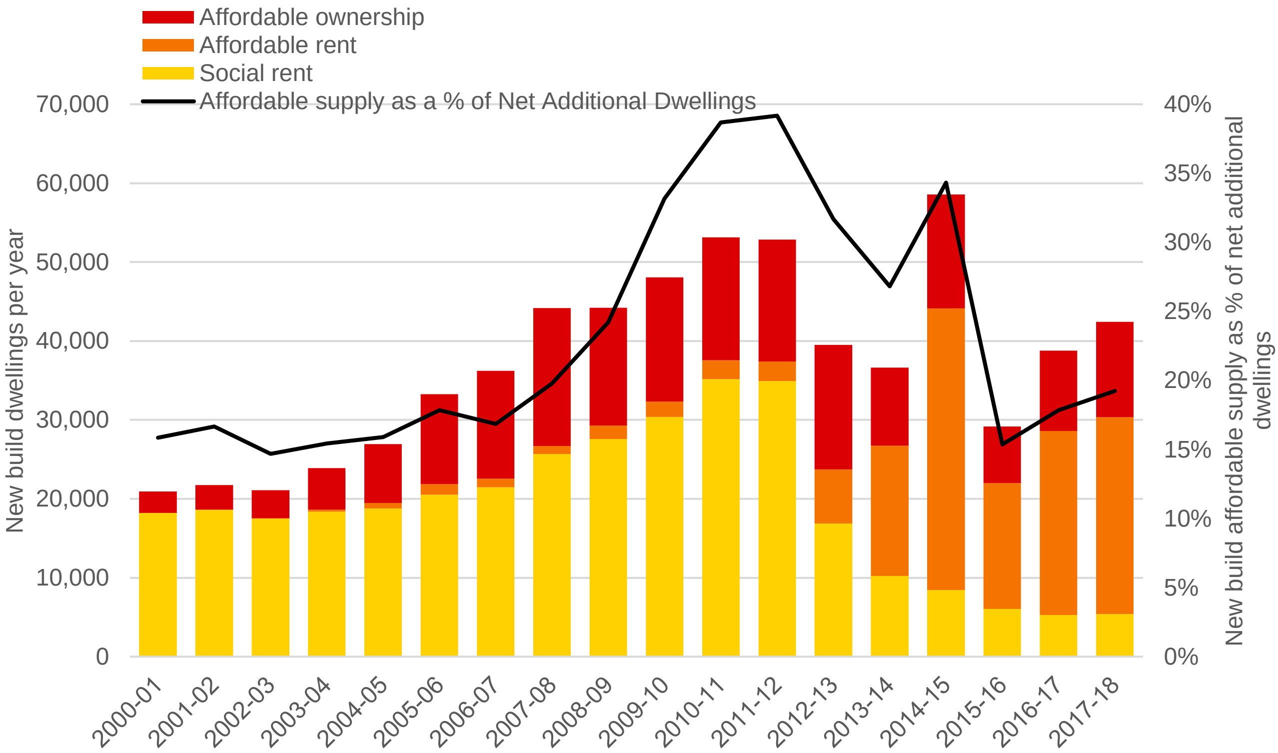
Figure 2 – Total affordable housing delivery in England



Source: MHCLG

Most of the increase in affordable housing in 2018 is due to rising affordable home ownership and affordable rent, while the number of new social rented homes appears to be at similar levels to 2017. Since 2013, new affordable homes have accounted for 18% of total net additional dwellings, levels comparable to the 2006-08 pre-downturn period.

Figure 3 – Total new build affordable housing delivery in England



Source: MHCLG

2.2. Delivery through Section 106

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.

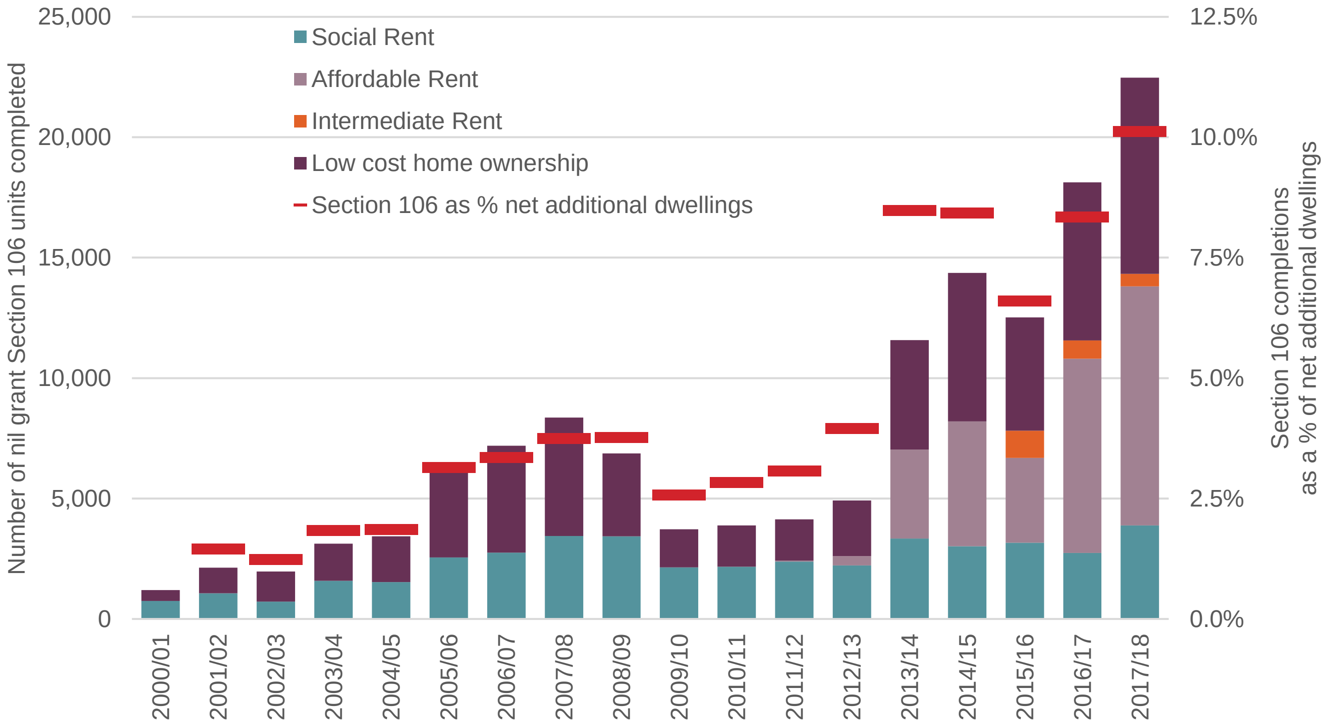
The number of social rented homes delivered by Section 106 has remained broadly constant, but there have been big increases in tenures that require less capital subsidy, namely affordable rent and shared ownership.

In 2017/18, 53% of total new build affordable supply was delivered under Section 106. Section 106 as a proportion of affordable housing delivery has increased year on year since 2014/15. Over the last three years, Section 106 affordable housing has been delivering on average 18,000 homes per annum, comprising 47% of total new build affordable housing delivery, compared to 19% in 2007-08, when grant on Section 106 units was commonplace.

Section 106 is 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.

In its current form, Section 106 can only be a small proportion of total 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 – Total nil grant Section 106 delivery in England



Source: MHCLG

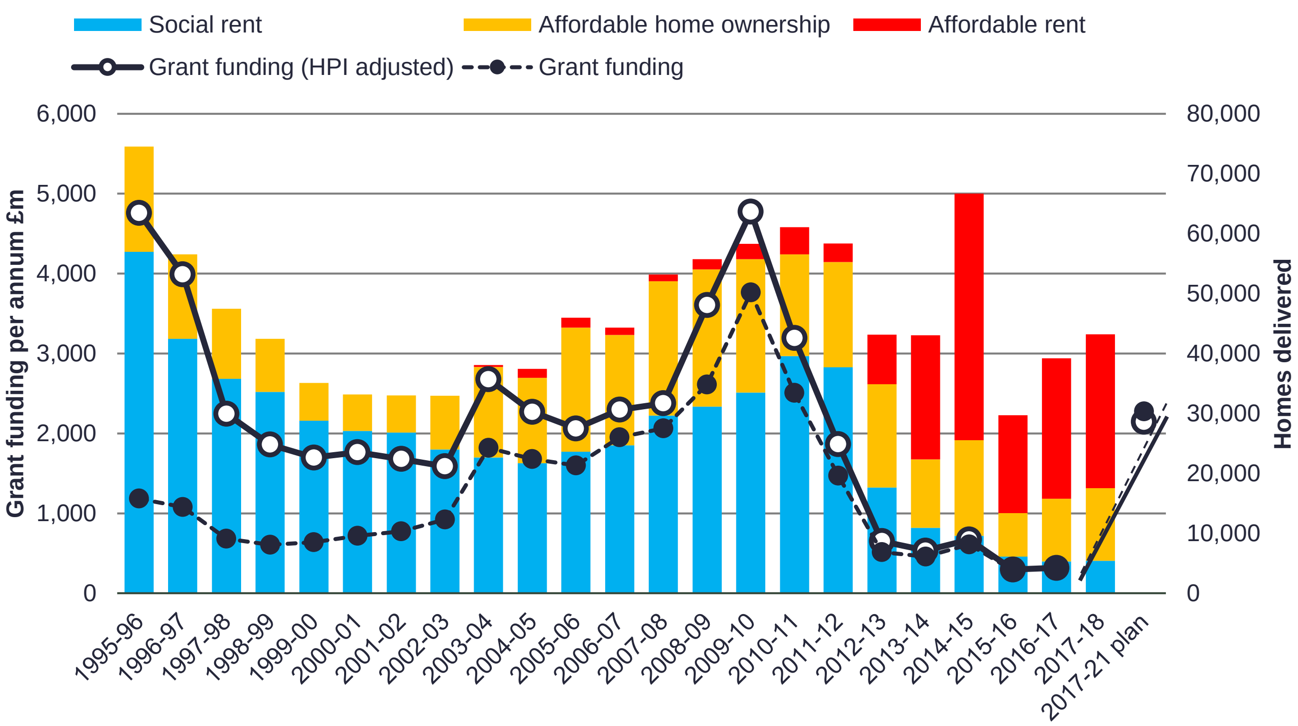
2.3. Grant funding

Grant funding fell significantly from 2010, however in recent years, grant has returned to the funding of affordable housing. The current £9bn 2016-21 programme of grant funding for affordable housing is intended to fund 225,000 homes over 5 years, being an average of 50,000 per annum, using housing association land led mixed tenure development to stretch that funding to deliver as many new affordable homes as possible

The government announcement an additional £2 billion of funding for affordable housing between 2021 and 2029 in September 2018 provides the sector with confidence and opportunity to invest in longer term projects and to be involved in more land led development.

Savills has estimated that, annual grant funding of £7bn a year would allow 100,000 social rented homes to be built, to provide sub-market housing for all households in need of sub-market housing[3]. This would in theory reduce the housing benefit bill for these households by £430m a year.

Figure 5 – Total grant funding



Source: Savills Research using MHCLG & HCA (affordable rent includes other discounted rental tenures), HCA grant funding adjusted for house price inflation (2016/17 base)*

[3] Savills 2017. *Investing to Solve the Housing Crisis*, https://www.savills.co.uk/research_articles/229130/224869-0

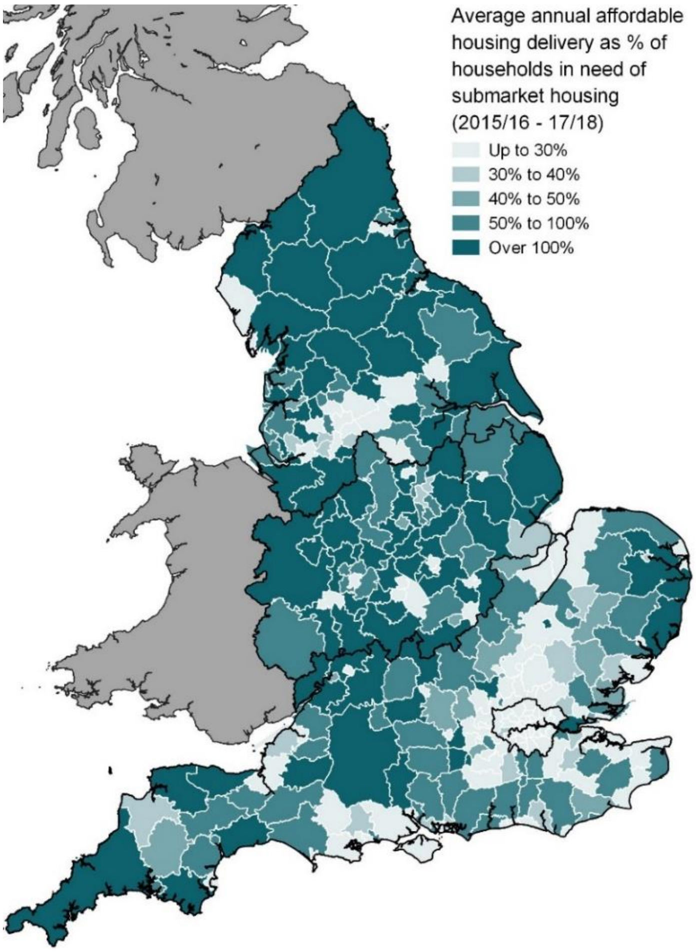
3. Affordable housing need

As noted above, Savills analysis indicates that, of the government's target to build 300,000 homes a year by the mid 2020's, 100,000 of these need to be priced at sub-market levels.

A Herriot-Watt University study[4] published in 2018 for the National Housing Federation, concluded that housing need in England is 340,000 per year until 2031. Within this 340,000, the study reported that 145,000 should be affordable homes. 90,000 should be for social rent, 30,000 for intermediate affordable rent and 25,000 for shared ownership.

In London and the South, there is an acute scarcity of affordable housing supply. According to Savills estimate of housing need, 42,500 sub-market homes are required in London despite an average of 5,600 sub-market homes being delivered annually since 2015/16.

Figure 6 – Shortfall in affordable housing delivery



Source: Savills using HM Land Registry, EHS, Rightmove, MHCLG

[4] Bramley 2018. *Housing supply requirements across Great Britain: for low-income households and homeless people*. Professor Glen Bramley, Heriot-Watt University, Nov 2018.

3.1. Shortfall in supply

This leaves an annual shortfall of at least 60,000 affordable homes per annum. Based on affordability alone, the annual need for additional affordable housing in England is 2.6 times greater than supply, rising to a multiple of 7.6 in London, according to Savills analysis.

This is before considering the wide range of other socio-economic reasons for households being unable to access a suitable home in the market. These wider reasons contribute to the 1.1 million households who were on local authority waiting lists in England in April 2018.

As a consequence, when new affordable housing for rent is released to the market, the take up from households is immediate, in contrast to market housing where the rate of sale or letting up is dependent on the local strength of market demand. Shared ownership homes fall between these two cases, as there is a purchase element which has some demand factors in common with outright sale. This high demand and rate of take up was recognised in the final report of the Letwin review[5], which concluded that there is a "virtually unlimited" demand for affordable housing.

[5], Letwin 2018. *Independent Review of Build Out Rates, Draft Analysis*, p.15 Rt Hn Sir Oliver Letwin MP, June 2018

4. Housing supply relative to the Government target

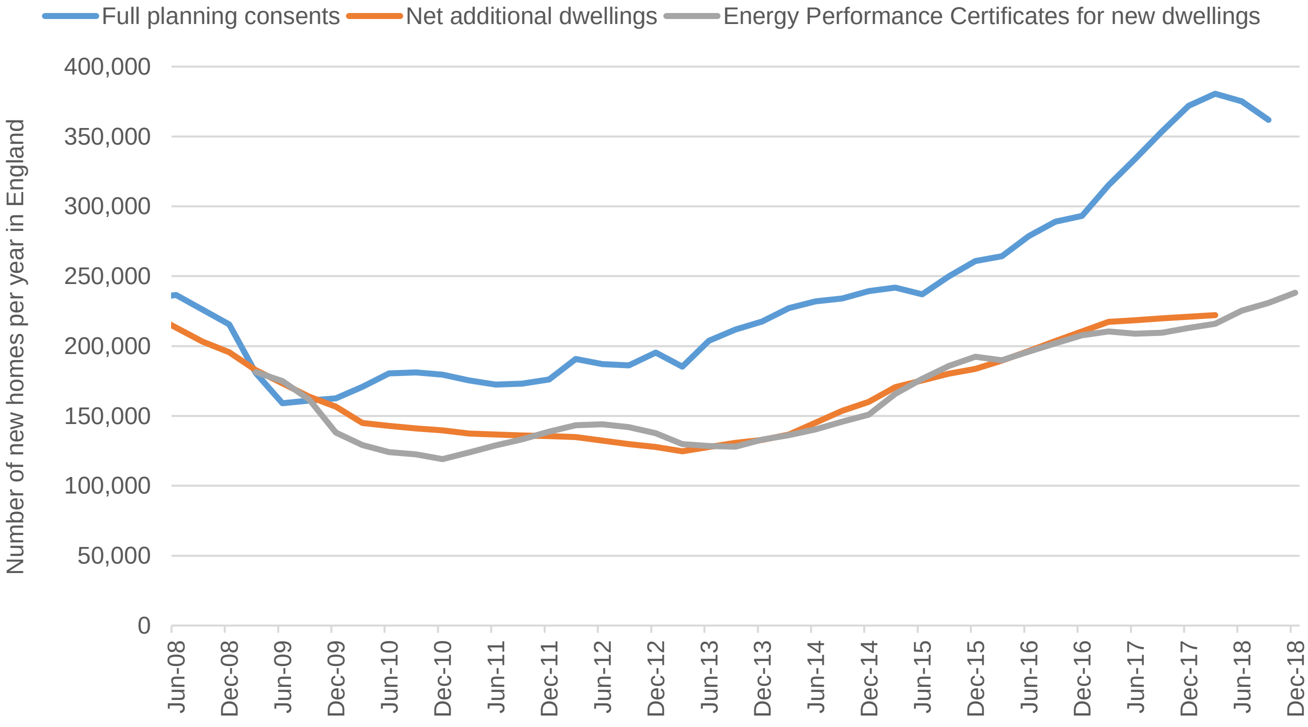
4.1. Supply across England

The government's target is to build 300,000 homes per year in England by the mid 2020's to significantly improve affordability pressures. There is also a wider role for housing in economic rebalancing and social regeneration.

In recent years we have seen rising levels of delivery, reaching 220,000 in 2017/18 and has continued to accelerate to 238,000 in December 2018, according to EPCs, a lead indicator of delivery. In the past five years, housing delivery has grown by 74%. However, there is a big shortfall between supply and need. The number of new planning consents remain well ahead of housebuilding.

There is a clear lag in delivery compared to consents. This gap is widening, suggesting that we are increasingly approaching limits to delivery. In the last quarter, the number of consents has started to plateau, after a constant increase in new consents following the introduction of the National Planning Policy Framework in 2012.

Figure 7 – Total housing delivery in England



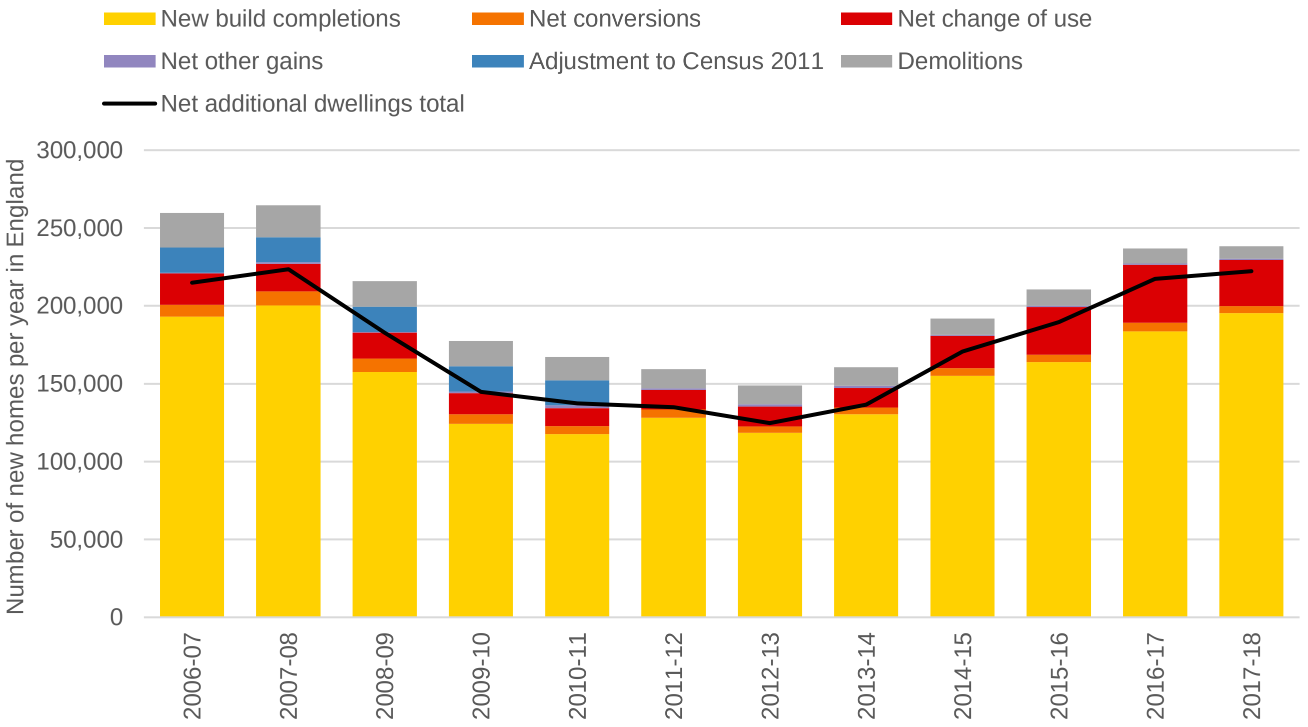
Source: MHCLG, HBF, Glenigan

Net additional dwellings in England reached 220,000 in 2017/18. Figure 8 breaks down net additional dwellings as the government's measure of additional housing delivery. New build completions have followed the same pattern of growth as net additional dwellings, rising consistently since 2013/14. The most recent data suggests that new build completions are continuing to rise.

The total number of homes added to stock each year includes conversions and change of use as well as new build homes. Change of use has increased significantly since Permitted Development Rights allowed the conversion of office buildings to residential.

However, the supply of this type of home is not unlimited and in many key cities the majority of viable conversions have already been made. In 2017/18, development through PDR fell by 28% compared to the previous year. We expect the decline to feed through in the number of homes completed through change of use over the next 3 years.

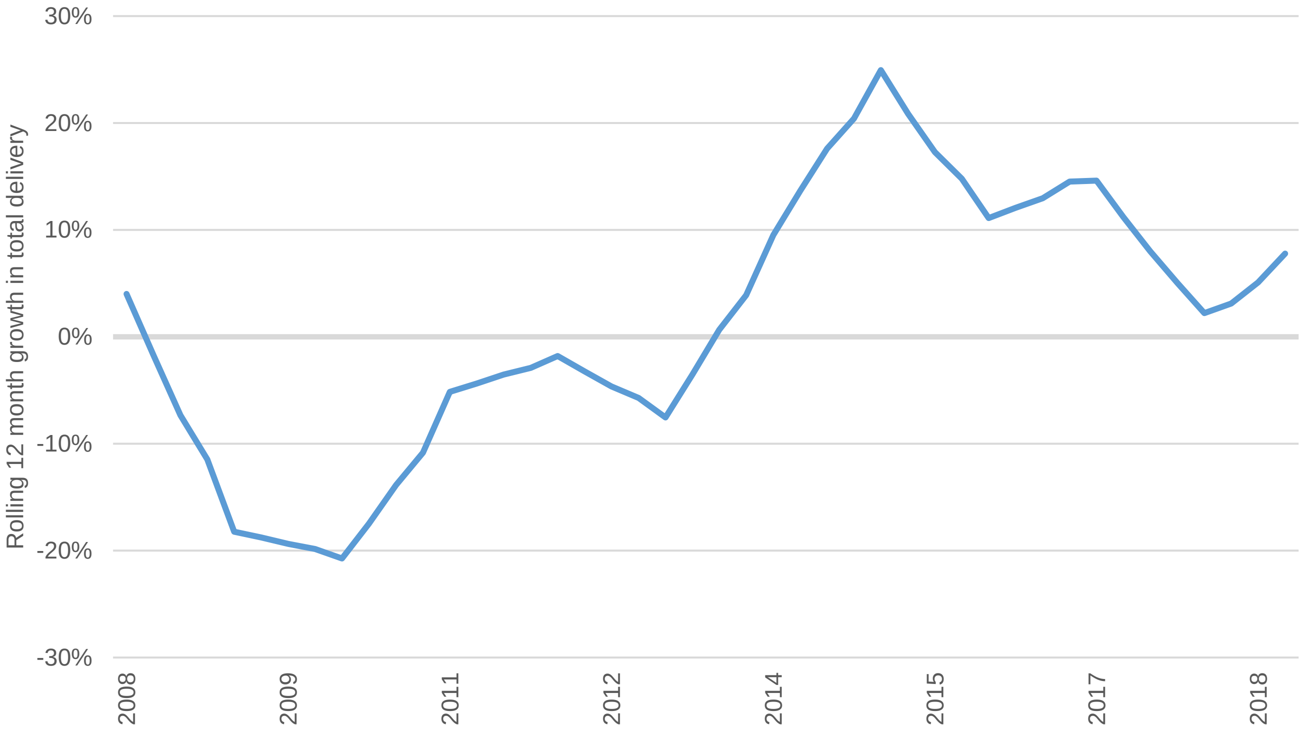
Figure 8 – Components of total housing delivery in England



Source: MHCLG

Although housing delivery has continued to rise in recent years, delivery has started to slow. The rate of annual increase in total delivery has fallen from an average of 14% during the 2014 to 2017 period, to around 5% per annum since then.

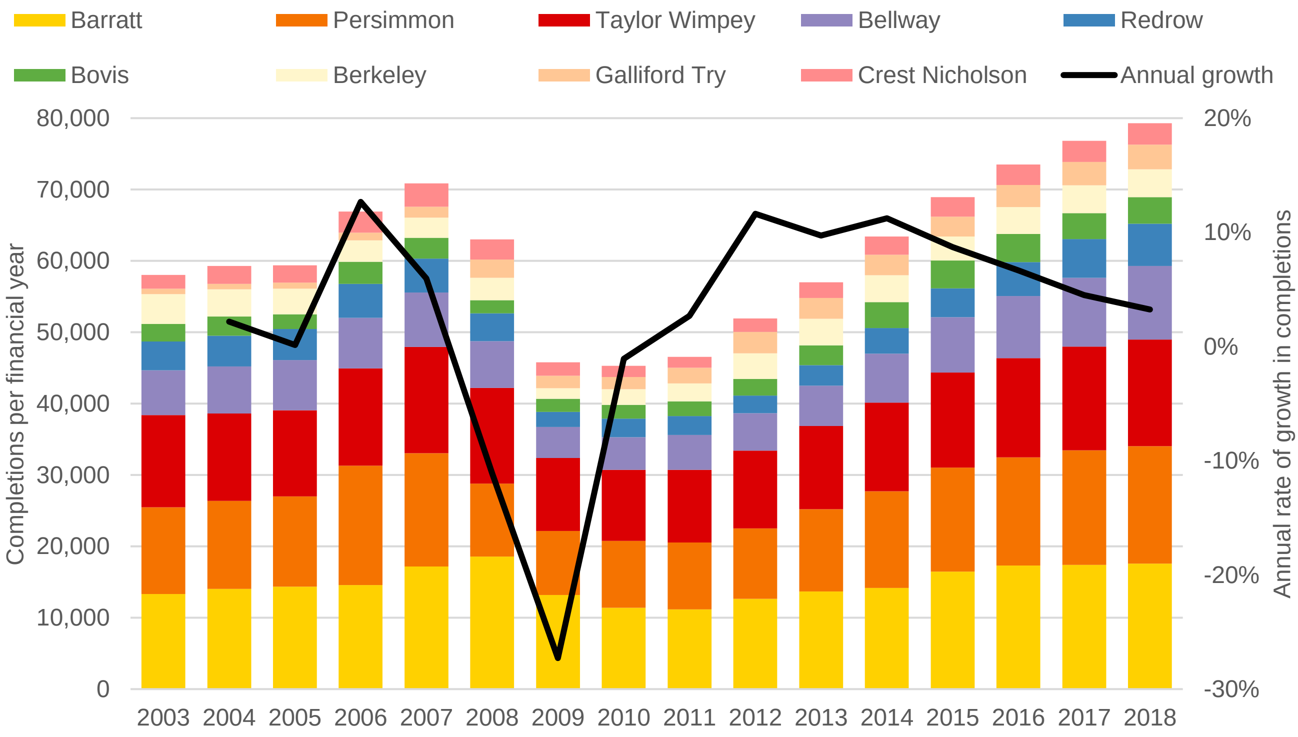
Figure 9 – Growth in total housing delivery in England



Source: Savills using MHCLG, EPCs

Between 2014 and 2017, the annual growth rates in total completions of the nine major housebuilders, who account for some 40% of total new build completions, have also been declining, falling from 11% in 2014 to 3% in 2018.

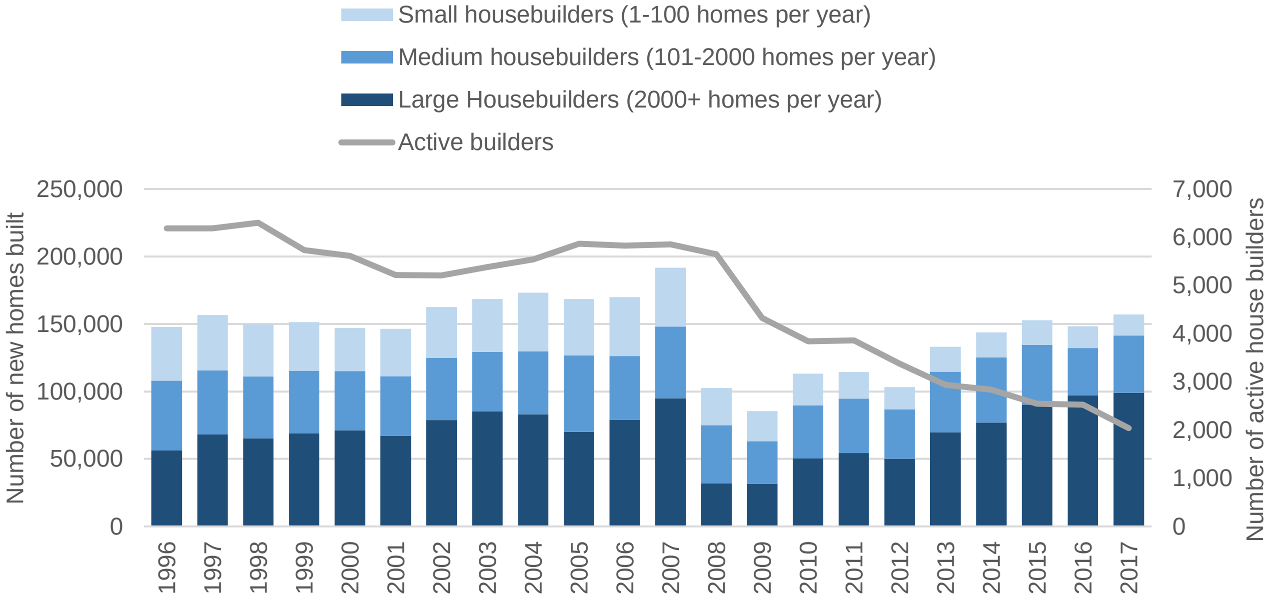
Figure 10 – Total completions by major housebuilders



Source: Savills using Housebuilder reports

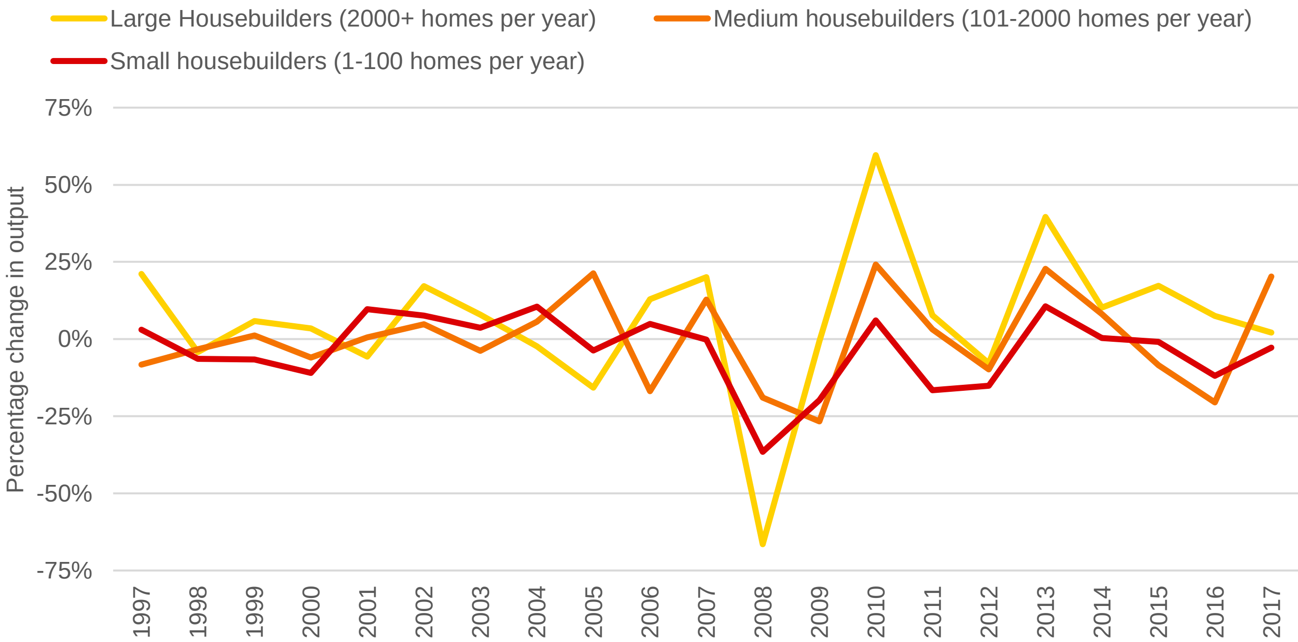
Supply has become increasingly reliant on larger housebuilders as the number of builders has declined since the Global Financial Crisis. Access to land, the cost and complexity of planning and access to finance are significant constraints for SME housebuilders and Government policy is seeking to unlock these barriers, through planning reforms and support for SME finance. Although the growth in output from larger housebuilders has been slowing in recent years, medium sized housebuilders are starting to see significant growth in output.

Figure 11 – Total output by size of housebuilder



Source: NHBC

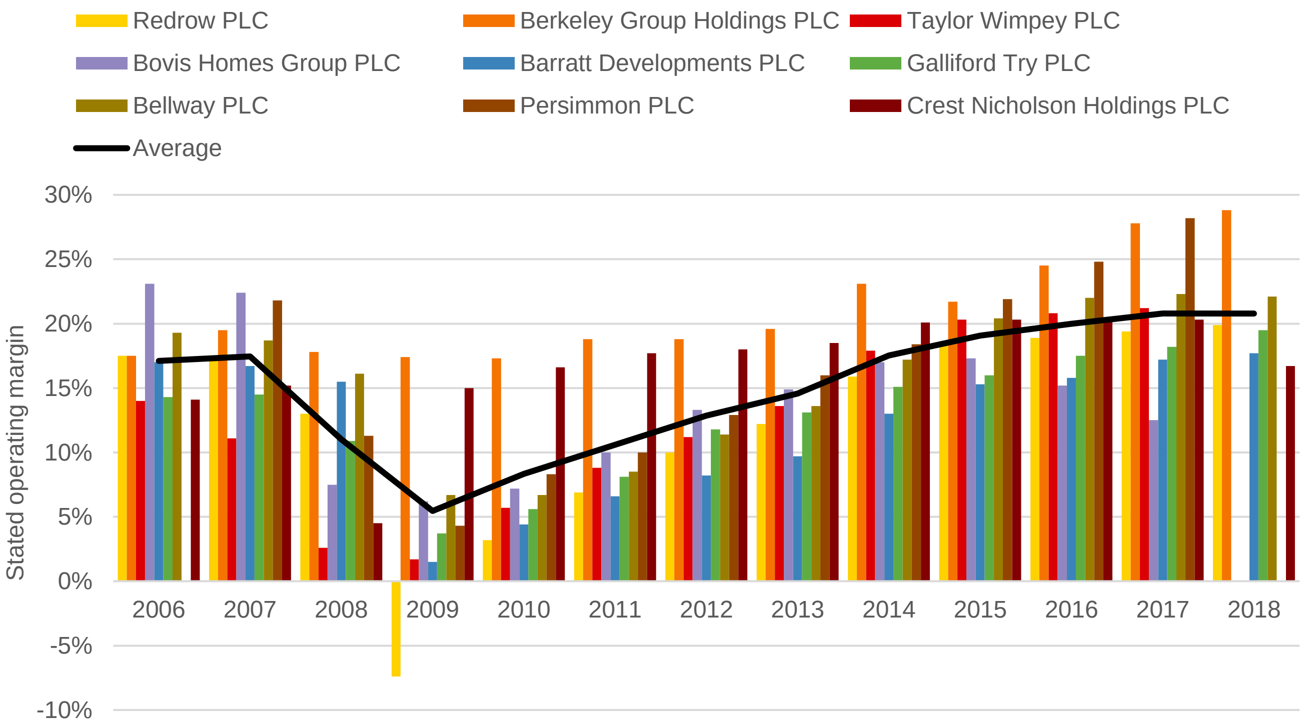
Figure 12 – Growth in total output by size of housebuilder



Source: Savills

Housebuilder expansion of all sizes has been incentivised by a recovery in operating margins, which are dependent on buoyant market conditions. In weaker market conditions there will be less incentive for new entrant start-ups and those looking to scale up a housebuilding business, taking account of the profile of market risk across the whole market cycle, including the risk of a market downturn.

Figure 13 – Housebuilder operating margins



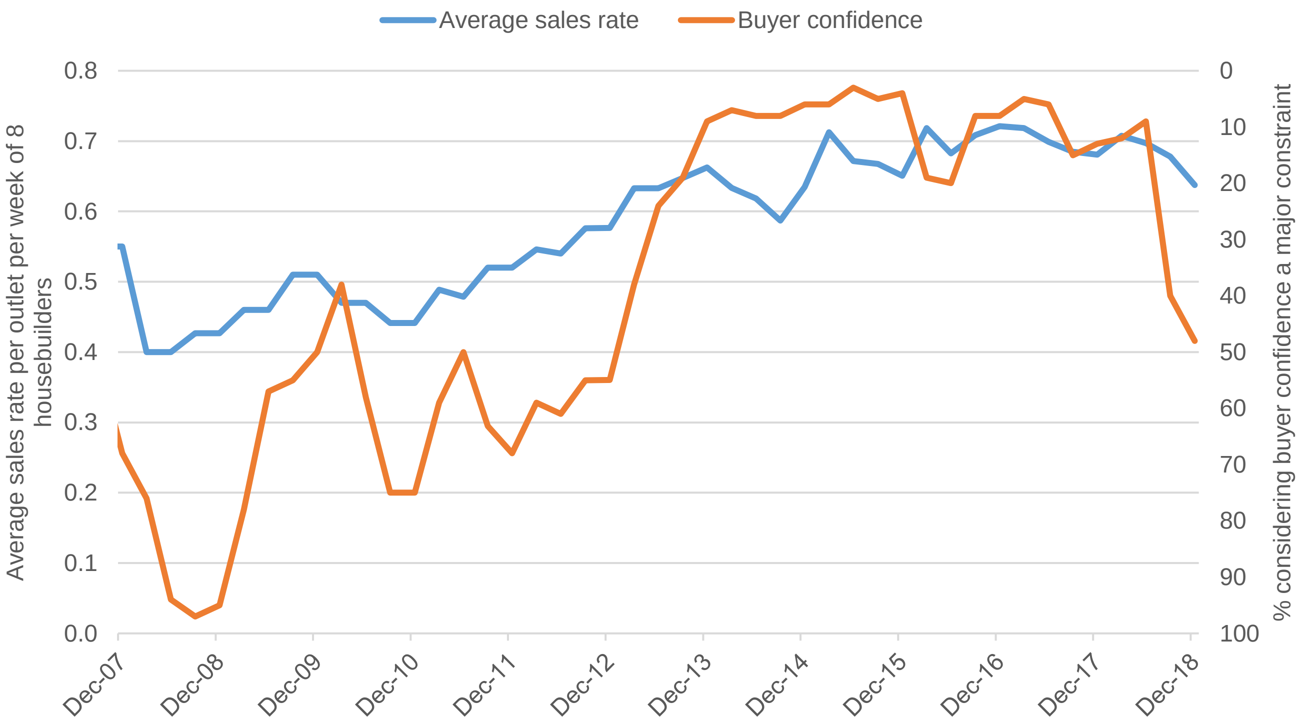
Source: Savills using housebuilder reports (note: not all of the major housebuilder have published FY 2018 reports, therefore the 2018 dataset is incomplete)

4.2. Rates of sale of new homes

Sales rate per outlet, as reported by the major housebuilders, have been relatively stable in recent years, but on average have softened in the most recent results. Taylor Wimpey have reported higher sales rates per outlet than last year. However, Bovis, Persimmon and Miller Homes all reported sales rates consistent with last year and Barratt, Crest Nicholson and Redrow have reported modest falls in sales rates. There is the most pressure on sales rates in London and the South East where affordability is most stretched.

Average sales rates reported by 8 listed housebuilders show modest falls at the end of 2018, following a period of stability. This coincides with a period when almost half of housebuilders surveyed by the HBF (48%) considered buyer confidence a major constraint to development; the highest level since 2012.

Figure 14 – Average sales rates of major housebuilders against major development constraints



Source: Savills using Housebuilder reports, NHBC

Shared ownership has demand factors in common with outright sale, so it is more pro-cyclical than sub-market rent. Shared ownership sales in Inner London in the year to March 2018 are down 43%, according to analysis of data from the Regulator of Social Housing, by Social Housing[6]. This is in contrast to an increase of 2% in Outer London and a 4% increase in the rest of England. The most recent Quarterly Survey from the Regulator of Social Housing reported that the stock of unsold units held by registered providers, for market sale or low cost home ownership (predominantly shared ownership), increased by 18% to 1755 homes in the quarter to December 2018. However:

- the number of units unsold for more than six months fell by 6%; and
- this reflects a much larger development programme, with total completions for sale or low cost ownership increasing by 33% to 5393 homes in December, compared with the previous three year average.

[6] Social Housing, February 2019

4.3. Supply by region

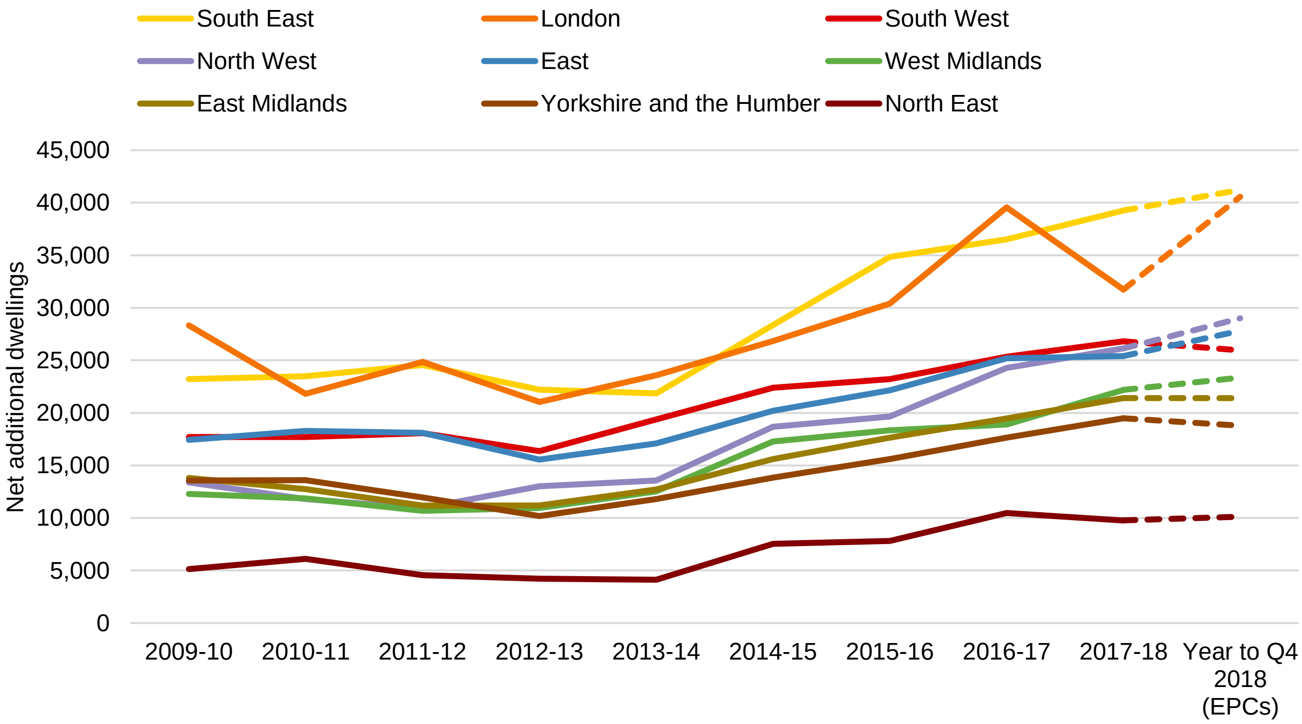
Figure 15 looks at total delivery by region. EPCs are a more up to date indicator of delivery and therefore are used to highlight recent delivery in the year to Q4 2018.

The fastest growth in net additional dwellings in 2017/18 compared to 2016/17 was in the West Midlands where total net additional dwellings grew by 18%.This was followed by 10% growth in both the East Midlands and Yorkshire and the Humber.

By contrast, net additional dwellings in London fell by 20% between 2016-17 to 2017-18, the first fall since 2011-12. More recent data from EPCs to December 2018 indicate that this fall in delivery has recovered.

In 2017-18, there were also falls in the North East where net additional dwellings fell by 7%.

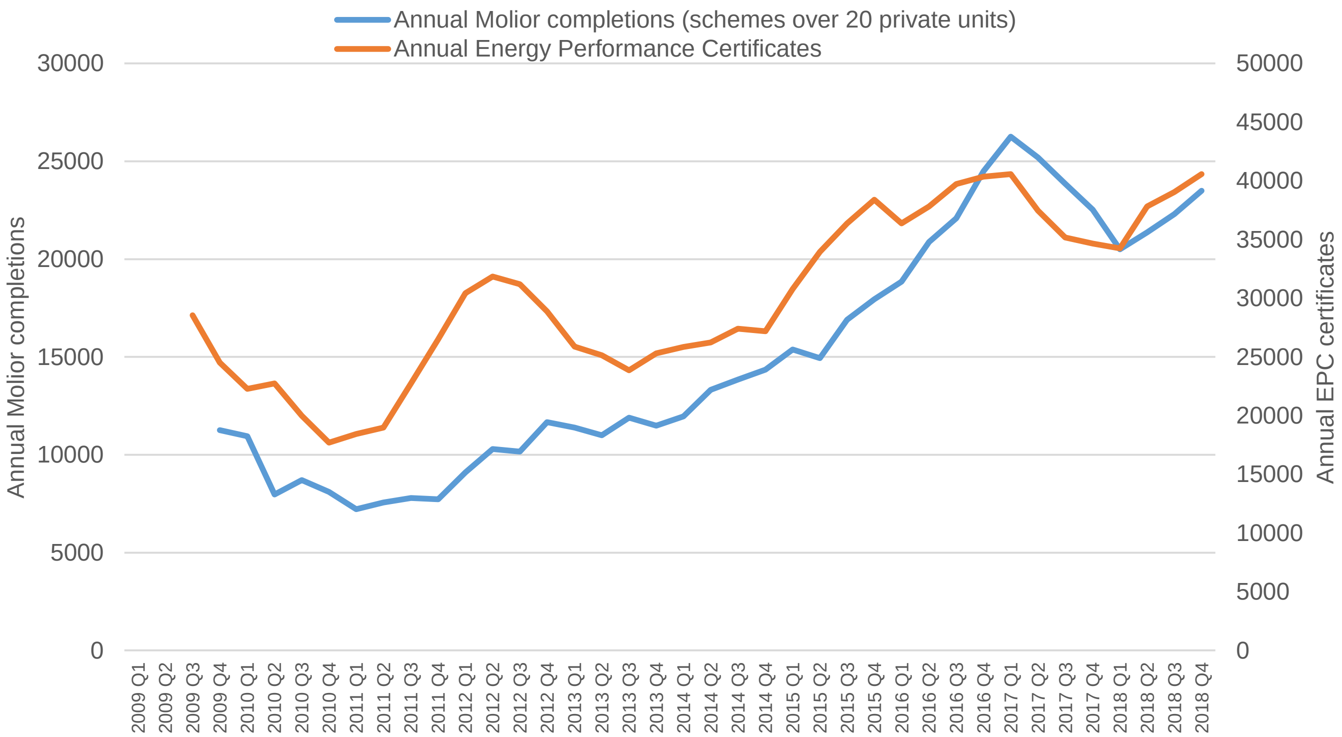
Figure 15 – Total housing delivery by region



Source: MHCLG, EPC

The bounce back in London supply has been driven by completions of homes for market sale or rent on larger schemes of more than 20 units, with a high proportion of market absorption (almost one third) being for large scale private rented operation in London in the last year. Completions by G15 members have risen significantly since March 2018, to include substantial mixed tenure development underpinned by market sale and rent. Latest estimates of G15 completions for market sale and shared ownership in London indicate a year on year increase of 1230 homes in the year to March 2019. This indicates that in the order of 40% of the uplift in 2018 supply could be attributable to housing association activity.

Figure 16 – Total housing delivery in London



Source: EPCs, Molior

Table 1 – G15 completions in London

	2015/16	2016/17	2017/18	2018/19 (Fcst)
Market Rent	659	688	647	1,453
Open Market Sale	2,188	1,530	1,430	1,854
Total	**2,847**	**2,218**	**2,077**	**3,307**

Source: G15

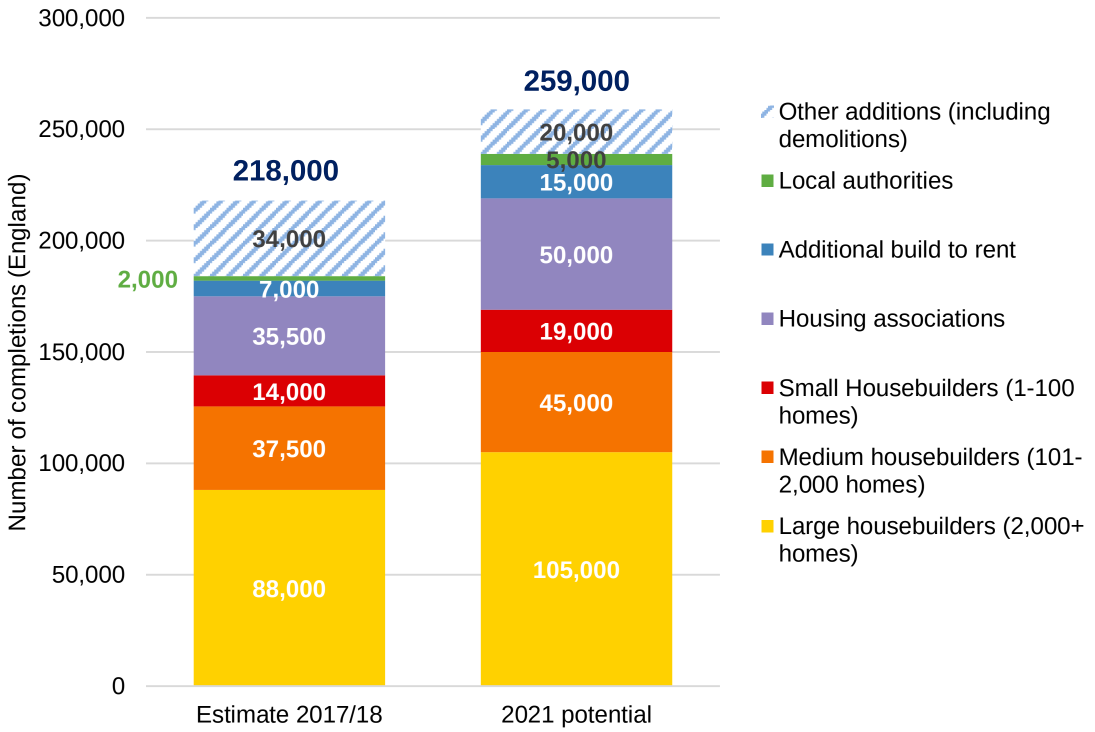
4.4. Housing supply projection

Analysis published by Savills in October 2018[7] indicates that annual housing supply will rise from around 220,000 to 260,000 homes in 2021, assuming:

- 6% growth pa from larger and medium sized housebuilders, including expansion of the number of housebuilders in each category, as builder expand.
- 10% growth pa from small housebuilders, as the availability of finance and land opportunities grow.
- Housing associations expanding from 35,000 to 50,000 homes per annum, in line with stated plans.
- Build to rent increasing its rapid expansion, going from 7,000 to 15,000 per annum, noting that much of this will support continued expansion of output by housebuilders and housing associations, so is partially included within the other assumptions.
- Local authorities increasing annual development to 5,000 homes, making use of new borrowing capacity within the HRA.
- Other completions, primarily those via Permitted Development Rights, falling from 34,000 to 20,000 per annum.

These projections build in the current £9bn affordable housing grant programme that runs to 2021 and expanded levels of funding thereafter. There is downside risk to the growth assumed for larger housebuilders, given that recent growth for the largest nine housebuilders has been at around half that level. Housebuilder expansion at all sizes has been facilitated by attractive operating margins which depend on buoyant market conditions. Those housebuilders that have stated their future growth intentions are planning for annual growth of between 3 and 5%. Our supply projections did not look beyond the end of the current Help to Buy programme in 2021 and we now know that the subsequent two year scheme to 2023 will be tapered and that Government does not currently intend to run an equity loan scheme thereafter.

Figure 17 – Housing supply projections



Source: Savills

[7] Savills 2018, *Spotlight: What Next For Housebuilding?* https://www.savills.co.uk/research_articles/229130/267509-0/spotlight--what-next-for-housebuilding-

5. Help to Buy

Help to Buy has accelerated new build delivery. The support of the scheme has enabled new build completions to continue growing, despite the relatively stagnant number of transactions in the wider residential market. Historically, the rate of new build completions has moved in line with the total number of residential transactions. MHCLG's most recent evaluation of the scheme[8] suggests that it has resulted in 37% demand additionality across England, and 16% supply additionality.

There are significant regional variations to the impact of Help to Buy. In London, supply additionality from Help to Buy is estimated to be only 7%, reflecting the low proportions of Help to Buy sales there. The North West has seen the highest proportion of Help to Buy Sales, but has a lower level of supply additionality of 17%, as house prices are lower and therefore there are more options available to buyers without having to use Help to Buy.

Figure 18 – Relationship between total transactions and private new homes completions

Source: Savills using HM Land Registry

[8] Williams, Whitehead 2018, *Evaluation of the Help to Buy Equity Loan Scheme 2017.* Christine Whitehead, Peter Williams, IPSOS MORI and the London School of Economics, Ministry of Housing, Communities and Local Government, October 2018. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/751359/Evaluation_of_the_Help_to_Buy_equity_loan_scheme_2017.pdf

5.1. Impact of tapering and potential end of Help to Buy

The Government announced that it will extend Help to Buy beyond the scheme's current end date of 2021, with a new scheme that includes some important restrictions. From April 2021 until March 2023, a new Help to Buy Equity Loan (HTB:EL) scheme will run. This new scheme will be restricted to first-time buyers, who currently take up 81% of HTB loans.

The revamped HTB:EL scheme imposes regional caps on the maximum property value people can buy under the scheme. These caps will be set at one and a half times the current regional average first-time buyer price, up to a maximum of £600,000.

Using the average value of loans completed, we have estimated the average property value purchased using Help to Buy by region. The caps exceed the Help to Buy value in all regions apart from the North East. In London and the South, typical HTB property values lie well below the proposed caps. In the North East, the value cap is marginally below the average value bought using the scheme.

In order to keep housing delivery on track to reach 300,000 homes per year by the mid 2020's, the additional sales supported by the Help to Buy scheme will need to be replaced. This could be achieved through increasing use of higher loan to value mortgages (but this is restricted by loan to income limits, particularly in higher value markets) and through diversifying tenures.

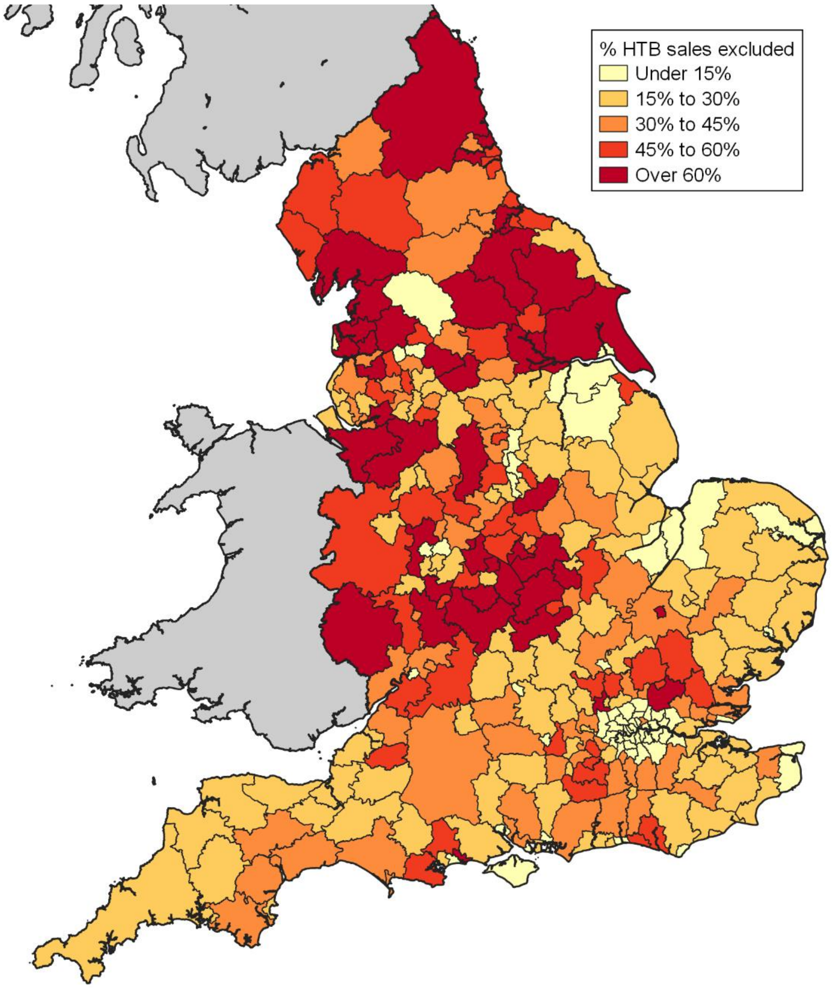
Figure 19 – Average Help to Buy property values and the new regional caps

Source: Savills, MHCLG, HMT

The maps show where the Help to Buy change exclude the most transactions. The new restrictions put the most pressure on the higher value parts of the North and Midlands, where the caps are low whilst it appears that they will have a more limited effect in London and the South.

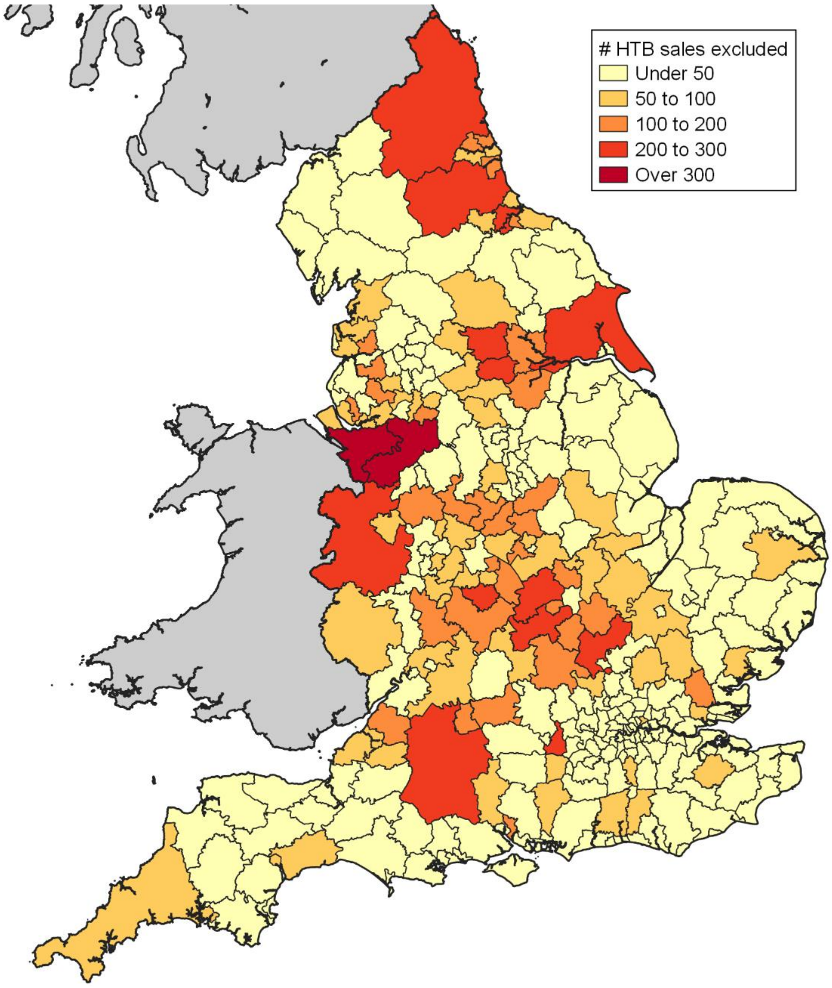
32% of homes sold through Help to Buy in the year to June 2018 had values above the suggested regional caps. Developers will have to build lower priced homes in those areas currently above the cap in order to enable Help to Buy users to access these homes.

Figure 20 – Proportion of Help to Buy sales excluded by changes to the scheme



Source: Savills, MHCLG, HMT

Figure 21 – Number of Help to Buy sales excluded by changes to the scheme



Source: Savills, MHCLG, HMT

We estimate that almost 17,000 Help to Buy sales, 34 percent of the total, would not have happened if the new planned restrictions for Help to Buy had been in place in the year to June 2018 as a result of the exclusion of home movers and imposing regional value caps.

By restricting Help to Buy to first time buyers from April 2021, this will exclude 18% of the scheme's current users. A total of 9,100 home movers took out a Help to Buy loan in the year to June 2018, 3% of all mortgaged home movers, but this varies greatly by district. For example, in Islington, there were no Help to Buy sales to home movers last year compared to 40% of Hackney's Help to Buy sales were to home movers. In some areas, the scheme has provided a boost to those looking to upsize in more expensive markets.

There is evidence to suggest that some of the Help to Buy sales excluded by this restriction would happen anyway. The Whitehead & Williams analysis of 2017 sales[9] suggests that while 38 percent of first time buyers using Help to Buy could not otherwise have bought a home, that proportion was just 33 percent for home movers. This suggests that restricting the scheme to first time buyers would have a less dramatic impact than simply reducing transaction volumes by 20 percent between 2021 and 2023, as only 3,000 of those home mover transactions were additional.

[9] Williams, Whitehead 2018, *Evaluation of the Help to Buy Equity Loan Scheme 2017.*

There is significant overlap in the transactions that would be excluded by each of the new restrictions as home movers using Help to Buy tend to buy larger, more expensive homes, as stated above. Assuming home movers buy the most expensive Help to Buy properties in each district, 34% of Help to Buy transactions last year would have been excluded by one or both restrictions. However, two thirds of these excluded buyers would probably have bought a different, probably cheaper, new build property.

There were some 50,000 Help to Buy sales in the 12 months to June 2018, comprising 33% of new homes sales. The assessment of the additionality of Help to Buy, for MHCLG[10], found that, in the absence of Help to Buy:

- 6% of buyers would have bought the same property;
- 45% would have bought a different property, either new or second hand
- 12% would have bought a second hand property
- 37% would not have bought.

It also found that 70% of Help to Buy users bought a larger home than they would otherwise have bought.

The overall impact on new homes sales of the tapering of the Help to Buy scheme from 2021, with the potential for no committed scheme from 2023, will depend on a wide range of factors. These include the extent to which mortgage markets improve, the impact of any other schemes put in place by Government, and the ways in which housebuilders adjust their product to retain buyers in the new homes market.

If, say, two thirds of would-be Help to Buy purchasers are retained within the new homes market via these factors, then there would be a reduction in all new homes sales of around 10%. This downside risk scenario of a 10% reduction in overall new homes sales in 2023/25, should there be a complete withdrawal of Help to Buy (with a worst case scenario of a 20% reduction), would be consistent with assumptions made by some equity analysts, alongside lower operating margins. This is before considering any mitigating policy options.

The scenario of a 10% to 20% cut in new homes sales and the associated Section 106 affordable housing represents a significant downside risk to completions after 2023, of between 17,000 and, in the worst case, 34,000 homes per annum. Tapering of Help to Buy in the 2021-23 period represents a much smaller but notable downside risk to completions.

The consequence of these downside risk scenarios would be that all other supply would have to expand by between 23% and, in the worst case, 33% between 2021 and 2025 to meet the 300,000 homes target, probably in more challenging market conditions.

[10] Williams, Whitehead 2018, *Evaluation of the Help to Buy Equity Loan Scheme 2017.*

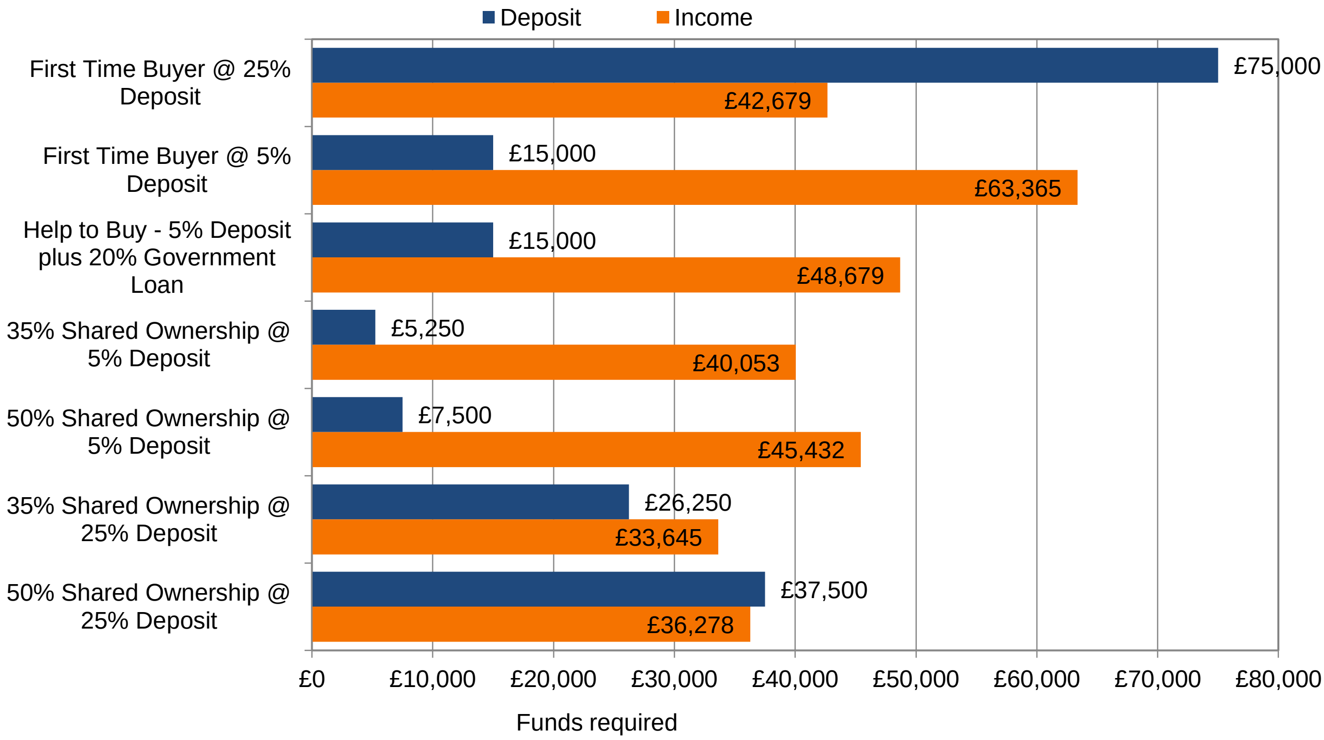
5.2. Affordability of Help to Buy and shared ownership

Figure 22 shows the different deposit and income requirements for households making different kinds of purchases, based on the pricing of a home priced at £300,000, assuming households spend 30% of income on housing:

- The average first time buyer using a 25% deposit would need an income of £42,679 and a deposit of £75,000 in order to purchase a home at this price.
- Buyers using the government Help to Buy equity loan would need a similar income of £48,679 but a considerably smaller deposit of £14,000.
- Households buying Shared Ownership properties again require a reduced deposit of as little as £5,000 and an income of £33,645 for a 35% share.

The analysis shows the significant deposit constraint to first time buyers using a 75% loan to value mortgage, together with the affordability advantages of using Help to Buy. It also shows that shared ownership can potentially play a valuable role in supporting demand for new homes, should Help to Buy be phased out. If this is to be the case, it will need to be made readily available in new homes sales offices.

Figure 22 – Affordability calculator



Source: Savills, CML, ONS

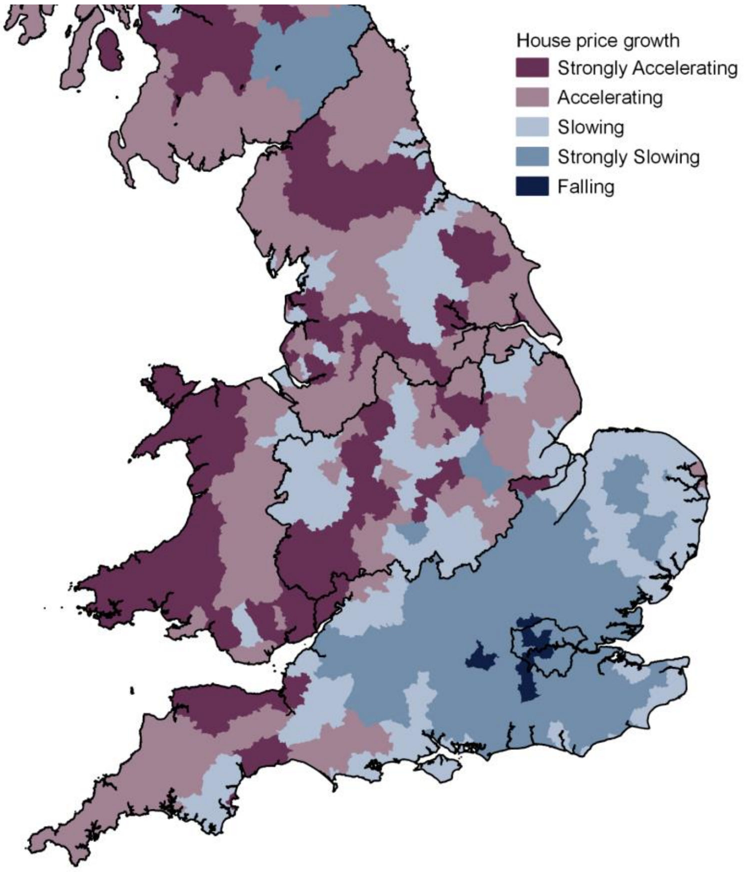
6. Market capacity

The tapering and, subsequently, the possible end of Help to Buy is likely to lead to lower rates of sale in the new homes market which, as a result, is likely to be more influenced by the factors that have constrained turnover in second hand markets.

6.1. House price growth

House price growth is decelerating across London and the South where house price growth has been the strongest since the 2007/08 peak and, consequently, affordability is most stretched. The North and Midlands are currently experiencing accelerating house price growth which is rippling out from the south of the country.

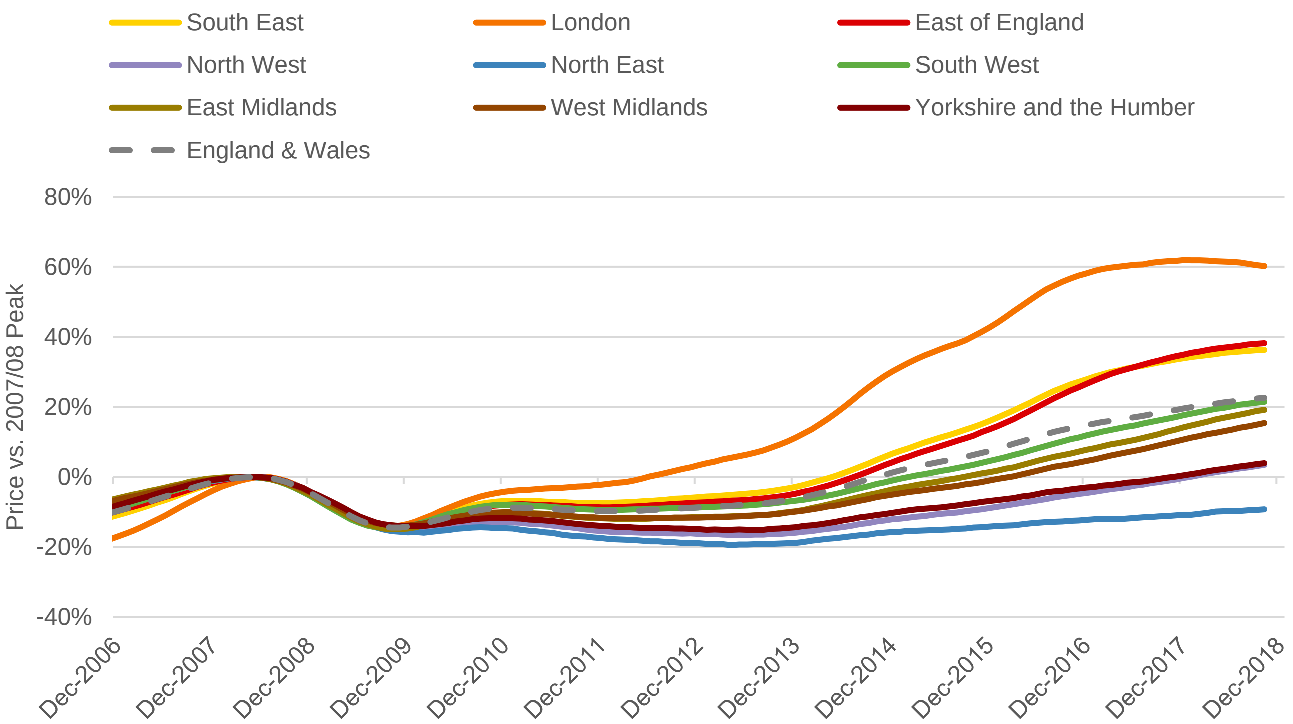
Figure 23 – House price growth performance



Source: Savills using HM Land Registry

House prices in London, South East and the East of England have recovered the most from the 2007/08 financial crash. Prices in London are 60% above their 2007/08 peak. On the other hand, price growth in the Northern regions has been a lot weaker. House prices in the North East are still 9% below their previous peak.

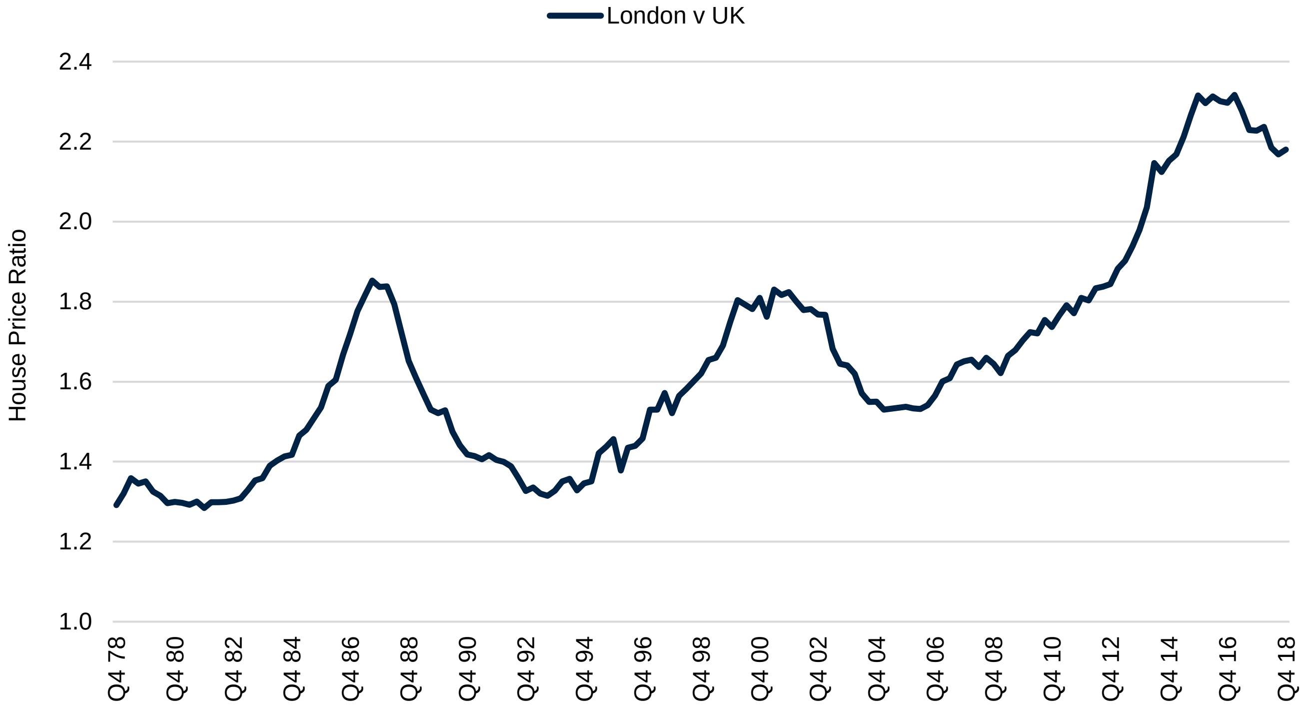
Figure 24 – House price growth by region



Source: Savills using HM Land Registry

The graph shows London house prices as a multiple of national house prices. Since 2008, house prices in London have significantly outperformed the rest of the country. As house prices in London are slowing whilst price growth moves out to the regions the North and the Midlands, the ratio has moved past the point of inflexion that has seen during recent house price cycles, indicating that we have moved into the later stages of this house price cycle.

Figure 25 – House price growth in London compared to the UK

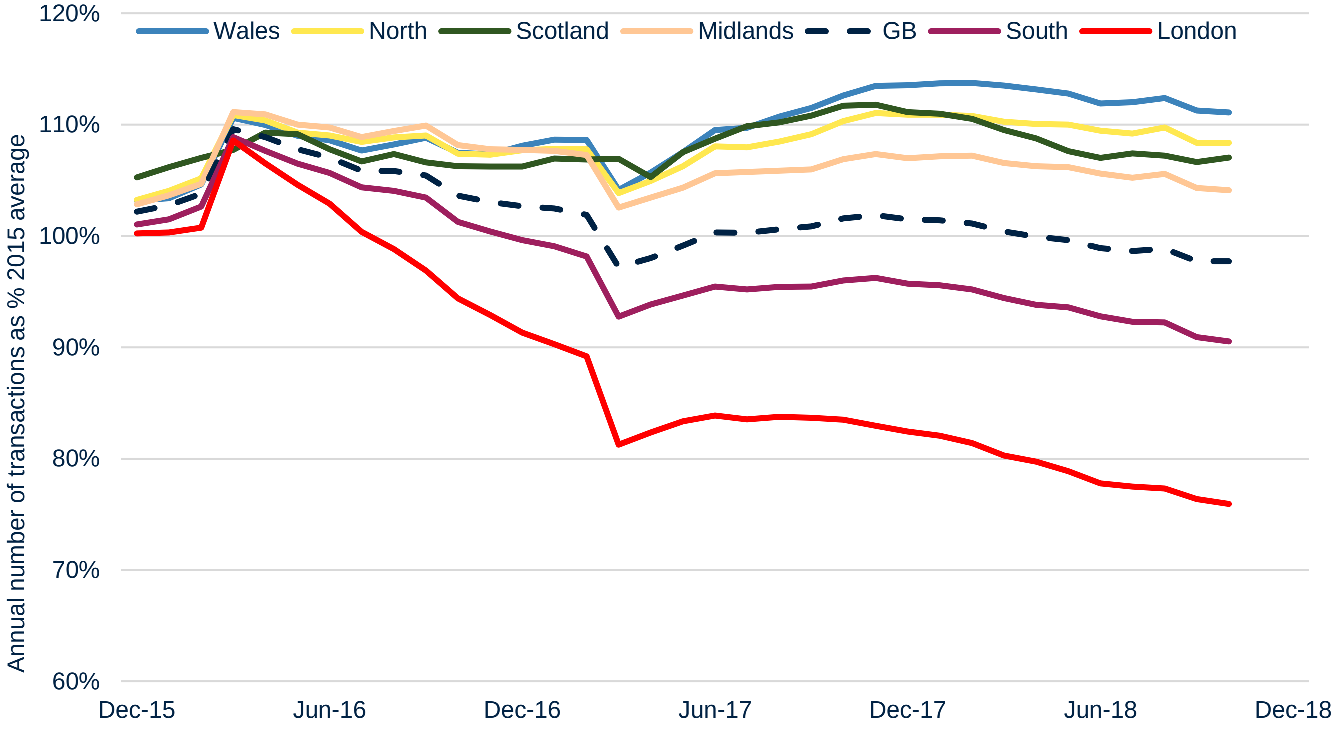


Source: Savills using HM Land Registry, Nationwide

6.2. Transaction volumes

In contrast to new homes sales, total residential transactions have largely flattened or have fallen across the country in 2018, with London showing the largest decline. On a 12 month rolling basis, sales volumes across the country were down 3.8% in October 2018, compared to the same time the previous year. London experienced the largest drop of 9.1%, while the North East has shown the most resilience, falling by only 1.0%.

Figure 26 – Total transaction volumes by region



Source: Savills using HM Land Registry (adjusted for count lag) and Registers of Scotland

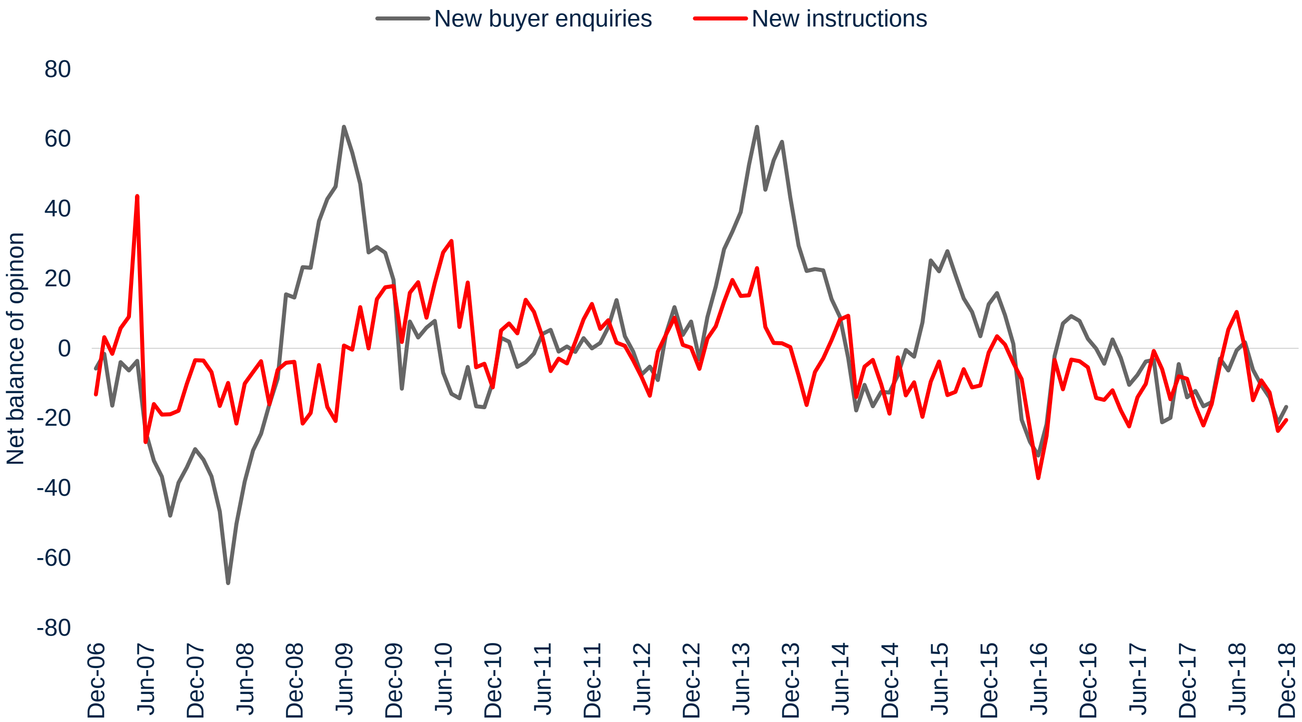
The report investigating the effects of Stamp Duty Land Tax on the housing market by LSE and the Family Building Society, published in July 2018[11] concludes that there was a marked decline in stamp duty receipts from residential transactions in the first quarter of 2018 when compared with the equivalent period in 2017. This is in part the result of lower transaction volumes as existing owners have less incentives to move due to the additional stamp duty charges.

[11] Whitehead, Scanlon, Blanc, 2018, *A tax too far? Monitoring the impact of SDLT, Report for Family Building Society.* Christine Whitehead, Kath Scanlon, Fanny Blanc, July 2018. https://familybuildingsociety.co.uk/About-us-home/MediaCentre/Stamp_Duty_-_Rich_v2.aspx

The December RICS Residential Market Survey shows that the number of surveyors reporting declining numbers of enquiries and instructions continues to grow. New buyer enquiries fell for the fifth consecutive month, with the balance of opinion at -17, slightly less negative than the -20 reported in November. New instructions also fell for the sixth consecutive month. Brexit related political uncertainty has contributed to subdued sentiment in the immediate term.

At December 2018, sales expectations in the short term were in negative territory in all regions across the country apart from the North West where sales expectations were relatively flat. Sales expectations were at their lowest since 1998. The lack of clarity surrounding the outcome of Brexit is closely related to pessimistic sales expectations and outlook across all regions.

Figure 27 – RICS sentiment survey



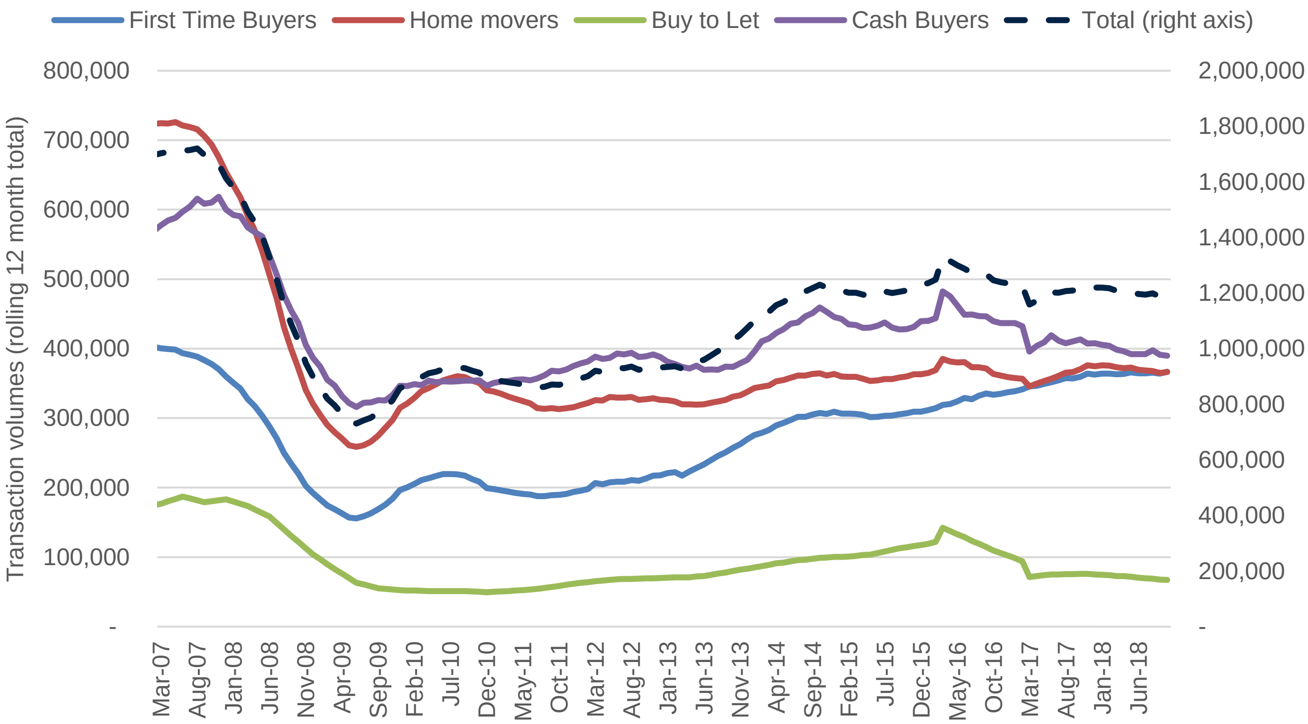
Source: RICS

First time buyer volumes are recovering from a low base partly as a result of Help to Buy and the 'Bank of Mum and Dad' and more recently the exemption from stamp duty.

On the other hand, home mover transaction volumes are failing to recover due to affordability constraints to moving up the housing ladder. In pre-1990 cycles home mover affordability was enhanced by the inflationary erosion of debt and, during much of the 1990s-2000s cycle, affordability was enhanced by relatively low interest rates coupled with lower house prices than is now the case.

Due to the increased challenges the buy to let sector is facing, mortgaged buy to let volumes have fallen by 41% since September 2016.

Figure 28 – Total transaction volumes by buyer type



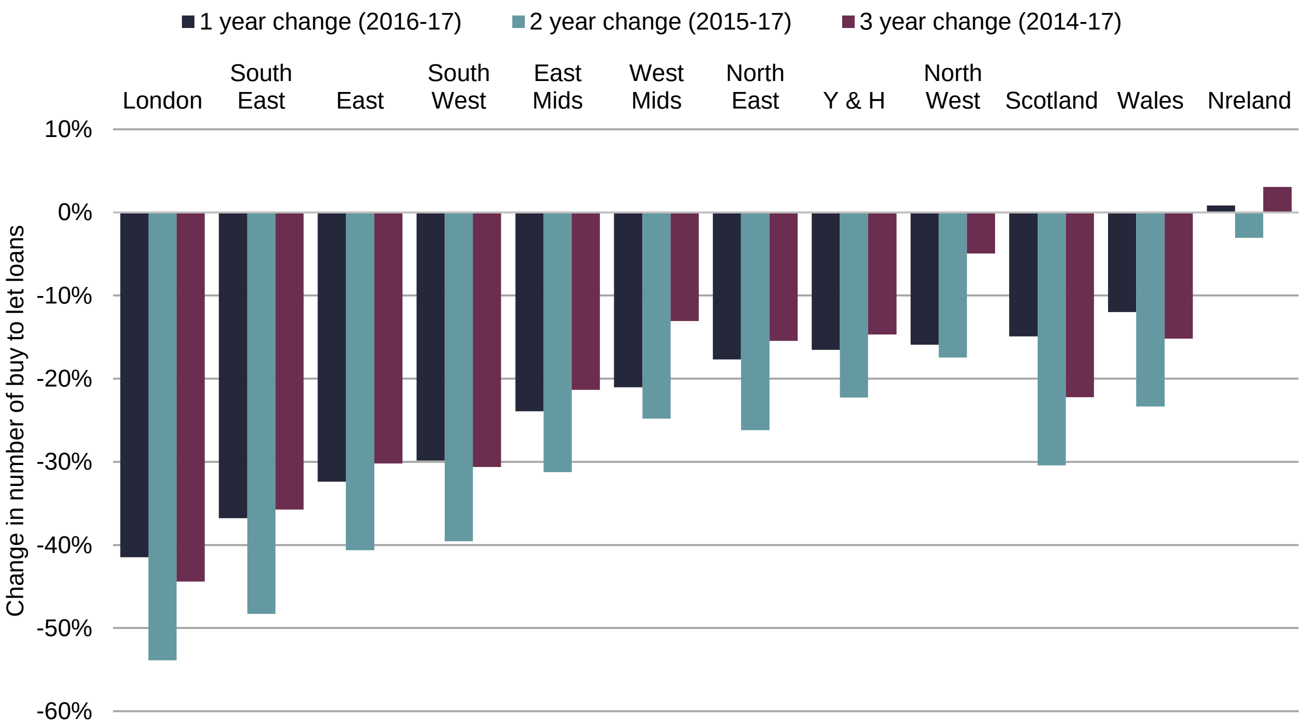
Source: UK Finance

6.3. Buy to Let lending

As noted above, buy to let mortgage lending has fallen by 41% in the last two years since September 2016. The greatest falls in buy to let lending are concentrated in London, the South East and the East where income yields are the lowest, following high house price growth. There are also fading capital growth prospects for buy to let investors.

Government and fiscal policy changes have made investment in the private rented sector less attractive. Buy to let investors are subject to an additional 3% stamp duty charge and capital gains tax on any value increase when they sell. Buy to let investors with a mortgage must now pass stricter affordability stress tests. In addition to tighter mortgage regulation on the sector, mortgage interest tax relief has been withdrawn t higher income tax rates.

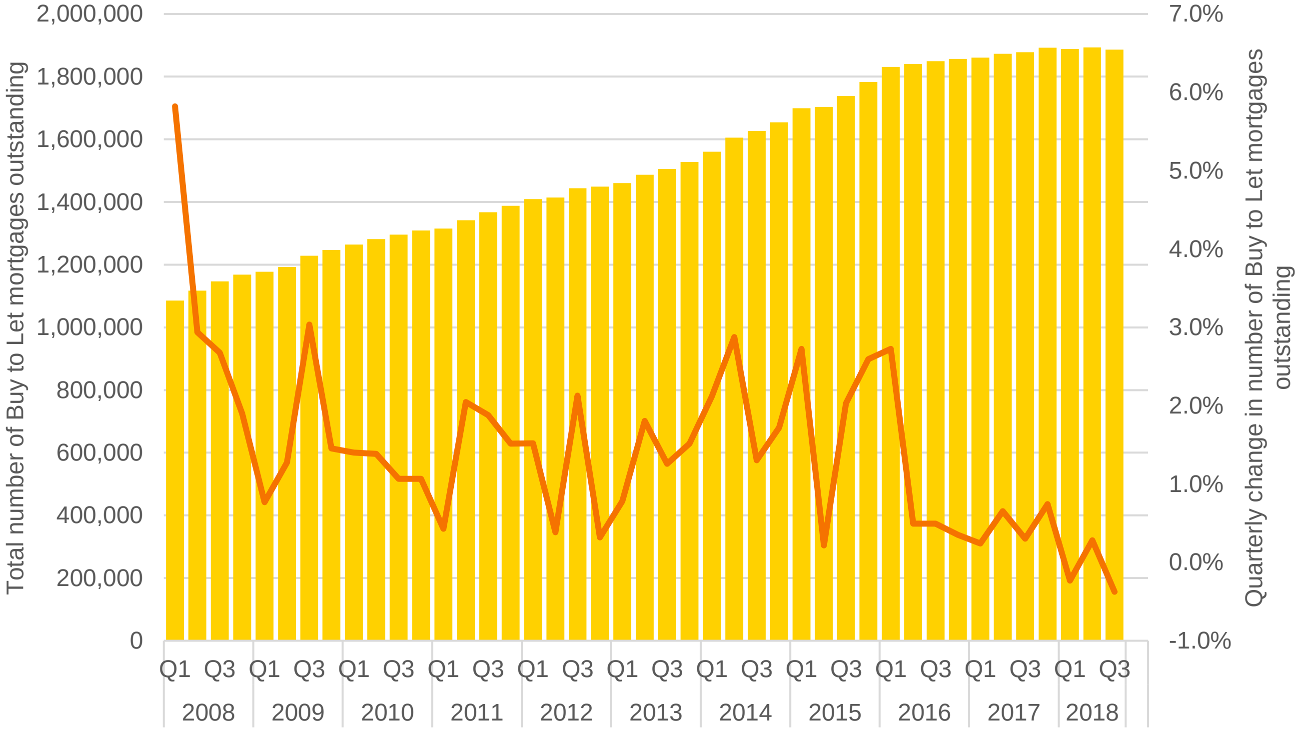
Figure 29 – Change in buy to let lending by region



Source: UK Finance

After a period of strong growth in outstanding buy to let mortgages, buy to let loans started to flatten off in 2017. In Q3 2018, the number of Buy to Let loans fell, representing the first fall in over 10 years.

Figure 30 – Change in the total number of buy to let mortgages

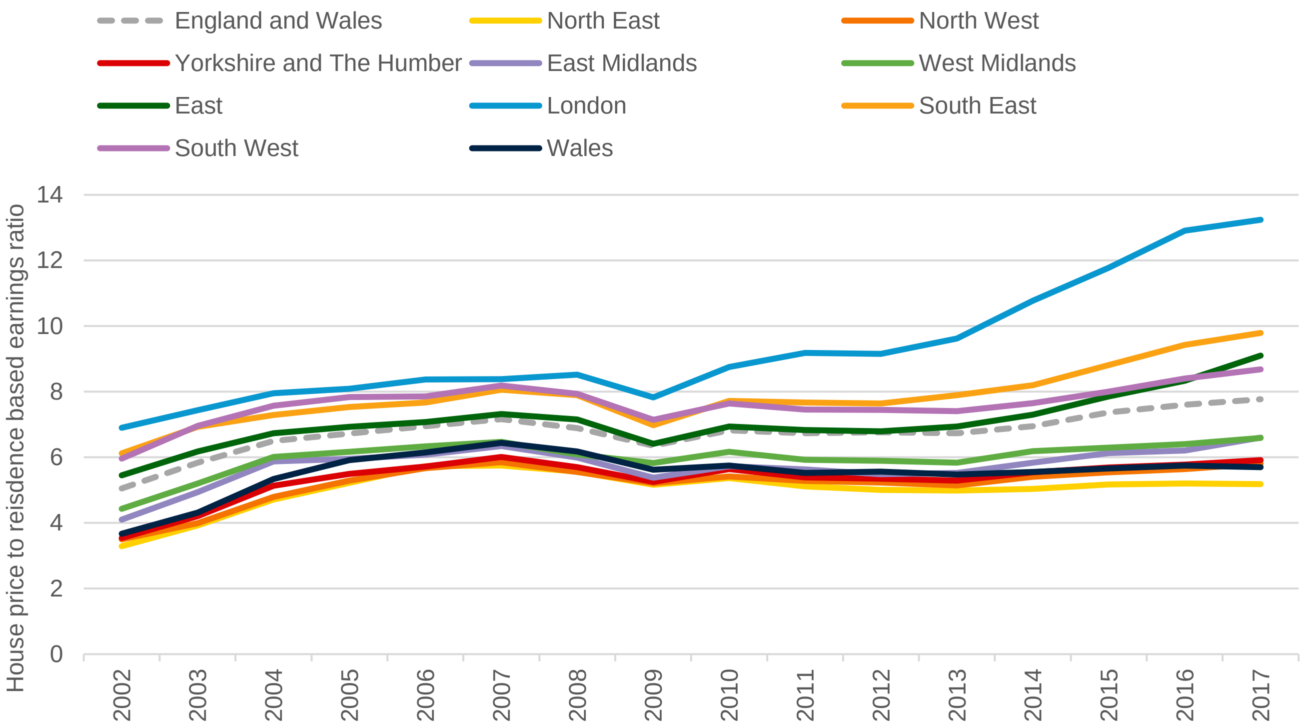


Source: UK Finance

6.4. The affordability constraint

Since the 2007/08 downturn, the house price to earnings ratio has been increasing in all regions. London's house price to earnings ratio has grown significantly, diverging from the national average, underlining how stretched affordability is in London. The house price to earnings ratio for London is 13.2, considerably above the national average of 7.8.

Figure 31 – Median house price to earnings ratio

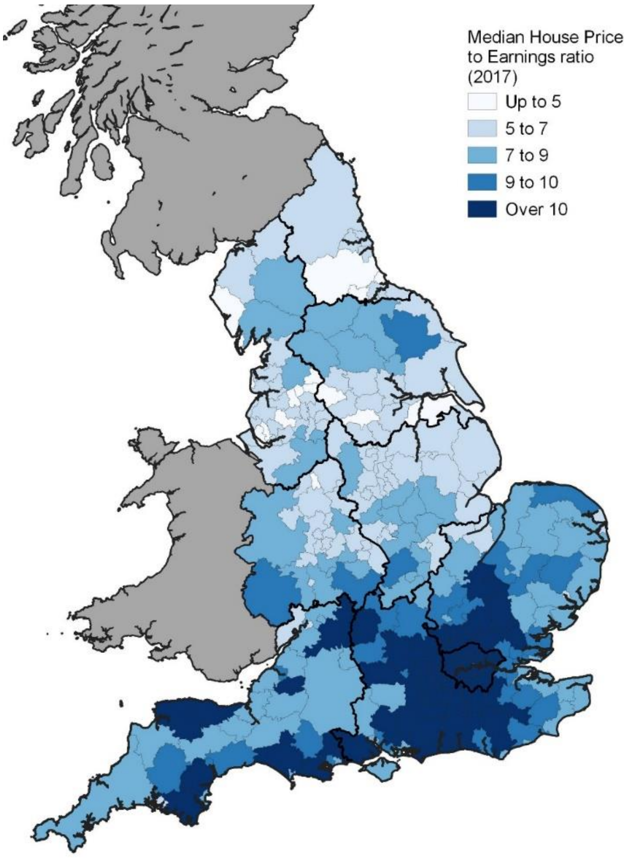


Source: ONS

The areas with the most constrained affordability are concentrated in London and the South East, where house prices have grown the most strongly.

The North and the Midlands are significantly more affordable when compared to London and the South East. However there are areas of high house prices and more constrained affordability within the North and Midlands.

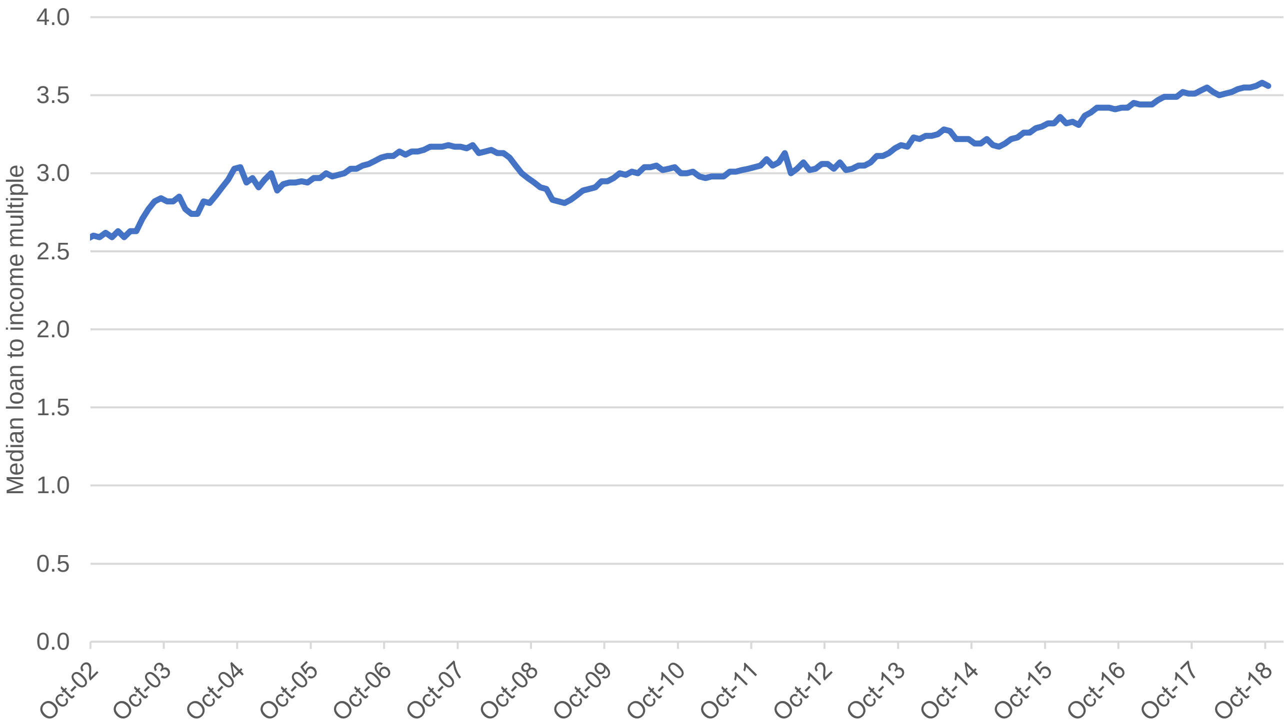
Figure 32 – Median house price to earnings ratio



Source: ONS

In line with fast growth in house prices, the median Loan to Income (LTI) multiple has been steadily increasing since the 1980s. During 2008 and 2009 the income multiple fell from its 2007 peak of 3.2 to 2.8. Since 2011 it has been on the rise and is now at an all time high of 3.51. The affordability of these higher loans is tested relatively stringently, as the 2014 Mortgage Market Review requires banks to stress test the affordability of new loans at 300bps above their current interest rate.

Figure 33 – Growth in loan to income multiples

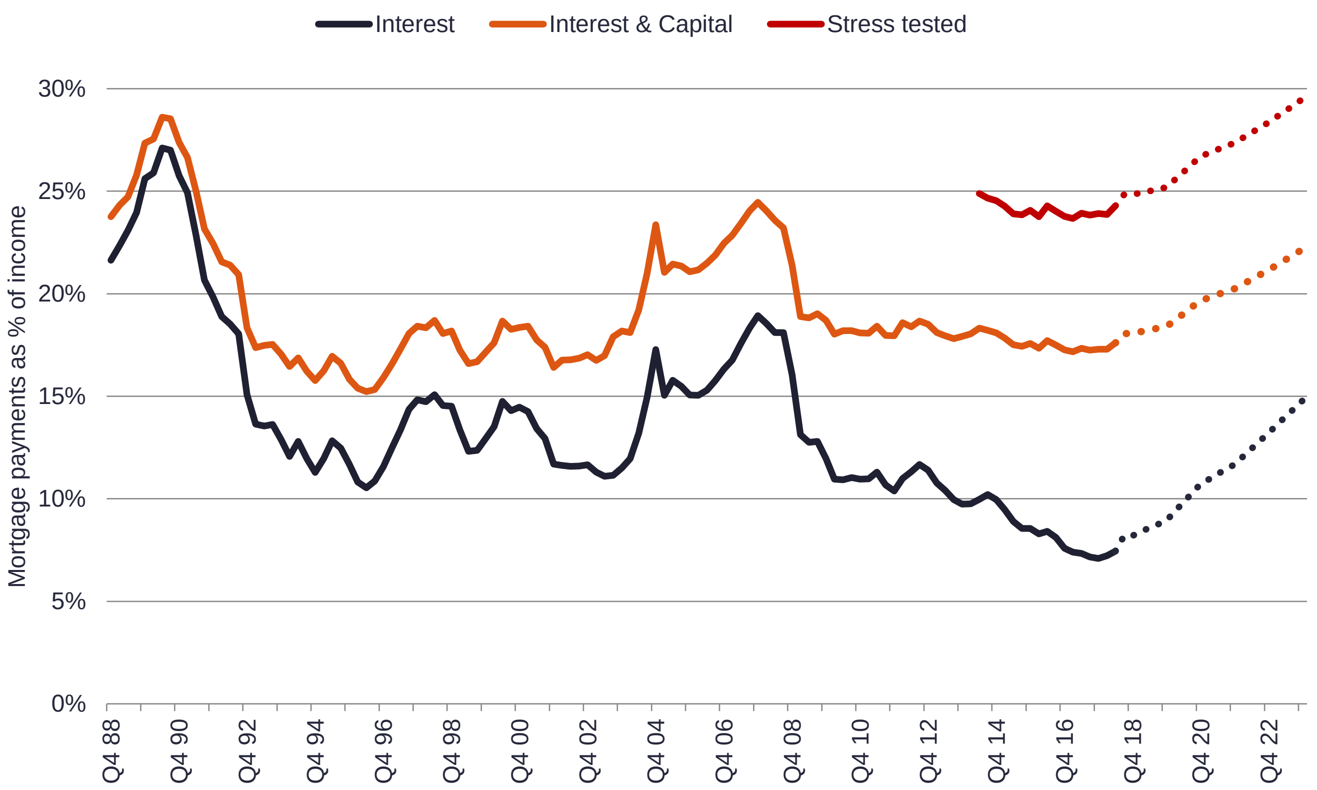


Source: UK Finance

Mortgage payments in recent years are at affordable levels for both interest only and interest and capital mortgage payments. The proportion of income spent on mortgage payments has consistently fallen since 2007/08 due to a sustained period of low interest rates.

The base rate is still only at 0.75%. However it is expected that interest rates will start to rise in the medium term, putting increased pressure on borrowing. This raises the question of whether further interest rate rises could result in a further squeeze on mortgage affordability, restricting the market to a smaller proportion of potential buyers

Figure 34 – Mortgage payments as a proportion of income



Source: Savills, UK Finance, Oxford Economics

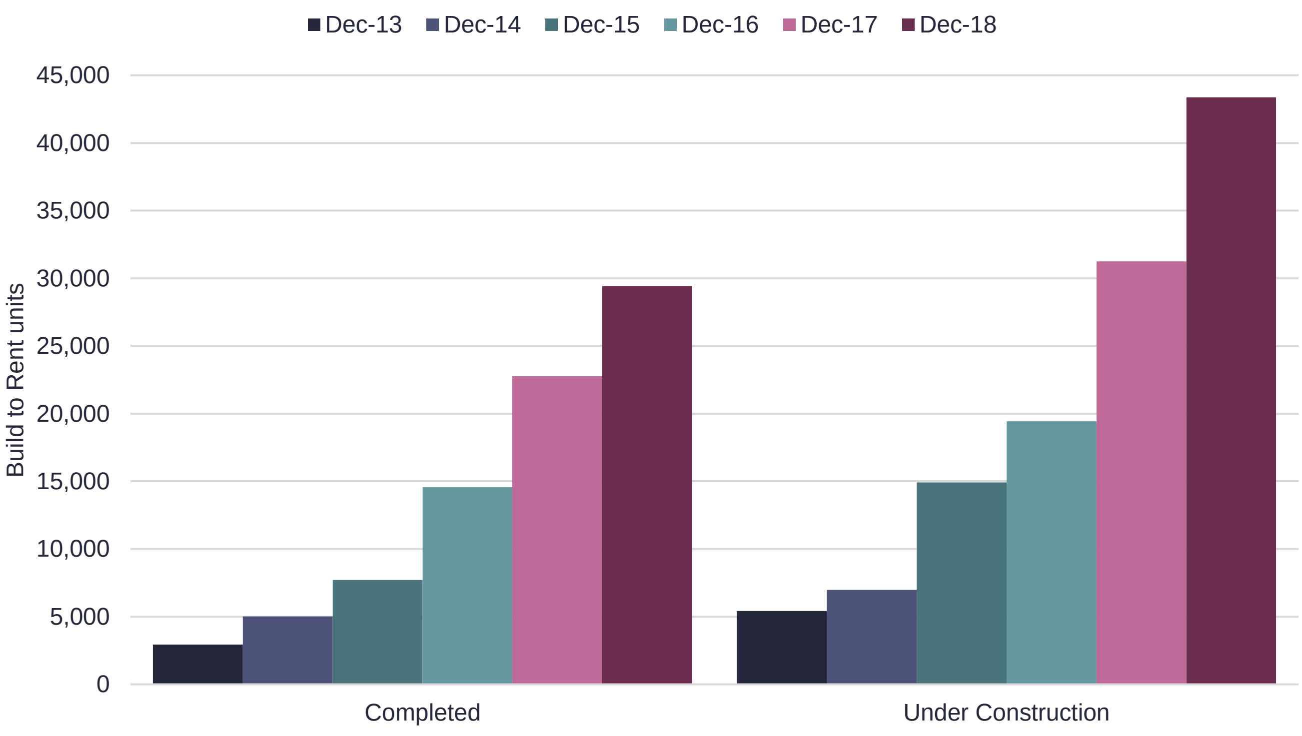
6.5. Build to Rent

The Build to Rent (BTR) sector has continued to grow in 2018. The total number of new BTR units completed, under construction, or in the longer term planning pipeline in the UK stood at 139,500 as at Q4 2018, a 22% increase on Q4 2017. In 2018, new Build to Rent completions accounted for 7,000 new homes. This rapid growth highlights the momentum of the sector which continues to attract significant investment, from both overseas and domestic institutional investors.

There were 43,374 BTR units under construction as at Q4 2018, a 39% increase on Q4 2017. The total number of completed BTR units was 29,416 as at Q4 2018, an increase of 29% year on year.

Build to Rent is gaining momentum and confidence as an alternative sector. The sector has potential to boost housing supply. Savills expects that annual Build to Rent completions could total 15,000 by 2021, over and above housebuilder completions that are acquired by Build to Rent operators. However this still leaves a significant gap between delivery and the government target of 300,000 homes by the mid 2020's.

Figure 35 – Growth of Build to Rent



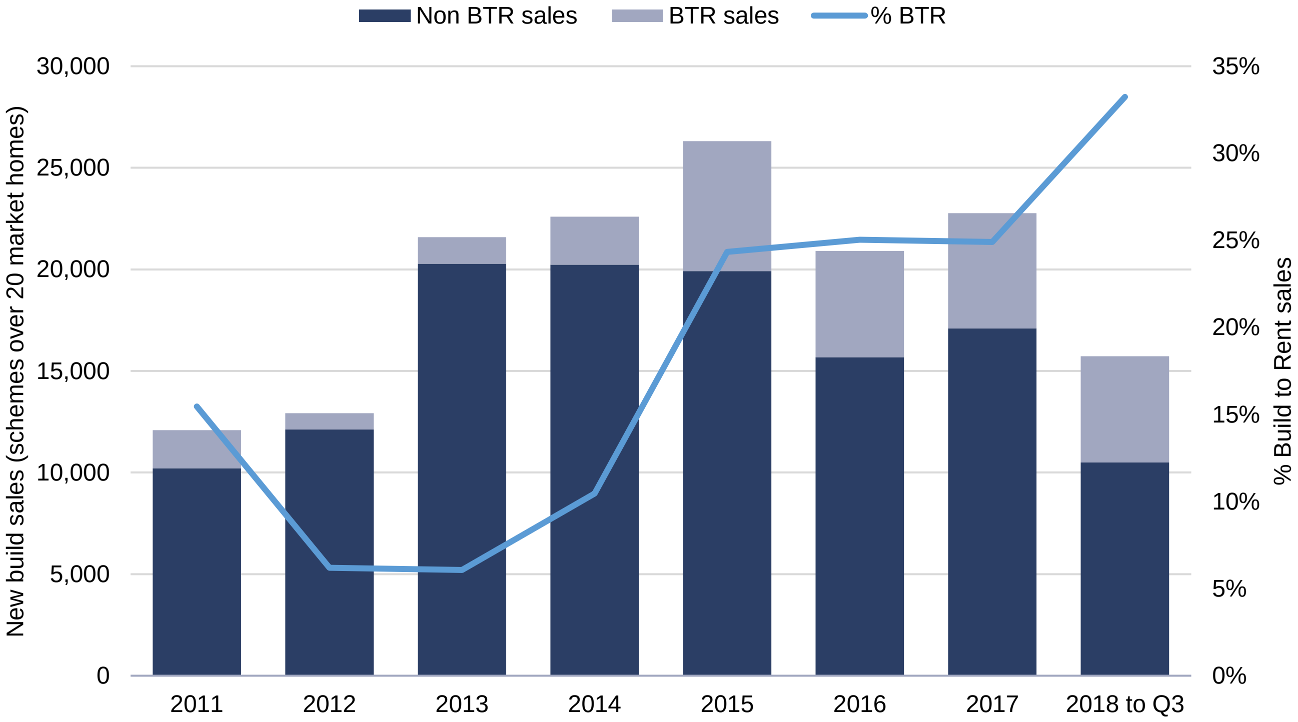
Source: Savills using BPF, Molior

The number of completed build-to-rent homes outside of the capital is now on par with those delivered in London. Key regional hubs such as Manchester, Birmingham and Leeds have all witnessed significant delivery of BTR stock. There are 14,600 completed homes across the regions compared to 14,800 in London. Given that the number of units under construction in the regions is now larger than the capital (24,000 vs 19,300 units), over the next year we expect to see the scale of completed BTR in the regions surpass that of the capital.

Importantly, our projection for Build to Rent completions assumes a supportive policy environment, in particular that the positive provisions in the NPPF are embraced by local and strategic planning authorities and that there is no new regulation that stifles investor appetite.

Build to Rent continues to make up a significant proportion of overall delivery in London, accounting for a third of new build sales in London in the first three quarters of 2018. There are a total of 19,304 build to rent units currently under construction in London with a further 38,662 in planning. The total number of build to rent units either complete, under construction or in planning in London has increased by 16% over the last year.

Figure 36 –Growth of Build to Rent in London



Source: Savills for BPF using Molior

6.6. Policy response

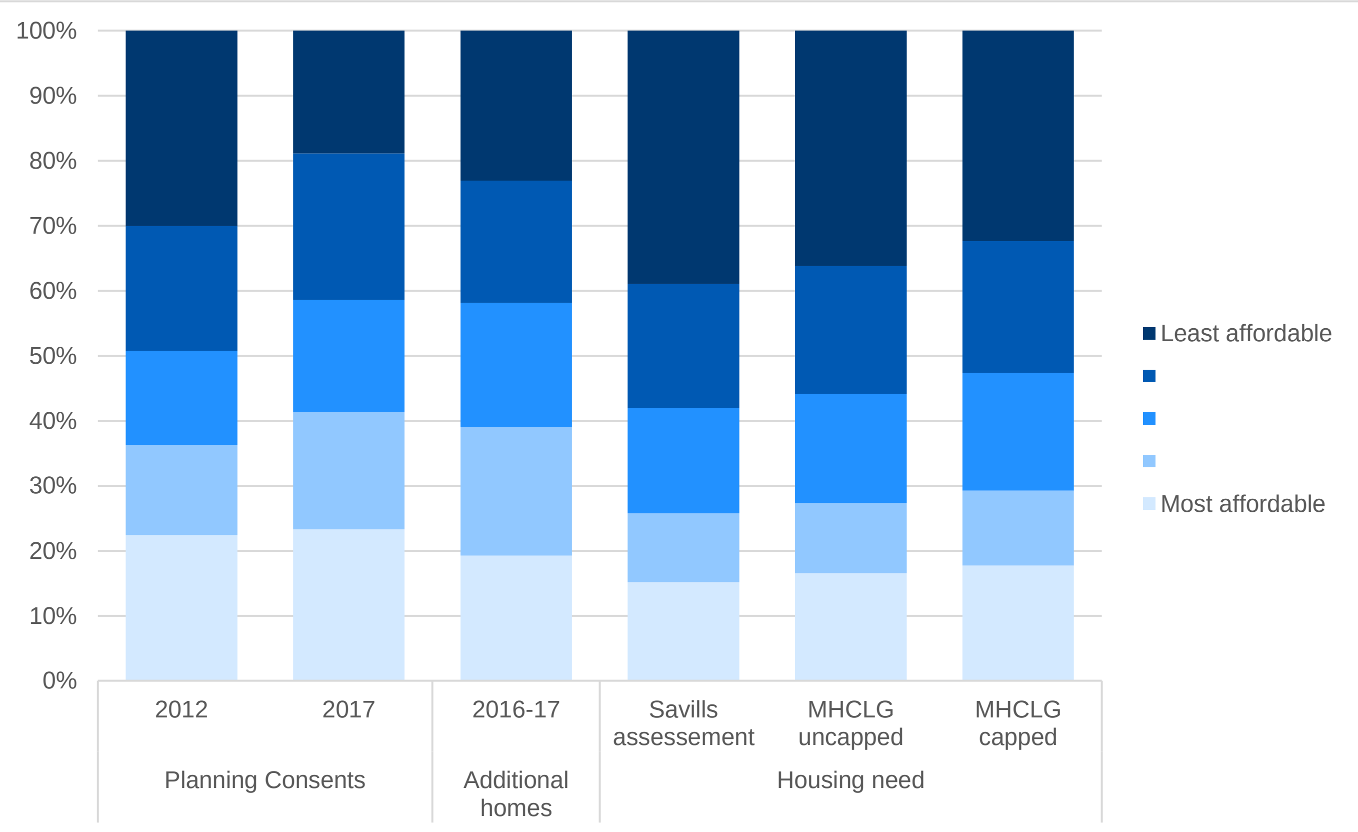
The Government can put in place new measures to support housebuilding of all tenures after 2023. It is possible that the Government will implement a further form of tapered Help to Buy, albeit that the Government's stated intention is not to run a further equity loan scheme. Other options are set out below.

6.6.1. Increase sales outlets in areas of highest demand

Policy responses include working with local planning authorities to build more homes in high value, relatively unaffordable, markets with low levels of housing supply, within the constraints of the principles of sustainable development, including selected Green Belt release. This would increase the number of new homes sales outlets across the country, off-setting the downward pressure on sales rate per outlet described above.

The revisions to the NPPF move some way towards this goal. The new standard methodology for calculating housing need allocates almost 40% of housing need to the areas in the highest quintile of affordability. The effect of this should be an increase in allocated sites and accordingly consented plots in the areas of the country with greatest need.[12] However, there are political limits to the scale of additional supply that can be unlocked via this route.

Figure 37 – Where are new homes being delivered?



Source: Savills using ONS, MHCLG, Glenigan

[12] Savills 2018, *Planning: New Measures to Increase Delivery*, https://www.savills.co.uk/research_articles/229130/246335-0/planning--new-measures-to-increase-delivery---2018

6.6.2. Promote growth in cities across the UK

Part of the solution is to promote productivity, growth and job opportunities in cities across the UK. The National Infrastructure Assessment[13] highlights cities' role in high value industries and employment, with 60% of all jobs and 71% of knowledge intensive business service jobs being in cities. Supporting growth in city-regions is essential to providing balanced growth across the UK, as cities provide employment and a range of specialist services across a whole region. The NIA recommends that unlocking growth in cities requires:

- developing integrated strategies for housing, employment and transport, to allow cities to grow and people to live and work where they want;
- devolving planning and funding for urban infrastructure to all cities;
- prioritising major upgrades for cities with the most growth potential and capacity constraints; and
- £43 billion of additional investment in urban transport by 2040.

6.6.3. Fund more affordable housing

The Letwin Review[14] recommended more diversity of the type and tenure of new homes, to accelerate market absorption and the build out rate of large sites. Diversification via Build to Rent is an important part of the solution. The evidence set out in this report indicates that the supply gap would be readily filled by an expansion of affordable housing supply, funded by a larger affordable housing programme. It is clearly important that expansion of affordable housing development does not crowd out private sector market focused delivery by restricting access to land and construction capacity.

[13] NIC 2018. *National Infrastructure Assessment*. National Infrastructure Commission, July 2018.

[14] Letwin 2018. *Independent Review of Build Out, Final Report*. Rt Hon Sir Oliver Letwin MP, October 2018

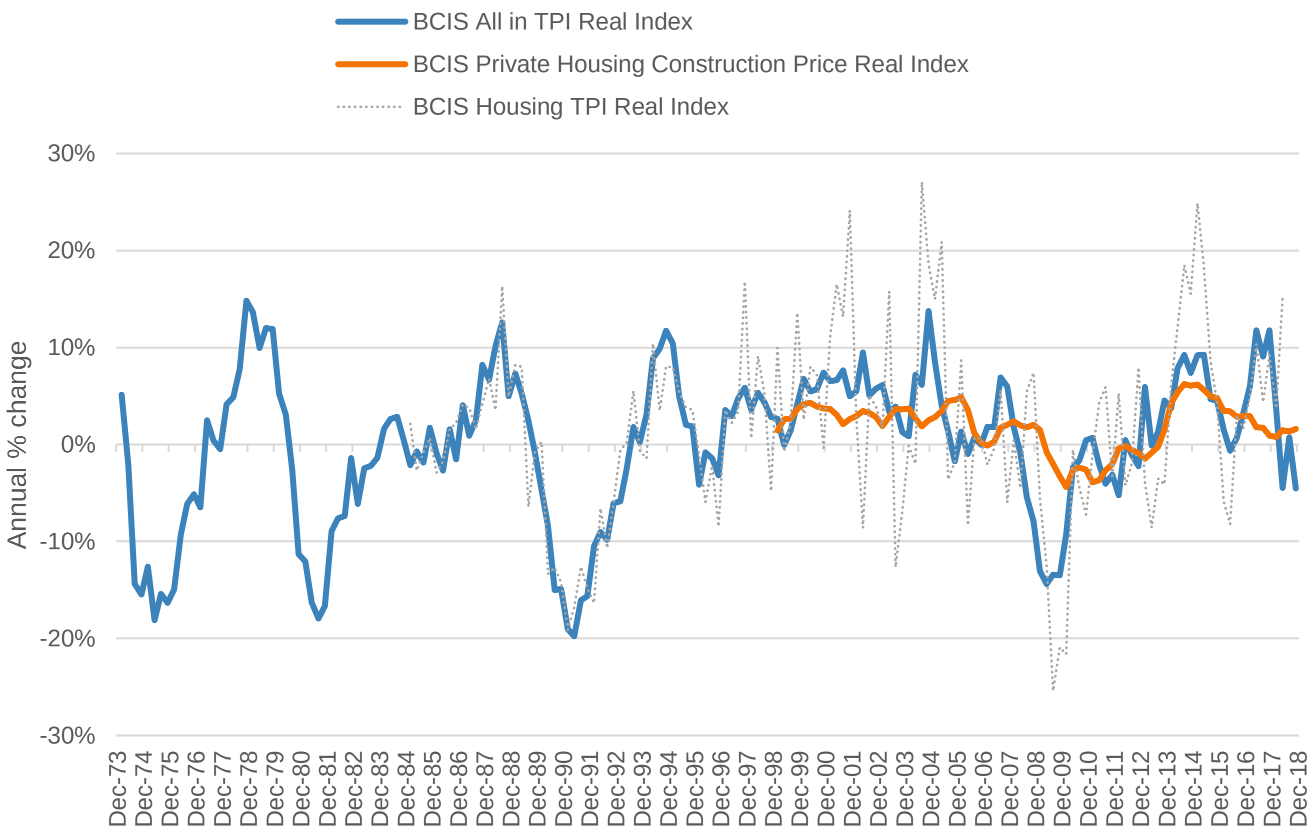
7. Availability of construction capacity and land

It is clearly important that expansion of affordable housing development does not crowd out private sector market focused delivery by restricting access to land and construction capacity.

7.1. Construction capacity

In recent years, the BCIS private housing construction price index suggests declining build cost inflation in real, inflation adjusted terms. This indicates that the construction sector has adjusted to the extra demand for development of new homes, albeit that there have been peaks of excess demand which are most evident in tender price inflation, which includes a main contractor margin that will vary in response to market conditions. This indicates that if expansion of affordable housing is phased over a period that allows forward planning at rates consistent with past expansion, then there should not be crowding out of private sector construction capacity. However, the availability of skilled labour is an issue, as noted below.

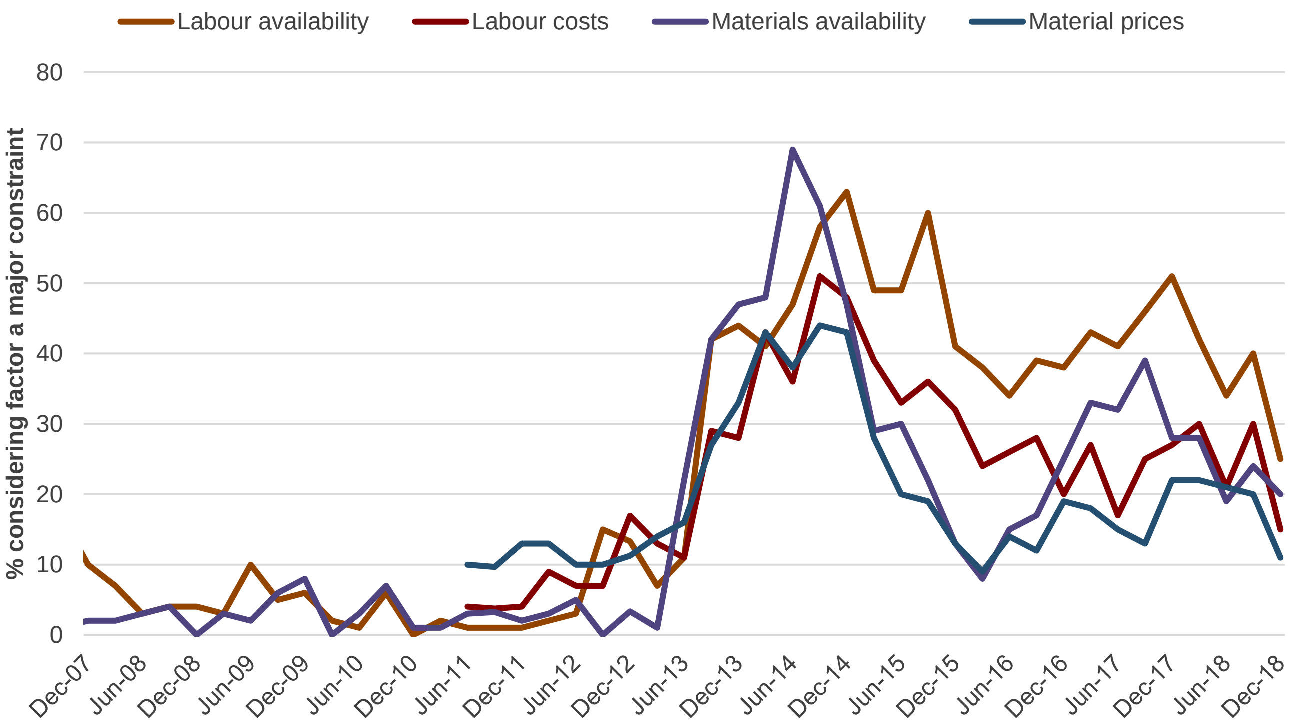
Figure 38 – Build cost inflation in real, inflation adjusted terms



Source: BCIS, ONS

The availability of labour is seen by housebuilders as a bigger constraint to development than the cost of labour, as shown in Figure 39. Amongst SME housebuilders the shortage of skilled workers is the fourth largest constraint on activity, behind land, planning and finance, as shown in Figure 40. The Letwin Review identified the number of skilled bricklayers as a relatively hard constraint on development capacity, recommending a major programme of investment in training of additional bricklayers. Successful expansion of reliable methods of offsite construction looks set to be part of the expanded construction capacity in the medium to long term.

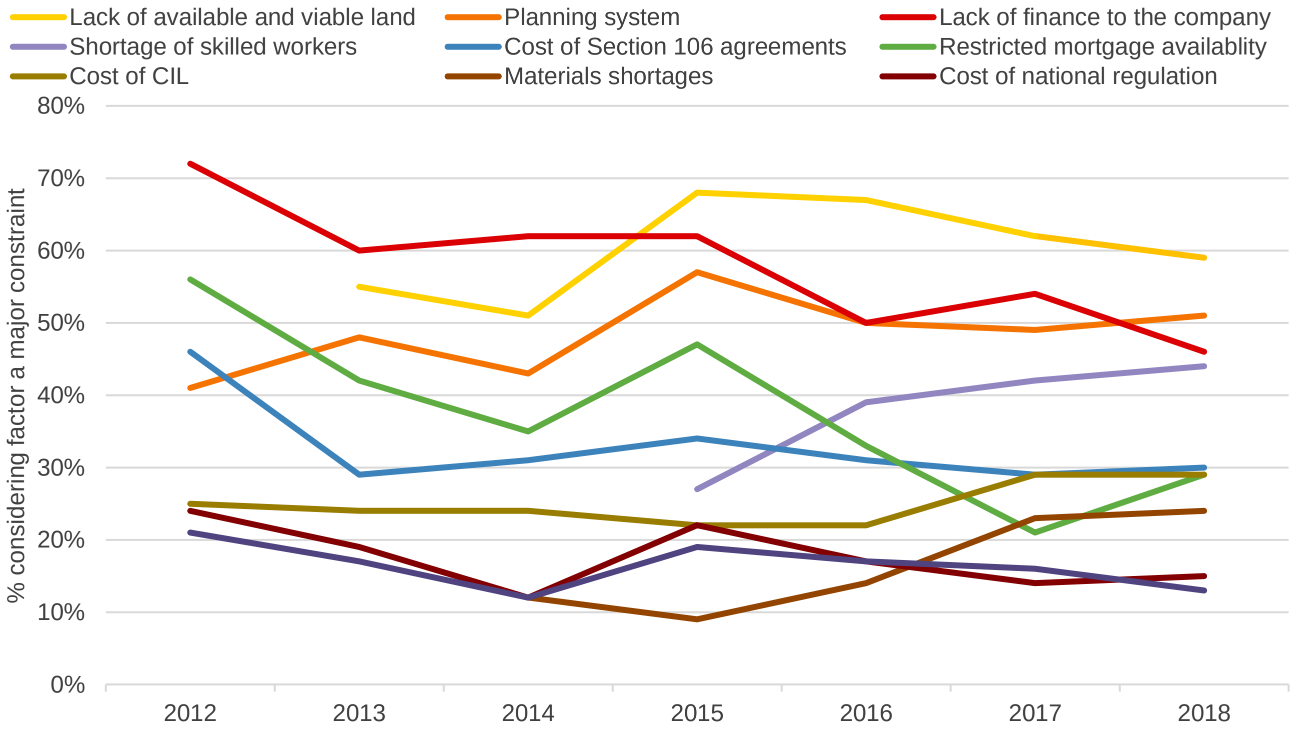
Figure 39 – Housebuilder constraints on development - labour and materials



Source: HBF Survey

An additional consideration is the impact of any external factors such as a change in UK immigration policy that would reduce the availability of skilled construction workers.

Figure 40 – Small and medium sized housebuilder constraints



Source: Federation of Master Builders

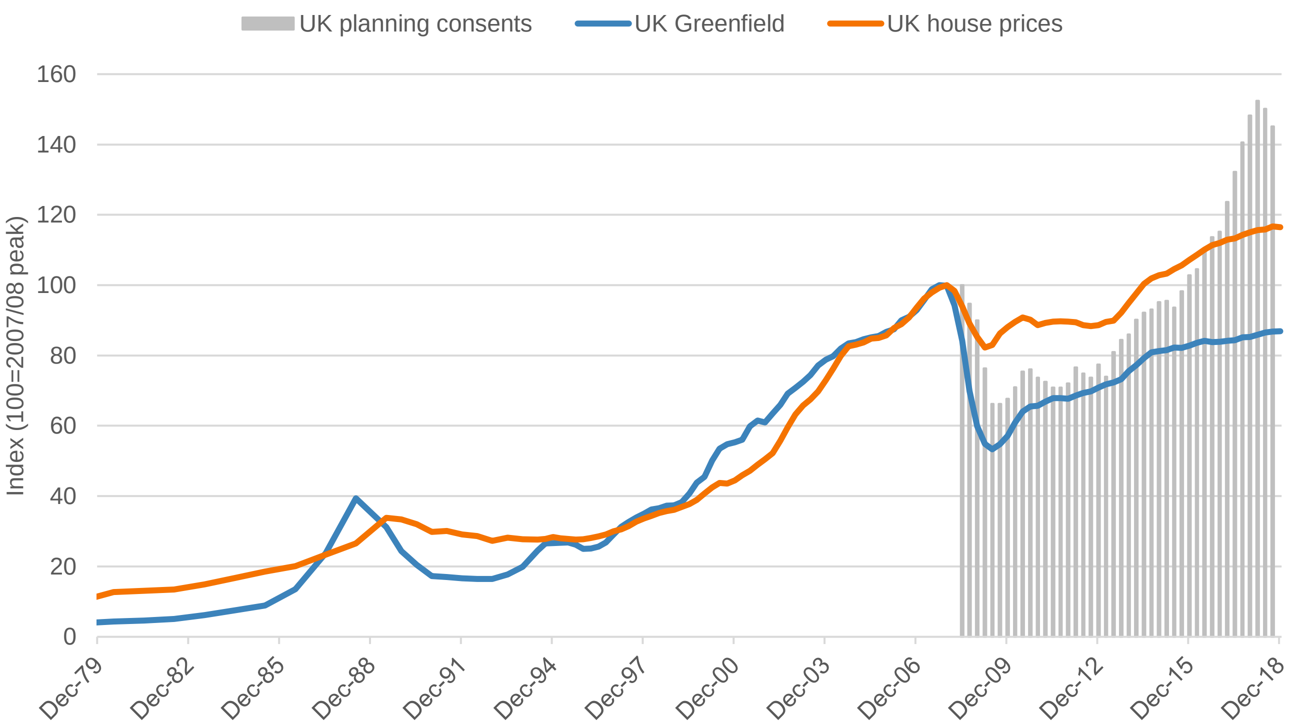
A further point to consider is that, in a lower house price inflation environment, build cost inflation squeezes either: operating margin and the associated incentive to expand development volumes; or residual land value and the associated viability of cross subsidy and Section 106 funding of affordable housing.

7.2. Land

During the last quarter of 2018, values have flattened for both greenfield and urban development land in the UK, bringing annual land value growth to 1.9% for greenfield sites and 6.2% for urban sites.

While there is still interest for sites, it is balanced by some Brexit-related uncertainty, slowing house price growth, steadying sales rates and rising build costs. Looking to the medium term picture, in this housing market cycle, an increasing supply of permissioned land has suppressed land value growth, such that the value of UK greenfield land is, on average, 13% below its previous peak in 2007/08, compared with house prices which are 17% above the previous peak level at that time.

Figure 41 – Growth in UK land values, house prices and planning consents



Source: Savills, Nationwide, HBF, Glenigan

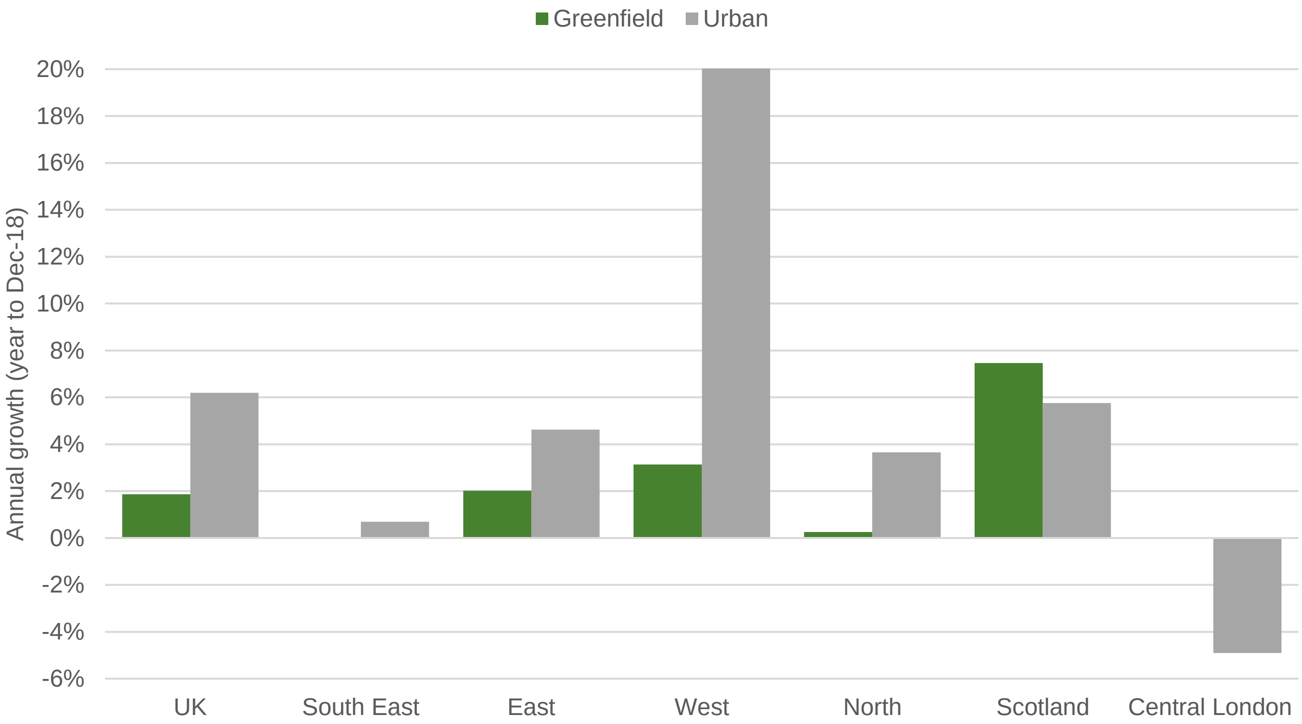
However, according to our 2018 survey of housing association chief executives, the availability of land is regarded as a constraint on development capacity by 86% of housing associations. As development plans evolve and land pipelines grow, this may become less of a constraint. The key issue is whether land can be acquired at a price to allow housing associations to develop at policy compliant levels, before expanding affordable housing delivery beyond that level, using grant funding.

In the year to December 2018, UK greenfield land values increased by 1.9% and urban values by 6.2%. Greenfield land value growth has been driven by growth in Scotland and the Midlands, supported by continuing strong house price growth.

The West Midlands and Scotland have been at the forefront of growth in urban land values. In these regions there has been house price growth and sustained demand for development sites.

In the last year Central London residential land values fell by 4.9% as a result of falling house prices, build cost inflation and an increasingly complicated policy environment.

Figure 42 – Annual growth in land values by region



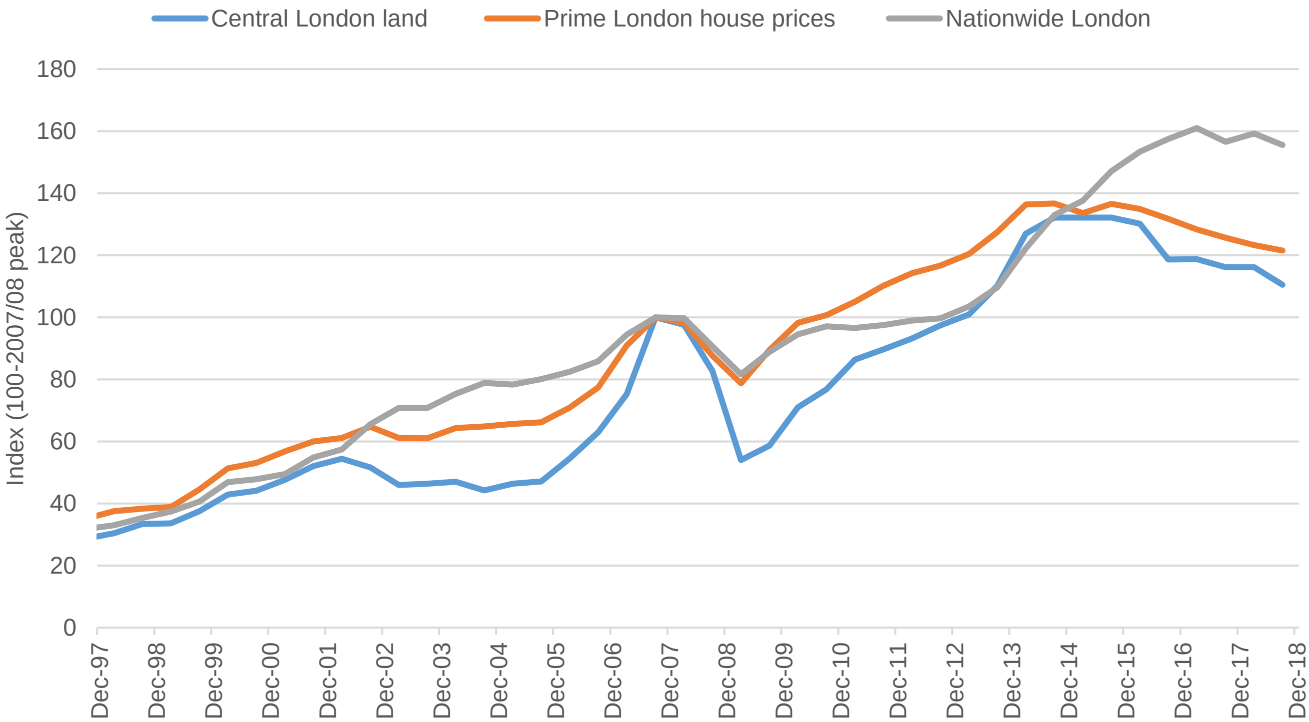
Source: Savills

As noted above, in the past six months, residential land values in central London have fallen by 4.9%, taking them to 16% below their 2014/2015 peak.

This is, in part, due to falls in house prices in the prime London markets, which fell by 5% in the past year and are now 11% below their peak. It also takes into account other factors, including build-cost inflation, sales rates and an increasingly complex policy environment. Recently, there has been a trend to lower numbers of land sales in London due to the uncertainty over the impact of Brexit and falling values.

Central London land supply is more constrained relative to demand than at a UK level. There is more competition for land, with land values some 10% above their previous cycle peak in 2007/08, albeit that there is still a gap with house prices which across prime London markets are some 20% above the previous cycle peak in 2007/08.

Figure 43 – Growth in land values and house prices in London

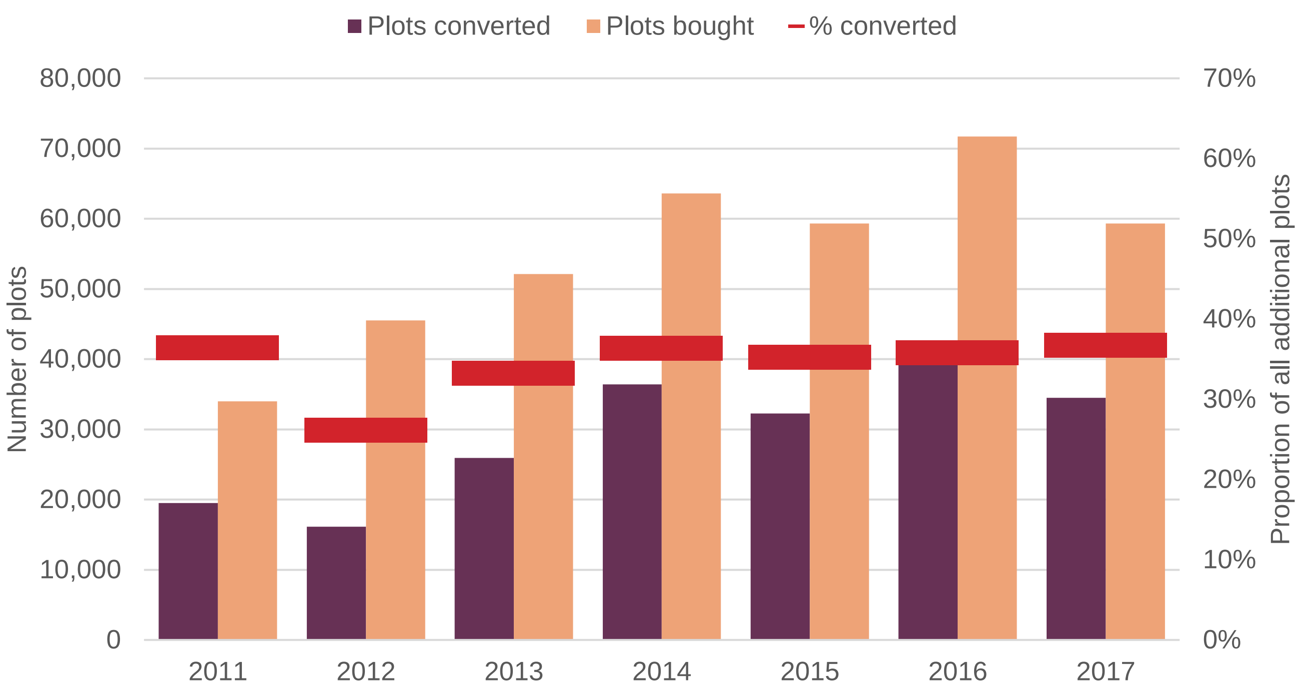


Source: Savills, Nationwide

7.2.1. Strategic Land Pipeline

Housebuilders use their strategic land to generate a significant part of their land pipeline, souring more than 35% of their immediate land from the strategic land pipeline, rather than acquisition. This is part of a long term approach to building a land pipeline, contributing to business resilience.

Figure 44 – Housebuilder use of strategic land



Source: Housebuilder annual reports, 7 of the top 10: Barratt, Bellway, Bovis, Crest Nicholson, Persimmon, Redrow, Taylor Wimpey

7.3. Strategic partnerships

The strategic partnerships being rolled out through the Homes England, and GLA strategic partnerships, are very relevant to how land and construction capacity can be built in line with a long term development programme.

The aim of the strategic partnerships is to increase affordable housing supply in return longer term funding certainty and flexibility, long called for by the housing association sector as a stimulus to more supply. The aim is for the grant provided through strategic partnership to deliver affordable supply on land led development supporting a shift away from Section 106 supply to sites controlled by housing associations therefore providing genuine additionality. Whilst the primary focus is on increasing affordable supply, there is a clear expectation that grant led land led supply will increase output of all tenures.

Strategic partnerships are in their infancy however Savills is seeing more activity in the land markets from Housing Associations generally, including from strategic partners. Housing associations are also targeting bulk purchase of non-Section 106 housebuilder stock with grant, and market conditions may create more scope for this in the short term.

Homes England strategic partners have committed to significant increases in their development programmes, in exchange for an additional year's funding beyond the current spending review settlement and the ability to use their funding flexibly across their development programme in response to the ebb and flow of progress on individual sites. They will also be able to respond to local market performance by determining the tenure of affordable homes as they near completion on individual sites.

8. Conclusions

The counterfactual case outlined in sections 5 and 6 of this report indicates that there are limits to market capacity to deliver 300,000 homes annually by the mid 2020s. These limits to market capacity have the same impact as the weaker market conditions referenced in the appraisal guidance (see section 1), in which additionality of a supply focussed intervention rises towards 100%.

If there is adequate land, development management and construction capacity, then grant funding to enable the viable development of more affordable housing will have high additionality of close to 100%. The availability of land, development management and construction capacity is important. Grant funding needs to be accompanied by measures to ensure that higher levels of affordable housing development do not crowd out private sector development of market housing by displacing these factors of production.

Joint ventures with private sector developers are an important part of the solution, particularly where either the scale and complexity of a project or market uncertainty creates the incentive to share risk and financial commitment.

The longer term funding arrangements being rolled out through the Homes England and GLA strategic partnerships should allow for sufficient forward planning of construction capacity to avoid displacement; and a measured programme of land acquisition at values consistent with policy compliant development without grant.

Additionality on Unviable Sites

Our 2013 report[15] reviewed evidence of capital grant being invested in costly regeneration sites where:

- the investment would deliver affordable homes that would not otherwise have been built; and
- development of the affordable homes would unlock a mixed tenure site, providing additionality to housing supply in excess of 100%. In this case, grant funding of affordable housing acts as a supply catalyst.

This remains the case where a site would be unviable without capital grant. There is clearly an overlap here with the objectives of the Housing Infrastructure Fund, which provides grant funding for new infrastructure that will unlock new homes in the areas of greatest housing demand. It is one of a number of funds where 80% of the fund is aimed at the 50% least affordable local authorities[16].

Housing Association Resilience in a Downturn

The current housing association development model is, by its nature, exposed to a market downturn. In the event of a downturn, grant funding for affordable housing would allow housing associations development to continue, building capacity towards meeting the 300,000 homes annual target.

[15] Savills 2013, *Additionality of Affordable Housing*, Report to G15

[16] https://www.gov.uk/government/publications/geographical-targeting-across-5-housing-programme-funds/geographical-targeting-across-5-housing-programme-funds

Important Note

Finally, in accordance with our normal practice, we would state that this report is for general informative purposes only and does not constitute a formal valuation, appraisal or recommendation. It is only for the use of the persons to whom it is addressed and no responsibility can be accepted to any third party for the whole or any part of its contents. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent, which will not be unreasonably withheld.

Our findings are based on the assumptions given. As is customary with market studies, our findings should be regarded as valid for a limited period of time and should be subject to examination at regular intervals.

Whilst every effort has been made to ensure that the data contained in it is correct, no responsibility can be taken for omissions or erroneous data provided by a third party or due to information being unavailable or inaccessible during the research period. The estimates and conclusions contained in this report have been conscientiously prepared in the light of our experience in the property market and information that we were able to collect, but their accuracy is in no way guaranteed.