DELIVERING A FISCAL STIMULUS THROUGH ADDITIONAL HOUSING INVESTMENT

Introduction

The UK has played a leading role internationally in recognising the importance of fiscal stimulus measures in supporting the economy through the current downturn. Alongside tax cuts and benefit increases, a key aspect of this approach is additional public expenditure on infrastructure investment.

The fiscal stimulus package set out in the Government's Pre-Budget Report featured a range of measures to increase investment in public infrastructure, including bringing forward expenditure on housing and regeneration programmes. This was followed in January by the Prime Minister's announcement of his intention to bring forward new policies to ensure that spare house building capacity is utilised to meet housing need, and his commitment to take whatever action is required to enable the speedy and cost effective delivery by local authorities of new social rented homes.

The purpose of this paper is to make the case for a programme of additional investment in new social housing and supporting infrastructure in England over a two year period as part of any further Government package to deliver a fiscal stimulus to the economy. Developed through the 2020 Group, the paper sets out proposals for what such a programme of investment could look like, explains why it is needed, and demonstrates how it could be delivered in order to have a rapid and high impact effect on the economy.

The economic downturn and its impact on housing supply

The collapse in mortgage lending, and therefore in house prices, has led to a severe drop in private housing supply. The number of private market completions in England fell from 31,790 to 26,050 between quarters two and three of 2008, and some commentators have estimated that the number of housing completions in Great Britain will decrease to 80,000 in 2009, down by 56% from the level achieved in 2007[1].

This decrease in output is already having a significant employment and economic impact. The redundancy rate in the construction industry was much higher than in any other major sector in the second half of 2008. According to the Bank of England's November 2008 Inflation Report, one of the biggest drags on UK growth

[1] Construction Products Association, *Construction Industry Forecasts, Winter 2008/09*

came from the marked decline in dwellings investment[2]. And recent research for the Local Government Association[3] estimates that over the period 2008-10, employment in the construction industry will decline by 20% - a higher proportion than any other sector and equivalent to around 447,000 job losses.

Once cut, levels of activity in the housebuilding sector will not be easy to reverse. Experience from the 1990s recession is that housebuilding does not automatically bounce back when the market recovers. In that case, housing output did not return to pre-recession levels until 2001, and did not markedly increase until after 2004. The Office of Fair Trading's recent report[4], '*Homebuilding in the UK: A Market Study'* noted that this development lag was caused by delays in obtaining planning permissions, and lack of suitable skilled labour, in particular experienced site managers. Most of the housebuilders consulted as part of the study attributed the shortage of skills during the late 1990s and early 2000s to the crash of the early 1990s as many of those who lost their job took up employment opportunities in other sectors and did not return.

The combination of diminished capacity in the housebuilding sector and continued demand presents the very real risk that once house prices begin to rise again the affordability crisis will rapidly reappear. If housebuilders are unable to increase supply quickly when the upturn comes, this could fuel further sharp price increases[5]. On the other hand, demand for additional housing supply is likely to remain, driven by the growing number of households. According to modelling by the National Housing and Planning Advice Unit, falling house prices over the short term will not improve long term affordability prospects, with affordability ratios reverting by 2016 to the same trajectory as would have been expected had no housing market adjustment taken place.[6]

Recent research for Shelter, based on official government demographic projections of household and population growth[7], predicts that to meet newly arising demand and need, a level of 242,000 net additions to the housing stock is required each year between 2006 and 2026. Of these, it estimates that 145,000 per annum should be to meet market demand, with 67,000 per year extra social rented homes and 30,000 per year extra intermediate homes. In addition, the research highlights the existence

[2] Bank of England, *Inflation Report November 2008*, p.41.
[3] Public and Corporate Economic Consultants, on behalf of the Local Government Association, *From recession to recovery: the local dimension*, November 2008.
[4] Office of Fair Trading, *Homebuilding in the UK: A Market Study',* September 2008.
[5] Savills, *The Residential Property Focus*, September 2008, p.10.
[6] National Housing and Planning Advice Unit, *Affordability still matters*, July 2008.
[7] Holmans A, Monk S and Whitehead C, *Homes for the future: A new analysis of housing need and demand in England*, 2008

of a very substantial backlog of existing housing need that has not been met. There are currently more than half a million households requiring social rented housing who are homeless, living in overcrowded or other unsuitable accommodation, and in April 2008, there were 1.77 million households on local authority housing waiting lists, an increase of 73% since 1997. As housing and labour market conditions worsen, these troubling levels of unmet need are likely to rise still further.

Proposed housing stimulus package

The Government has already announced that it is bringing forward £550 million of the expenditure allocated for new social rented housing in the Comprehensive Spending Review from 2010/11 to 2008/9 and 2009/10, in order to accelerate the delivery of 7500 of the 110,000 social rented homes to be built over the three year period to 2010/11[8]. However, we believe the opportunity exists to provide a substantially greater fiscal stimulus, by injecting more investment into additional provision of social housing. We propose that this stimulus package should consist of the following, time-limited, components:

- Extra Investment: to increase by 20,000 - 30,000 the number of social rented homes built by 2010/11, over and above the Government's original target of 110,000. At a minimum, the Government's original target should be increased by 20,000, which could be achieved using a 75% Government funding rate. However, if the Government is willing to fund some of the new homes using a 100% subsidy model, this creates the potential to go further and in this case we propose the Government should increase the number of social rented homes delivered by 30,000.
- A £0.75 billion infrastructure fund to pump-prime new developments that would not otherwise be started in the short term.

This programme of investment would offset the reduction in the number of new market homes through the period of the downturn, providing a platform for levels of market provision to increase again once conditions improve. The economic benefits that would result are considerable:

- *Reducing job losses:* Research carried out in 2005 for Kate Barker's review of housing supply concluded that 1.5 workers per dwelling were directly engaged in the housebuilding process, including office staff and wider

[8] In September 2008, the Government announced that it was bringing forward £400 million of expenditure on social housing forward from 2010/11 to 2008-10, accelerating the delivery of 5500 social rented homes; subsequently in the pre-budget report, it announced that it would bring forward a further £150 million in the same way, corresponding to a further 2000 social homes.

professional support associated with development.[9] On this basis, an additional 20,000 social rented homes over a two year period would directly preserve 30,000 jobs, and an additional 30,000 homes 45,000 jobs. In addition, housebuilding activity indirectly supports employment across a range of other industries, including building materials, furniture and white goods. There is also a major risk of damaging capacity loss in these supporting sectors.

- *Sustaining business activity*: The proposed programme would improve cash flow and reduce risk for private and social developers and suppliers currently experiencing severe financial pressure, preserving the solvency of these businesses and their ability to support new development.
- *Retaining skills and driving innovation*: Preserving jobs will help to prevent a loss of key skills that could take years to replace. A shift towards a greater proportion of social and affordable housing units further provides an opportunity for the public sector to take the lead in driving innovation within the housebuilding sector, in particular the changes needed to enable the achievement of the Government's 2016 zero carbon homes target.
- *Increasing labour market mobility*: Worsening affordability and lack of affordable and social housing make it more difficult for households to move to take up new jobs and contribute to recruitment and retention difficulties, especially in the public sector. Additional social housing will ease some of these pressures, benefiting both individuals looking for work, and employers grappling with skill and labour shortages.
- *Promoting long-term macroeconomic stability*: Since 1970, growth in private sector housing development has shown five times as much volatility as GDP, and has contributed significantly to UK economic cycles[10]. Supporting the housebuilding industry through the downturn will help smooth this volatility, enabling housebuilders to continue to invest in housing supply and reducing the risk of a housing supply shortage once the upturn comes. This in turn should diminish house price volatility, which can feed through into the wider economy through household spending decisions[11].

As well as providing a much-needed economic stimulus, by improving access to social housing for those in housing need and reducing long term affordability pressures, the proposed investment package would generate a substantial social return. There is an extensive body of research showing the significant impact of secure and affordable housing in promoting economic well-being and positive health

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[9] Ball Michael, *The labour needs of extra housing output: can the housebuilding industry cope*, CITB – Construction Skills and the Home Builder Federation, December 2005

[10] Corder M. and Roberts N, *Understanding dwellings investment*, Bank of England Quarterly Bulletin 2008, Q4.

[11] HM Treasury/ODPM, *Housing policy: an overview*, 2005.

and educational outcomes, and highlighting the permanent influence that housing conditions have on children's future life chances[12]. These social benefits translate into real savings in Government expenditure. For example in 2004, Shelter estimated the additional cost to the public purse of living in temporary accommodation rather than social housing at over £5000 per household per year[13]. Equally, by reducing the likelihood of further sharp price spikes once the housing market recovers (by retaining capacity in the industry) , additional social housing investment will help to avoid the emergence of further housing wealth inequalities, in which the young and less well off lose out to older and wealthier households already on the housing ladder.

Some have suggested that the Government could deliver a fiscal stimulus by extending its £200 million scheme to buy up existing, unsold stock from private developers for use as social and affordable housing. However, we are not attracted to this proposition. In our view, buying up existing homes for social rent would have considerably less impact in stimulating the economy than building new ones, and with the greater support for mortgage finance now proposed, these homes may meet with improved market demand. In addition, purchasing existing homes from developers is also less beneficial in housing terms: not only does it fail to move us closer to the Government's goal of 3 million additional homes by 2020; there is also a danger that the homes which are bought may not be suitable for social housing in terms of size, location or quality.

Delivering the programme

Although the number of new market homes has fallen sharply over the last two years, delivery of new social rented homes has not been subject to the same decline. According to the latest figures available, the number of social rented homes delivered in England in 2007/08 was 29,000, up from 26,000 in 2006/07.[14] Large developers such as Barratts, Belway, Bovis and Persimmon all increased their share of affordable housing development in 2008. There is considerable appetite across the industry for the notion of social sector led development as a means of sustaining housebuilding activity through the downturn and laying the foundations for a future recovery in market housing provision.

To increase by 20,000 - 30,000 the number of social homes built over and above the Government's original target of 110,000 by 2010/11 implies an average rate of around 50,000 to 55,000 per year over the next two years. We believe that, with a

[12] See, for example Harker, L, *Chance of a lifetime*, Shelter 2006.

[13] Shelter, *Living in Limbo: survey of households living in temporary accommodation*, 2004.

[14] CLG, Affordable housing supply in England, 2007-08, 18 December 2008

strong shared commitment across Government and the housing sector, and with sufficient Government funding, these figures can be delivered, although delivery may be more challenging in the first year. However, in order to do so, we must be willing to modify our delivery models to cope with the exceptional challenges posed by the credit crunch and the worsening economic environment. Without this, it will not be possible to achieve the scale and speed of increase in social housing delivery that is needed to provide a rapid economic stimulus effect.

While we anticipate that the majority of the additional social homes proposed would be delivered by housing associations, we also see an increasingly important role for local authorities. Already, a number of local authorities are utilising their land and assets to partner with private developers in delivering housing through Local Housing Companies and other joint ventures. But we believe that Government must go further in supporting and empowering local authorities to take a lead in delivering new social housing, including through direct local authority investment.

We set out below the main policy measures required to support the delivery of our proposed programme.

Finance

The stalling of section 106 developments, falling land values and the drying up of receipts from market and LCHO sales have deprived housing associations of a significant proportion of the subsidy previously used to support the building of new social homes. At the same time, borrowing costs for housing associations have increased significantly, the availability of private finance has reduced, and in some cases banks are demanding rate revisions across housing associations' entire loan books as a precondition for new borrowing. As a result, the grant rates previously agreed for many developments are too low, and new social housing is significantly more difficult to finance.

These pressures mean that the Government will need to fund a substantially increased proportion of the new social homes being proposed compared to previous programmes. We warmly welcome the Homes and Communities Agency (HCA)'s policy of showing flexibility in increasing grant rates on a case by case basis to allow schemes to go ahead, in return for commitments from housing associations to continue to bring forward new affordable housing schemes. We also note with interest the work being undertaken by the HCA to develop a model of part equity stake funding for social housing, and believe that this may hold considerable potential, provided it is based on the principle of full risk sharing. For instance, financial support could be provided by the HCA in the form of land or cash, with a return being generated on future capital gains once the market recovers, as low cost home owners staircase up or properties are converted from market or intermediate rent to owner occupation. Such a model could also be used as a means of attracting in additional private sector investment, for instance from large scale landlords or institutional investors.

Equally, it is vital that the difficulties being experienced by housing associations in accessing private borrowing are tackled. Government should support the efforts of the HCA and Tenant Services Authority to stimulate the flow of private finance to the housing association sector. Until the credit crunch eases, there may also be a need to provide housing associations with access to public loans, in order to plug the gap in bank lending.

The Government must reform the housing revenue account system to incentivise local authorities to invest in new social housing using their prudential borrowing powers. However, it is absolutely critical that finance raised by local authorities is genuinely additional, and is not offset against the funding available for social housing under the National Affordable Housing Programme. In addition, the HCA should open up access to local authorities to bid for social housing grant.

Land

Many existing sites with planning permission are owned by private developers who may be reluctant to release them at current market prices for fear of crystallising a loss. To ensure sufficient sites for social housing development, the Government must therefore urgently bring forward surplus public sector land. This should form part of the public sector's upfront contribution to the financing of schemes, and be provided at subsidised prices or on an equity stake basis. To ensure the release of central Government land at below market levels, the Government will need to review, and possibly amend, the Government Accounting Rules.

Some housing associations have reported that they are experiencing difficulties with certain local authorities who appear unwilling to renegotiate existing planning obligations to reflect market conditions, and who are instead insisting on the submission of new applications. It is important that the Government and the HCA work with local authorities to promote a flexible approach where this is required to allow social housing developments to progress, and to expedite their progress through the planning system as quickly as possible.

Infrastructure

Without pump prime funding to help meet up front infrastructure costs, many sites are unlikely to be developed in the immediate future. Government should use the £0.75

billion infrastructure fund we have proposed to ensure that suitable sites are quickly equipped with the necessary infrastructure, including sewerage, water, electricity, schools, GP surgeries, telephony and internet. Funding could in suitable cases be provided in the form of an equity stake, using a similar investment model to that already developed for infrastructure by English Partnerships.

Quality and tenure mix

Clearly, it is absolutely vital that we continue to deliver social housing that is built to high quality and design standards and forms part of mixed income, mixed tenure communities. In recent years, over half of affordable housing units have been delivered through section 106 agreements as part of relatively large scale private schemes. However, many of these are now on hold. Given this, the development of smaller sites is likely to take on a more important role, as these are less subject to tenure mix concerns, and can be progressed relatively quickly, so delivering an immediate economic stimulus. However, there is also a range of approaches that may be possible with larger sites and, by reducing the sales risk, the presence of more affordable housing in fact increases the prospect of these being fundable. One option which may be feasible in some cases is to deliver affordable housing first, with market housing following later once demand improves. Another possible solution is to mix social rented homes with private housing for rent at market or intermediate levels, possibly with the option of future sale at a later date.

Cost

Approximately £6.5 billion was originally allocated to new social rented housing provision over the 2008/11 spending review period. Stimulating the economy through the package of social housing and infrastructure investment proposed would inevitably involve substantial additional Government expenditure. However, the upfront cost could be partially recouped if some of the additional investment required is provided in the form of an equity stake on which a return is subsequently received by the public sector. Further, the additional economic activity generated by the programme would lead to higher taxation revenues for the Exchequer, including income tax, national insurance, VAT and corporation tax, and lower benefit expenditure.

The upfront cost to Government of the proposed social housing programme will depend on the average level of financial support required per social housing unit in order to make development viable, both in relation to the existing programme and the additional homes we are proposing. The table below sets out possible figures as a preliminary of the upfront total cost of the programme on two different scenarios, using assumptions from the National Housing Federation. Scenario 1 involves delivering an additional 20,000 social homes based on an average public subsidy rate of 75%, while scenario 2 involves delivering an additional 30,000 homes at a 100% public subsidy rate.

Figure 1 – Estimated cost of proposals

	Scenario 1: 20,000 additional homes, average 75% public subsidy	**Scenario 2: 30,000 additional homes, average 100% public subsidy**
Average Government funding per home[15]	£150,000	£200,000
Cost of additional social homes over and above current CSR target (including additional subsidy/equity finance)	£3bn	£6bn
Extra investment to deliver the current targets for 2008/11[16]	£2.6bn	£2.6bn
Infrastructure fund	£0.75bn	£0.75bn
Total package	**£6.35bn**	**£9.35bn**

Our figures in Scenario 1 are based upon the assumption that an average social rent delivers an income stream sufficient to support around 25% of the costs of new development. This approach reduces the overall cost of a programme of 20,000 new homes to the public purse, but does expose it to the risk of housing associations being unable to secure the private finance to match fund due to uncertainties in the corporate lending market. In practice the funding might not all be made available as straight grants – these are difficult times in which different funding models may be needed.

[15] Assuming cost figure per social rented home of £200,000, based on indications from leading housing associations.
[16] Extra investment to deliver current targets assuming a revised subsidy rate of £102,000 per home constant across both scenario 1 and 2.

This problem might need to be mitigated by the HCA and/or the Government stepping in to provide public loans as an alternative to bank funding. Although this increases the upfront cost to government it would provide government with a stream of income in the form of loan repayments that could be recycled into additional investment in due course.

Scenario 2 demonstrates the required level of public subsidy to fund an additional 30,000 homes through a 100% grant rate. This model is more costly to the public purse, but removes the risk to delivery posed by the uncertainties associated with raising private finance in the current environment.

With a 100% subsidy model housing associations have the capacity to deliver significantly more than 20,000 new homes. Although total sector capacity in these circumstances is very hard to estimate it is likely the critical limiting factor under these arrangements would be the supply of suitable sites rather than any limitations in the development or construction capacity of the housing association sector.

Our proposed package also recognises that the welcome additional flexibility introduced by the HCA has resulted in average grant rates for the existing NAHP being higher than anticipated at the point at which the programme was agreed. The suggested additional £2.6bn for current targets recognises the increased costs of the additional programme flexibility should these arrangements need to continue to run until the end of the 2008/11 programme. They assume a required average grant rate of around £102,000 per new social rented home, rather than the average of around £70,000 assumed at the start of the programme. If market conditions improve more quickly then the additional resources required to deliver the existing programme, and the additional homes, will reduce.

Conclusion

At this critical time for the economy, an programme of increased social housing and infrastructure investment offers the opportunity to provide a rapid fiscal stimulus that would provide a substantial boost to a particularly vulnerable sector of the economy and safeguard substantial numbers of jobs. At the same time, such a programme would represent a significant step forward in tackling the urgent and growing unmet need for additional social housing, while providing a platform for a rapid upturn in overall housing supply also once the housing market recovers. Though ambitious, we believe that our proposals in this paper are achievable. They could and should be designed in such a way as to provide some financial return to the public sector over the longer term.