

Increasing investment in affordable
homes

Shelter

This briefing sets out Shelter's position on increasing investment in affordable homes over the course of the 2015 – 2020 parliament, which must form part of a package of reform and investment to deliver the new homes we desperately need. The briefing summarises some of the policies set out in detail by Capital Economics in their recent research for Shelter: Increasing Investment in Affordable Housing (2014). This briefing also contains additional analysis by Shelter.

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Introduction

Everyone now agrees that we need to build more homes in England. If we want young families to have the chance of a home of their own to rent or buy then we need to build more and better homes in the right locations which are affordable now and remain affordable into the future.

People are looking to politicians for answers to the housing shortage but no political party yet has a comprehensive plan in place. Bold solutions are required to deliver the minimum 250,000 homes per year we need to keep up with additional housing need and start addressing the huge backlog of households who are overcrowded, 'concealed' within another household, living in unfit conditions or homeless and in temporary accommodation.¹ In 2013, we built just 109,660 new homes in England, so there is a lot of ground to make up.²

We cannot rely solely on a major public spending programme to build these much needed homes. Fiscal and political realities mean that government spending its way out of this problem is no panacea. Equally, public spending alone would not address the dysfunctions within the wider house building and land supply systems, which must be addressed in any credible home building plan to get us to 250,000 new homes per year.³

Some extra investment is however vital to kick-start house building quickly and provide the types of homes that are most needed. In particular, building the low rent, secure homes we need⁴ to help those on low or middle incomes will need extra public investment beyond than already

planned for 2015 - 2018.⁵ Currently, the government spends just over £1 billion per year on new affordable housing grants. On current plans, investment will fall again to around £960m per year from 2015 – 2018. It will not be possible to get to 250,000 new homes per year with current investment plans.

Another approach is possible.

Shelter asked Capital Economics to set out a range of practical options to boost investment in affordable housing which would have the minimum impact on government finances. To provide these options Capital Economics looked at the best international and domestic examples and how these might be applied across England. In this briefing, we outline some of these ideas, such as a National Housing Investment Bank, support for local builders and smarter use of public land, which could deliver affordable homes without requiring extra public spending.⁶

Shelter also asked Capital Economics to estimate how much extra direct public spending on new affordable housing could be sustainable for the public finances. They estimate that this would be £3.6 billion per annum additional investment in affordable housing,

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1. DCLG, Estimating Housing Need 2010. In 2010 DCLG estimated backlog housing need at 1.99m households in 2009 (8.8% of all households), falling gradually as a proportion of all households out to 2021 (6.9% of all households).
 2. DCLG, Live Table 244
 3. Shelter and KPMG will be setting out a full plan for a 2015 government to approach building 250,000 homes per year by the end of the next parliament, building on Capital Economics' findings and other research programmes.
 4. Housing need is assessed locally, making it difficult to build a definitive national picture of how many social rent homes or other tenures are needed. According to a recent study for the TCPA, 78,500 new households requiring 'social' sector homes will be required each year from 2011 to 2031. Holmans, New estimates of housing need 2011 – 2031, TCPA 2013
 5. The government has allocated £2.9 billion for the Affordable Homes Programme 2015 – 2018. HCA, Affordable Homes Programme 2015-2018, 2014. £1.25 billion is allocated for London through the Greater London Authority and £1.7 billion is allocated for the rest of England.
 6. The full research report is Capital Economics, Increasing investment in affordable housing, 2014

and that borrowing this would not be a concern to the government's creditors.⁷

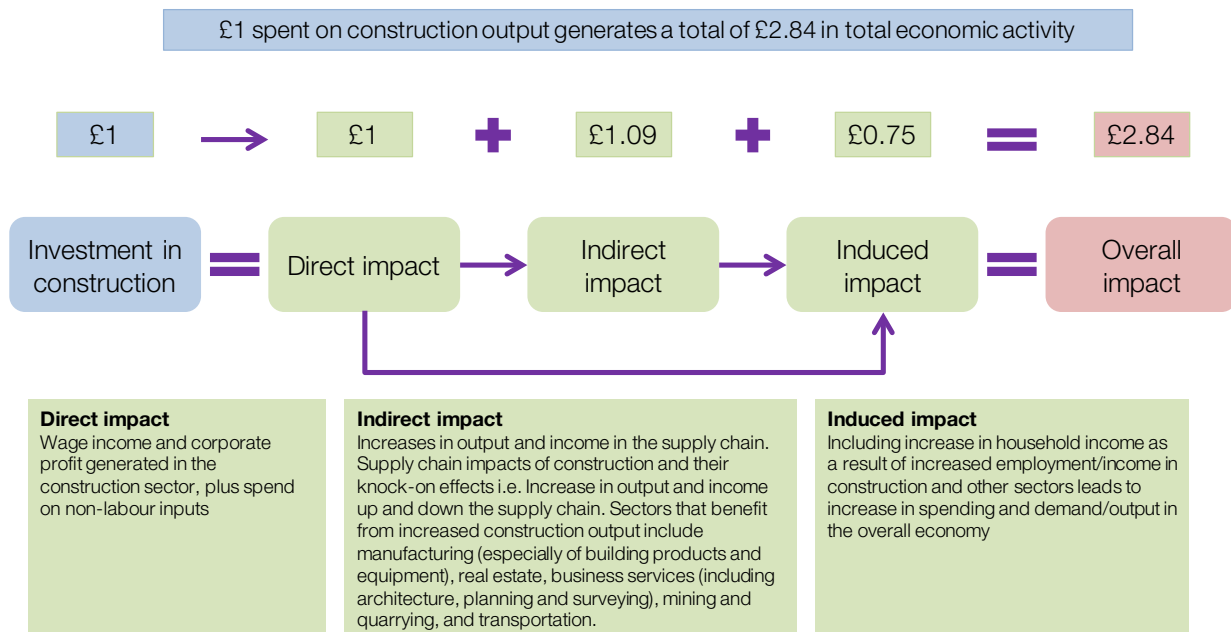
Shelter argues that as part of a wider package of private investment and market reform, just £1.22 billion extra per year in grant funding could be needed from 2015 – 2020 to get us building enough homes. Shelter advocates investing in new social rent homes, intermediate rent homes and also shared ownership affordable homes to address the range of housing needs for low and middle income households.⁸ The £1.22 billion per annum we recommend represents only a third of the amount Capital Economics think is sustainable for the public finances.

The investment measures in this briefing would deliver more than 58,000 new homes per year at current build rates, or more than 73,000 if combined with wider reforms

to make the housing supply system as responsive as it has been historically.

These new homes will generate jobs, apprenticeships and economic growth, reduce pressure on housing benefit, and increase tax revenues. Capital Economics estimate that the proposed measures (excluding grant funding) would deliver 71,000 additional jobs and over £12 billion of economic growth (0.8% of GDP), as well as a net £2.4 billion annual saving to the Treasury from increased tax and reduced welfare spending.⁹ Shelter's additional recommendation of £1.22 billion extra annual investment in affordable housing grant funding would generate £3.46 billion of extra GDP growth according to standard multipliers (below).

Multiplier effect of construction spending on the UK economy (L.E.K consulting)



Source: Justin Chaloner and Mark Pragnell. Capital Economics Ltd

7. Capital Economics, Increasing investment in affordable housing, 2014; Capital Economics, Let's Get Building: the view from the City, 2012
8. For more information on reforming, growing and improving shared ownership as a tenure for low and middle income families see Shelter, Homes for Forgotten Families, 2013. Shelter recommends a programme of 50% social rent, 25% affordable rent and 25% shared ownership.
9. This estimate is for the recommendations set out in Capital Economics, Increasing Investment in Affordable Homes, 2014. It does not include estimates for direct grant funding, which Shelter has modelled elsewhere.

Recommendations to increase investment in affordable housing

Below we set out proposals for direct investment and innovations that would boost investment but may not impact on the public finances. Whoever forms the 2015 government will need to do both.

Direct investment by national and local government

1. Increase direct capital grant funding for house building

Currently, government plans to invest £960m per year for 2015 – 2018 in grant funded affordable housing. Capital Economics recommends an additional £3.6 billion investment per year in affordable housing grant funding, based on the current state of government finances. They state that: “[grant funding]... **is the simplest, quickest and cheapest method to deliver new affordable homes**”.

Shelter believes that a 2015 government could increase housing supply substantially with less grant funding than this, so long as a tough package of reform is also delivered.¹⁰ Shelter therefore recommends an additional £1.22 billion public grant funding per year over the next parliament.

There are several options for government to finance this extra spending, the most obvious being:

- Fund the capital investment programme through increased revenue (tax) and/or shifting spending from other programmes.
- Fund the capital investment by bringing forward future investment programmes, meaning that capital investment would be cut after 2020.
- Fund the capital investment by increasing prudential government borrowing.

In terms of potential sources of revenue Shelter notes that:

- i. The OBR's projection for Stamp Duty Land Tax is that the Treasury will receive £12.5 billion in 2015/16 compared to £8.9 billion in 2013/14 (a £3.6 billion per annum increase). The increase from the March 2013 forecast to the December 2013 forecast alone was £3.2 billion for 2015/16.¹¹ This substantial extra revenue more than covers the extra house building spending we recommend.
- ii. HMRC estimate that private landlords are evading at least £550m of tax on rental income per year, roughly half the amount that we recommend investing in new affordable homes.¹²
- iii. The National Audit Office has cast doubt on the value for money of the New Homes Bonus which costs £2.2 billion per year.¹³ Further evidence of its impact is required, but it may be that some of this budget could be diverted to house building.

2. Allow local authorities to borrow and build, by raising arbitrary debt caps

Capital Economics argue that the current borrowing caps on those local authorities with Housing Revenue Accounts (HRAs) are “arbitrary, distorting and counter-productive”. Progressively raising these caps on those authorities which are constrained could deliver £7 billion of extra investment in secure, low rent housing over the course of the next parliament.

The Treasury could raise HRA borrowing caps towards the limits set under the prudential borrowing rules. These govern other areas of local authority capital investment and are based upon the level of extra spending authorities are able to sustain from the revenue generated.

Under current accounting rules, the extra borrowing by local authorities would count towards measures of total government debt (hence the strict borrowing caps). However, Capital Economics argue that there is a case to

10. We will set out our recommendation on investment and reform in a forthcoming report with KPMG.

11. OBR, Economic and Fiscal Outlook 2013

12. HMRC official quoted in Guardian, March 2014

13. NAO, The New Homes Bonus, 2013

reform these rules to reflect international practice which does not count such borrowing towards total debt.¹⁴

Why local authority borrowing does not have to impact politically sensitive measures of debt

Giving greater flexibility to local authorities to borrow within prudential limits would increase their borrowing, but this does not have to increase the more politically sensitive measures of national public debt. The UK is unique in Europe in classifying a very wide range of bodies as within the definition of 'public sector' used to measure public debt. Not only is direct central and local government spending counted within the definition used, but so are 'public corporations'. Other EU countries and most other OECD countries split out certain types of public corporation borrowing from general government expenditure when reporting public debt.¹⁵ In practical terms, the UK's accounting rules mean that grant funding for housing associations, local councils and ALMOs¹⁶ all counts towards total public current debt (PSND), as does local council and ALMO borrowing within their HR, but housing association borrowing does not.

This is despite that for local authorities, housing associations and ALMOs the cost of their borrowing is serviced by their ring fenced housing revenue, not by taxes or other public funds. There is a strong case for removing this anomaly and aligning our accounting practices with other countries so that extra local authority or ALMO borrowing through the HRA mechanism is not counted towards total public sector debt.

Innovations to boost investment with minimum impact on borrowing

Boosting private investment in homes, learning the lessons of PFI

Funding affordable housing investment with private finance can be a controversial proposition. The (relatively few) housing projects commissioned under the Private Finance Initiative since 1998 have been criticised for being excessively complex, incurring high consultancy costs, and delivering poor long term value for the tax payer. Shelter's aim in this briefing is

not to reopen the debate around the PFI programme, as public policy and market conditions have changed dramatically since the PFI was designed. The global financial system has endured its longest ever crisis, and returns on investment have hit all time lows, changing the relative attractiveness of investment opportunities. On the public policy side, barriers to the use of government investment guarantees have been overcome, public sector banks have emerged, and a whole new regulatory structure for the financial sector has been established.

These changes mean that the time is now ripe to learn lessons from the PFI experience and identify simpler, more transparent and cost effective models than can make best use of capital investment from both public and private sectors to deliver more affordable homes quickly and efficiently.

3. A National Housing Investment Bank, funded by ISAs

Currently, housing associations face higher financing costs than local and national government, or semi-public organisations such as Network Rail. Capital Economics estimate that if the borrowing costs of housing associations were reduced to the same level as national government, it would represent a £900m per year saving on interest payments. This is money that could instead be invested in affordable homes. A National Housing Investment Bank could provide low cost, long term financing to affordable housing providers, with government guarantees to reduce financing costs and therefore allow more investment into house building.

A National Housing Investment Bank could build on the model in the Netherlands where the Bank Nederlandse Gemeenten (BNG) is a major funder of affordable house building, providing 47% of all loans to housing associations. In the Netherlands, the BNG is also a source of finance for major regeneration schemes and other public investment.

The new National Housing Investment Bank in England could be set up as a new institution, as part of the existing Green Investment Bank, or as part of the British Business Bank that is currently being established. It would require a mandate and a supervisory system to assess lending and ensure that it fulfils its role of reducing financing costs for affordable housing providers. The Bank could either be government owned and controlled – in which case it could be part funded by government gilts and pay a

14. The case for broader accounting changes which would help the delivery of affordable housing are set out in the full report by Capital Economics.

15. Perry, Treating Council Housing Fairly, National Federation of ALMOs, 2013

16. Arm's Length Management Organisation

dividend to the Treasury – or it could be not-for-profit. If the Bank were not-for-profit it would have no impact on public sector net debt.

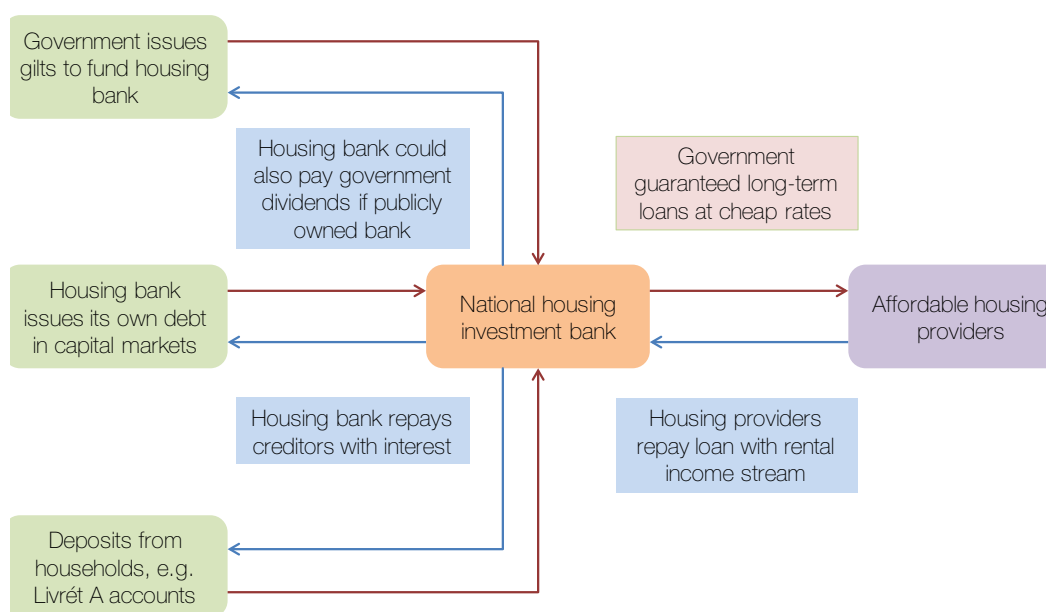
A not-for-profit Bank could self-finance by issuing its own debt in capital markets with government guarantees ensuring low cost loans for affordable house building are possible.

Another potential source of funding for a not-for-profit Bank is from preferential individual savings accounts (ISAs). In France, 70% of affordable house building is financed through Livrét A accounts which are held by commercial banks, but then aggregated and invested into affordable house building by the Caisse des Depots et

Consignations. In 2011, 120,000 new affordable homes were financed through this model.

Capital Economics do not think the same scale on investment via ISAs will be possible in England as in France, partly as the policy would only be applicable to a proportion of new savings each year (rather than transferring existing ISAs). However, if only a quarter of new ISA savings were channelled into affordable housing this would be equivalent to £3.9 billion per year. The remuneration of commercial banks providing the ISAs and the operating costs of collating and channelling the funds into the National Housing Investment Bank would be funded by the difference between the rate of interest paid on ISAs and the interest rate paid by housing associations on their debt

Illustration of how the Bank could function, either as government owned or not-for-profit



Source: Justin Chaloner and Mark Pragnell. Capital Economics Ltd

4. A 'Help to Build' scheme for local builders who build affordable homes

Since the financial crisis, small builders have struggled to access development finance as lenders have changed their credit allocation policies in a way that has disadvantaged small and medium enterprises in particular. A 'Help to Build' guarantor could give SME builders access to credit for building affordable housing units by making them as attractive to lenders as other large businesses or households.

The guarantor would remove some of the risks of lending to SME builders for affordable house building, with risk sharing arrangements to ensure that lenders are not incentivised to lend to any firm regardless of risk.

A 16 per cent rise in lending to SMEs would return lending to pre-recession levels. On current build rates, this scale of increased lending would finance the development of an addition 3,000 affordable homes. This increase would amount to £435 million additional lending, which would require at least £40m of loan guarantees from government.¹⁷ One way of funding these loan guarantees

17. The amount of guarantees required could be higher than £40m if lenders require a larger proportion of a new loan to be guaranteed before they are willing to increase credit allocation to SME builders for affordable house building.

would be re-allocating a small amount of the £12 billion of loan guarantees set aside for the Help to Buy scheme.

The modelling that Capital Economics have done to show the potential impact of the Help to Build policy is based upon S106 agreements¹⁸, which would provide affordable homes as part of larger private developments. There is however a wider potential for a Help to Build scheme which would be to help small builders access finance for small sites (such as urban in-fill) for private market units. Our estimate of 3,000 extra units per year is therefore likely to be conservative.

5. Joint public/private ventures on local authority land

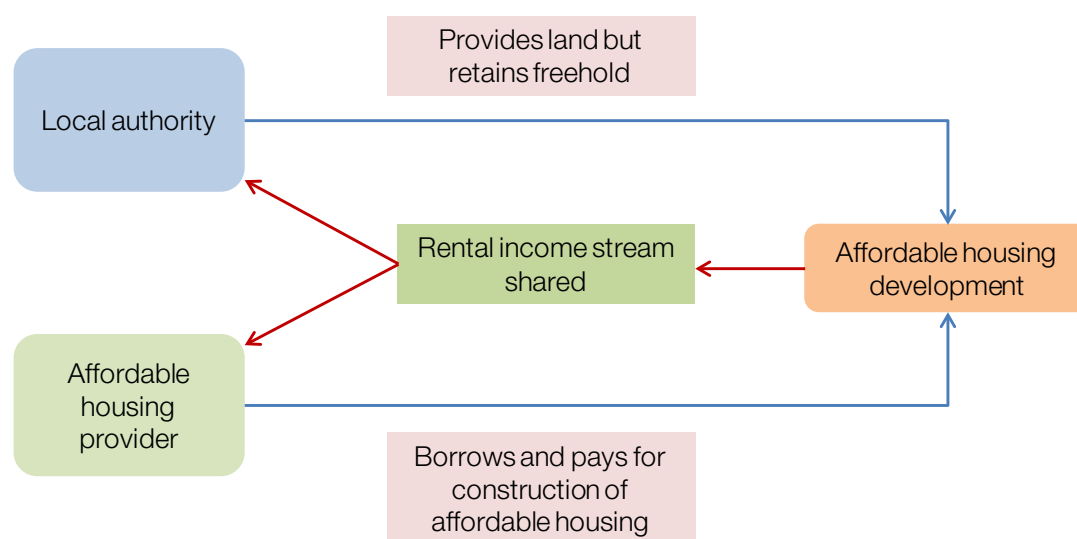
Local authorities own around 20% of land that has been identified as suitable for development.¹⁹ However local authorities are constrained in their ability to build on that land due to the caps on their ability to borrow to finance investment in building (see above). Equally, affordable housing providers – like all developers – experience very high land costs as a major barrier to development in the areas of greatest housing need.

Local authorities could lease their land to affordable housing providers while retaining the freehold (i.e. the long term ownership). This would avoid the public sector gifting substantial profits to developers or land owners, while leaving the authority with a stronger ability to ensure that public assets are put to best use.

Models like this are already in use, including the Birmingham Municipal Housing Trust and Kensington and Chelsea’s partnership with Grainger Plc over a private rented development.²⁰ The homes will be managed by Grainger for a management fee under a 125 year agreement, while the council retains the freehold ownership of the sites and shares a proportion of the long term rental income stream.

Capital Economics estimate that local authorities who adopt this model could receive substantial rental revenues from the sites (between 15% and 31% of the rental share on the site) and that such sites would not require public grant to fund the construction of rented units.

Illustrative local authority land joint venture model



Source: Justin Chaloner and Mark Pragnell. Capital Economics Ltd

18. S106 planning agreements are between developers and planning authorities and provide finance for affordable housing, affordable housing units and/or infrastructure to mitigate for the impact of new development.

19. DCLG, Accelerating the release of public sector land: update, overview and next steps, 2011

20. See Capital Economics, Increasing Investment in Affordable Housing, 2014 for further detail

6. Institutional Investment

As well as debt finance, there is also scope for greater use of equity finance for housing supply. For at least ten years there has been considerable interest in the potential for institutional investment in both social and private rented housing.²¹ There are now signs that these models may finally start to deliver.

In the United States there has been a long tradition of pension funds investing in private rental housing, for which they receive a stable income that is broadly linked to inflation, as rents typically rise with general inflation. But with only a couple of notable exceptions, large scale institutional investment in building new homes for the Private Rented Sector has not yet proved viable in the United Kingdom. The barriers mostly related to the scale of investment and the reliability of the income stream.

Pension and life-assurance funds have very significant capital to invest, but for precisely this reason they need suitably large investment opportunities. Moreover, it is not

realistic to expect such investors to drive the development process themselves: they need developers to supply them with the stock to buy.

Social rents are lower than those in the private sector, and returns to investors would be expected to be lower as a result. But social housing has other advantages, which can help it meet investors' need for scale and steady returns. There is a huge demand for social housing, which consequently has far lower rates of turnover and voids than the PRS. Social housing also benefits from a strong regulatory regime, and implicit or explicit government support that can make it a less risky investment prospect.

The safe long term returns social housing providers can bring are particularly suited to the investment profile of pension funds – several of which are now actively exploring options for investing in social housing projects.

Legal & General: Institutional investment into affordable housing

Legal & General (L&G) is one such institution actively pursuing long term investments into affordable housing. One model planned to deliver new affordable homes is for L&G in its capacity as a property investor to fund the construction and retain the ownership of new affordable homes, without recourse to public grant. L&G's cost of capital is likely to be cheaper than that of the capital markets, because the return is structured to run down the cost of the initial investment over a longer period than a normal loan. The homes would then be leased to a local Council or housing association, on a long lease of between 25 and 50 years.

During the period of the lease, the council or association would guarantee a net rental income at a rate to match L&G's pension liabilities. The social rents collected would cover both the management and maintenance costs of the housing provider, plus a surplus over and above the rent paid to L&G.

Under this model, L&G is investing in the secure rental income it receives throughout the period of the lease: it is not investing in the potential capital growth of the homes. This means that, at the end of the lease term, L&G is able to hand the ownership of the properties to the council or housing association for a notional amount.

Because social rents are relatively low, and do not vary as much as capital values do from region to region, the viability of this model relies on land being relatively cheap – but there is no reason the model cannot work in high value areas if land can be acquired at modest rates (i.e. in a joint venture as outlined in Option 5 above).

L&G believe that the main constraints to the expansion of the investment model are access to sites with appropriate planning permissions at viable prices and the ambition of local authorities.

21. Invest to Rent, London Councils and BPF, 2011; Review of the barriers to institutional investment in private rented homes, DCLG 2012; Informal consultation on REITs, HM Treasury 2011

Conclusion

To build the minimum 250,000 homes per year we need in England will take both reform and investment. Shelter believes that increased investment will need to come from direct government spending through traditional routes (capital grant funding and local government borrowing), but that innovative approaches to development finance could also increase the supply of affordable homes without adding to sensitive measures of government debt.

Impacts of extra investment on housing supply and government finances

Below we provide Capital Economics, Shelter and L&G calculations for the impact of the policies considered in this briefing paper.

Table 1. Impact on annual investment and affordable and market house building

Recommendation	Additional new homes in each year			
	Additional investment finance in each year	Affordable	Open Market	All
1. Increasing grant funding²²	£1,220m	20,429	N/A	N/A
2. Raising borrowing cap on local authorities²³	£1,401m	9,800		9,800
3. National Housing Investment Bank²³	£1,055m	5,145	2,232	7,377
4. Help To Build²³	£523m	1,280	2,377	3,657
5. Joint ventures on local authority land²³	£978m	6,839		6,839
6. Direct institutional investment²⁴	£1,000m	10,000		10,000
Total	£6,117m	53,493	4,609	58,102

22. Figures are based on calculations set out in Shelter, Solutions for the Housing Shortage, 2013

23. Capital Economics have calculated potential output on the basis of units being delivered as Affordable Rent. This is a reasonable modelling assumption, as it allows ready comparison between the proposed innovations and the current 2011 – 2015 Affordable Homes Programme, which prioritises Affordable Rent provision. Shelter advocates reforming the 2015 – 2018 Affordable Homes Programme so that it prioritises more affordable tenures (social rent levels), which would in practice reduce the number of units that the innovations modelled here could support.

24. These figures are illustrative only, and are based upon conversations with pension fund investors about their expected investment programmes.

Shelter advocates investment in affordable homes alongside reform of the housing supply system designed to increase the overall responsiveness of house building in England, which has declined in recent decades. We therefore asked Capital Economics to estimate what the potential output of the package of investment measures would be if the housing building system was as responsive as it was in the 1970s, when we were building far more homes and supply responded more rapidly to price signals.

Table 2: Estimates of potential impact of housing output at 1970s build rates

Recommendation	Affordable	Open Market	All
1. Increasing grant funding	20,429	N/A	N/A
2. Raising borrowing cap on local authorities	9,800		9,800
3. National Housing Investment Bank	9,441	4,095	13,537
4. Help To Build	2,348	4,361	6,709
5. Joint ventures on local authority land	12,549		12,549
6. Direct institutional investment	10,000		10,000
Total	64,567	8,456	73,023

Table 3: Assumptions for modelling the impacts

Recommendation	Impact assessed through
1. Increasing grant funding	Updated prospectus for the HCA which allocates 50% of £1.22bn grant funding for social rent units, 25% for intermediate rent units and 25% for affordable home ownership.
2. Raising borrowing cap on local authorities	Local authorities borrowing £7 billion more over the course of a parliament (5 years)
3. National Housing Investment Bank	Impact of 100bp cut in HA cost of funds plus HAs build 10 per cent more due to reduced borrowing constraints
4. Help To Build	SME guarantee scheme, which reduces funding costs by 100bp and increases lending to SMEs by 16 per cent
5. Joint ventures on local authority land	Local authorities lease land to housing associations, who share the rental income stream with local authorities, lowering the amount of development finance required per unit and hence the cost of finance. Reduced costs applied to increasing output.
6. Direct institutional investment	Assumes that two major institutional investors adopt a programme similar to the L&G model outlined above, and make 5 investments of £100m each per year.

Table 4. Impact on public finances

Recommendation	Funded by central government borrowing or taxation	Funded by local government borrowing or taxation	Increase in General Government Debt?	Increase in PSND?	Indirect Treasury Support as guarantor	HMT
1. Increasing grant funding	Yes	No	Yes	Yes	No	N/A
2. Raising borrowing cap on local authorities	No	Yes	No	Not necessarily (accounting rule changes)	No	No
3. National Housing Investment Bank	No	No	No	No	Yes	Yes
4. Help To Build	No	No	No	No	Yes	Yes
5. Joint ventures on local authority land	No	Depends on balance of financial commitments	No	No	Depends on 'control' of joint venture	Depends on 'control' of joint venture
6. Direct institutional investment	No	No	No	No	No	No