

Affordability
matters

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Foreword by the Chairman of the National Housing and Planning Advice Unit



Over the last decade, it has become increasingly difficult for young people to gain a foothold on the housing ladder. And given current plans, it is unlikely that this situation is going to improve any time soon. So while homeowners have found the dramatic increases in house prices in recent years a source of both comfort and collateral, those who are outside the magic circle of homeownership experience increasing frustration as homes become less and less affordable.

But this is not just about the frustration of the increasing numbers excluded from the housing market. As affordability in the market sector worsens, more people are pushed either into the private renting sector, driving up rents, or into the already hard-pressed social renting sector. Deprivation will increase and the situation will worsen in already deprived areas. And this affects all of us. The economy suffers from the consequent impediments to labour mobility and an increasing

quantity of taxpayers' money is required to deal with the social problems generated both by increasing deprivation and the inability of numerous key workers to find somewhere to live in the area where they work.

The job of the National Housing and Planning Advice Unit (NHPAU) is to help make market housing more affordable and hence to slow down, and even to reverse, the apparently inexorable rise in the numbers of people locked out of the housing market. Our role is to advise regional and national decision makers on the consequences of any given set of house building plans for trends in affordability going forward. This is not a matter of simply saying more house building means better affordability. For example, more housing development in one place may induce more buyers moving in from other areas with little impact on affordability. In other words, this is a complicated business. It is our job at the NHPAU to sort out these complications and provide the best available estimates of affordability trends generated by any given pattern of house building. And since planning authorities must now consider affordability when making decisions, our advice could turn out to be invaluable. It is up to us at the NHPAU to make sure that it is and, ultimately, to enable more people to afford their own home.

Stephen Nickell

Why does housing market affordability matter?

Affordability is a complex matter. At its simplest, the affordability of housing is determined by housing costs relative to household income.

Successive governments have had a goal for housing policy which can reasonably be summarised as 'a decent home for every family at a price within their means' met by the social, rented or owner occupied sectors.

However, most people aspire to own their own home. A recent survey by the Council of Mortgage Lenders revealed that 84 per cent of adults hoped to be homeowners in ten years time¹. At present 70 per cent of homes are owner occupied and the Government has set a target of 75 per cent by 2016.

Home ownership not only provides a place to live, it also provides for a greater sense of comfort, security and affluence. Property can be used as collateral to secure loans, provides rent free accommodation in retirement, and can provide children with an inheritance. It gives people a stake in the community in which they live, which in turn promotes social capital.

Of course, it is not responsible to promote home ownership to people for whom it is not affordable or sustainable. But there are strong arguments for promoting greater market affordability. The scale of house price increases over recent years has led to a rapid deterioration in affordability. For example, the ratio of lower quartile house prices to lower quartile earnings has risen from under four at the turn of the century to over seven by the end of 2006. This has consequences, not only for individuals and their families, but for the economy and society as a whole.

Rapidly deteriorating affordability tends to be associated with house price volatility. This can translate into wider macroeconomic instability through the impact house price changes may have on household spending decisions². Excessive house price growth may also feed on itself by encouraging speculative investment which in turn diverts investment away from more productive areas of the economy.

Higher house prices mean that significant numbers of workers are unable to buy a home in an area where they work. A recent report by the Halifax³ stated that the average house price in more or less every town across Great Britain was unaffordable for the typical nurse in March 2007. In addition for key workers as a whole the average house price was unaffordable in over two thirds of towns. This makes it increasingly difficult to recruit and retain the best staff, with adverse consequences for the quality and delivery of important services, especially in those regions with the highest house prices.

The growth of regional economies is in part driven by a flexible supply of labour, both in general and specifically in relation to more skilled and qualified workers. A ready supply of labour requires a responsive housing supply, with owner occupation a desire for the majority of skilled and qualified workers.

¹ CML Housing Finance Issue 01 (2007). The survey was undertaken by BMRB Omnibus Surveys in January 2007. The research was based on a face-to-face interview with 2,814 adults aged 18 and over.

² Housing policy: an overview (HM Treasury/ ODP, 2005).

³ Halifax Key Worker Housing Review, 13th April 2007.

The impact of poor affordability is particularly felt by younger people trying to buy their first home, or to move to one where they can best raise a family. This group experiences the real costs of rising house prices and falling affordability. For those who do get on the housing ladder, mortgage repayments eat up an increasing proportion of their incomes. And in an era of low general inflation, high repayment costs persist for longer than they did for earlier generations.

Rapid and sustained house price inflation means that individuals who are not home owners lose out and that younger generations will tend to face poorer housing than their parents. In a new survey commissioned by NHPAU⁴ almost half of people

aged 18 to 34 believed they will have a lower standard of living than their parents due to rising house prices.

Crucially, the supply and affordability of market housing has a fundamental effect on the housing system overall. If demand cannot be met by supply, the cost of housing relative to income rises. New owner occupiers, or first time buyers, find it increasingly difficult to enter the market. Demand for private renting increases as does the pressure on social housing. Ultimately the number of people living in temporary accommodation and overcrowded conditions⁵ will increase.

Against this backdrop, it is not surprising that housing is one of the highest priority areas of domestic policy across the political spectrum.



⁴ The survey was undertaken by YouGov on behalf of the NHPAU in May 2007. The research was based on a representative sample of 2,721 adults in England aged 18 and over. Full results from the survey will be published on the NHPAU website in July 2007.

⁵ Research by Shelter published on 18th May 2007 reported that 955,000 children in England are living in overcrowded housing – 50,000 more than three years ago (see www.shelter.org.uk).

How serious is the affordability problem?

Four years ago the Chancellor and the Deputy Prime Minister commissioned a review of housing supply by Kate Barker⁶, a member of the Bank of England Monetary Policy Committee.

At the time concerns were growing about a lack of responsiveness in the supply of housing given demand pressures.

The Review stated that:

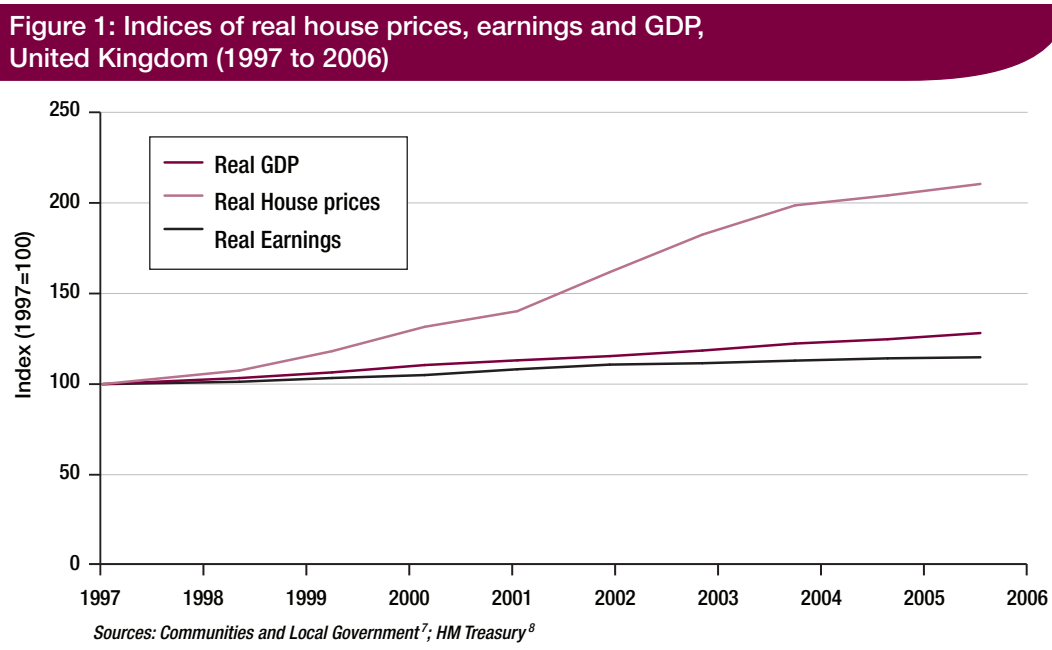
“ For many people, housing has become increasingly unaffordable over time. The aspiration for home ownership is as strong as ever, yet the reality is that for many this aspiration will remain unfulfilled unless the trend in real house prices is reduced. This brings potential for an ever widening social and economic divide between those able to access market housing and those kept out.”

The Barker Review of Housing Supply was published in March 2004. The affordability of market housing was recognised as a real and growing problem. Since that time the position has deteriorated further.

House price inflation outstripping growth in the economy and earnings

In the past ten years house prices have increased at a much faster rate than both earnings and growth in the economy (see Figure 1).

Some commentators and pundits warn that house prices are significantly overvalued and about to crash, just as they have been doing since 2002. However, there is convincing academic research on the subject which indicates that current levels of house prices are not inconsistent with fundamentals⁹. Demand for housing, driven by economic and population growth, is simply outstripping available supply.



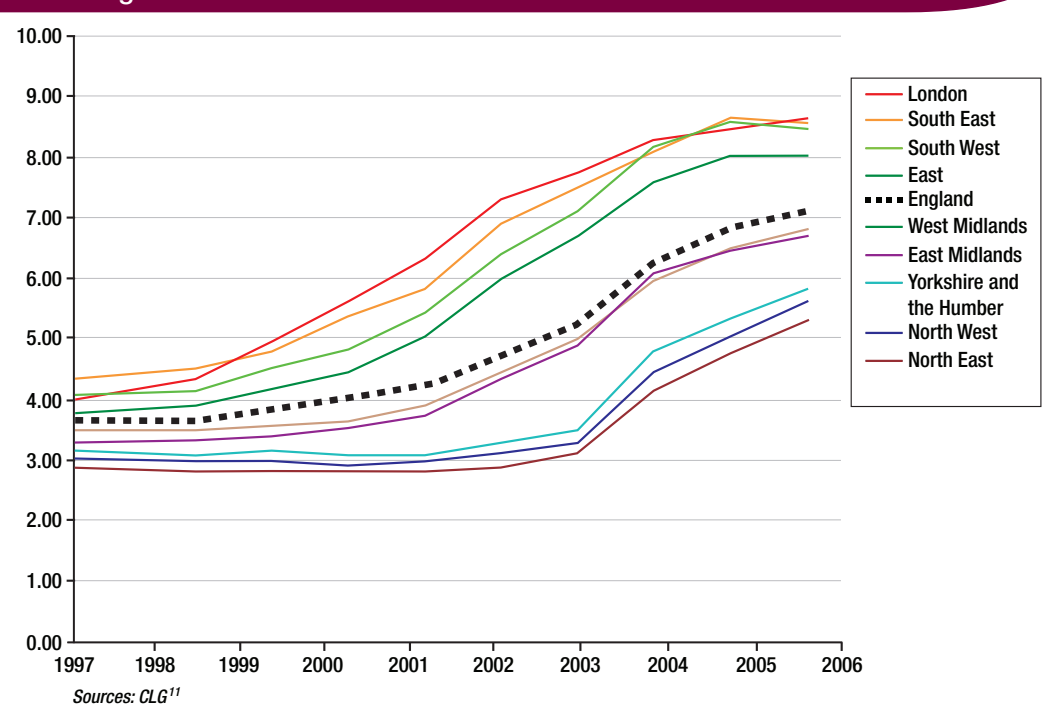
⁶ Barker, K. (2004), *Review of Housing Supply*, ODPM.

⁷ The house price index is derived from the CLG annual house price inflation rate. This rate has been adjusted for retail price inflation.

⁸ Average earnings (excluding bonuses) are adjusted for retail price inflation.

⁹ Cameron, G., Muellbauer, J., Murphy, A. (2006): *Was there a British House Price Bubble? Evidence from a Regional Panel*, Nuffield College, Oxford.

Figure 2: Housing Affordability: ratio of lower quartile house prices to earnings



As each month passes, signs of an inevitable cooling in the market are sought and heralded, but prices currently continue to grow at an annual rate of around six per cent. Many of the leading commentators feel that the economy is too healthy for there to be a significant drop in prices. Even if there were a future readjustment in prices, the amount they would have to fall to get back to the levels of affordability seen when the Barker report was published is substantial.

Table 1: Selected independent house price forecasts for 2007, UK

Source	Percentage increase
Royal Institution of Chartered Surveyors	7
Halifax	4
Council of Mortgage Lenders	7
RightMove	6
KnightFrank	6
Savills	7
Average	6

Sources: RICS, Halifax, Council of Mortgage Lenders, RightMove, KnightFrank, Savills¹⁰

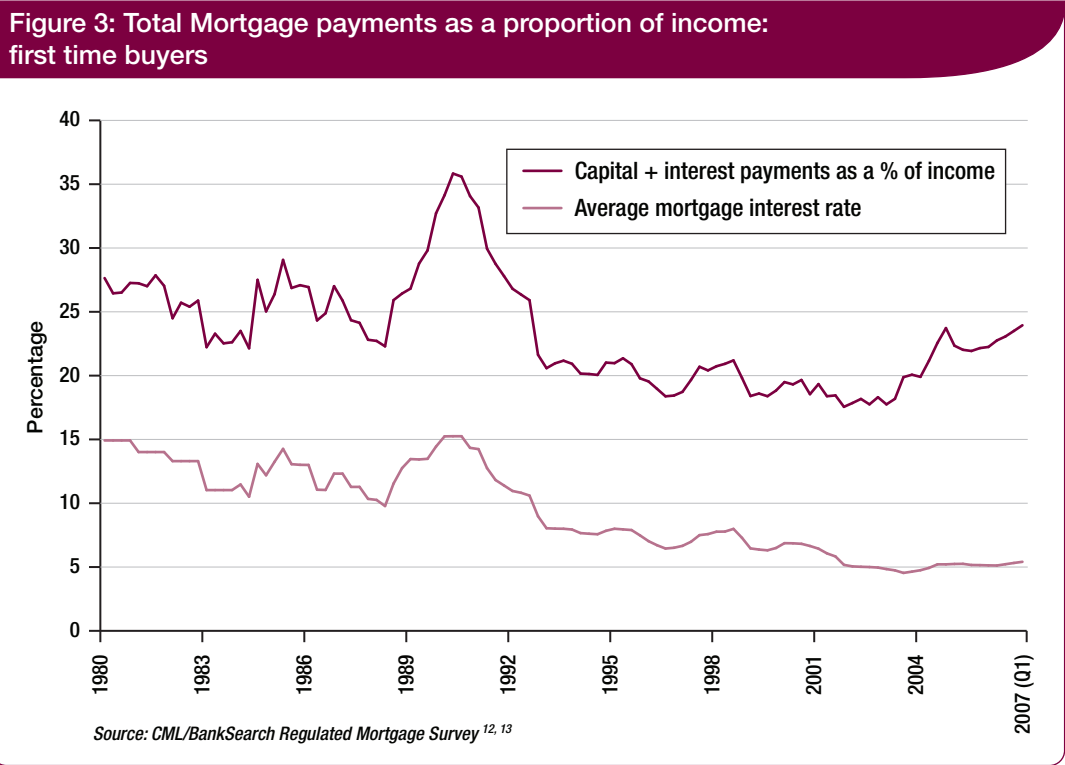
Affordability continues to erode

The affordability of market housing may be crudely measured by a house price to earnings ratio or by mortgage payments as a proportion of income for first time buyers. Using these measures it is clear that the housing market has become more expensive to enter in the last decade.

The ratio of lower quartile house prices to lower quartile earnings was the measure of affordability preferred by Barker. When her report was published, data for 2003 showed this ratio was standing at 5.2 across England as a whole. This had risen from around four at the turn of the century. The latest data, available for 2006, indicates how much worse the national picture has become, with the ratio now standing at 7.1 (see Figure 2).

¹⁰ All forecasts made publicly available December 2006.

¹¹ Earnings data comes from the Annual Survey of Hours and Earnings (ASHE).



The proportion of first-time buyers' household income taken up by mortgage payments has increased significantly in the past three years (see Figure 3). On this measure of affordability, payments have now returned to the range experienced during the 1980s, although they remain well below the spike experienced at the end of that decade.

The key data behind this measure are nominal mortgage interest rates, average mortgage advances to first time buyers, and average incomes used in support of those mortgage applications. In order to draw valid comparisons between the 1980s and the current period further analysis is required.

For example, this is a self-selecting sample in that only those who have been able to enter the market are included in this measure. What we also need to know is how and why entry rates differ between periods. And joint incomes rather than single incomes are likely to make up a higher proportion of the basis for mortgage applications than they did in the past.

A research aim of the Unit might be to further develop this measure, including at a regional level. A comparison of average house prices for first time buyers, against full time earnings data or the average income of households aged under 35, may be more helpful to an understanding of market affordability.

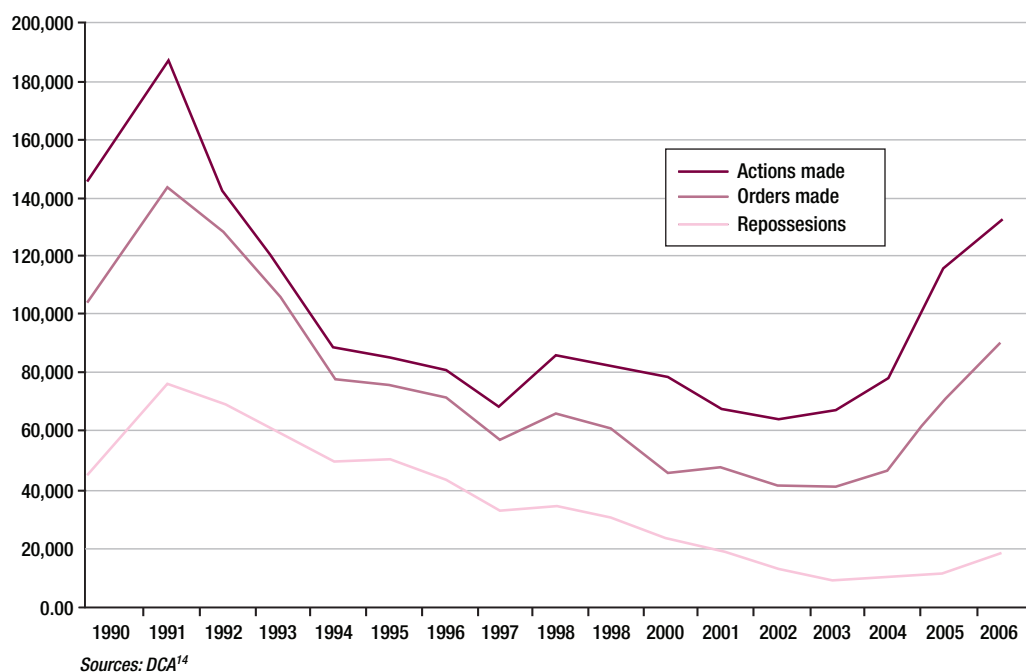
In considering affordability a number of other factors are also important. As house prices have risen, first time buyers have needed increasingly larger deposits to be able to enter the market. In order to manage risk, lenders will tie mortgages to fixed income multiples, limit loan to value ratios, and increasingly use affordability models based on residual incomes.

In 2006 the average price of a dwelling purchased by a first time buyer was around £150,000. To put this into context, a deposit of £45,000 would be required to get a mortgage based on an income multiple of 3.5 and an income of £30,000.

¹² First time buyer numbers will include some buyers who have previously owned a property, but are not in owner-occupation at the time of this purchase. Estimates from the Survey of English Housing suggest that that around 20 per cent of stated first-time buyers may fall into this category.

¹³ Capital and interest payments are calculated using the average mortgage advance, interest rate and income in each period.

Figure 4: Actions, orders and repossessions (1990-2006)



The rise in the size of deposits has resulted in more and more first time buyers relying on friends and relatives for financial help to get them onto the first step of the property ladder. A recent survey¹⁵ showed that after personal savings this was the second most common way of financing a deposit. This method of financing is selective. A growing number of potential first time buyers are locked out of the market because they are unable to fund such high deposits.

Median loan to income multiples for borrowers have risen steadily in the last three decades. This rise is particularly noticeable in recent years, with the ratios standing at 3.3 for first-time buyers in the first quarter of 2007, up from 2.4 in the first quarter of 2000¹⁶. For those on higher salaries, even more can be borrowed. In a low inflation and low interest rate environment, more money, relative to income, is being lent to homebuyers than ever before. Home owners are more likely to get into financial difficulties if they have stretched their finances to get onto the housing ladder.

Interest rate rises increase the cost of mortgages for those on variable rate deals, and increase interest payments on other loans. Since interest rates have started to rise, an increasing proportion of borrowers have taken out 'fixed rate' mortgages. But most of these deals are relatively short term, meaning the impact of rate rises will be felt once they finish.

In a rising market, owners at risk of repossession are usually able to sell their property to repay the loan. Despite this, repossessions have started to increase in the past few years, although they remain at a low level in historical terms (see Figure 4). The rising level of actions entered is significant, suggesting a potential problem for the future, for example if prices were to fall and interest rates rise further.

¹⁴ Repossessions are UK figures whilst actions entered and orders made are from England and Wales only.

¹⁵ Survey of English Housing, 2004/5.

¹⁶ Council of Mortgage Lenders (CML).



The geography of affordability

At a regional level, the problem of unaffordable housing is no longer confined to London and the South East, but now affects the country as a whole. Figures 5(a) to 5(c) indicate worsening affordability over time based on the ratio of lower quartile house prices to lower quartile earnings.

There are country wide influences at work, but at regional level it is essential to understand the impact of intra-regional and inter-regional dynamics. For most people, jobs or family tie them to employment concentrations and geographically defined housing markets. The housing choices people make involve buying into a level of amenity, and access to facilities. In this respect housing markets are broadly defined and often correspond to 'city regions'.

As affordability deteriorates, the ability to live in a desired location diminishes, whether that desire is for access to family, employment, education, retail, leisure, culture, transport or green space. Essentially the more desirable a location then the less affordable the housing is relative to other places.

While they are important, regional measures of affordability are too broad for detailed planning. Local authority level measures of affordability are also problematic because often they do not correspond with the operation of housing markets.

The NHPAU will consider the development of methodologies to chart affordability at a relevant sub-regional level. We will draw on the extensive work undertaken by Regional Assemblies and their partners to identify housing markets in support of their Regional Spatial and Housing Strategies. We will also consider the recently released central Strategic Housing Market Assessment guidance and alternative approaches to identifying and delineating markets. A degree of pragmatism is required, both in relation to how sub-regional markets operate and with respect to the importance of administrative boundaries in the planning regime.

Figure 5a

Housing affordability:
Ratio of house prices
to earnings, 1998



Figure 5b

Housing affordability:
Ratio of house prices
to earnings, 2002

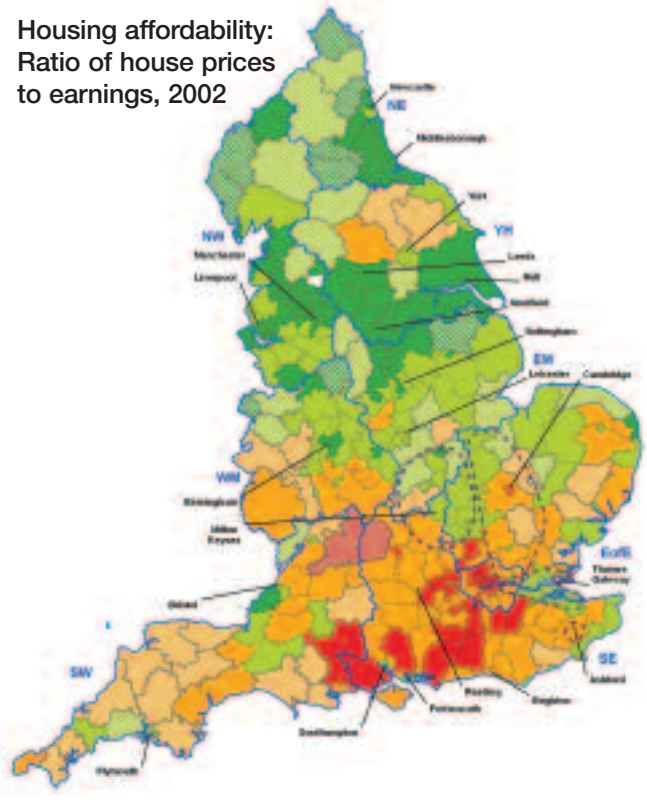
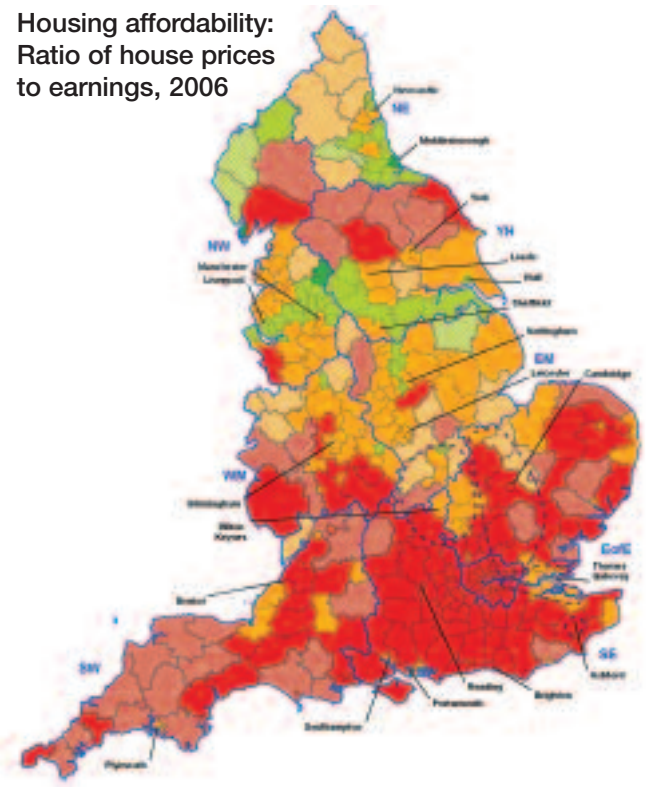


Figure 5c

Housing affordability:
Ratio of house prices
to earnings, 2006



Ratio of lowest quartile
house prices to lowest
quartile earnings*

England average

< 4 times

4–6 times

6–8 times

> 8 times

CLG Growth Areas

Hatched LAs have
a population under
100,000 and a
pop. density under
2 people per hectare
(2004 est.)

*as defined in Barker Review

Case Study – Manchester¹⁷

Within housing markets localised issues and challenges exist and must be understood. The Manchester city region is characterised by socio-economic and environmental polarisation. During the second half of the 20th Century it experienced substantial decentralisation from the older towns and cities, particularly from the urban core of Manchester and Salford. A process of outward movement was accompanied by an increase in unemployment and dereliction.

The trends of previous decades are now being reversed by a combination of sustained economic growth and focused regeneration, but there is considerable variation in the extent and nature of recovery. Parts of the core area and older satellite towns continue to face considerable regeneration challenges as a result of population loss, manufacturing decline, poor quality housing and concentrations of deprivation. Housing Market Renewal Pathfinders in Manchester – Salford and Oldham – Rochdale are seeking to address these challenges.

The context within which housing regeneration operates in the Manchester city region has changed radically in the last five years. New growth related drivers of change and social pressures are now evident, including inward population migration, minority ethnic community growth, an increase in private renting, and a transformation in city centre living created by the new economy. These are resulting in a high demand for quality housing and pressures for new development in many parts of the conurbation.

Affordability has become a major issue at all levels of the market. The challenge is to improve the overall quality of the residential offer, not just to provide more 'affordable' housing for people on low incomes. Supply needs to keep pace with demand throughout the market for the city region to achieve its economic potential.

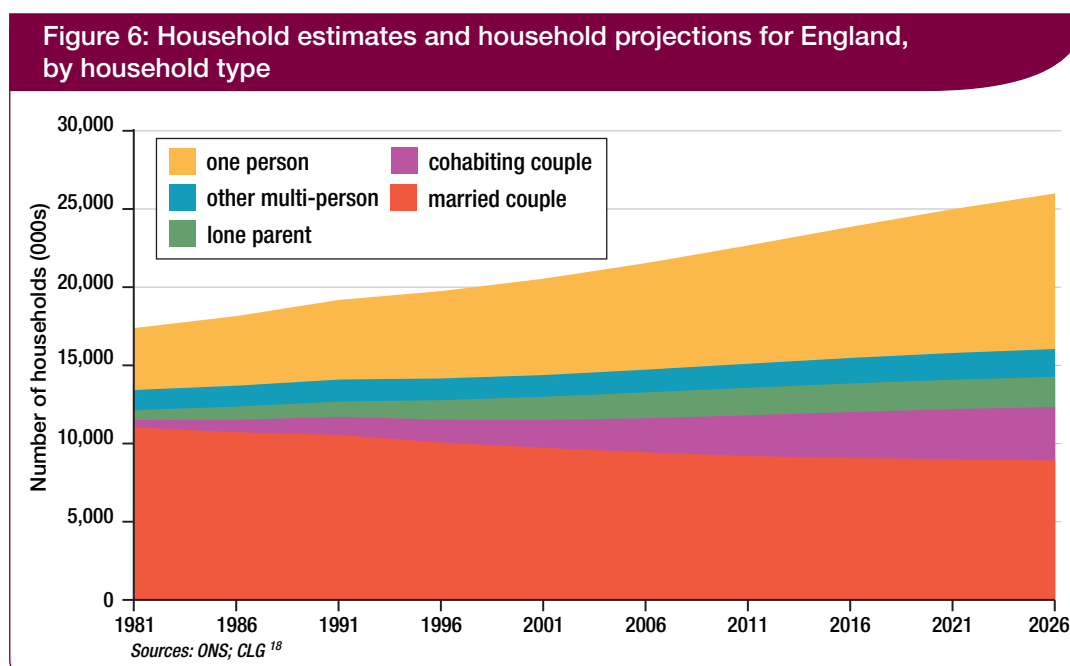
The low income market to rent or buy has tightened significantly, vacancies have reduced across tenures, and the social rented sector has seen a significant fall in the supply of re-lets, with substantial increases in waiting lists. In some areas there is an acute shortage of quality affordable housing which is needed to support an increasingly polarised labour market.

Affordability in the low income market is not unconnected to what is going on higher up the housing ladder. If those who are getting better off cannot move up, they will still be competing in the low income market, continuing to drive up prices. The supply of higher quality housing needs to be expanded or the continued growth in values in this sector may act as a disincentive to inward investment. Quality and choice at all levels are critical to improving economic performance, building sustainable mixed communities, and extending the benefits of growth throughout the city region.

While the turnover of properties has been falling in the social rented sector and in the more expensive semi detached and detached stock, transactions associated with the terraced stock have increased substantially. A large amount of this activity is accounted for through buy-to-let activity. The private rented sector is increasingly becoming the provider for households which previously would have bought a low value dwelling or rented from a social housing agency.

There is evidence that the provision of new accommodation is insufficient to meet the growth in overall demand. Between 2001 – 2006 net new housing supply was up to 28 per cent below the level of household growth being experienced by the Greater Manchester local authorities. The draft RSS for the North West proposes a challenging increase in the number of new homes planned for construction.

¹⁷ Adapted from Ecotec, Draft Manchester City Region Housing Market Report, 2007.



Demand for housing continues to grow

There are clear indications that house price pressures are continuing to build.

The most recent demographic projections released by government indicate that the number of households across England will grow by 223,000 per annum up to 2030 (see Figure 6). A combination of smaller average household sizes and a growing population have seen the projected growth in household numbers accelerate.

Whilst some caution should be exercised in the use of household projections they are clearly an important indicator. An issue with the projections is their inbuilt circularity, for example recent trends in household formation will be affected by the suppression of potential housing demand which stems from supply constraint and worsening affordability. There is also a high degree of uncertainty about the levels of migration being captured in these projections.

In recent years housing has increasingly been used as an investment vehicle, or as a supplement to pension arrangements. The result of this has been

the creation of a vibrant UK buy-to-let market, with the number of buy-to-let mortgage advances per year increasing from 44,000 in 1999 to 330,000 by 2006, leaving 850,000 buy-to-let mortgages outstanding at the end of 2006¹⁹. This has been fuelled by products made available in the credit markets, the weakness of equity markets in the early part of the century and a healthy demand in the private rented sector.

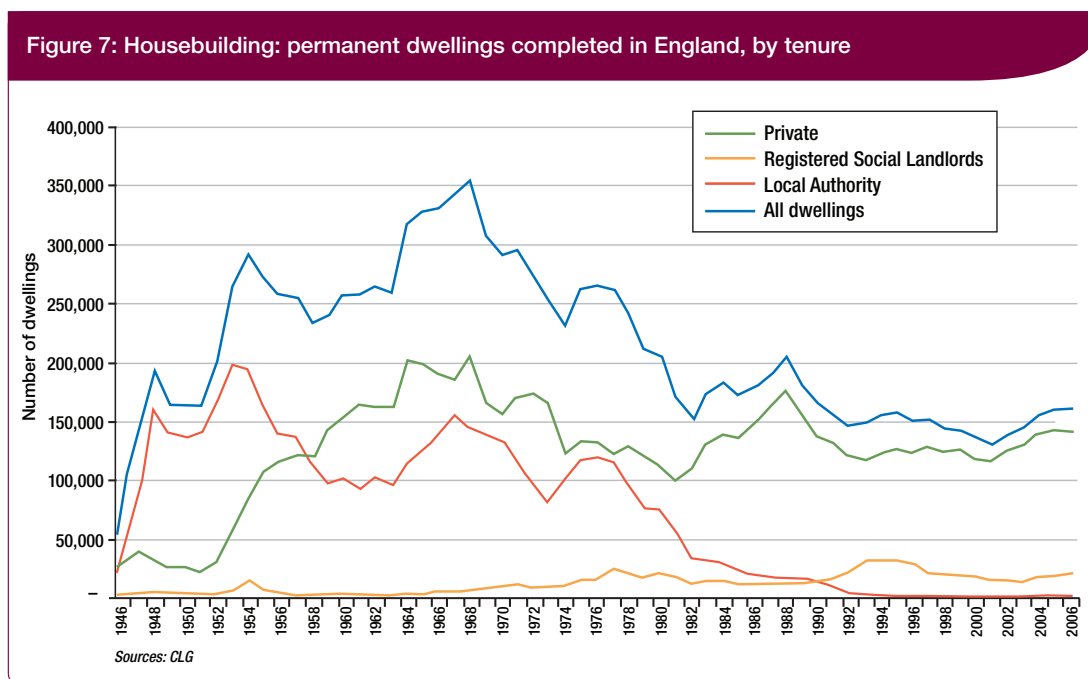
There has also been a rise in the number of second homes. For instance, between 2005 and 2006 the number of second homes increased by more than two per cent, to stand at around 240,000 or 1.1 per cent of the total dwelling stock²⁰. This increased consumption of housing has been supported by rising incomes, and rising house prices and equity withdrawal.

In a situation where supply is unresponsive, the effect of buy-to-let and second homes is likely to have resulted in some potential owner occupiers being priced out of the market. These changes in the market may prove to be fundamental shifts, altering previous trends and ratios. They are certainly becoming increasingly important considerations for planning authorities and the house building industry when planning provision.

¹⁸ Figures to 2004 are derived from mid-year population estimates. Estimates have been revised to align them with the revised population series. Figures for 2006 onwards are 2004-based projections.

¹⁹ CML.

²⁰ Savills Residential Research, based upon CLG statistics (19th March, 2007) also report wide regional variation in the distribution of second homes, with 21 per cent being in the South West and 3.2 per cent in the North East.



Housing supply and future plans – On an upward trend, but is it enough to prevent worsening affordability?

In 2006/7 the number of new dwellings completed was around 168,000. This was a slight increase on the previous year and continued an upward trend in delivery that began at the start of the century. However, it is worth putting these figures into their historical context.

The UK suffers from a slow and deteriorating response in matching housing supply to housing demand. Despite a build up in demand, the number of new homes built in 2006 was only 45 per cent of the level achieved in 1968, when house building reached a post-war peak of over 350,000 (see Figure 7), and is still well below the number built at the end of the 1980s.

In recent years the supply of new homes has consistently failed to match the number of new households projected, let alone accommodate the increasing demand for better quality housing as a consequence of rising prosperity. And worryingly, figures published by CLG in May 2007 indicate a fall of six per cent in the number of house building starts for 2006/7 as compared with the previous year.

A key finding from the Barker Review was that an under supply of new homes was forcing house prices upwards. The Government published their response to the Barker Review in December 2005 and recognised this. A target to build 200,000 new homes per year by 2016 was set. But, taken together with household projections, pent up demand in the market, and an increased level of consumption by existing owner occupiers and investors, the indications are that this level of house building will not be sufficient.

Barker's findings indicated that a more significant step change in supply was likely to be required to generate a sustainable improvement in housing affordability. The Government may need to consider the scale of its ambition as part of the Comprehensive Spending Review if it is to achieve this outcome.

The house building industry is keen to see targets for more houses to be built, and keen to see the relaxation of planning constraints that prevent this. But some observers question whether the sector has the capacity to deliver the step change required.

It is essential that the necessary infrastructure is planned and either available or put in place before major housing developments are completed. This has been a criticism of developments in the past, and a criticism of plans heard today. The role of the planning system is covered in the next section.

The role of the planning system

The planning system is 'gatekeeper' to the supply of land for development and thus central to delivery housing.

Planners consider social, economic and environmental impacts in order to promote development in the right places. A balance must be struck in terms of local, regional and national net benefit.

The planning system is open to the public and influenced by politics. Indeed, no matter what 'system' is in place, a principle of openness will be a key influence on the process, timescales and decisions that result.

While planning is an essential tool for the delivery of – among other things – development, good design and high environmental standards, the system has been criticised for not taking market signals adequately into account when determining the right supply of land for housing.

The planning system has undergone significant reform in the last year or so. Further change is likely to follow Kate Barker's most recent Review of Land Use Planning published in 2006 and with the publication

of the planning White Paper Planning for a Sustainable Future, in May 2007. Central to these developments are the three key issues of flexibility and responsiveness, efficiency of process, and more efficient use of land.

Key recent changes specific to the provision of housing have been: Planning Policy Statement 3 (PPS3) on Housing; and Planning Policy Statement 11 (PPS11) on Regional Spatial Strategies. PPS3 sets out the national planning policy framework for delivering the Government's housing objectives.

Strategic housing policy objectives

The Government's key housing policy goal is that everyone has the opportunity of living in a decent home, which they can afford, in a community where they want to live. To achieve this, it identifies four strategic objectives:

- To improve affordability across the housing market, including by increasing the supply of housing.
- To achieve a wide choice of high quality homes, both affordable and market housing, to address the requirements of the community.
- To widen opportunities for home ownership and ensure high quality housing for those who cannot afford market housing, in particular those who are vulnerable or in need.
- To create sustainable, inclusive, mixed communities in all areas, both urban and rural.



These housing policy objectives should provide the context for planning for housing through development plans and planning decisions. The specific outcomes that the planning system should deliver are:

- High quality housing that is well-designed and built to a high standard.
- A mix of housing, both market and affordable, particularly in terms of tenure and price, to support a wide variety of households in all areas, both urban and rural.
- A sufficient quantity of housing taking into account need and demand and seeking to improve choice.
- Housing developments in suitable locations, which offer a good range of community facilities and with good access to jobs, key services and infrastructure.

- A flexible, responsive supply of land – managed in a way that makes efficient and effective use of land, including re-use of previously-developed land, where appropriate.

Regional Planning Bodies and Local Planning Authorities must take these objectives into account when determining housing provision.

The aim is to ensure the delivery of housing through an identified and flexible supply of land, which is responsive to market signals.

The supply of land and housing will be reviewed with other indicators in Annual Monitoring Reports. Assessing delivery against targets will indicate if remedial action or strategic reviews are required. Affordability should be one of the relevant key indicators when assessing progress in delivering the overall strategy.

There may be difficult choices and issues to confront in the future. These potentially include brownfield versus greenfield development, and building on some Greenbelt land. As well as analysing planning policy and decision making, measures may also be needed with regard to fiscal policy and the development industry. There are crucial inter-relationships between all of these in terms of their influence on the provision and consumption of housing.



So where does the NHPAU fit in?

In placing new requirements on planning authorities to consider affordability, PPS3 identifies the NHPAU as a key source of advice.

In placing new requirements on planning authorities to consider affordability, PPS3 identifies the NHPAU as a key source of advice. A first priority for the NHPAU then will be to engage with the Regional Spatial Strategy (RSS) process.

The RSS process is quite lengthy, currently spanning an average of over three years. Regions are at different stages of delivery, and most are well advanced. Our approach in each region will therefore need to be tailored.

Broadly, the regions fall into three groups:

- A first group where NHPAU has an opportunity to contribute to the RSS process prior to the Examination-in-Public (EiP).
- A second group where the EiP is ongoing or has passed, but where there remains an opportunity to deliver some analysis prior to the issue by the Secretary of State of any final proposed changes.
- A third group where final proposed changes to the RSS have been or are about to be published.

In some cases where the RSS process has been completed or is drawing to a close, mini-reviews of

certain aspects of the Strategy are anticipated. This is a normal part of the process and will enable stakeholders to take into account important new evidence or policy developments.

Aside from the development, review and finalisation of each RSS, the NHPAU will also have an interest in the Annual Monitoring Reports of delivery against the RSS and proposed corrective action.

What will be our starting point?

The Affordability Model is an econometric model developed by Reading University. It captures the relationship between housing supply and affordability through the interplay of demographic trends, incomes, the labour market and the housing market. The model represents a significant step forward in understanding affordability and is an important tool.

The model provides a mechanism to chart how key variables in the housing market impact on each other, for example quantifying better the relationship between supply and prices; demand and prices; prices and household formation; and prices and inter-regional migration (see Figure 8).

Figure 8: Simplified overview of the Affordability Model

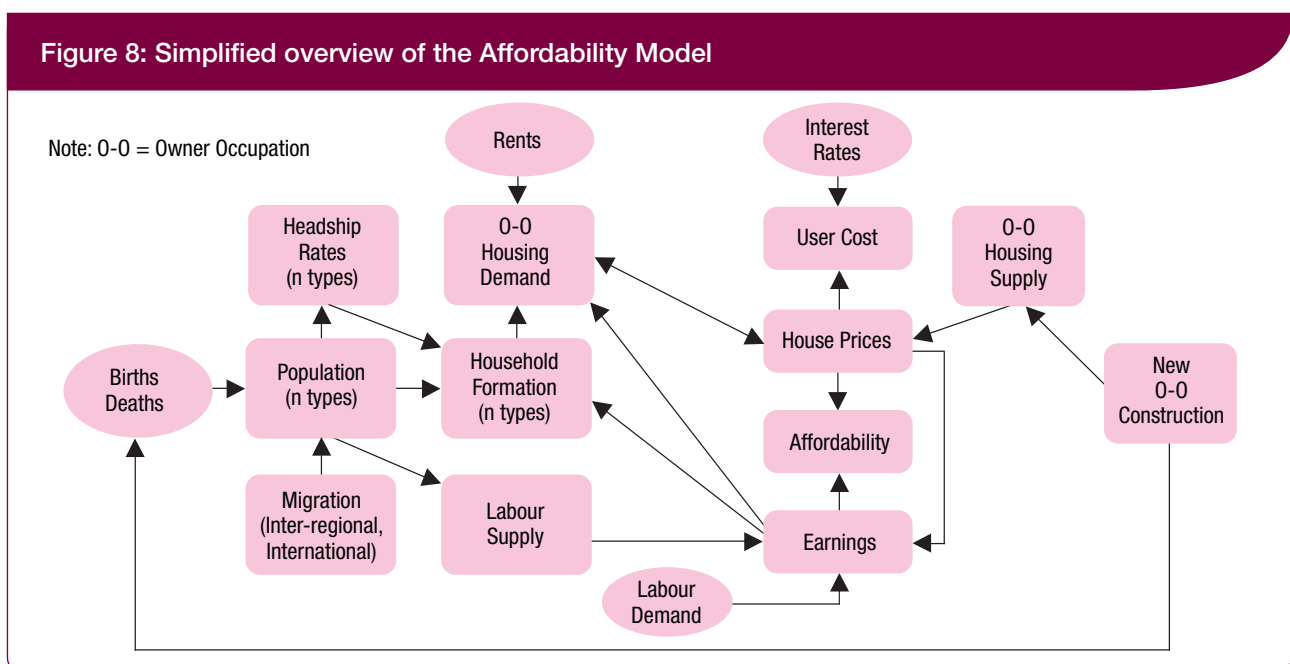
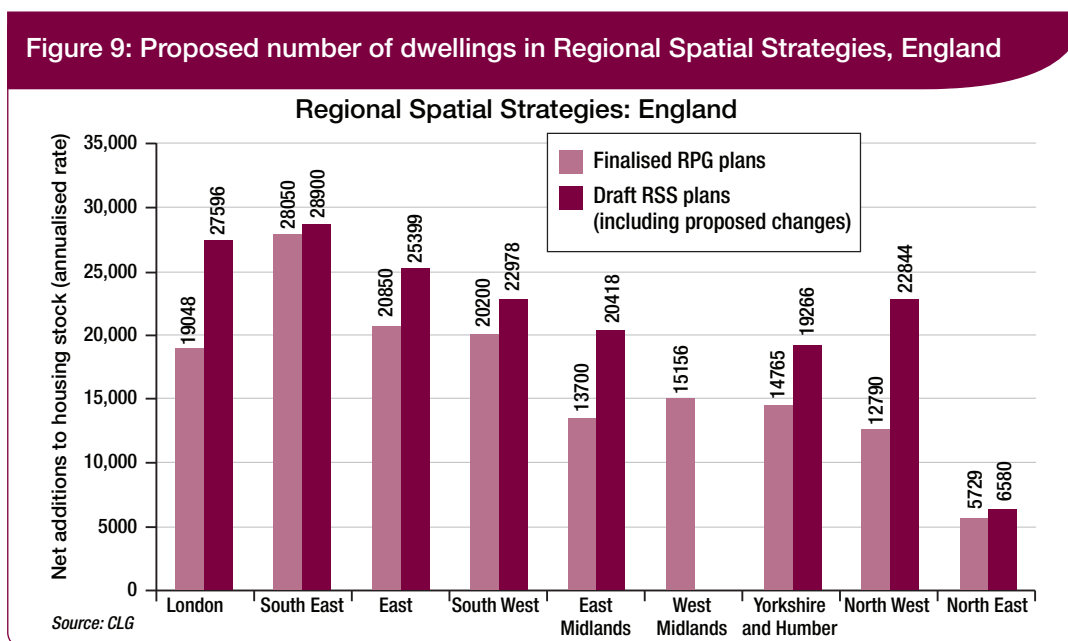


Figure 9: Proposed number of dwellings in Regional Spatial Strategies, England



To boil down some of the key relationships embedded within the model – which are based on evidence from research – a useful way of understanding how the housing market actually operates, in the long run, is as follows:

- If real incomes rise by one per cent, then house prices will rise by around two per cent
- If interest rates rise by one percentage point, house prices will fall by around three per cent
- If housing *stock* increases by one per cent, house prices will fall by about two per cent
- If the number of households increases by one per cent, house prices will increase by two per cent.

There are many relationships like these built into the Model which combine to enable scenario testing of the impact of new building on the housing market.

Of course, any econometric model is based on historical trends and correlations. Furthermore, it is only as good as its specification. The Unit will work with regional partners and others to develop the Affordability Model.

The NHPAU will not rely exclusively on the Affordability Model. We will develop alternatives, conduct a range of econometric and statistical analysis, and draw on local information and informed opinion, as well as taking account of those other factors which cannot readily be incorporated into a statistical model.

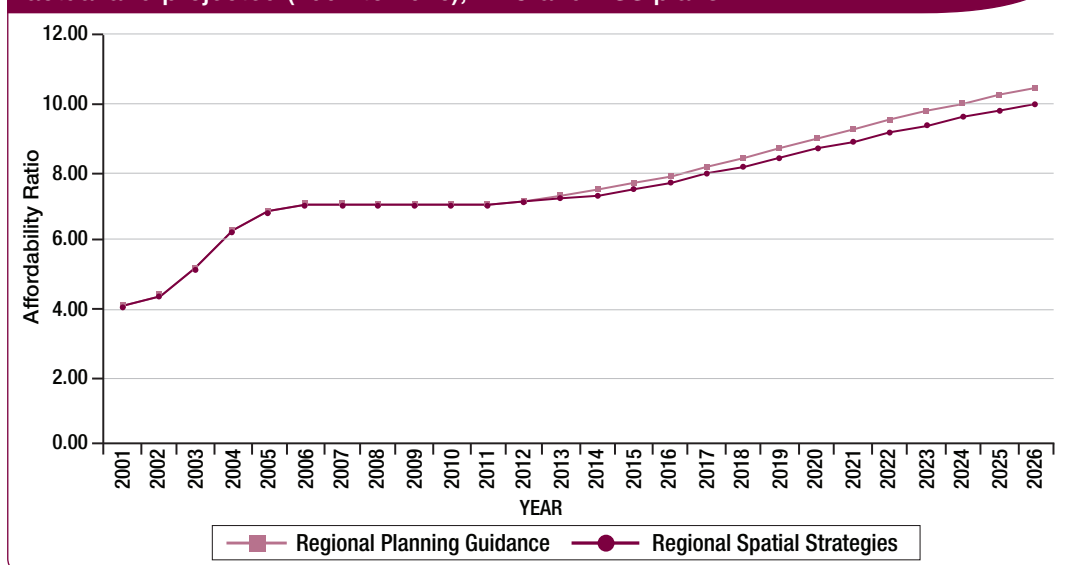
Some early analysis

One of the areas where the NHPAU will be able to add value is by looking across all the English regions to understand the overall impact of planned housing provision, and the interaction between the regions.

Collectively the regions have increased their housing provision plans significantly from about 150,000 under the former Regional Planning Guidance (RPG) regime to around 190,000 as part of the RSS process²¹ (see Figure 9). But given the pressures outlined earlier, there must be concern about the pace and scale of planned provision.

²¹ For West Midlands, the draft RSS plan has not yet been published. In order to produce a comparison between RPG and RSS plans for England as a whole an annualised rate of 16,167 calculated from figures in Structure Plans and Unitary Development Plans has been used.

Figure 10: The ratio of lower quartile house prices to lower quartile earnings: actual and projected (2001 to 2026), RPG and RSS plans



Our first use of the Affordability Model has been to begin to understand what the implications for market affordability across England might be in two different scenarios (see Figure 10):

- Former RPG house building plans
- Current draft RSS house building plans.

Our initial work suggests that the real problem of affordability – which has seen the average lower quartile house price to earning ratio increase from four in 2000 to over seven now – is highly likely to deteriorate even further under existing RSS plans.

As the graph shows, Regional Assemblies have ensured an improvement in the housing affordability prospects for their communities in the future by replacing RPG planned provision with their RSS. Indeed, some economists would argue that the effect on affordability will be greater than projected as the impact of a sustained increase in supply begins to have an impact on prices by dampening expectations about the scale of future increases.

Nevertheless, the affordability problem is highly likely to get even worse. Under RSS plans the ratio of lower quartile house prices to lower quartile earnings is projected to erode from around seven in 2006 to about ten by 2026.

Extrapolating these findings and focussing on the 30-34 age group (largely first time buyers), the

implication is that whereas in the late 1990s over 60 per cent of this group could afford to buy an average flat, by 2006 this figure had fallen to 57 per cent. The prospects for the next generation are much worse. Based on this analysis by 2026 only 40 per cent of the 30-34 age group would be able to buy²².

It is vital to recognise that these are the most likely outcomes but, as with any forecasts, there is a degree of uncertainty. It is quite possible that affordability will worsen more rapidly. On the other hand, it is equally possible that a housing market slowdown at some point will generate a temporary improvement in affordability.

We will develop this initial analysis to understand the broader implications, for example the impact on: home ownership rates; specific demographic groups; and household formation rates.

Working with our partners to develop the affordability toolkit

The NHPAU, working closely with the Regional Assemblies and other key regional stakeholders, will also be delivering affordability analysis which is regionally specific. We will share our findings and make them public.

In developing regionally specific outputs we will need to understand: the particular circumstances that apply in each area; the evidence base put forward to support each RSS; and links with the Regional Economic and Housing Strategies.

²² These figures have been calculated using a similar methodology to that used by CLG in 'The Government Response to Kate Barker's Review of Housing Supply: The Supporting Analysis'. An updated version of the affordability model has been used with RSS data and so the results are not directly comparable.

As well as feeding into the RSS and Annual Monitoring process, a further output might be a comparison of approaches used across the regions, potentially allowing us to identify and disseminate examples of best practice.

Looking further forward, as well as working with Reading University to develop the Affordability Model with regional partners, we will also want to ensure support is provided to key regional personnel in understanding how the Affordability Model works.

In developing an affordability toolkit the Unit will consider complementary econometric and statistical methods developed in the regions for example, to understand the potential implications of growth aspirations on housing.

The NHPAU will consider both the work being done in the regions on Strategic Housing Market Assessments and how affordability analysis might be approached at this sub-regional level.

We need to help develop an agreed and consistent methodology across the regions to assist planning authorities with meeting the new requirements in PPS3 on housing market affordability.

New research on aspects of affordability

Another part of the NHPAU's remit is to commission research on matters related to the housing market. What is working well and where are the barriers to delivery of improved affordability?

The Government has put in place a wide-ranging programme to tackle the broad issue of housing supply including: Growth Areas and Growth Points; Planning Reform; Housing Market Renewal Pathfinders; the Community Infrastructure Fund; proposals to develop the planning gain regime; and affordable housing initiatives. We will have an interest in all these matters as well as the impact of wider policies and practice.

The aim is to provide policy makers and practitioners in central, regional and local government, and elsewhere, with high quality evidence to help develop policies and initiatives to improve the affordability of housing.

The Unit is beginning to gather potential themes for an ongoing research programme. Some of the suggestions we have received to date include:

- Drawing on the work by the regions to identify sub-regional housing markets which are useful for the purposes of measuring and forecasting affordability.
- Reviewing the impact of the reformed planning regime on housing delivery including how planning authorities are dealing with affordability.
- Identifying differences between the planning system's definition of 'supply' ('provision') and what actually gets built, including current and possible future trends in demolitions and conversions.
- Assessing the impact of the buy-to-let market on house prices (see Figure 11).
- Assessing the impact of infrastructure constraints on housing supply, and charting the role and impact of the Environment and Highways Agencies in facilitating delivery.
- Reviewing appropriate international case studies to understand the experience of other nations in dealing with housing affordability and supply.
- Assessing the impact of the planning gain regime – the approach of industry and local authorities, an assessment of costs, benefits and incentives in the system.
- A stock take of progress in the light of recent and ongoing reviews of the house building industry for example, the Callcutt and Egan Reviews and Miles Review in the finance sector.
- Analysing the relationship between housing market vacancy rates and price change.
- Monitoring the social and demographic background of first time buyers, and wealth transfers from parents.
- Analysing specific attributes of houses and the local environment that drive prices.
- Consideration of the consequences of worsening affordability in terms of specific economic and social issues, including the demand for social housing.

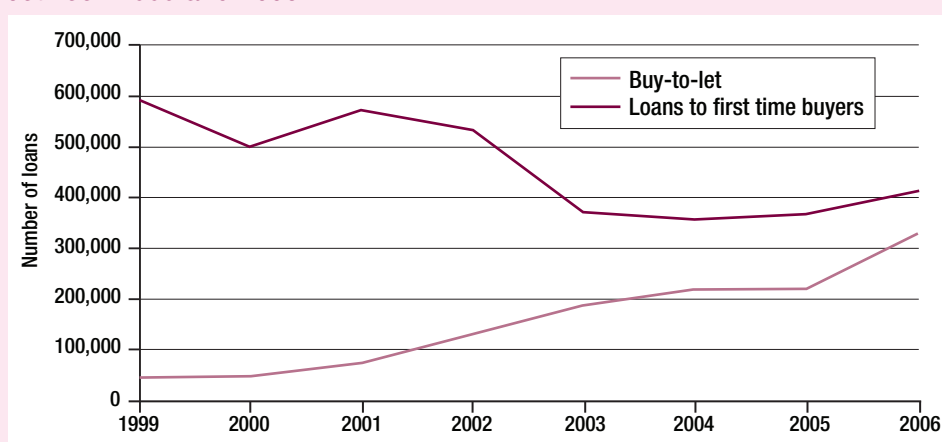
Suggestions for further research themes are welcomed, together with a brief explanation of their relevance to NHPAU's remit

Impact of Buy-to-Let

A possible research topic is the role played by the buy-to-let (BTL) market and the role of property investment on house prices.

For example, Figure 11 shows that since the turn of the century the number of buy-to-let mortgages has increased while the number of mortgages to first time buyers has fallen. This does not mean there is a causal relationship. But one hypothesis is that investment in the BTL market has pushed up the price of properties to such a degree that they are increasingly unaffordable for first-time buyers. Many questions arise here for example, are these short or long term changes in the market? And what is the impact on the private rental provision?

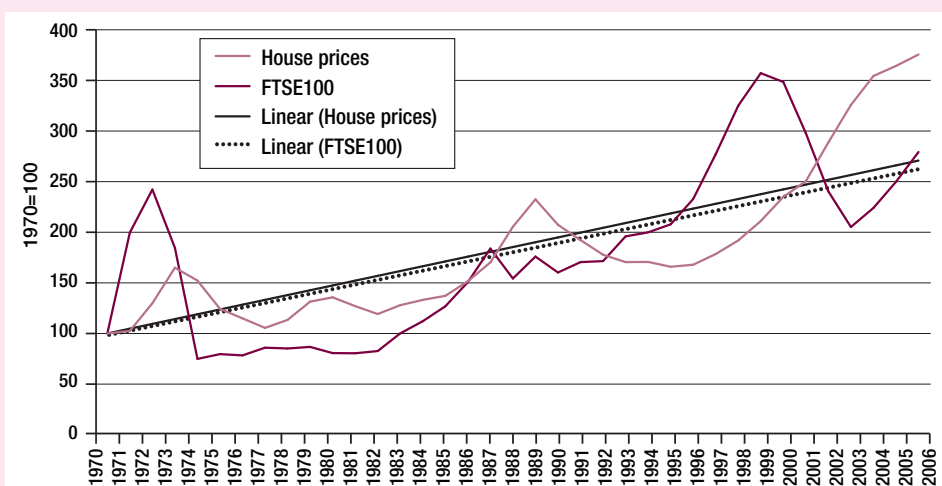
Figure 11: Buy-to-let mortgage advances and loans to first time buyers between 1999 and 2006



Source: CML and HM Treasury

Investment in the housing market may also be related to the performance of the stock market. For instance Figure 12 shows that in recent years house prices (in real terms) have risen on average at a much faster rate than the FTSE100 index since the turn of the century. This may have encouraged some investors to switch from equities into property, and this in turn may have fuelled a further increase in house prices that would otherwise not have occurred. Again many questions arise for example, would future higher returns from equities reduce levels of investment in the BTL sector? What is the likely behaviour of a BTL investor under a range of different market conditions?

Figure 12: Indexes of house prices and the FTSE100 in real terms from 1970 to 2006



Source: CML and HM Treasury

Summary

Affordability of housing matters – worsening affordability can have a series of negative economic and social consequences.

For example, it can impact on macroeconomic stability; make it difficult for households to manage spending and savings; undermine peoples' housing aspirations; and inhibit the creation of sustainable communities and labour market flexibility.

Between 2000 and 2007 commonly used measures of affordability indicate that the position has deteriorated significantly – over this period the ratio of lower quartile house prices to lower quartile earnings has increased from four to over seven. And mortgage payments as a proportion of income for first time buyers has risen from 19.3 per cent to 24 per cent.

Other indications of tightening affordability include a rising level of deposits and an increase in average earnings to loan multiples.

Worsening affordability will erode some people's chance of owning and could undermine the Government's target to achieve 75 per cent home ownership by 2016.

Affordability is a big issue across the whole of England. It is not just a problem restricted to London and the South East. According to findings from a new survey commissioned by NHPAU:

- More than eight out of ten people think that the Government should be taking steps to make housing more affordable;
- Almost half of those aged under 35 think they will have a lower standard of living than their parents due to rising house prices; and
- About a third of non-home owners believe they will never be able to buy a home.

Predictions of a housing market crash do not reflect market fundamentals – **demand for housing, driven by economic and population growth, continues to outstrip available supply.**

Indications are that demand for housing will continue to increase. Demographic projections indicate that between 2004 and 2030 the number of households in England will increase by an average of 223,000 each year and many of these will be single person households which could add to the affordability problem.

With over 850,000 buy-to-let mortgages across the UK and with around 240,000 second homes in England, these important elements of demand need to be considered.

While the number of new dwellings completed is on a slightly upward trend – in 2006/7 completions reached 168,000 – supply remains too low. And worryingly the number of new starts for the same period fell by six per cent compared to 2005/6.



The planning system is ‘gatekeeper’ of the supply of land for housing – it has undergone recent reform and is central to delivery of housing objectives.

One of the Government’s four strategic housing objectives is to improve affordability across the market, including by increasing supply.

The impact of PPS11 on Regional Spatial Strategies and PPS3 on housing, will provide a key test of the effectiveness of the planning regime.

Regional Assemblies have ensured that affordability prospects for their communities have improved. RPG plans for 150,000 net additional dwellings have been replaced by Regional Spatial Strategies that provide for around 190,000.

However, initial analysis by NHPAU shows that Regional Spatial Strategies are likely to lead to worsening housing market affordability across England.

All other things being equal, current plans would lead to a further deterioration in the lower quartile house price to earnings ratio from seven to around ten by 2026.

The NHPAU has been set up to provide independent and authoritative advice on affordability to the Regions, Government and other stakeholders.

We will initially focus on three key areas:

- **Contributing advice on market affordability matters throughout the Regional Spatial Strategy process**, including in the development, delivery, monitoring and review phases.
- **Developing and delivering an affordability toolkit with regional partners.** This will enable forward looking econometric and statistical analysis on the impact of planned housing provision. The focus will be at national, regional and ultimately sub-regional levels.
- Building an evidence base as a resource for regional partners and others on housing market affordability. This will include **delivery of a new programme of research.**

Contacting the NHPAU

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NHPAU Board Members

Stephen Nickell (Chair)

Currently Warden of Nuffield College Oxford. He was an External Member of the Bank of England Monetary Policy Committee from 2000 – 2006 writing a number of pieces about the impact of the UK housing market on the wider economy. Until 2005 he was School Professor of Economics at the London School of Economics, following his role from 1984 – 1998 as Professor of Economics and Director of the Institute of Economics and Statistics at the University of Oxford.

Max Steinberg

Has been Chief Executive of Elevate East Lancashire, a housing market renewal pathfinder since 2003, following 25 years at the Housing Corporation where his roles included Director of Investment & Regeneration for the North and Regional Director of the North West and Merseyside. He is a leading UK practitioner in Urban Regeneration and Housing. Max is Chair of the Board of Liverpool John Moores University European Institute for Urban Affairs and the Chair of Governors at King David High School in Liverpool.

Max is the linked Board member for the Yorkshire and Humber region.

Prof Glen Bramley

Professor of Housing and Planning/Urban Studies at Heriot – Watt University in Edinburgh since 1994 leading research on planning, housing and urban policy. Prior to this he lectured in Urban Studies at the University of Bristol specialising in local government finance, housing and economic aspects of public policy. He has published papers and extensive research analysing the economics around housing affordability and its relationship with planning and house building.

Glen is the linked Board member for the South West and North East regions.

Bob Lane

Is currently Chief Executive for North Northants Development Company responsible for growth and regeneration in the area. His previous roles include Chief Executive of Speke Garston Development Company, Liverpool, Assistant Chief Executive of the Merseyside Development Corporation and roles at Oldham and Lambeth Councils managing urban programmes. He is a specialist in the delivery of complex urban regeneration projects, with more than twenty five years experience as a regeneration practitioner/manager.

Bob is the linked Board member for the East of England and the North West regions.

Prof Paul Cheshire

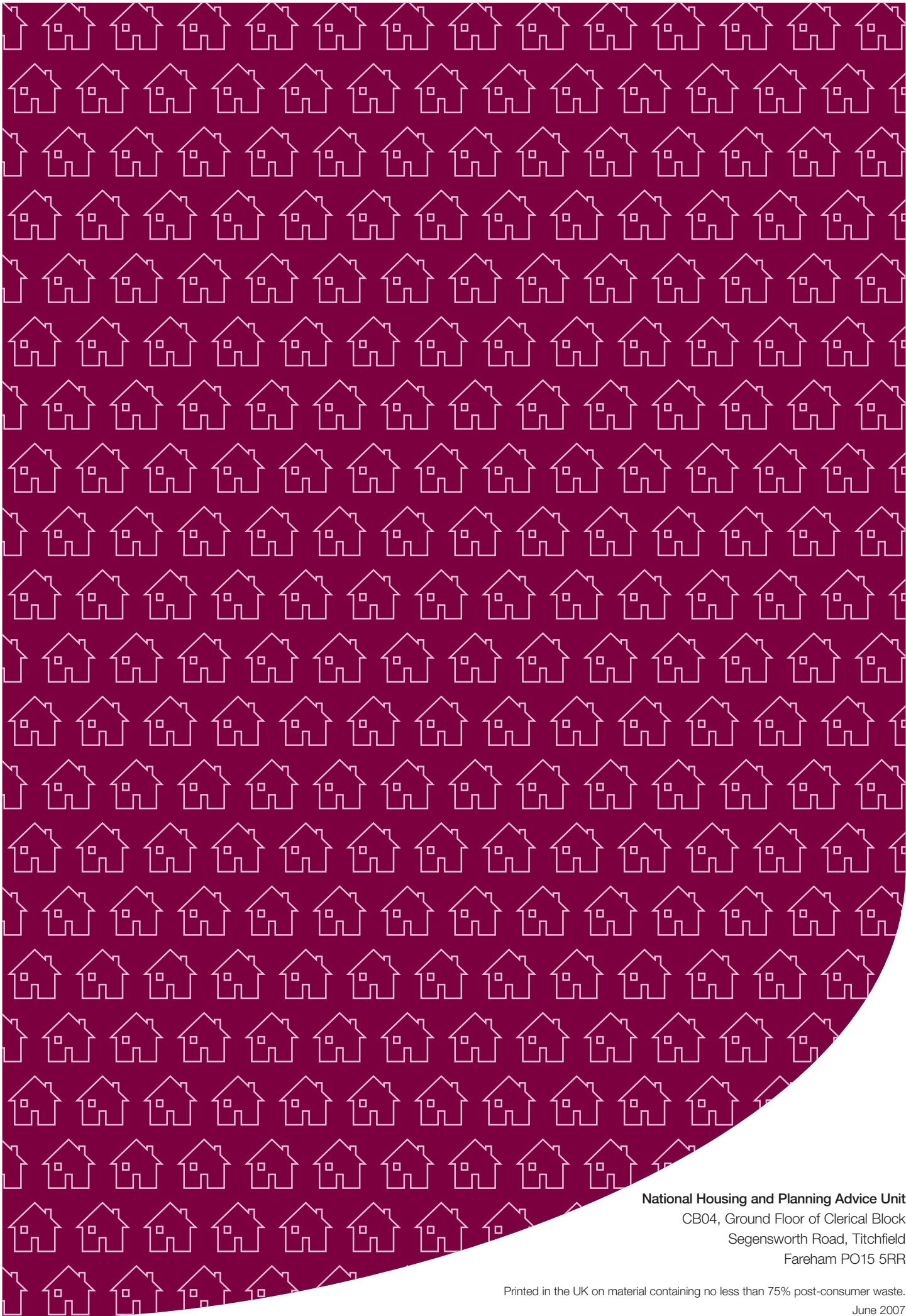
Has been Professor of Economic Geography at the London School of Economics and Political Science since 1995. Prior to this he was Professor of Urban and Regional Economics at the University of Reading and has spent time at Washington University in the USA. He has written extensively and conducted research on applied urban and regional economics, particularly the economics of housing, land markets and land use regulation.

Paul is the linked Board member for London and the East Midlands region.

Dr Peter Williams

Is now an independent consultant on housing and mortgage markets. His clients include the Intermediary Mortgage Lenders Association and Acadametrics. He was previously Deputy Director General of the Council of Mortgage Lenders. Prior to that he was Professor of Housing Management at Cardiff University, Deputy Director at the Chartered Institute of Housing and as an academic at the Australian National University and the University of Birmingham. He previously served on the Board of the Housing Corporation (1995-2002) and Housing for Wales (1989 to 1993). He is a Visiting Professor at the Centre for Housing Policy at the University of York.

Peter is the linked Board member for the West Midlands and South East regions.



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