



CAPITAL ECONOMICS

# INCREASING INVESTMENT IN SOCIAL HOUSING

Analysis of public sector expenditure on housing in England and social housebuilding scenarios

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**A report by Capital Economics for submission to Shelter's  
Commission on the Future of Social Housing**

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# EXECUTIVE SUMMARY

Capital Economics has been commissioned by Shelter to provide robust economic analysis on public sector expenditure on housing in England in order to inform the debate on funding more social rent housing.

## Key findings:

- We estimate that public expenditure on housing in England was £26.8 billion pounds in 2016-17.
- Public spending on housing has lagged behind expenditure on other public services over the past twenty years and the focus of spending has increasingly been on housing benefits rather than investment in new social or affordable housing.
- Real terms housing benefits payments in England have been on a long-term upwards trend, more than doubling since the start of the 1990s. The increase is mainly due to rising housing benefit payments per caseload as real terms rents for all tenures have increased. However, an increased reliance on private rented sector tenures has also raised the housing benefit bill and the cost in rents to tenants.
- Reduced investment has lowered the number of additional social rent homes being delivered each year. Social rent housing additions have fallen by 79 per cent since the first half of the 1990s.
- Grant funding for social housing has been limited since 2011. Instead, the focus has predominantly been on making funds available for affordable rent homes or the Help to Buy equity loan scheme. This appears to be changing though with the government recently making £1.7 billion of grant funding available, which will be available for social rent homes. The government envisages that this will provide £72,600 of funding per social rent home built.
- Meanwhile, “Help to Buy” appears to have delivered a relatively small number of additional, relatively expensive private sector homes to buyers on relatively high incomes. Funding per additional home has averaged between £123,000 and £380,000, compared to grant funding per affordable rent home of £26,000.
- There is a strong investment rationale for the government funding new social rent housing. Building these homes would deliver savings in welfare expenditure generated by moving families receiving housing benefit from private rented accommodation into social rent tenure.
- Building new homes requires up-front expenditure. Our calculations suggest that building 3.1 million social rent homes over the next twenty years, entirely funded by the government, would add 6.5 percentage points to the ratio of public sector net debt to gross domestic product by 2039. The welfare savings accumulate however and government debt would be lower over a longer time horizon.

A range of bodies spend public money on social and affordable housing, including central government, local authorities, public corporations, housing associations and private developers. Using publicly available sources, we have calculated that the public sector as whole spent £26.8 billion on housing in England in 2016-17. Housing benefits accounted for 77 per cent of the expenditure (£20.7 billion), gross investment in housing nineteen per cent (£5.0 billion) and planning, regulation, administration and other activities the remainder.

Spending on different public services can fluctuate over the shorter-term, for example due to the economic cycle or to changing government spending policies. Assessing spending over the past twenty years helps to iron out some of these shorter-term influences and reveal the underlying trends in spending. To do that requires spending figures for the United Kingdom. Cumulative net public expenditure on housing in the United Kingdom between 1997-98 and 2016-17 has been lower than that on each of public order and safety, defence, education, health and social protection (excluding housing benefits).

When public finances are under pressure, as they have been in the United Kingdom since the financial crisis struck in late 2008, capital spending budgets can be particularly vulnerable to cutbacks. That appears to have been the case with housing. Real terms public housing gross investment in the past five years was one third lower than in the five years to 2007-08, with central government grant funding cut by 60 per cent. Over the same period spending on housing benefits rose by nearly half, although it is now falling in real terms.

However, the increased importance of housing benefit spending relative to investment spending is not just attributable to the negative impact of the financial crisis on public finances, but is a longer-term trend. Data for Great Britain show that in 1979-80, public housing investment was five times larger than spending on housing benefits. By 1990-91, spending on the two was broadly equal, then from the mid-1990s to the financial crisis benefits spending was around double that on housing investment. Since 2011-12 benefits spending has been at least three and a half times the size of public housing investment. (See chapter 1.)

In England, housing benefit caseloads in 2016-17 were little changed compared to 25 years earlier, while real terms housing benefit spending had more than doubled. The rising bill for housing benefits largely reflects increasing payments per housing benefit recipient. The underlying driver of rising housing benefits payments is that real terms rents for local authority tenants, registered social landlord tenants and private rented sector tenants have all increased more rapidly than tenants' ability to pay. These increases reflect both the under-supply of housing and government policy of above inflation rent increases for local authority and registered social landlord housing.

An increased reliance on private rented sector tenures has also increased the housing benefit bill and the cost in rents to tenants. Over the past decade this rising proportion of housing benefit caseloads in the private rented sector has cost nearly £14 billion in additional benefits and rental payments in real terms. (See chapter 2.)

Investment in social and affordable housing has fallen over the longer term, with real terms investment in the past five years less than half of that in the first half of the 1980s and one third lower than in the first half of the 1990s. Reduced investment has lowered the number of additional social and affordable homes being delivered from an average of 61,000 each year in the first half of the 1990s to an average of 45,000 per annum in the past five years. Social rent housing, the affordable housing with the lowest average rental cost, accounts for the bulk of the decline as grant funding has been increasingly focused on affordable rent and affordable ownership housing. Annual additions to social rent housing have dropped from an average of 48,000 per annum during 1991-92 to 1995-96 to an average of 10,000 per annum during 2012-13 to 2016-17, a decline of 79 per cent.

The government introduced the Help to Buy equity loan scheme in April 2013. By providing low cost loans, the aim of the scheme is to: help credit-worthy households without a sufficient deposit to obtain a mortgage; increase the supply of new, private-sector housing; and support economic growth. However, simple calculations suggest that much of the 55 per cent increase in private housebuilding seen since the scheme was introduced is due to a recovery in the housing market more generally, rather than to the scheme.

Uncertainty over the scale of the impact of the scheme on new housebuilding by the private sector means that the size of the average loan per additional new home built is uncertain, but may range from between £123,000 and £380,000. Either way, the funding is significantly higher than the grant funding from Homes England and the Greater London Authority of £26,000, on average, per new home for affordable rent under the Affordable Homes Programme for 2015 to 2018. It is also higher than the £72,600 grant that the government envisages for new social rent homes under the amended Shared Ownership and Affordable Homes Programme 2016 to 2021. Overall, the Help to Buy scheme appears to be enabling those on relatively high incomes to buy relatively expensive homes. (See chapter 3.)

There is a consensus that there is a long-term under-supply of housing in England and estimates of the annual number of new homes required range from 240,000 to 300,000. Experience in the post-war period is that delivery of more than 200,000 new homes per year in England has only been achieved when there has been significant contributions from public sector building programmes.<sup>1</sup>

Building new homes has positive effects on the economy beyond the initial amount invested, due to impacts on demand in the supply chain and additional spending from increased numbers of people in employment. A report for the UK Contractors Group estimated that every pound spent on construction output stimulates an increase of £2.84 in gross domestic product.<sup>2</sup> The increased economic activity boosts tax receipts for the exchequer and lowers benefits spending. Moreover, if the new homes being built are affordable rent homes, there are also savings to the exchequer from lower housing benefits payments compared to those in the private rented sector.

<sup>1</sup> House of Commons Library, *Tackling the under-supply of housing in England*, (House of Commons Library, London), 2018.

<sup>2</sup> L.E.K. Consulting, *Construction in the UK Economy: The Benefits of Investment* (The UK Contractors Group, London), 2009.

Taking these effects into account, we calculate that a new grant funded social rent home in an area of high affordability pressure<sup>3</sup> delivers a net financial benefit to the government's coffers of £10,800 when applying a 3.5 per cent real discount rate.<sup>4</sup> At prevailing interest rates, real terms borrowing costs for the government are zero and at this discount rate the net present value is £38,500. There is a strong investment rationale for grant funding of new social housing. (See chapter 4.)

We have modelled the implications of building 3.1 million social rent homes over the next twenty years. This would enable every family who is currently living in the private rented sector and receiving housing benefit to move into a new social rent home, as well as those who are likely to be in similar circumstances as the population grows in the future. These homes would generate welfare savings for the government. What's more, a social housebuilding programme of this size would provide over one million homes for households who would like to live in the social rented sector and don't receive housing benefit. If the government owns these homes then they would deliver a stable income stream for the government.

Building 3.1 million social rent homes, whether part-funded through government grant and owned by housing associations or wholly funded and owned by the government, would require additional government borrowing. Over time though, the welfare savings would accumulate and, if the government owns the homes, the income stream would grow.

In the first case, where the government owns the newly built homes, additional public sector net borrowing should peak in 2032-33 at 0.7 per cent of gross domestic product. And public sector net debt will be 6.5 percentage points of gross domestic product higher than it would be under current policies by 2038-39, the final year of the building programme. In the second case, where a new grant funding programme is introduced, net additional public sector net borrowing should peak in 2033-34 at 0.2 per cent of gross domestic product. Public sector net debt as a percentage of gross domestic product would be 0.8 percentage points higher in 2038-39.

However, the policy would lead to a reduction in government net debt over a longer time horizon. If the policy stops after twenty years, the level of government net debt falls to less than it would have been under current policies by 2066-67 in the government ownership scenario and by 2057-58 in the government grant scenario. And with the policies delivering annual savings to the exchequer, public net debt as a share of gross domestic product is 0.3 percentage points lower by 2067-68 in the government ownership scenario and 0.9 percentage points lower in the government grant scenario. (See chapter 5.)

The structure of the report is as follows. In chapter one of we quantify the scale and type of public expenditure on housing in England and consider it in relation to the amount and structure of public sector spending on other areas. In chapter two we examine the historical trends in housing benefit by tenure and analyse the drivers of them. In chapter three we review the changes in the amounts of public sector housing investment, grant funding and additional affordable housing

<sup>3</sup> The government funding for social rent homes will only be available in areas of high affordability pressure. We have used the example of Epping Forest in these calculations.

<sup>4</sup> This is the real discount rate in HM Treasury's Green Book.

being provided and compare them to the Help to Buy scheme. In chapter four we quantify the economic and fiscal impact of building new affordable rent homes in England. Finally, in chapter five we model the implications of building 3.1 million social rent homes over the next twenty years on the economy and government finances.

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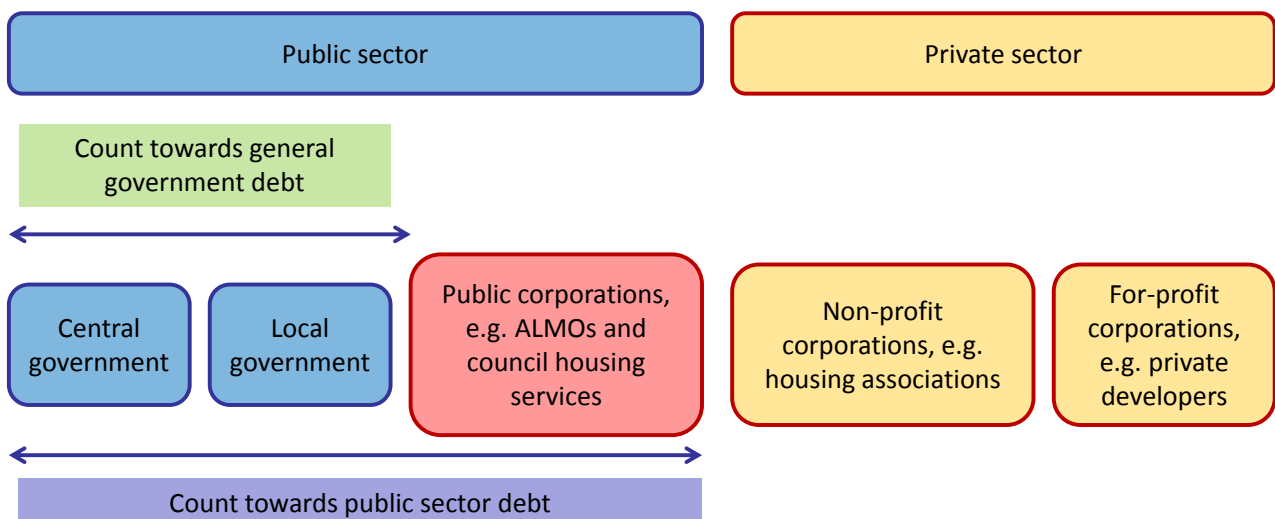
# 1 GOVERNMENT SPENDING ON HOUSING COMPARED TO OTHER SECTORS

In this chapter, we quantify the scale and type of public expenditure on housing in England and consider it in relation to the amount and structure of public sector spending on other areas.

## 1.1 Defining the public sector

In order to quantify the scale of expenditure on housing by the public sector we must first be clear about what is, and is not, included in the public sector. The public sector comprises central government, local government and public corporations. The housing services activities of local authorities plus their Arm's Length Management Organisations (ALMOs) fall under the definition of public corporations and are included in the public sector.<sup>5</sup> (See Figure 1.)

**Figure 1: Public and private sector definitions and housing**



Source: Capital Economics.

The status of English housing associations have changed twice in recent years. In 2015 they were re-classified by the Office for National Statistics from the private sector to the public sector as a

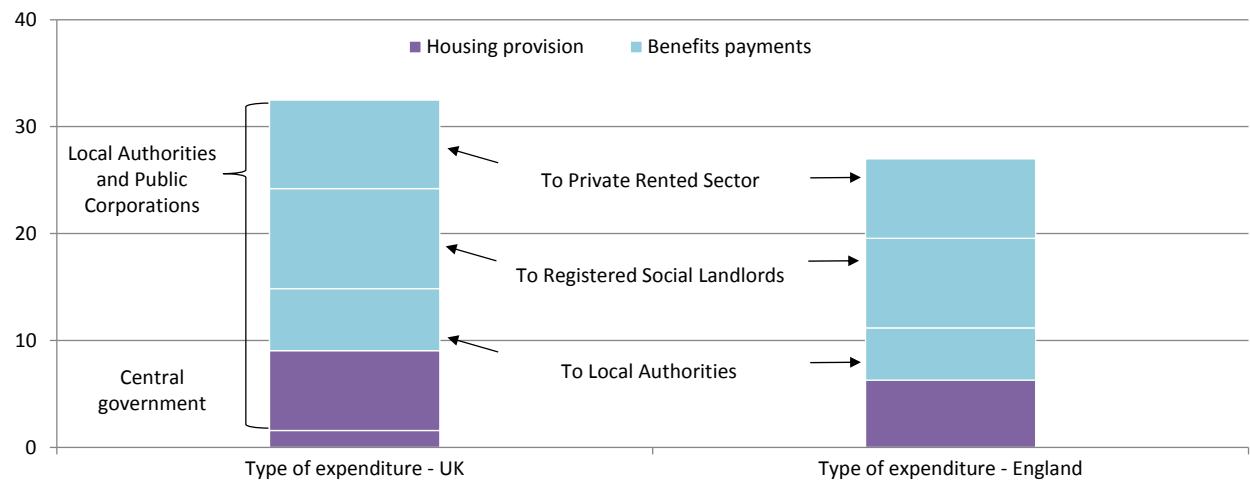
<sup>5</sup> Further details can be found in John Perry, *Let's get building* (National Federation of ALMOs, York), 2012.

result of an update to the European System of Accounts, which is the classification system used in the European Union for compiling national economic accounts. In 2017 they were classified as private sector once more after new government regulations reduced the level of central government control of housing associations.<sup>6</sup> The expenditure figures in this report treat housing associations as being in the private sector, with only the element of housing associations’ funding provided by central or local government counted as public sector expenditure.

## 1.2 The scale of public spending on housing in England

A range of bodies spend public money on social and affordable housing and funds can flow from one part of the public sector to another. In order to quantify the scale of public sector housing expenditure and avoid double counting, we have drawn on HM Treasury’s Public Expenditure Statistical Analyses and supplemented it with housing benefits figures from the Department for Work and Pensions and investment and capital receipts data from the Chartered Institute of Housing’s United Kingdom Housing Review.

**Figure 2: Expenditure on housing by the public sector in the United Kingdom and in England by type of expenditure and by public sector segment (£ billions, 2016-17)**



Sources: Capital Economics, UK Housing Review 2018, HM Treasury and the Department for Work and Pensions.

We calculate that public sector spending on housing in the United Kingdom in the financial year 2016-17 totalled £32.1 billion, with central government accounting for £1.6 billion and local authorities and public corporations the rest. (See Figure 2.)

Central government expenditure includes pay and procurement, grants and subsidies to individuals and enterprises in the private sector and subsidies to public corporations. Central

<sup>6</sup> Richard Johnstone, *Housing associations classified as public bodies*, (Public Finance, The Chartered Institute of Public Finance and Accounting, London), October 2015. Anthony Barej, *Housing association £66bn debt wiped off public balance sheet*, (Public Finance, The Chartered Institute of Public Finance and Accounting, London), November 2017.

government support for local government and for the capital expenditure of public corporations are counted as spending by those segments of the public sector.<sup>7</sup> For example, housing benefits are paid by local authorities from funds allocated by the Department for Work and Pensions and are counted as spending by local authorities.

We calculate that public sector spending on housing in England totalled £26.8 billion in 2016-17.<sup>8</sup> Figures for the split in spending between central government and the rest of the public sector are not available for England, but the proportions are likely to be in line with those for the United Kingdom given England's high share of overall public expenditure on housing.

Expenditure on housing benefits in England totalled £20.7 billion in 2016-17, 77 per cent of English public sector housing spending. By type of housing tenure, the largest share of housing benefits, 40 per cent, was for recipients in properties owned by registered social landlords (which are predominantly housing associations). The next largest share, 36 per cent, was for those in the private rented sector, while recipients in local authority housing accounted for the remaining 24 per cent. The benefits received as rents by local authorities and registered social landlords are used to run, maintain and invest in the social and affordable housing stock.

We have grouped all non-benefit housing spending as 'housing provision'. This category of spending includes:

- Construction, acquisition and remodelling of homes;
- Acquisition of land for construction;
- Grants, loans and subsidies for expansion, improvement and maintenance;
- Regulation and administration of housing development;
- Provision of social housing and administration of housing benefits.<sup>9</sup>

Investment spending is counted as gross spending, i.e. capital receipts from sales of publicly owned housing have not been deducted. In 2016-17 gross investment was £5.0 billion, nineteen per cent of total housing expenditure. Other spending in the housing provision category totalled £1.0 billion, four per cent of total spending.

<sup>7</sup> HM Treasury, *Public Expenditure Statistical Analysis, 2018*, (HM Treasury, London), 2018.

<sup>8</sup> National Audit Office, *Housing in England: overview*, (National Audit Office, London), January 2017, reported that public sector spending on housing in England in 2015-16 was £28.0 billion. Our calculation for that year is also £28.0 billion.

<sup>9</sup> HM Treasury, *Public Expenditure Statistical Analysis, 2018*, (HM Treasury, London), 2018.

### 1.3 Comparison of public spending on housing and other functions

Spending on different areas of public services can fluctuate over the shorter-term due to the state of the economy or changing government spending policies. Assessing spending on housing relative to other areas of public expenditure over the past twenty years helps to iron out some of these shorter-term influences and reveal the underlying trends in spending.

Departmental spending can be spread across a variety of functions of government and the structure of government can change over time, which complicates the comparison of departmental spending. To aid longer-term analysis of government spending, expenditure figures are reported by HM Treasury by function, in accordance with the United Nations Classification of the Functions of Government (COFOG)<sup>10</sup>, as well as by department.

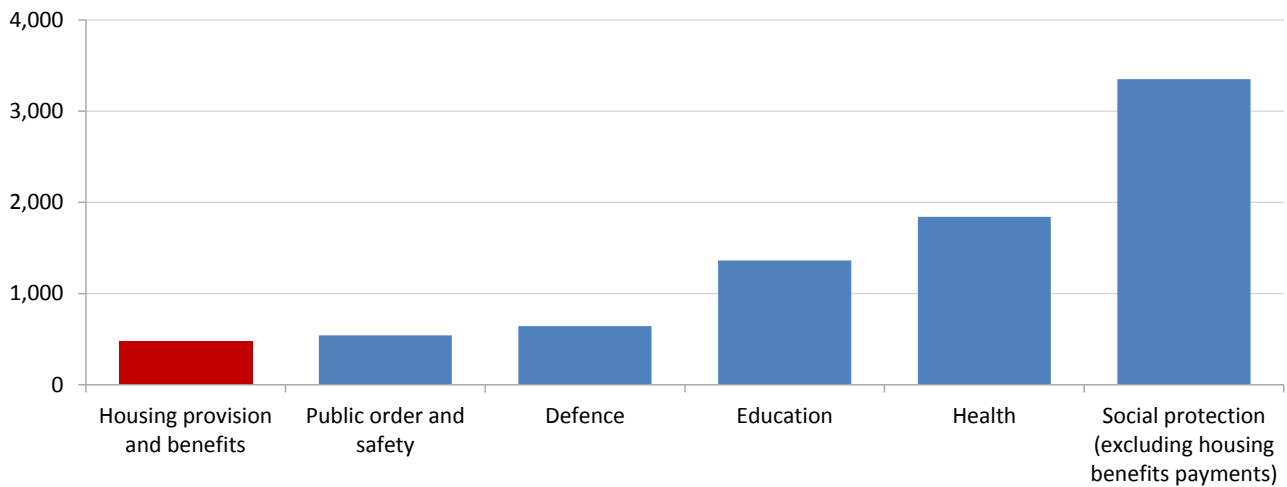
Public expenditure figures reported by HM Treasury are net of capital receipts for all functions. In section 1.2 we adjusted the housing investment figures for capital receipts in order to derive gross spending. In this section, to maintain consistency in the comparison across functions, net expenditure figures are used.<sup>11</sup>

Total current and net capital housing spending has been less than that of other government programmes. Cumulative spending since 1997-98 on each of public order and safety, defence, education, health and social protection (excluding housing benefits) has been larger than that on housing. For net capital expenditure the ranking of housing is higher and on a par with health. (See Figure 3 and Figure 4.)

<sup>10</sup> HM Treasury, *Public Expenditure Statistical Analysis, 2018*, (HM Treasury, London), 2018.

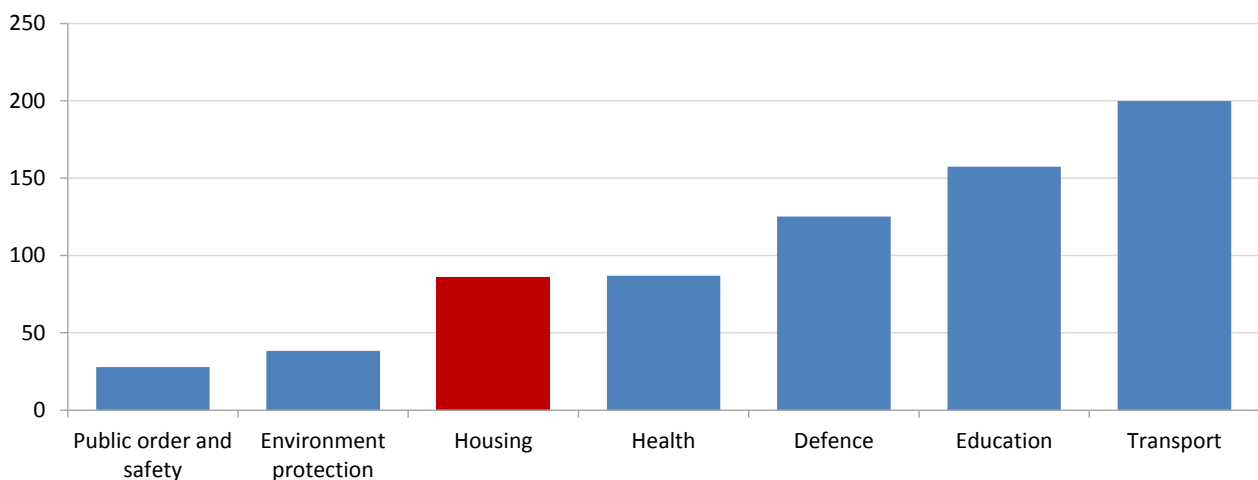
<sup>11</sup> Housing capital receipts over the past twenty years were £38 billion in real terms, mainly the result of the sale of local authority housing.

**Figure 3: Cumulative current and net capital expenditure by the public sector in England by function, 1997-98 to 2016-17 (£ billions, 2017-18 prices)**



Sources: Capital Economics, UK Housing Review 2018, Office for National Statistics, HM Treasury and the Department for Work and Pensions. Note: For comparability with the other sectors shown, spending on 'Housing provision and benefits' is reported net of capital receipts. Housing capital receipts totalled £38 billion in real terms over the period.

**Figure 4: Cumulative net capital expenditure by the public sector in England by function, 1997-98 to 2016-17 (£ billions, 2017-18 prices)**



Sources: Capital Economics, UK Housing Review 2018, Office for National Statistics and HM Treasury. Note: Net capital expenditure excludes capital receipts from, for example, asset sales and loan repayments. Housing capital receipts totalled £38 billion in real terms over the period.

Public sector spending on infrastructure is not a functional category in its own right, but forms part of the transport, communication, waste management, waste water management, water supply and street lighting functions and sub-functions. In 2016, public sector spending on infrastructure in the United Kingdom totalled £18.9 billion in current prices,<sup>12</sup> while public sector investment in

<sup>12</sup> Office for National Statistics, *Developing new measures of infrastructure investment*, (Office for National Statistics, London), 2018.

housing in the financial year 2016-17 was £6.8 billion. If housing were treated as infrastructure, then it would have comprised 26 per cent of public infrastructure investment.

## 1.4 Comparison of public spending by department and public sector tier

Data on public spending by government department have the advantage of being available by different governmental budget types, but the drawback that changing departmental structure and responsibilities means the figures are available on a consistent basis only for the past five years. (See Box 1.)

### Box 1: Public finance accounting terminology

**Total Managed Expenditure (TME)** – is a definition of aggregate public spending derived from economic National Accounts. It is the consolidated sum of current and capital expenditure of central and local government, and public corporations.

- **Current expenditure** – is spending on items that are consumed in the process of providing public services or, in other words, is recurring spending. This includes, for example, wages and salaries, benefits, and purchasing goods and services.
- **Capital expenditure** – in National Accounts, capital expenditure is usually understood to mean capital formation, net acquisition of land, and expenditure on capital grants. Loans are not counted as capital expenditure. In the functional analysis, capital expenditure is recorded gross of depreciation and net of capital receipts.

Total Managed Expenditure can also be presented as the sum of Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME):

- **Departmental Expenditure Limits** – are firm plans for three years for a specific part of a department's expenditure. Departmental Expenditure Limits cover all administration costs and programme expenditure except where some programme spending cannot reasonably be subject to close control over a three-year period or spending relates to non-cash costs other than depreciation and impairments
- **Annually Managed Expenditure** – is spending included in Total Managed Expenditure that does not fall within Departmental Expenditure Limits. Expenditure in Annually Managed Expenditure is generally less predictable and more difficult to control than expenditure in Departmental Expenditure Limits.

Both resource (current) and capital budgets are divided into Departmental Expenditure Limits and departmental Annually Managed Expenditure.

Sources: HM Treasury Public Expenditure Statistical Analysis and Capital Economics.

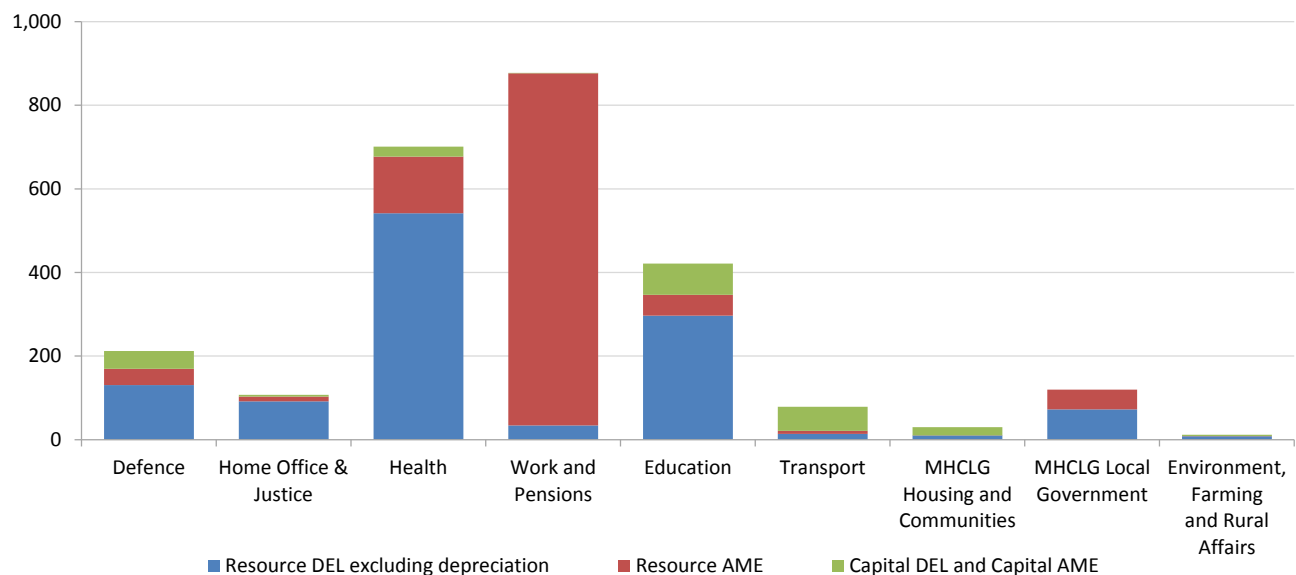
Public expenditure on housing in England is predominantly within the remit of the Ministry of Housing, Communities and Local Government (MHCLG)<sup>13</sup> and the Department for Work and Pensions. Spending by the Ministry is reported in the Housing and Communities budget sub-section; Homes England is the agency within the Ministry responsible for housing provision, such as grants for affordable housing. Spending on housing benefits is via the Department for Work and Pensions.

<sup>13</sup> The Ministry of Housing, Communities and Local Government was called the Department for Communities and Local Government until January 2018. We use the new name throughout the report.

The different spending priorities of the two sub-categories are reflected in the spread of their expenditure across the different budget categories. (See Figure 5.) Over the past five years capital budgets were the largest budget type for Housing and Communities, accounting for 66 per cent of spending. This budget pattern was similar to that for the Department of Transport, but distinct from that for other Departments and Ministries. For the Department for Work and Pensions, 96 per cent of spending was from the Resource Annually Managed Expenditure budget type, a very different budget pattern to other Departments and Ministries. (See Figure 6.)

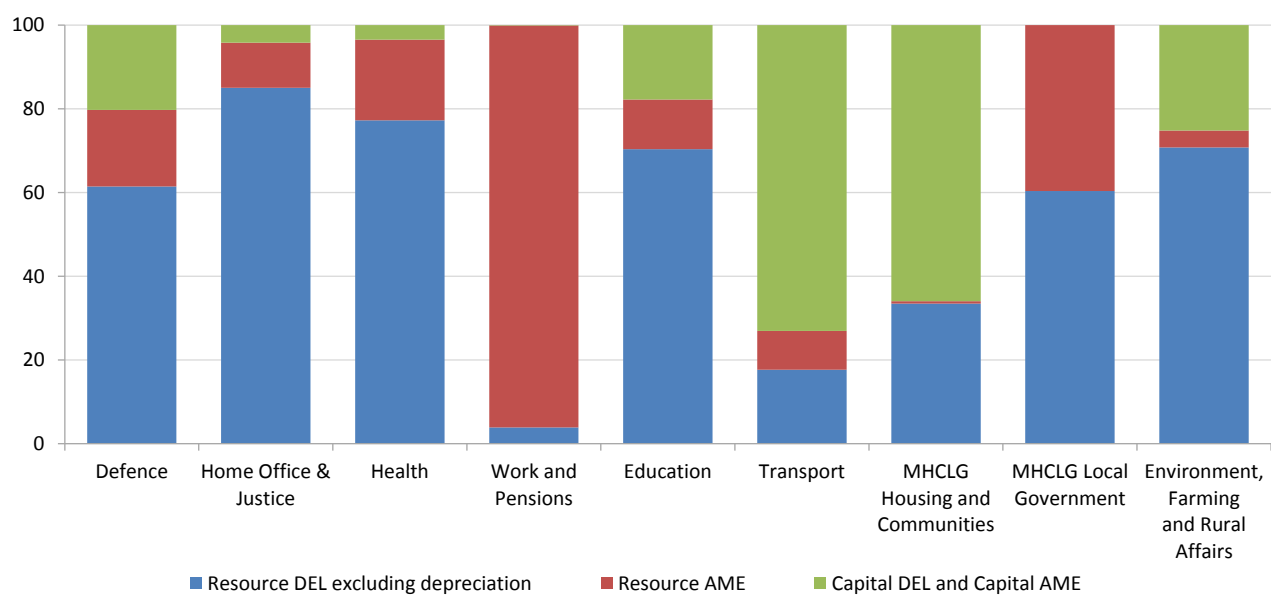
The type of expenditure undertaken by parts of government and the structure of budgets can be significant. When public finances are under pressure, capital budgets can be politically easier to reduce than current budgets. The impact of reduced public sector capital expenditure on housing or infrastructure, for example, accumulate to society over time, while the impact of reduced current spending, such as on benefits or public sector wages, are felt more immediately. Capital budgets can therefore be more vulnerable than current budgets when governments need to balance the fiscal books.

**Figure 5: Cumulative current and net capital departmental expenditure by budget category in the United Kingdom, 2012-13 to 2016-17 (£ billions, 2017-18 prices)**



Sources: Capital Economics and HM Treasury. Note: Resource Departmental Expenditure Limit (DEL) is planned current spending. Resource Annually Managed Expenditure (AME) is current spending that is outside of DEL. Capital DEL is planned net capital expenditure and Capital AME is net capital expenditure outside of DEL.

**Figure 6: Cumulative current and net capital departmental expenditure by budget category in the United Kingdom, 2012-13 to 2016-17 (percentage share of departmental expenditure)**



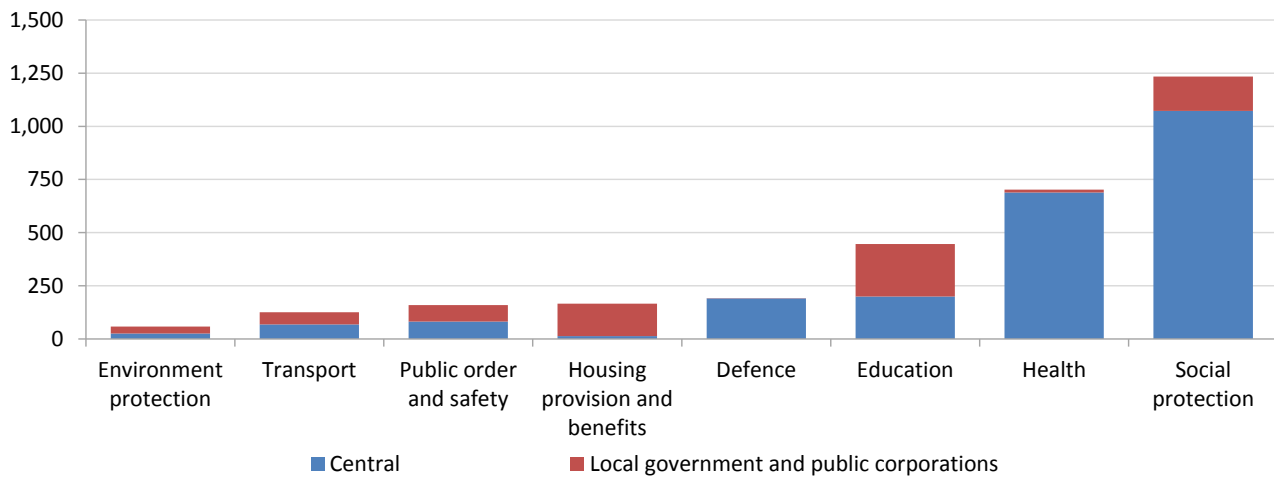
Sources: Capital Economics and HM Treasury. Note: Resource Departmental Expenditure Limit (DEL) is planned current spending. Resource Annually Managed Expenditure (AME) is current spending that is outside of DEL. Capital DEL is planned net capital expenditure and Capital AME is net capital expenditure outside of DEL.

The split of responsibility between central government and local government and public corporations for spending on housing is markedly different to that for other functions. Housing has the highest proportion of spending undertaken by local governments and public corporations at 92 per cent, with the next highest being the environment at 56 per cent. The high proportion of spending for housing is because housing benefit payments are administered by local authorities rather than central government, something that has happened since 1983.<sup>14</sup> (See Figure 7 and Figure 8.)

<sup>14</sup> The National Archives, 'The administration of Social Security 1979-1997', *Operational Selection Policy*, No. 5, 2012.

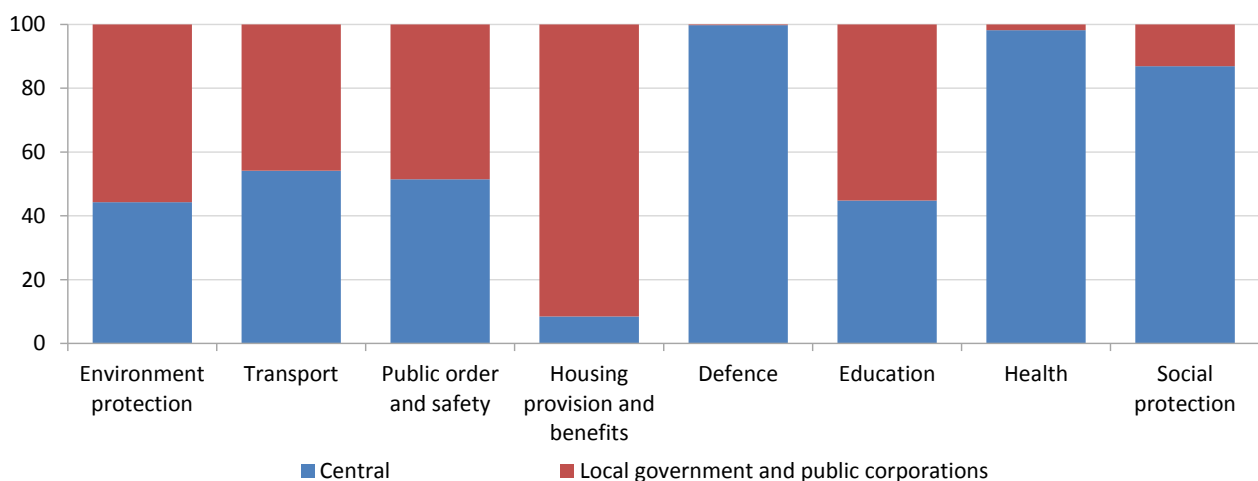


**Figure 7: Cumulative current and net capital expenditure by the public sector in the United Kingdom by function, 2012-13 to 2016-17 (£ billions, 2017-18 prices)**



Sources: Capital Economics and HM Treasury. Note: Expenditure figures for all functions are net of capital receipts. Social protection excludes housing benefits payments.

**Figure 8: Cumulative current and net capital expenditure by the public sector in the United Kingdom by function, 2012-13 to 2016-17 (percentage share of spending within each function)**



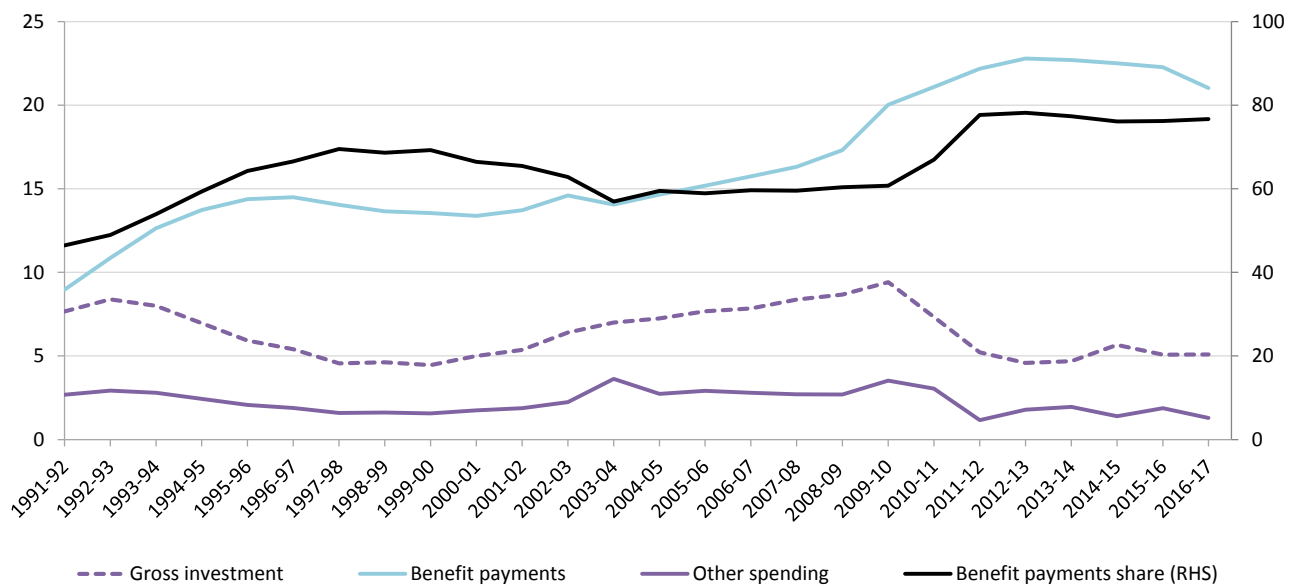
Sources: Capital Economics and HM Treasury. Note: Expenditure figures for all functions are net of capital receipts. Social protection excludes housing benefits payments.

## 1.5 Composition of public housing expenditure over time

Grouping housing expenditure into the three categories of benefits payments, gross investment and other, reveals that the composition of public spending on housing in England has evolved over time. After adjusting for inflation, annual benefits spending has been on a rising trend and more than doubled from £9.0 billion in 1991-92 to over £20.0 billion in recent years. Over the same

period, annual gross investment expenditure has fallen by one third from £7.7 billion to around £5.0 billion in recent years in 2017-18 prices. A discontinuity in the source data mean that the other housing expenditure figures are Capital Economics’ estimates prior to 2003-04. We estimate that other expenditure of close to £1.5 billion per annum in recent years is around half the level of the early 1990s. (See Figure 9.)

**Figure 9: Expenditure on housing by the public sector in England by type of expenditure (£ billions, 2017-18 prices) and share of housing expenditure accounted for by benefit payments (per cent)**



Sources: Capital Economics, UK Housing Review 2018, HM Treasury and the Department for Work and Pensions. Note: For ‘Other spending’, figures prior to 2003-04 are estimated by Capital Economics due to a discontinuity in the source data.

Housing benefits comprised 46 per cent of public housing spending in 1990-91, fluctuated between a low of 57 per cent and a high of 70 per cent during the years 1995-96 and 2010-11, and has average 77 per cent since then. Expenditure on housing benefits increased between the early 1990s and mid 1990s in part due to deregulation of private rents, then levelled out until the mid-2000s before rising once again as the number of claimants in the private rented sector increased and as local authority and housing association rents increased.<sup>15</sup>

<sup>15</sup> National Audit Office, *Housing in England: overview*, (National Audit Office, London), January 2017.

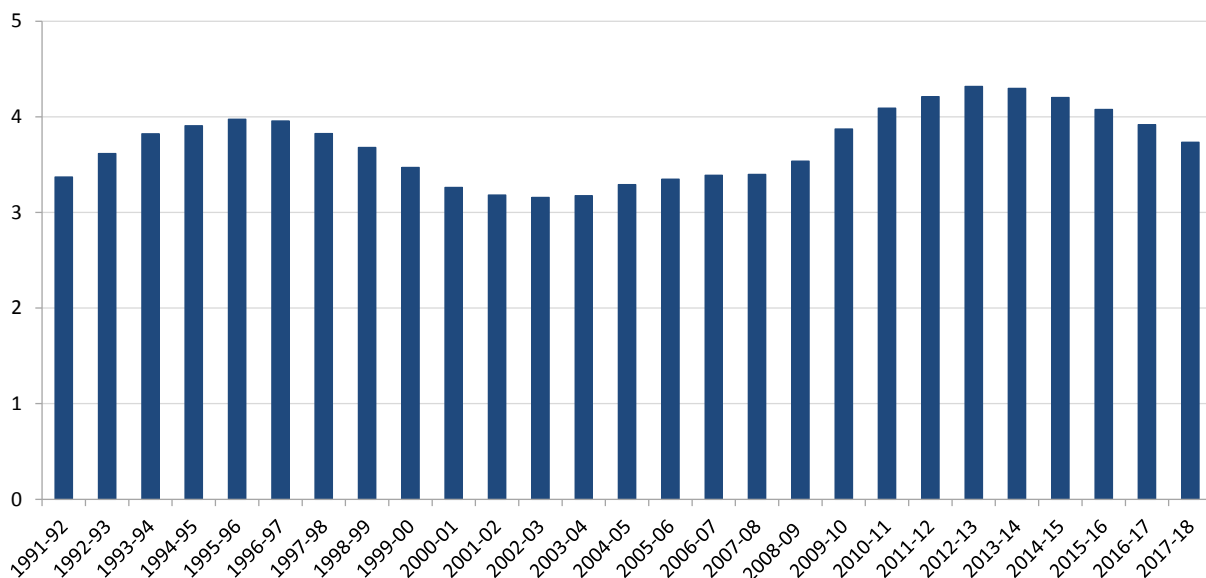
## 2 HOUSING BENEFITS PAYMENTS

In this chapter, we examine the historical trends in housing benefit by tenure and assess the additional benefit and rent costs that have arisen from an increased reliance on renting in the private sector.

### 2.1 The changing composition of housing benefit payments

Between the early 1990s and today, housing benefit caseloads in England fluctuated with the economic cycle and government policies, ranging from a low of 3.2 million in 2002-03 to a high of 4.3 million in 2012-13. However, caseloads in 2017-18 of around 3.7 million are little changed from the early 1990s, while real terms benefits payments have more than doubled. (See Figure 10.)

**Figure 10: Housing benefit caseloads in England (millions)**

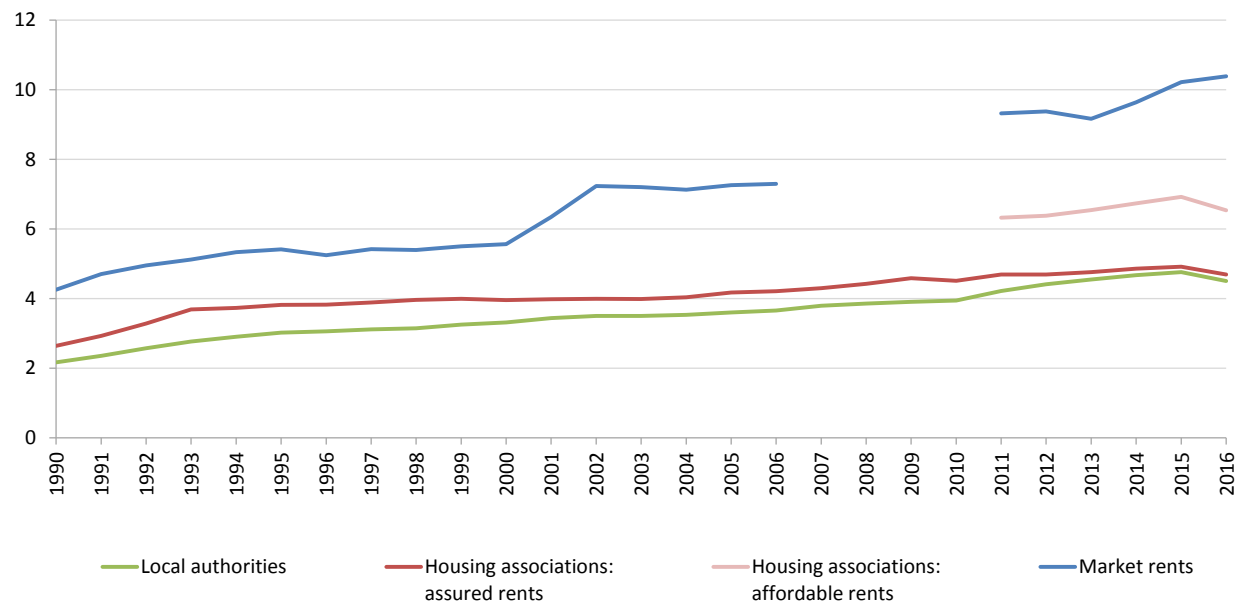


Sources: Capital Economics and the Department for Work and Pensions. Note: The 2017-18 figure is a forecast consistent with Autumn Budget 2017 Economic and Fiscal Outlook published by the Office for Budget Responsibility on 22 November 2017.

Average rents and benefit payments for local authority tenants, registered social landlord tenants and private rented sector tenants have increased over time in real terms. Rises in market rents reflect the under-supply of housing, while local authority and registered social landlord rents have risen due to policy choices. Governments from 2002 to 2015 adopted policies of raising local authority and registered social landlord rents by more than inflation each year. Since 2015 the

policy has changed and rents are being reduced by one per cent per annum through to 2019-20.<sup>16</sup> Throughout the period for which figures are available, average local authority housing rents are the lowest, with private rented sector rents the highest. Housing association assured rents (social rents) are at a similar level to local authority rents, but housing association affordable rents are 45 per cent higher. (See Figure 11.)

**Figure 11: Average rents for all tenants by tenure in England (£ thousands per annum, 2017-18 prices)**



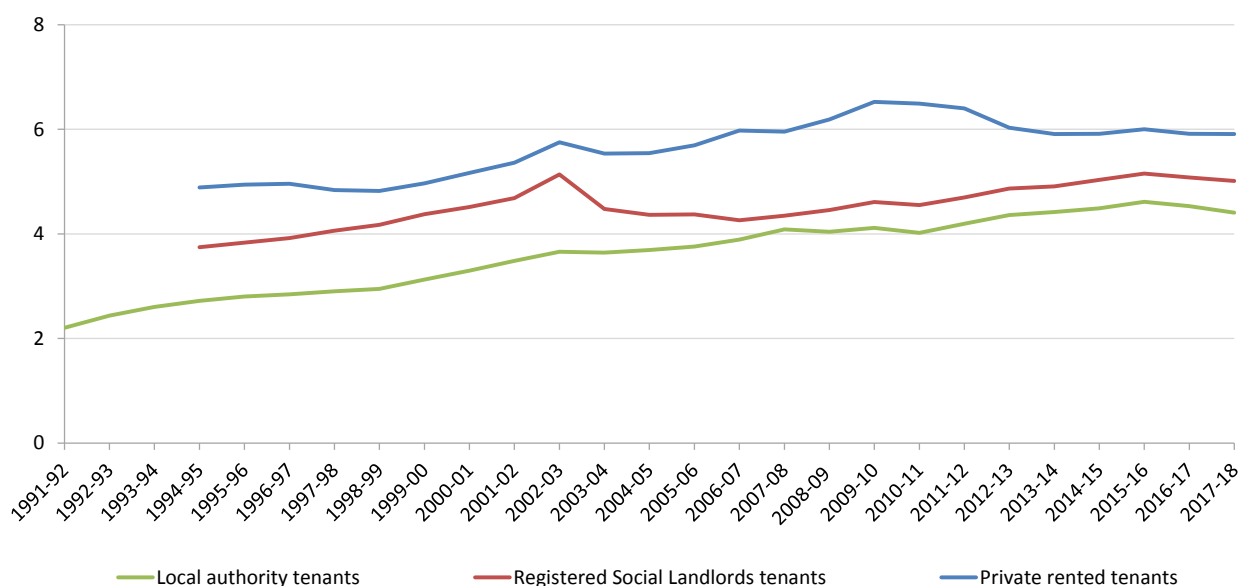
Sources: Capital Economics and the UK Housing Review. Note: These figures include tenants that are receiving housing benefits as well as those that are not. Private market rents for years prior to 2002-03 are those determined by the Rent Officer when referred for housing benefit purposes while those from 2011 are from the Valuation Office Agency; figures are not available for 2007 to 2010, inclusive.

Against the background of across the board increases in rents which, other things equal, will have pushed up housing benefit payments per tenant, there has been a shift in tenants from the lowest cost tenures to higher costs ones. More detail on the composition of housing benefits payments is available for Great Britain than for England and we use data for Great Britain in the following analysis. Reflecting rising rents, there has been an upward trend in average housing benefit payments since the early 1990s. (See Figure 12.)

In addition, there has been a change in the composition of payments reflecting changes in housing tenure. Overall, there has been a shift in provision of affordable housing from local authorities to registered social landlords and an increased reliance on the private rented sector. (See Figure 13.)

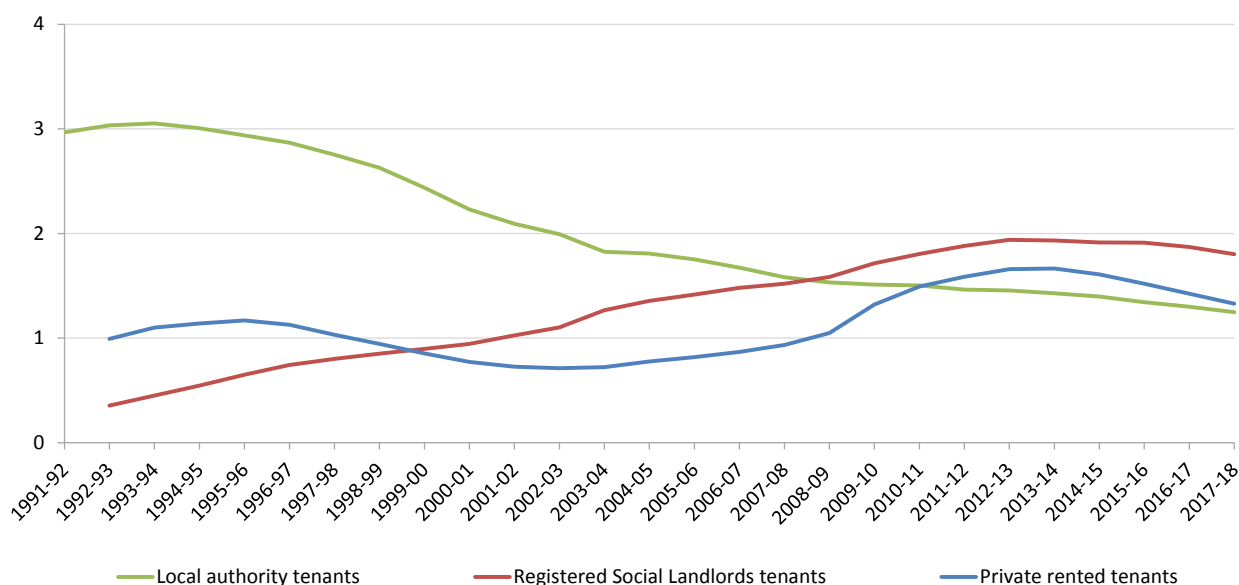
<sup>16</sup> House of Commons Library, *Rent setting: social housing (England)*, (House of Commons Library, London), 2017.

**Figure 12: Mean average housing benefit by caseload by type of tenure in Great Britain (£ thousands per annum, 2017-18 prices)**



Sources: Capital Economics and the Department for Work and Pensions. Note: The 2017-18 figure is a forecast consistent with Autumn Budget 2017 Economic and Fiscal Outlook published by the Office for Budget Responsibility on 22 November 2017.

**Figure 13: Housing benefit caseloads in Great Britain by tenure (millions)**

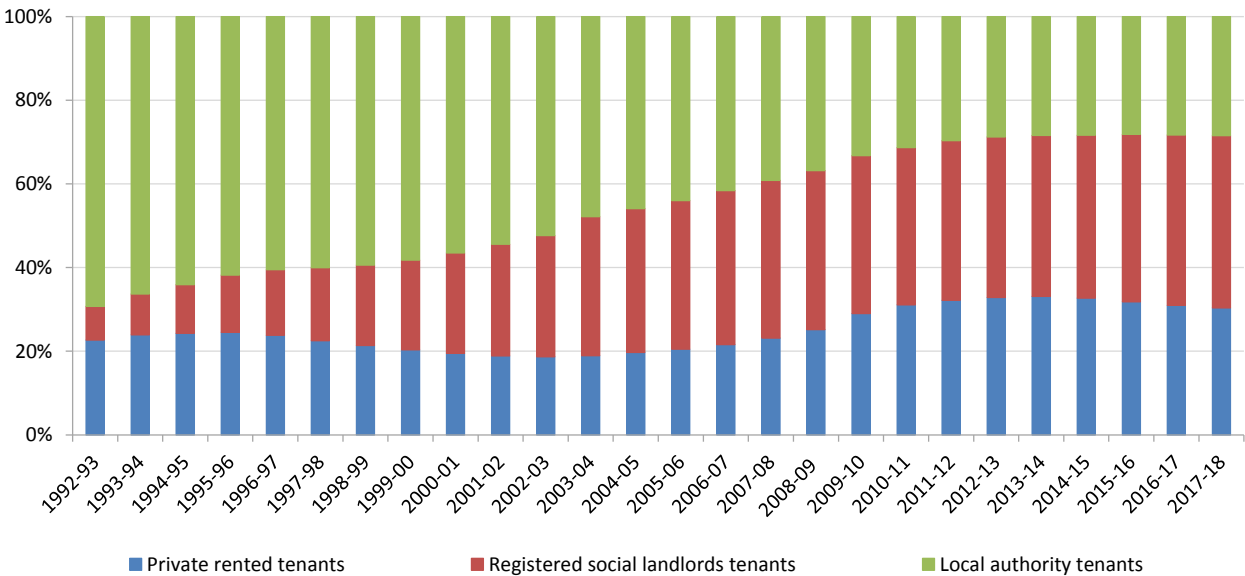


Sources: Capital Economics and the Department for Work and Pensions. Note: The 2017-18 figure is a forecast consistent with Autumn Budget 2017 Economic and Fiscal Outlook published by the Office for Budget Responsibility on 22 November 2017.

In the early 1990s, there were around three million housing benefit cases for tenants in local authority housing, 72 per cent of total housing benefits caseloads in Great Britain. In 2017-18, official estimates are that the number of local authority cases will have fallen to 1.2 million and will

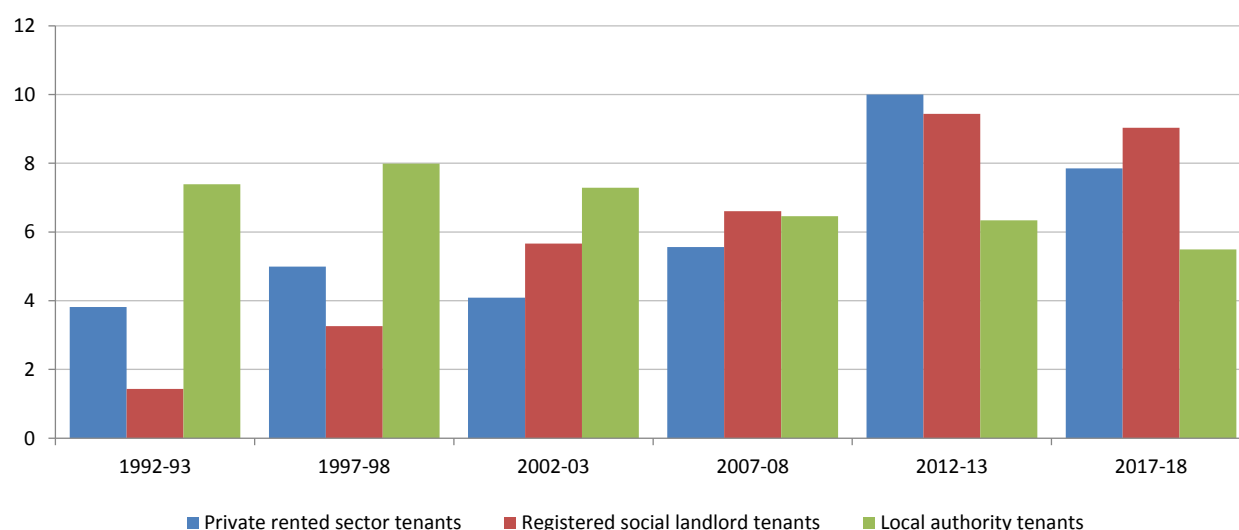
account for 28 per cent of caseloads. Over the same period cases for registered social landlord tenants will have risen from 0.4 million to 1.8 million, an increase from eight per cent to 41 per cent of total caseloads. Private sector tenant cases will have risen from one million to 1.3 million, a rise from 23 per cent of total caseloads to 30 per cent. (See Figure 14.)

Figure 14: Shares of housing benefit caseloads in Great Britain by tenure (per cent)



Sources: Capital Economics and the Department for Work and Pensions. Note: The 2017-18 figure is a forecast consistent with Autumn Budget 2017 Economic and Fiscal Outlook published by the Office for Budget Responsibility on 22 November 2017.

The combination of rising average benefits payments for each tenure type and the shift in tenants to higher costs tenures has driven the rise in overall housing benefits payments. Housing benefit payments to tenants in local authority housing has been on a downward trend in real terms over the past 25 years, while payments for registered social landlord tenants have increased more than six-fold and those for private rented sector tenants have doubled. (See Figure 15.)

**Figure 15: Real government expenditure on housing benefit in Great Britain (£ billions, 2017-18 prices)**

Sources: Capital Economics and the Department for Work and Pensions. Note: The 2017-18 figure is a forecast consistent with Autumn Budget 2017 Economic and Fiscal Outlook published by the Office for Budget Responsibility on 22 November 2017.

## 2.2 Rent and housing benefits by tenure in England

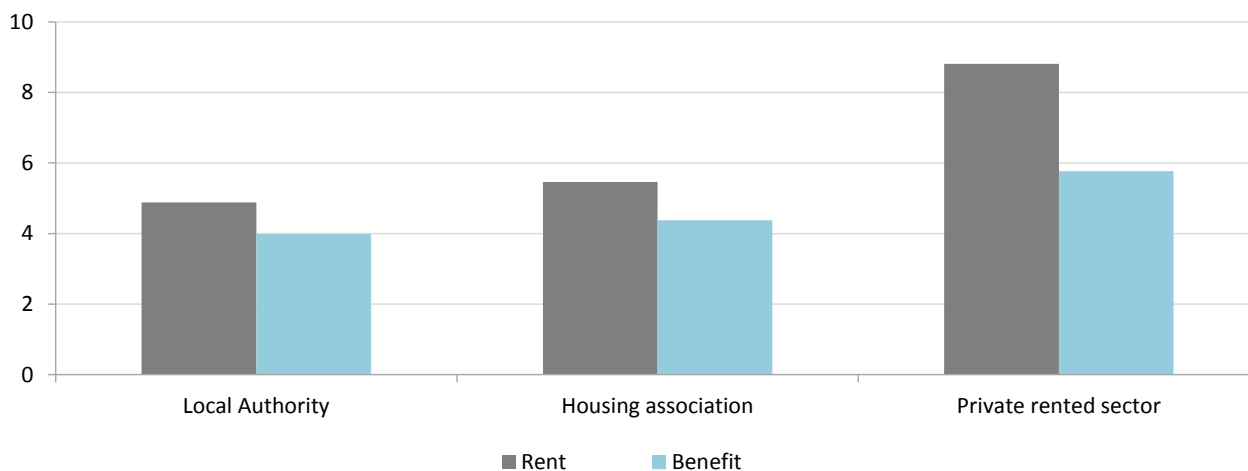
The English Housing Survey reports average rent and housing benefits receipts for housing benefit claimants by type of tenure, with the latest figures being for 2016-17.

For those receiving housing benefit, average annual local authority rents in England were £5,074, average registered social landlord rents were seven per cent higher at £5,432 and average market rents were 75 per cent higher than local authority rents at £8,873. The difference between housing benefit payments received by tenure were somewhat less marked. On average, tenants in local authority housing received £4,123, registered social landlord tenants received six per cent more at £4,380 and private rented sector tenants paying market rents received 30 per cent more at £5,365. (See Figure 16.)

On average, housing benefit payments to private rented sector tenants paying market rents cost the exchequer £982 per year more than housing benefits to registered social landlord tenants and £1,242 more per year than payments to local authority tenants.

While housing benefits payments received by local authority tenants and by registered social landlord tenants cover 81 per cent of rent payments, for tenants paying market rents in the private rented sector benefits payments on average cover 60 per cent of rent payments. The differential is in line with the higher gross income level of private rented sector tenants compared to those in the affordable housing sector.

**Figure 16: Mean annual rent and housing benefit by tenure for households in England receiving housing benefit in 2015-16 (£ thousands)**



Sources: Capital Economics and the English Housing Survey.

## 2.3 Housing benefit and rental cost of the changing tenure composition

The changing composition of the tenures of those receiving housing benefit has contributed to additional costs to the tenants and to the exchequer. We focus on the additional cost over the past decade due to the increased reliance on the most expensive housing tenure, the private rented sector.

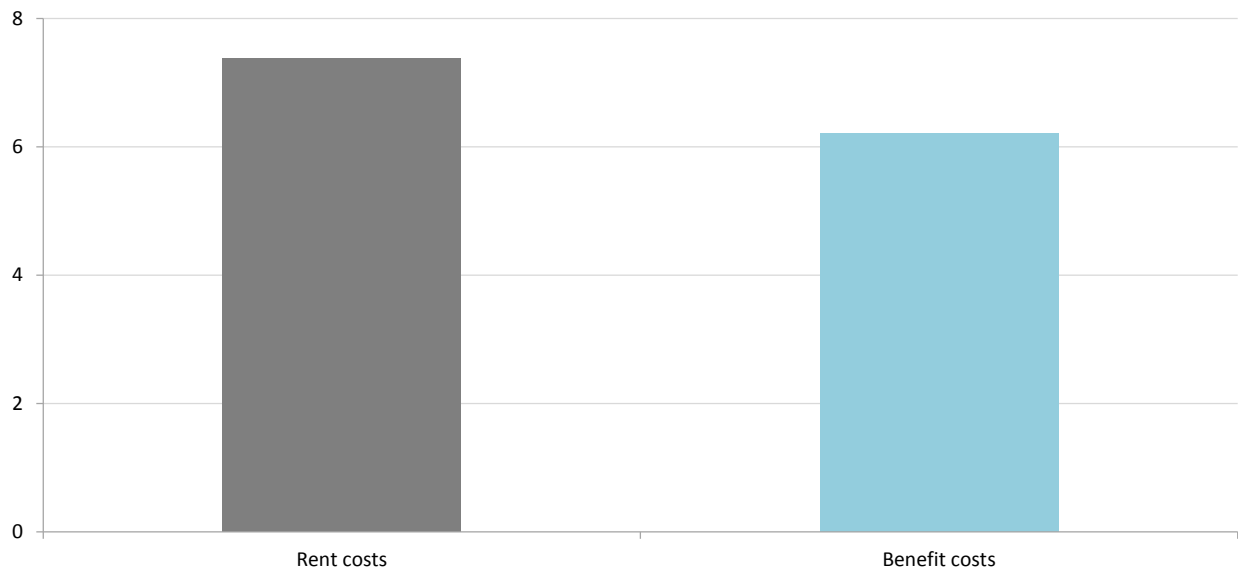
The share of housing benefits cases in private rented sector tenures was cyclical, but broadly flat from the early 1990s until around 2006-07 and averaged 22.6 per cent. If the share had remained at this level over the following decade and those claiming housing benefit had been housed in the affordable housing sector instead, they would have paid a cumulative £7.4 billion less in rent in real terms over the decade. Housing benefits payments would have been a cumulative £6.2 billion pounds lower in real terms. In other words, the increased reliance on the private rented sector has increased the costs to tenants and taxpayers by £13.6 billion pounds in rent and housing benefits payments. (See Figure 17.)

At current grant levels for affordable rent housing<sup>17</sup>, the benefits savings are equivalent to providing funding for 238,000 affordable rent homes over the past decade in addition to the 445,000 affordable homes that were built.

<sup>17</sup> Chartered Institute of Housing, *UK Housing Review 2018*, (Chartered Institute of Housing, Coventry), 2018.



**Figure 17: Estimated costs due to the increased share of housing benefit caseloads accounted for by the private rented sector in the ten years to 2016-17 (£ billions, 2017-18 prices)**



Sources: Capital Economics, the English Housing Survey and the Department for Work and Pensions. Note: Additional costs are compared to the counterfactual of the Private Rented Sector share remaining unchanged at the average level between 1991-92 and 2006-07, with all other things unchanged.

# 3 AFFORDABLE HOUSING INVESTMENT AND THE HELP TO BUY EQUITY LOAN SCHEME

In this chapter we review the changes in the amounts of social housing investment, grant funding and additional affordable housing being provided and compare them to the Help to Buy scheme.

## 3.1 Affordable housing investment and grant funding

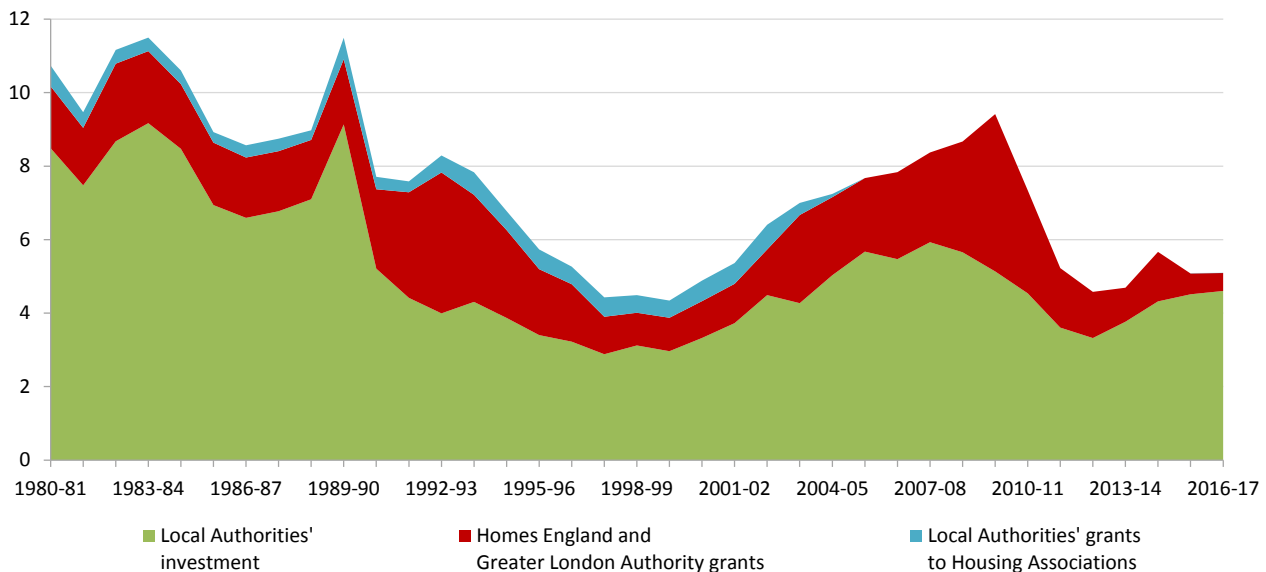
In the financial year 2016-17, the most recent for which figures are available, publicly-funded affordable housing investment totalled £5.0 billion. After adjusting for inflation, investment in recent years has been amongst the lowest recorded since 1980-81, comparable to the period between 1996-97 and 2001-02. (See Figure 18.)

While the level of investment is similar to that two decades ago its composition has changed. In the period 1996-7 to 2001-02 real terms grant funding by Homes England (which provides grants for affordable housing in England outside of Greater London) and the Greater London Authority averaged £1.1 billion per annum while grant funding from local authorities to housing associations averaged £0.5 billion per annum. Grant funding accounted for 36 per cent of publicly funded housing investment. In the latest financial year, real terms grant funding by Homes England and the Greater London Authority amounted to £0.5 billion and there was no grant funding from local authorities to housing associations. Grant funding accounted for ten per cent of publicly funded housing investment.

The bulk of public social housing investment is funded by local authorities. A local authority's Housing Revenue Account is the account which holds its council housing revenue and costs. In 2012, Housing Revenue Account self-financing was introduced, which enabled local authorities to fully retain the money they receive in rent in order to plan over a longer-term horizon and to provide services to their current and future tenants.<sup>18</sup> These changes have helped raise local authority investment to £4.6 billion in real terms in 2016-17 from a low of £3.3 billion in 2012-13.

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<sup>18</sup> Chartered Institute of Public Finance and Accountancy, *Voluntary code for a self-financed housing revenue account*, (Chartered Institute of Public Finance and Accountancy, London), 2013.

**Figure 18: Publicly funded social housing gross capital investment in England (£ billions, 2017-18 prices)**

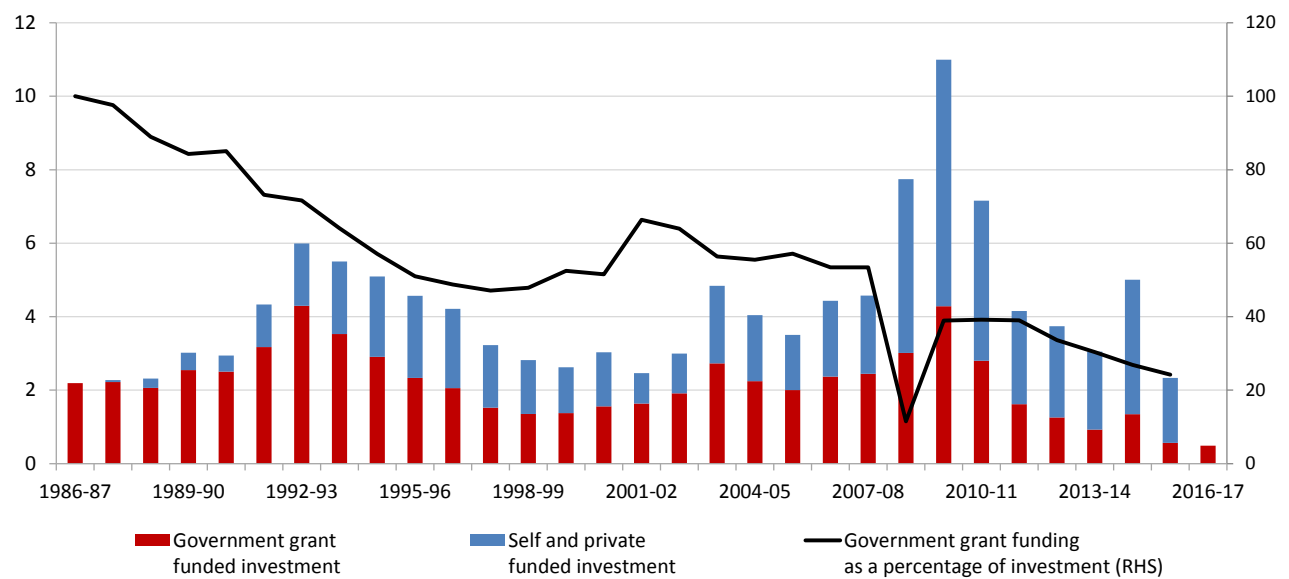
Sources: Capital Economics, Homes England and the UK Housing Review 2018. Homes England and the Greater London Authority includes investment by predecessor bodies. In 2017-18, affordable housing grants by Homes England were £543 million.

Housing associations' funding of investment has changed over time. In the mid-1980s their investment was entirely grant-funded by central government and local authorities, but over time self-financing (from revenues) and external private financing has become an increasingly important component. Housing association investment can be volatile from year-to-year, but in 2015-16, the latest data point for total investment by housing associations, self and private funded investment accounted for 76 per cent of housing associations investment. In 2016-17 grant funding was the lowest since the mid-1980s in real terms. (See Figure 19.)

The mix of funding has changed over time, but the trend in new dwellings completions has been broadly flat between the early 1990s and now. Completions have averaged 23,000 per annum and fluctuated between a high of 31,000 and a low of 13,000. (See Figure 20.)

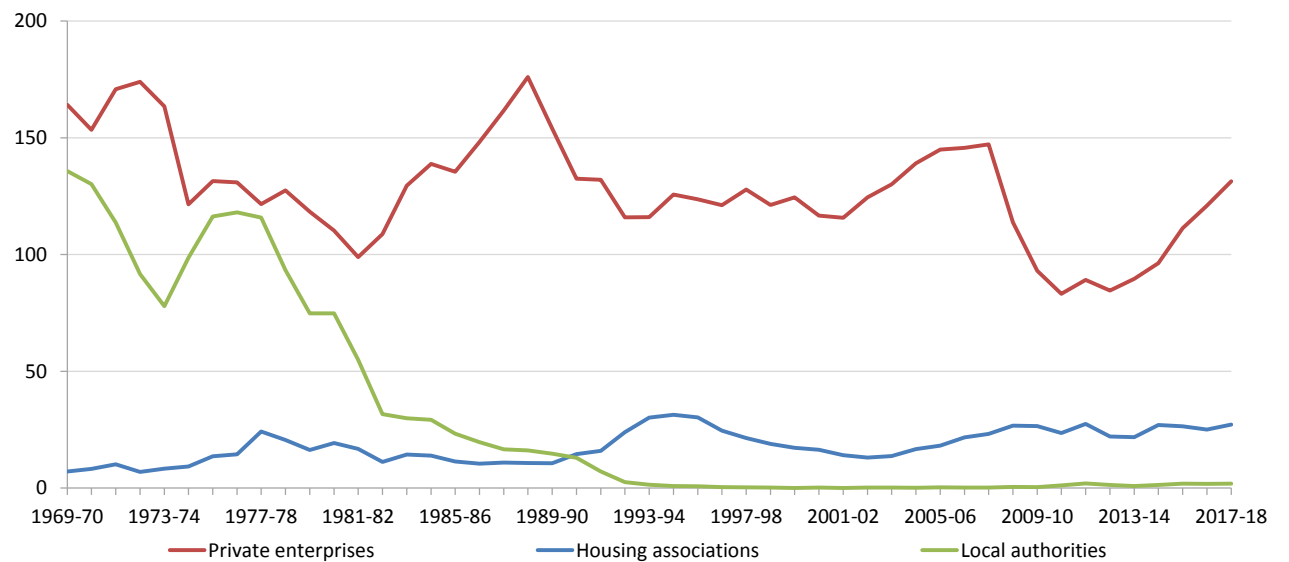
Local authority investment outside of grant-funding for housing associations has fallen over the longer-term and the focus of investment has switched from new build to renovation of the existing stock. The switch in focus of investment spending is evident in the number of local authority dwellings being completed. During the 1970s local authorities commonly completed in excess of 100,000 new dwellings per annum and in 1980-81, when our investment data begin, 75,000 dwellings were completed. By 1999-00 completions had fallen to just 60. The reforms to the Housing Revenue Account in 2012 have seen completions rise to almost 2,000 per annum in recent years. (See Figure 20 again.)

Figure 19: Housing association gross investment by source of finance (£ billions, 2017-18 prices) and grant funded investment share of investment (per cent) in England



Sources: Capital Economics and the UK Housing Review 2018. Note: Grant financed investment includes grants from Homes England and from Local Authorities. The latest data point for total investment by housing associations and therefore the percentage share that is grant funded is 2015-16.

Figure 20: Dwellings completed by tenure (thousands)



Sources: Capital Economics and the Ministry of Housing Communities and Local Government.

### 3.2 The changing composition of additional affordable housing

Eligibility to access affordable housing is determined with regard to local incomes and local house prices. Affordable housing comprises homes that are classified as either social rent, affordable rent or intermediate housing:

- *Social rent*: mostly owned by local authorities and private registered providers. Guideline target rents are determined through a national rent regime and are lower than those for 'Affordable rent' homes;
- *Affordable rent*: let by local authorities or private registered providers of affordable housing. Rents can be no more than 80 per cent of the local market rent (including service charges, where applicable);
- *Intermediate housing*: homes for sale and rent provided at a cost above social rent, but below market levels. These can include shared equity (shared ownership and equity loans) and other low cost homes for sale and intermediate rent.

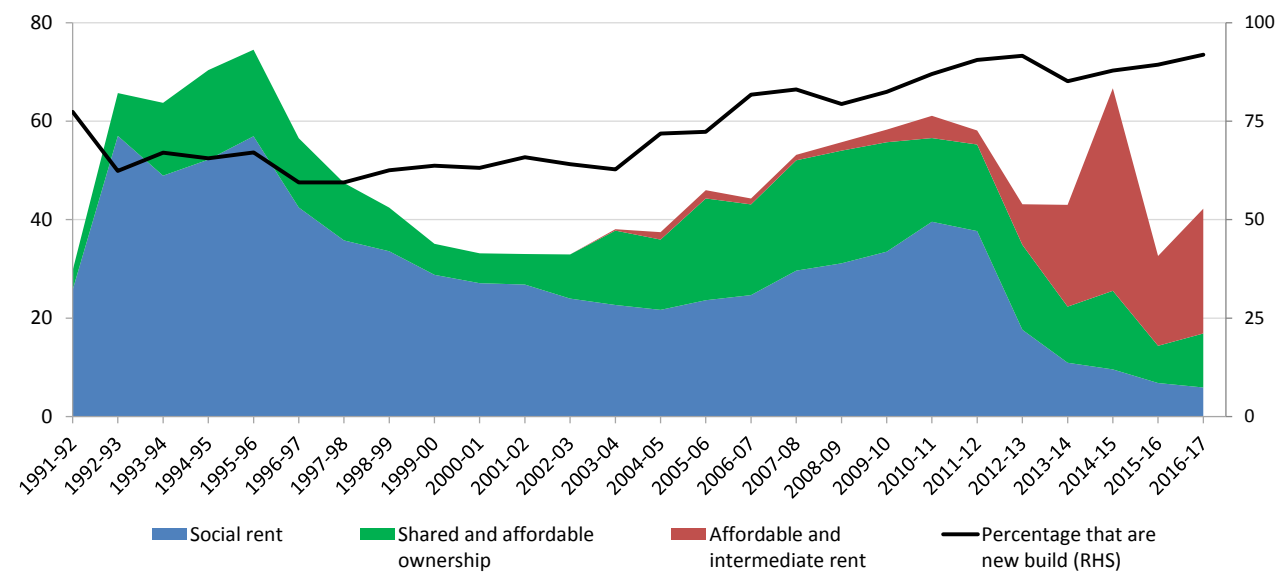
Additional affordable housing is provided through new build or acquisition, with the proportion that are new build averaging 90 per cent per annum in the most recent five years compared to around 50 per cent in the first half of the 1990s. Additions include those by local authorities, private registered providers (including housing associations), non-registered providers and via Section 106 agreements (i.e. those that are provided by developers as part of planning obligations) whether they have received grant funding or not. (See Figure 21.)

The mix of affordable housing being added each year has changed over the longer term as the level and mix of investment funding has evolved. (See Figure 21 again.) Namely:

- Central government grant funding has increasingly focused on the provision of affordable rent housing;
- The increasing reliance of housing associations on self-financing from revenues and on external private financing has encouraged a switch away from social housing and towards affordable and intermediate rent housing, which have higher average rents than social rent housing;
- The reduction in new building by local authorities.

Additions to social rent housing averaged 48,000 per annum in the first half of the 1990s and accounted for 80 per cent of annual additional social housing. By 2016-17 additions had fallen to 6,000 and accounted for fourteen per cent of total additions. Conversely, affordable and intermediate rent housing was only introduced in 2003-04 and by last year additions had grown to 25,000, contributing 60 per cent of total additions.

**Figure 21: Additional affordable homes provided in England each year by type (thousands) and share that are new build (per cent)**



Sources: Capital Economics and the Ministry of Housing, Communities and Local Government. Note: Additional affordable homes comprise new builds and acquisitions.

The changing nature of government funding programmes has led to a decrease in the number of homes being built for social rent and an increase in those for affordable or intermediate rent. Nevertheless, the relative newness of these programmes means that social rent homes still account for the largest share of the affordable homes dwelling stock. It is estimated that there are just over four million homes in England that are rented from private registered providers or local authorities.<sup>19</sup> Assuming that this represents the entire stock of homes available for social, affordable or intermediate rent, we can estimate the relative contributions from each tenure.

Affordable or intermediate rent homes are relatively new tenures. Since 2003, 21,350 homes have been provided for intermediate rent in England and 110,000 homes have been provided for affordable rent since 2011.<sup>20</sup> These figures imply that there are 3.9 million homes available for social rent in England, accounting for almost 97 per cent of the ‘affordable housing’ rented dwelling stock. (See Figure 22.)

<sup>19</sup> Ministry of Housing, Communities & Local Government, *Table 104: by tenure, England (historical series)* (Ministry of Housing, Communities & Local Government, London), 2018.

<sup>20</sup> Ministry of Housing, Communities & Local Government, *Table 1000: additional affordable homes provided by type of scheme, England* (Ministry of Housing, Communities & Local Government, London), 2018.

**Figure 22: Estimated dwelling stock by affordable housing tenure (2017)**

Type of tenure	Estimated dwelling stock	Share of estimated dwelling stock (per cent)
Social rent	3,914,650	96.8
Affordable rent	110,000	2.7
Intermediate rent	21,350	0.5
<b>Total</b>	<b>4,046,000</b>	<b>100.0</b>

Sources: Capital Economics and Ministry of Housing, Communities & Local Government.

### 3.3 Help to Buy equity loan scheme

The Help to Buy equity loan scheme was announced by the government in the Budget in March 2013 and came into operation the following month. The aim of the scheme is to help credit-worthy households without a sufficient deposit to obtain a mortgage, increase the supply of new housing and support economic growth.<sup>21</sup>

The scheme is open to first time buyers and home movers in England and has the following criteria<sup>22</sup>:

- The home buyer provides a five per cent deposit to purchase a new build home and the government provides a competitively-priced equity loan of up to twenty per cent of the purchase price (up to 40 per cent in London);
- The maximum loan is £120,000 (£240,000 in London) and the maximum purchase price £600,000;
- No interest or repayments are due during the first five years of the loan;
- The borrower can choose to repay the loan at any time, but the loan must be repaid if the house is sold;
- The government owns a twenty per cent share of the house, so the amount repaid will depend on the market price of the home at the time repayment.

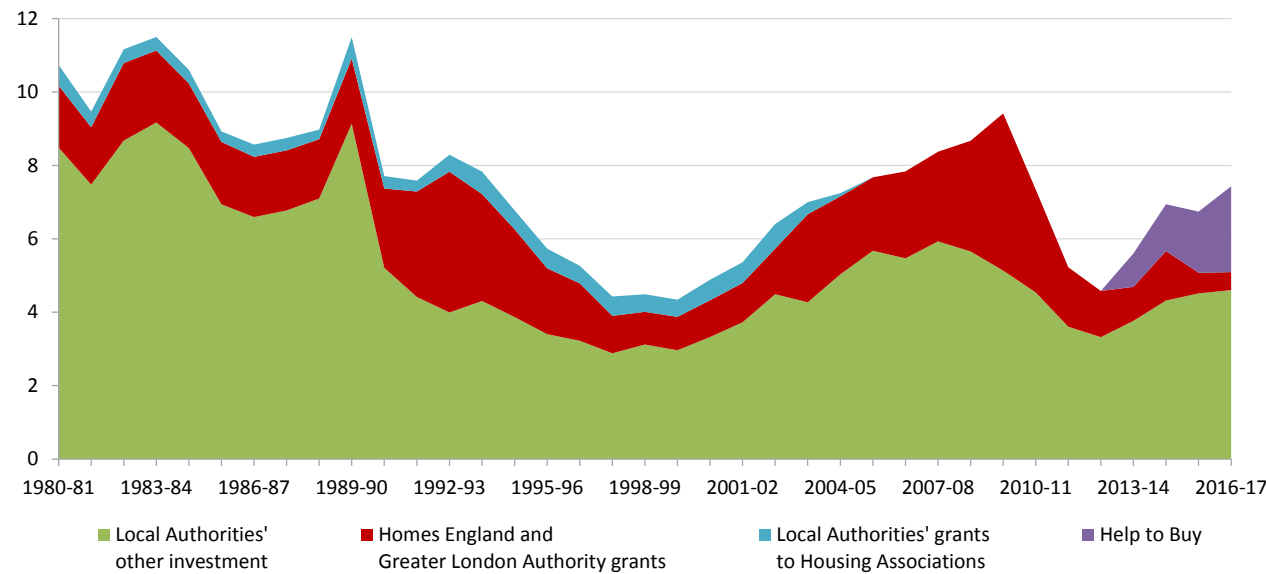
Expenditure under the scheme has gathered pace and between its launch and 2016-17 cumulative lending totalled £5.9 billion. A further £3.1 billion was lent last year, bringing the total to £8.9 billion (numbers do not sum due to rounding). This compares to £2.4 billion spent by Homes England on grant funding of affordable housing over the same period. (See Figure 23.)

<sup>21</sup> HM Treasury, *Budget 2013*, (HM Treasury, London), 2013.

<sup>22</sup> HM Government, <https://www.helpstobuy.gov.uk/equity-loan/equity-loans/>

In October 2017 the government announced a further £10.0 billion of funding for Help to Buy through to April 2021<sup>23</sup>. Unlike grants and capital expenditure, Help to Buy loans are not counted in the public spending aggregate, Total Managed Expenditure.

**Figure 23: Publicly funded social housing gross capital investment and expenditure on the Help to Buy program in England (£ billions, 2017-18 prices)**



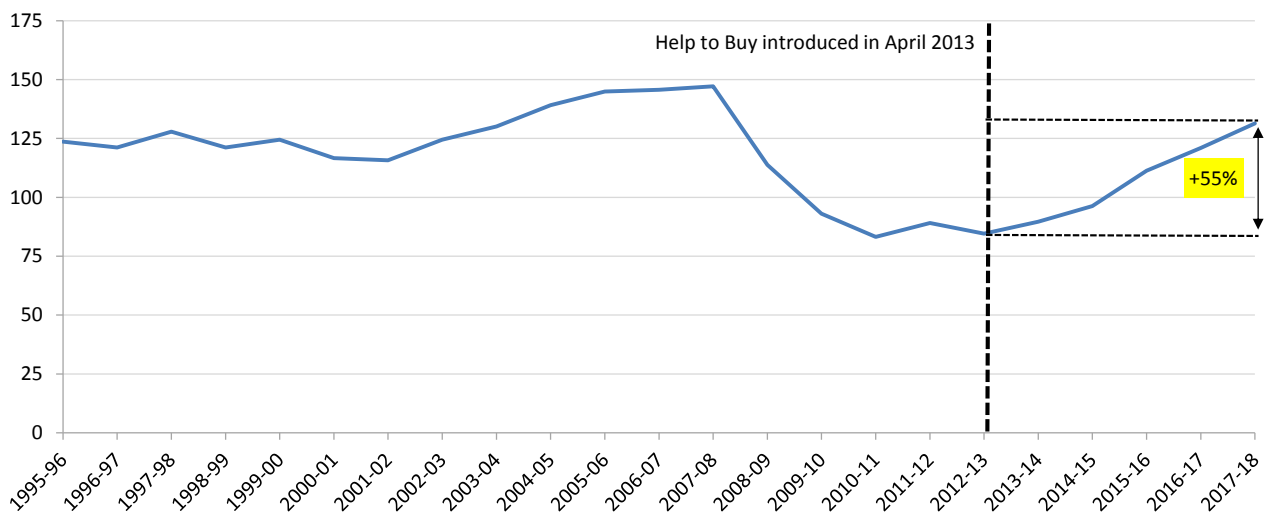
Sources: Capital Economics, Homes England and the UK Housing Review 2018. In 2017-18, affordable housing grants by Homes England were £543 million and Home to Buy equity loans were £3.1 billion.

In the aftermath of the global financial crisis that hit in 2008, private dwellings completions fell to 85,000 in 2012-13 from 147,000 in 2007-08. Since the Help to Buy scheme was introduced, private dwelling completions have increased by 55 per cent to 131,000 last year. (See Figure 24.) Sales of new dwellings have grown in line with completions.

Help to Buy purchases accounted for 48 per cent of new sales last year and the cumulative number of purchases under the scheme has been 169,000. At first glance, the scheme appears to be responsible for a material increase in the rate of housebuilding.

<sup>23</sup> Ministry of Housing, Communities and Local Government, *£10 billion new funding for Help to Buy Equity Loan*, (Ministry of Housing, Communities and Local Government, London), October 2017.

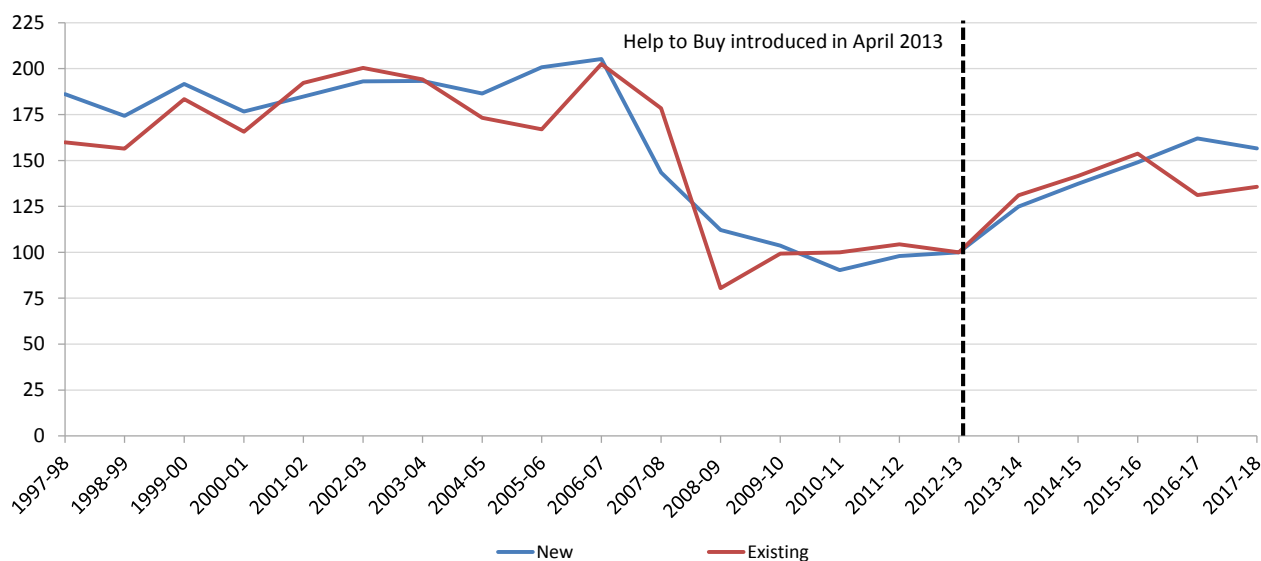


**Figure 24: Private sector dwelling completions in England (thousands)**

Sources: Capital Economics and the Ministry of Housing, Communities and Local Government.

Much of the recovery in the sales and completions of new homes can be attributed to the recovery in the economy over the past five years. Sales of existing homes, which are not covered by the Help to Buy scheme, have increased by 36 per cent since 2012-13. Although sales of existing homes have stalled in the past two years that appears to be at least in part due to a shortage of stock coming on to the market for sale. (See Figure 25.)

A simple but transparent estimate of the impact of the scheme on new sales can be derived by comparing actual sales with how many new homes would have been sold over the past five years if sales had increased in line with existing sales. Actual sales of new homes from 2013-14 to 2017-18 totalled 469,000. If new sales had grown in line with existing sales over the same period they would have totalled 446,000, implying that the Help to Buy scheme generated an additional 24,000 sales of new homes.

**Figure 25: Sales of new and existing dwellings in England (2012-13 = 100)**

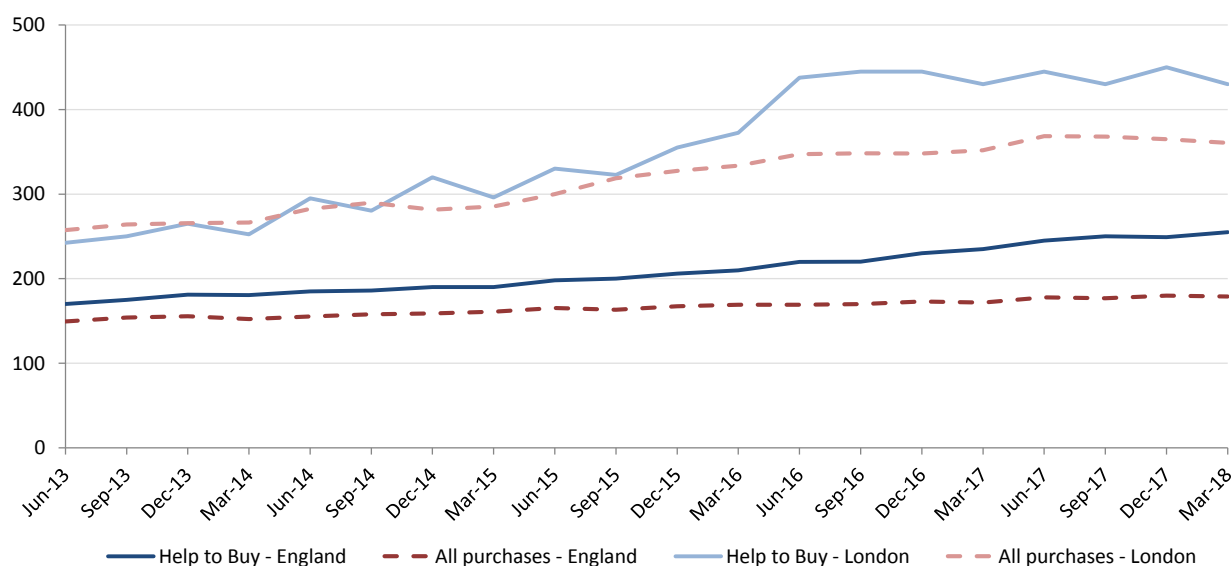
Sources: Capital Economics and the Office for National Statistics.

Clearly, our estimate is subject to a wide margin of uncertainty and contrasts with a government-commissioned evaluation which concluded that, between its introduction and June 2015, 43 per cent of Help to Buy purchases were additional to what would have happened in the absence of the scheme.<sup>24</sup> Applying this percentage to all sales under the scheme implies that Help to Buy is responsible for sales of an additional 73,000 newly-built homes.

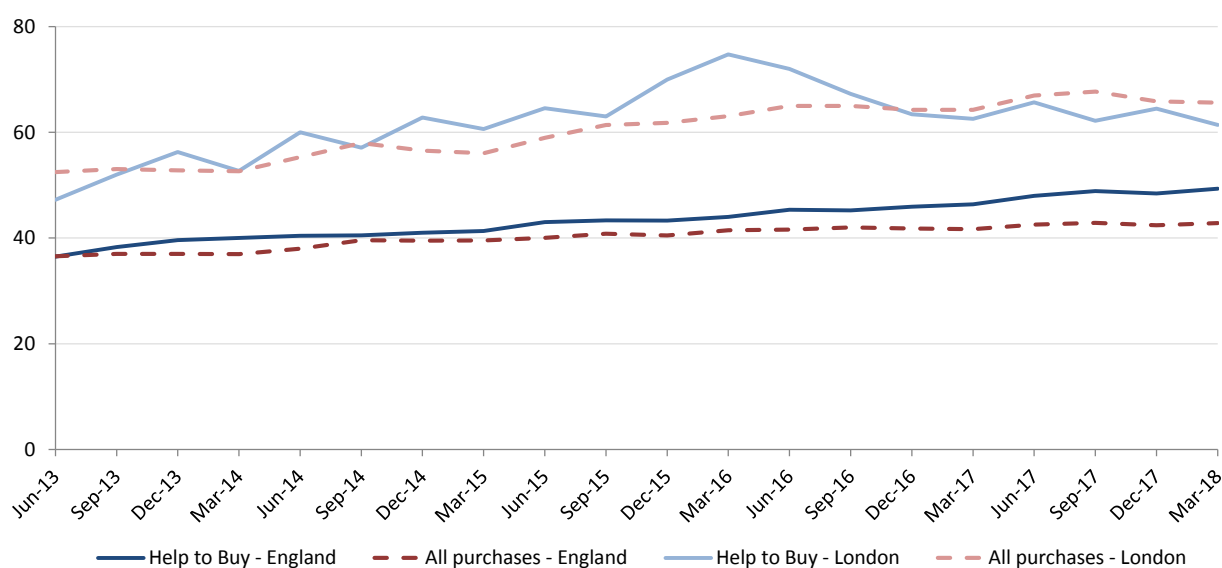
First time buyers comprise 81 per cent of Help to Buy purchases. The median purchase price of homes bought by first time buyers under the scheme have risen faster, and are higher, than all purchases by first time buyers, both in London and the whole of England. (See Figure 26.) The income of first time buyers using the scheme have risen faster than those of all first time buyers and, outside of London, are higher. (See Figure 27.) And first time buyers under the scheme have a higher median house price to income ratio than all first time buyers, both in the whole of England (5.2 versus 4.2) and in London (7.0 versus 5.5).

Those facts are hard to reconcile with the idea that the scheme is predominantly being used by first time buyers at the margins of the market who were previously unable to buy. Instead, it appears that many buyers are opting to use the scheme because of the much lower debt servicing costs that result and because it enables them to buy more expensive property than they would otherwise be able to afford.

<sup>24</sup> Stephen Finlay (Ipsos MORI) and Peter Williams and Christine Whitehead (the London School of Economics), *Evaluation of the Help to Buy Equity Loan Scheme*, (Ministry of Housing Communities and Local Government, London), February 2016.

**Figure 26: Median prices paid by first time buyers in England and, of which, London (£ thousands)**

Sources: Capital Economics, the Ministry of Housing, Communities and Local Government and UK Finance.

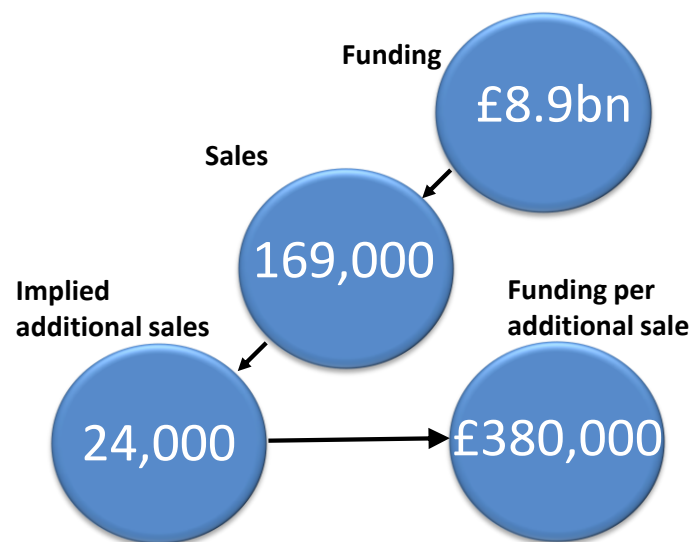
**Figure 27: Median incomes of first time buyers in England and, of which, London (£ thousands)**

Sources: Capital Economics, the Ministry of Housing, Communities and Local Government and UK Finance.

Our derived estimate that the Help to Buy equity loan scheme has resulted in an additional 24,000 newly-built, market homes implies that the funding per additional home has averaged £380,000. Using the estimate that Help to Buy has generated an additional 73,000 newly-built, market homes reduces the average funding per home to £123,000. Either way, the funding is significantly higher than the grant funding from Homes England and the Greater London Authority of £26,000, on

average, per new home for affordable rent under the Affordable Homes Programme for 2015 to 2018.<sup>25</sup> (See Figure 28.)

Figure 28: Help to Buy, 2013-14 to 2017-18



Sources: Capital Economics and Ministry of Housing, Communities and Local Government. Numbers reported are rounded.

<sup>25</sup> Chartered Institute of Housing, *UK Housing Review 2018*, (Chartered Institute of Housing, Coventry), 2018. Note that when grants for new affordable ownership homes are included, the average per home is £24,000.

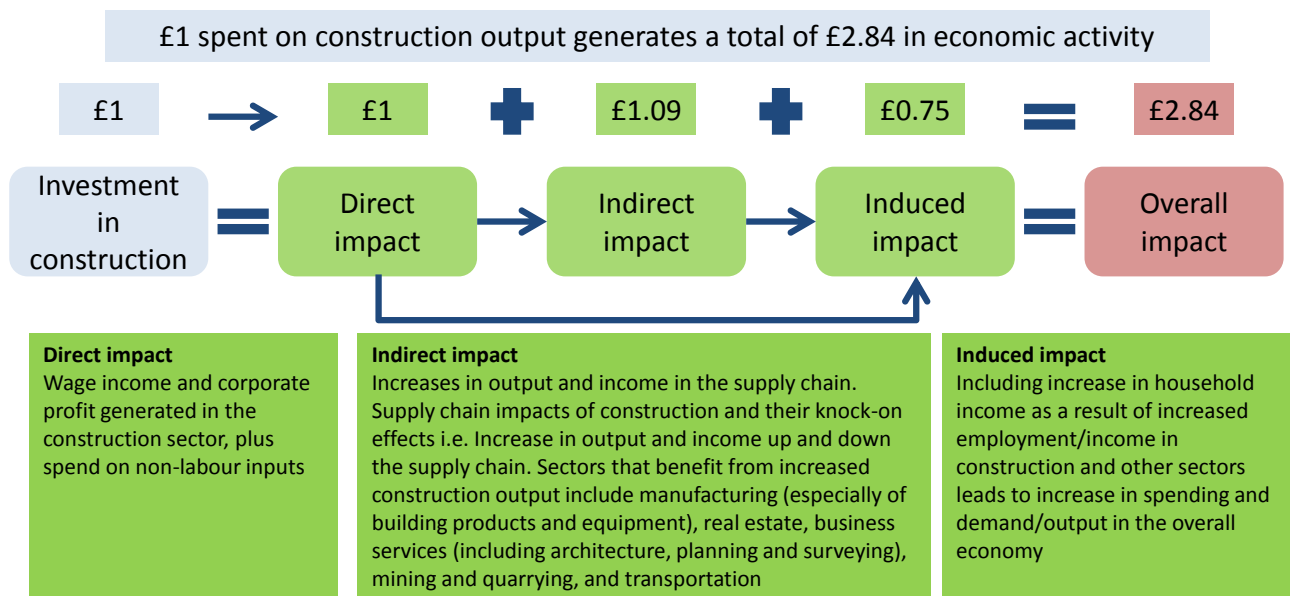
## 4 THE ECONOMIC AND FISCAL IMPACT OF BUILDING SOCIAL HOMES

In this chapter we calculate the economic and fiscal impact of grant funding for building new affordable rent housing.

### 4.1 Implications for economic activity

Building new homes has an immediate impact on the economy through the wage income and corporate profits generated in the construction sector. However, the impacts don't just stop there. The investment in construction stimulates activity elsewhere in the economy, for example for building materials manufacturers and architects. This has the additional benefit of generating further economic activity and tax revenue for the government.

Figure 29: The economic impact of investment in housing

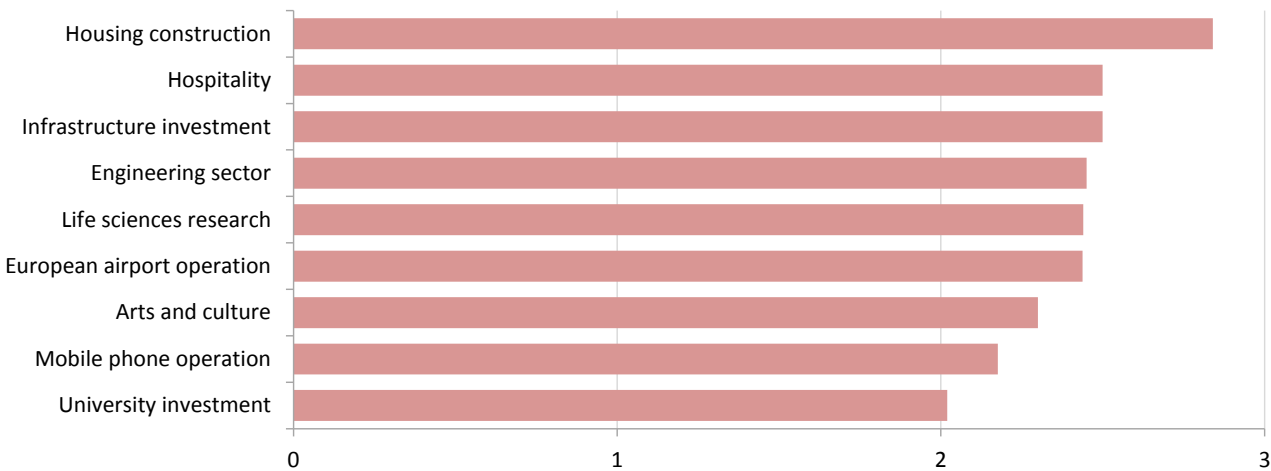


Sources: Capital Economics and L.E.K. Consulting, Construction in the UK Economy: The Benefits of Investment (The UK Contractors Group, London), 2009.

A report for the UK Contractors Group estimated that every pound spent on construction output stimulates an increase of £2.84 in gross domestic product. What’s more, there is an additional 56 pence benefit to the exchequer from increased tax revenues and reduced benefits payments as the activity stimulates employment growth.<sup>26</sup> (See Figure 29.)

The construction multiplier appear large in comparison to other sectors. This is partly the result of a large proportion (92 per cent) of construction revenues remaining in the domestic economy and not being spent on imported inputs. (See Figure 30.)

Figure 30: Comparison of estimated multipliers in selected sectors



Sources: Capital Economics, Biggar Economics, Centre for Economic and Business Research, Intervistas, LEK, Oxford Economics, PWC and Standard and Poors. Note: The multipliers shown include direct, indirect and induced effects only. The multipliers have been estimated by a range of organisations which may impact their comparability.

4.2 Implications for public finances

Of course, the provision of grants to support a programme of building new social or affordable rent homes requires up-front expenditure by the government. Since 2011, grant funding has been provided principally for homes for affordable rent rather than social rent.<sup>27</sup> The government has recently announced that it will make available £1.67 billion to help fund the building of 23,000 new affordable homes, of which 12,500 will be social rent homes.<sup>28, 29</sup> This implies an average grant

<sup>26</sup> L.E.K. Consulting, *Construction in the UK Economy: The Benefits of Investment* (The UK Contractors Group, London), 2009  
<sup>27</sup> Homes and Communities Agency, *2011-15 Affordable Homes Programme – Framework* (Homes and Communities Agency, London), 2011.  
<sup>28</sup> Ministry of Housing, Communities & Local Government, *Brokenshire confirms social housing investment boost* (Ministry of Housing, Communities & Local Government and The Rt Hon James Brokenshire MP, London), 2018.  
<sup>29</sup> Ministry of Housing, Communities & Local Government, *Share Ownership and Affordable Homes Programme 2016 to 2021 Addendum to the Prospectus* (Ministry of Housing, Communities & Local Government, London), 2018.

award of £72,600, which is materially higher than the £26,000 awarded on average for each home built for affordable rent in England under the Affordable Homes Programme 2015-18.<sup>30</sup>

Although this level of funding per home may appear high compared with the average grant awarded under recent programmes, it will only be available within a local authority that is subject to high affordability pressures – areas where the difference between average social rents and private rents is £50 per week or more.<sup>31</sup> As such, the cost of building a new home will be higher in these areas and require greater government support. While it remains to be seen if this level of grant is actually required/awarded, we use this figure in our subsequent analysis.

The level of grant awarded isn't the only consideration for understanding the overall impact on public finances. First, in most locations, there are savings in welfare expenditure generated by moving families receiving housing benefit from private rented accommodation into social or affordable rent tenure. On average this is around £1,250 per annum in England. However, there is considerable variation by local authority. The saving would be around £100 per annum in Cheshire East, £2,350 in Epping Forest and in Peterborough tenants in the private rented sector receive £160 less in housing benefit on average than those in the social rented sector.<sup>32</sup> Second, increased construction activity generates higher tax revenues equivalent to more than half of the initial spend on construction. Third, there is an impact on interest payments on outstanding government debt.

The interaction of these three factors can be shown via simple net present value calculations. (See Figure 31.) We consider three examples in our analysis:

1. **National average** – the government provides £72,600 in grant to build a new social rented home as implied by the *Shared Ownership and Affordable Homes Programme 2016 to 2021 Addendum to the Prospectus*. This provides a home for a household that would otherwise be in the private rented sector. The subsequent weekly savings to the government in housing benefit payments are equivalent to the average difference in housing benefit awarded in England to a private rented sector tenant and a social rented sector tenant;
2. **Area of high affordability pressure** – the level of grant is the same in the first example but the household is in an area that is subject to high affordability pressures. We assume that the welfare saving to the government is £45 per week – the same as in Epping Forest local authority; and
3. **Affordable rent** – the level of grant is £26,100, which is equivalent to the average award under the *Affordable Homes Programme 2015-18*. We assume that the weekly welfare saving

<sup>30</sup> Chartered Institute of Housing, *UK Housing Review 2018*, (Chartered Institute of Housing, Coventry), 2018.

<sup>31</sup> Ministry of Housing, Communities & Local Government, *Shared Ownership and Affordable Homes Programme 2016 to 2021 Addendum to the Prospectus* (Ministry of Housing, Communities & Local Government, London), 2018.

<sup>32</sup> Data are for May 2018 from the Department for Work and Pensions 'Stat-Xplore' database. Social rented sector tenants include those paying affordable rents.

is equivalent to the average difference between housing benefit paid to housing association tenants and private rented sector tenants.

Taking the first two examples, we assume that the government provides £72,600 in grant funding for a new social rent home that will be owned by a housing association (i.e. the home will not be a public sector asset) and that this is spent on construction activity in the first year. The negative impact of government finances of the grant expenditure will be partially offset by the £40,700 generated in additional tax contributions arising from constructing the home.<sup>33</sup> This leaves net government borrowing at a little under £32,000 in the first year.

However, there are ongoing housing benefit savings from housing a family in social rent accommodation rather than in the private rented sector. These savings accumulate over time. On average, the government currently pays around £1,250 more per annum in housing benefit to tenants in the private rented sector compared to those renting from local authorities. However, with the grant funding for new social rented homes set to be available only in areas of high affordability pressure, using the average saving will understate the benefit savings to the government. As such, we also look at an example where there is a £45 weekly saving to the government or £2,350 per annum. We take the simplifying assumption that these annual savings stay constant in real terms over time.

Over a 30 year time horizon and accounting for the cost of borrowing by applying a 3.5 per cent real discount rate – the same as in the Treasury’s Green Book – the net present value to the government of providing the grant funding ranges between -£8,650 and £10,850, demonstrating that the government will save money over a reasonable time horizon in areas of sufficiently high affordability pressures. (See Figure 31.)

However, the government is able to borrow at even cheaper rates of interest at the moment. For example, the average nominal yield on long term government bonds in the United Kingdom has averaged just 1.9 per cent so far in 2018.<sup>34</sup> Assuming an inflation rate of two per cent – the central point of the Bank of England’s target – this implies a real yield of around zero per cent. Using this in our net present value calculation brings the savings to the government in today’s money to £5,600 in areas with the average housing benefit saving and £38,500 in areas such as Epping Forest. (See Figure 31 again.)

<sup>33</sup> Note, we have assumed that without the grant funding the remainder of the money required to build the home would have been spent elsewhere in the economy. Therefore, only the benefit to tax receipts from the grant funding element of the construction costs is included in the net present value calculation.

<sup>34</sup> Data from Thomson Reuters for United Kingdom government bonds with a 25 year maturity. The time period covers 1 January 2018 to 24 September 2018.



**Figure 31: Net present value calculations for different levels of grant funding**

Type of tenure	Grant funding per home	Additional tax contribution from constructing home	Annual housing benefit savings	Net present value (3.5% real discount rate)	Net present value (0.0% real discount rate)
<b>Social rent home (Average benefits saving)</b>	£72,610	£40,660	£1,250	-£8,630	£5,600
<b>Social rent home in area of high affordability pressure (e.g. Epping Forest)</b>	£72,610	£40,660	£2,350	£10,840	£38,470
<b>Affordable rent home</b>	£26,130	£14,630	£990	£6,400	£18,060

Sources: Capital Economics and the UK Housing Review 2018. Note: net present value calculated over a 30 year time horizon. The grant funding for an affordable rent home is based on the average award under the *Affordable Homes Programme 2015-18*. The grant funding for a social rent home is a hypothetical figure based on the level implied in the Addendum to the *Share Ownership and Affordable Homes Programme 2016 to 2021*.

# 5 SOCIAL HOUSEBUILDING SCENARIOS

In this chapter, we consider the economic and fiscal implications of a government funded housebuilding programme that delivers 3.1 million new social rented homes over the next twenty years. We evaluate two scenarios: (i) all homes are built and subsequently owned by the government; and, (ii) all homes are built and subsequently owned by housing associations.

## 5.1 Scenario assumptions

We have quantified two policies that result in the government building 3.1 million new social rented homes in England over the next twenty years. We compare these to the existing policy regime and assume that the demand for these homes is met by three groups<sup>35</sup>:

1. There are currently 1.1 million recipients of housing benefit in the private rented sector in England.<sup>36</sup> Moving these families into the social rented sector will, on average, deliver ongoing welfare savings to the government.
2. The population is expanding and the Office for National Statistics has estimated that the number of households living in England will grow by 3.2 million between 2020 and 2039.<sup>37</sup> Without more social rented homes, a proportion of these would live in the private rented sector and receive housing benefit. Similar to our first identified group, the government would spend less on welfare payments if they were housed in the social rented sector. We assume that this group accounts for fifteen per cent of the newly formed households (0.5 million) – equivalent to the proportion of households today that receive housing benefit.
3. Households that would like to live in the social rented sector but don't currently, or are unlikely to in the future, and that do not receive housing benefit. These households account for the remaining 1.5 million of new social rented homes. Although they don't deliver a welfare saving to the exchequer, they do pay rent which would provide an income stream to service the additional government borrowing in the scenario where the government owns the homes. This group doesn't deliver welfare savings or an income stream to the

<sup>35</sup> These three groups have been identified independently by Capital Economics and have no bearing on the groups that Shelter have defined to arrive at a target for building 3.1 million social homes over the next twenty years.

<sup>36</sup> Department for Work & Pensions, *Housing Benefit Caseload Statistics* (Department for Work & Pensions, London), 2018. Data from May 2018.

<sup>37</sup> Office for National Statistics, *2016-based household projections in England* (Office for National Statistics, London), 2018.

government in the scenario where the homes are subsequently owned by housing associations.

We have estimated that the total cost of building each new home is £135,700 on average.<sup>38</sup> This includes the cost of purchasing land (£68,100)<sup>39</sup> and the construction cost (£67,700).<sup>40</sup> This assumes that the land has been purchased on the open market.

Of course, it is possible that the government will be able to reduce its in-year borrowing by using public sector land that it already owns. Estimates suggest that there is capacity to deliver up to two million homes on public land.<sup>41</sup> However, this would ignore the opportunity cost to selling the land on the open market. As such, it is a more suitable comparison to include the cost of purchasing the land.

We summarise our assumptions in Figure 32.

**Figure 32: Scenario assumptions**

Variable	Assumptions
<b>Current policy</b>	<ul style="list-style-type: none"> <li>• Total of 38,800 homes for social/affordable rent or affordable ownership built per annum</li> <li>• 5,300 social rent units completed each year</li> <li>• 22,400 affordable rent homes completed each year supported by government grant of £26,000</li> <li>• Total of 145,000 private sector homes built per annum</li> </ul>
<b>Exemplar policy one: government ownership</b>	<ul style="list-style-type: none"> <li>• 3.1 million social rent homes built over 2020 to 2039 – an average of 155,000 per annum</li> <li>• These are fully funded by the government at an average cost of £135,700 per unit in 2017-18 prices</li> <li>• The government subsequently owns the homes</li> <li>• 1.5 million of these social rent homes are for households who don't receive housing benefit. 50 per cent of the rent received by the government is used to pay for management and maintenance costs</li> </ul>
<b>Exemplar policy two: housing association ownership</b>	<ul style="list-style-type: none"> <li>• 3.1 million social rent homes built over 2020 to 2039 – an average of 155,000 per annum</li> <li>• These are partially funded by government grant of £72,600 per unit on average in 2017-18 prices</li> <li>• They are subsequently owned by housing associations</li> <li>• 1.5 million of these social rent homes are for households who don't receive housing benefit</li> </ul>
<b>Underlying economic assumptions</b>	<ul style="list-style-type: none"> <li>• Forecasts for public finances, inflation and gross domestic product taken from the Office for Budget Responsibility's July 2018 fiscal sustainability report</li> </ul>

Source: Capital Economics.

<sup>38</sup> This assumes an average property size of 65 square metres. We have used the number of claimants by entitled bedrooms for March 2018 (data from Department for Work and Pensions, Stat-Xplore) to estimate the average bedroom requirement for the new properties. We have worked out the average size property using the space standards set out in Department for Communities and Local Government, *Technical housing standards – nationally described space standard* (Department for Communities and Local Government, London), 2015.

<sup>39</sup> Analysis based off land value estimates from: Ministry of Housing, Communities & Local Government, *Land Value Estimates for Policy Appraisal May 2017 Values* (Ministry of Housing, Communities & Local Government, London), 2018. We have used the guidance to calculate the average cost of land per square metre of developed area. We have calculated a weighted average for England based on the Office for National Statistics' projections for household formations by local authority over the next twenty years.

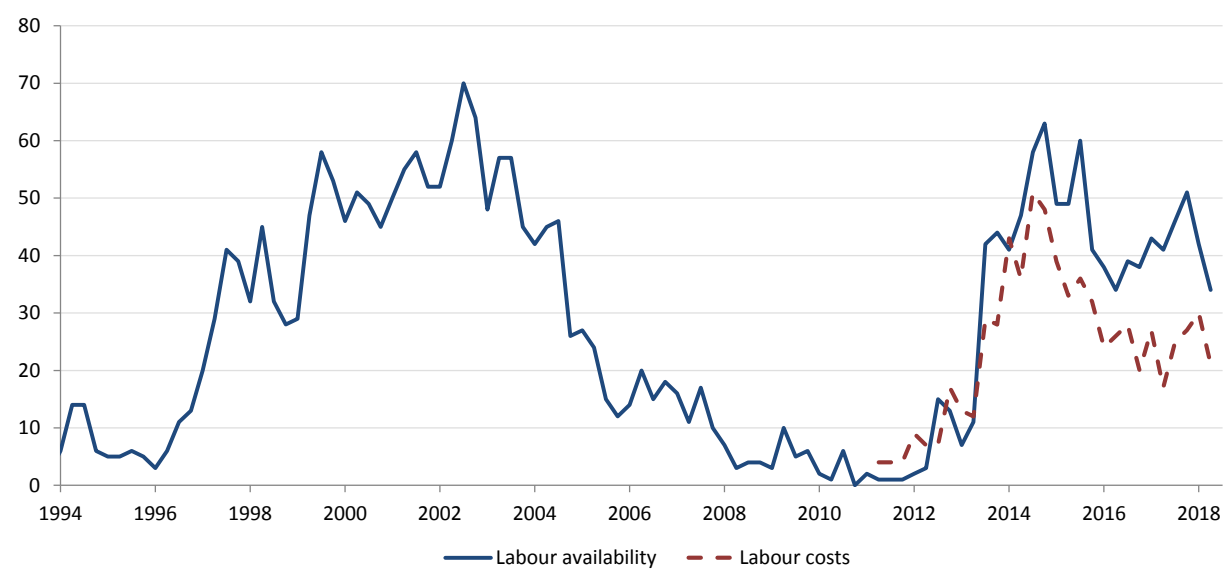
<sup>40</sup> We have used construction cost data from The Building Cost Information Service, *Housing development: the economics of small sites – the effect of project size on the cost of housing construction* (The Building Cost Information Service, London), 2015. We have uprated the data to 2017 prices using the Building Cost Information Service's house building cost index.

<sup>41</sup> Savills, *Public Land: unearthing potential* (Savills, London), 2014.

## 5.2 Capacity to deliver three million new social rented homes

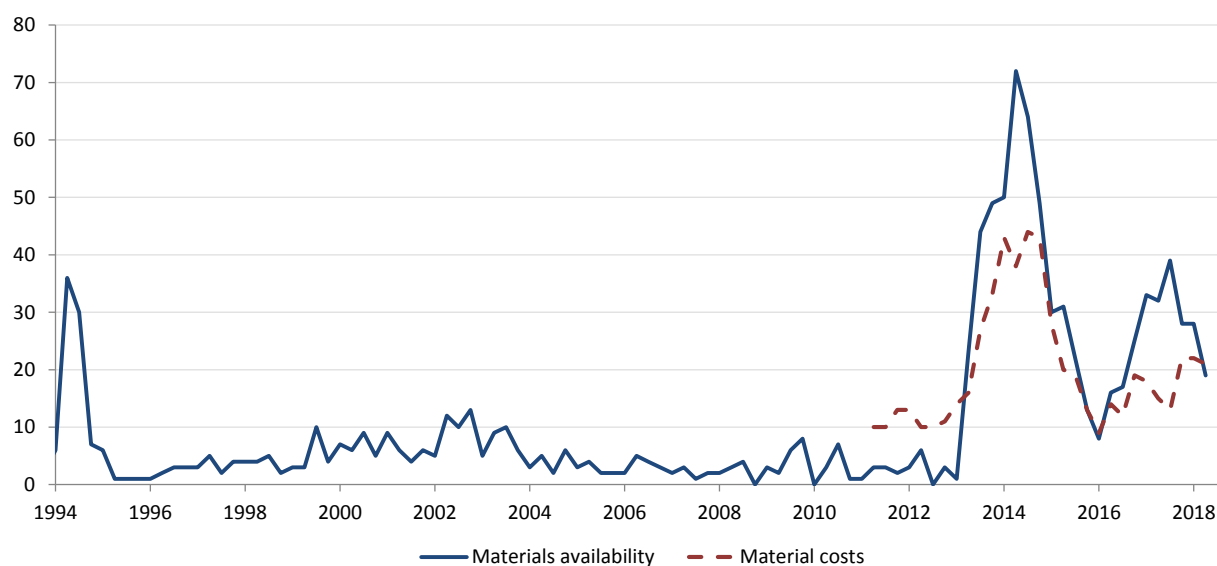
Of course, it is implausible to expect a sudden jump in the number of new social rent homes being built each year. Time is needed to enable the construction industry and supply chain to build up capacity. Meanwhile, the government will need sufficient time to plan new developments and arrange for new gilt issuances to fund the developments. However, conditions in the labour and materials markets that supply residential construction have eased considerably in recent years. What’s more, new technologies such as off-site construction would help to boost capacity.<sup>42</sup> (See Figure 33 and Figure 34.)

**Figure 33: Home builders reporting labour availability and costs a constraint on production, per cent**



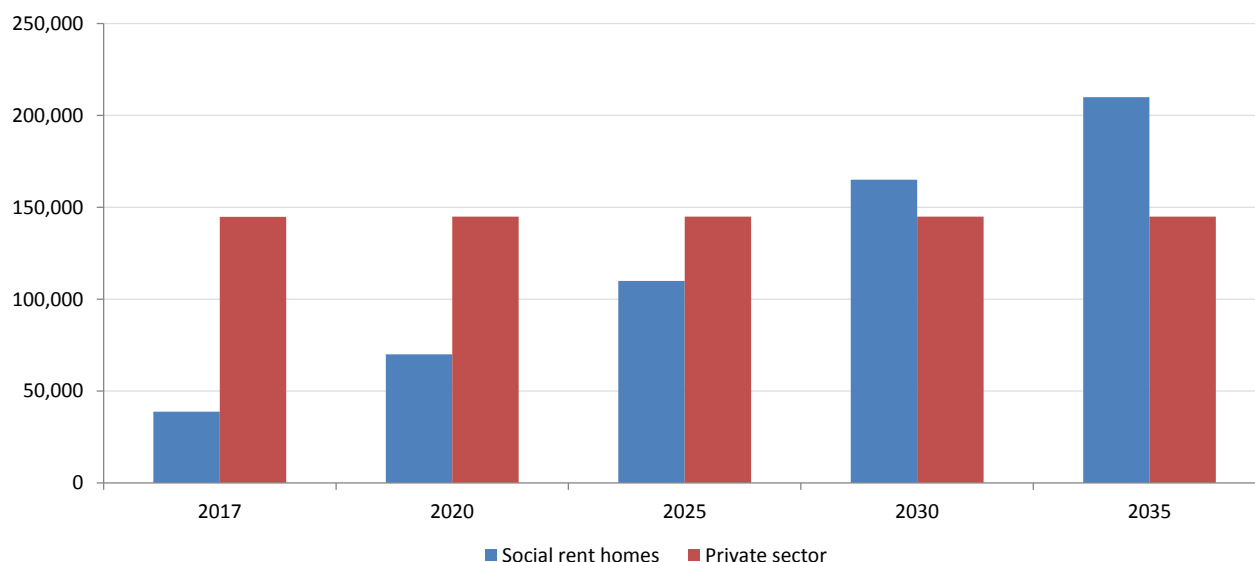
Sources: Capital Economics, Thomson Reuters and the Home Builder’s Federation.

<sup>42</sup> House of Lords Science and Technology Committee, *Off-site manufacture for construction: Building for change* (Authority of the House of Lords, London), 2018.

**Figure 34: Home builders reporting materials availability and costs a constraint on production, per cent**

Sources: Capital Economics, Thomson Reuters and the Home Builder's Federation.

Overall, a steady build-up to 210,000 net social rent additions per annum by 2035 seems reasonable. (See Figure 35.)

**Figure 35: House building profile, net additions per annum**

Source: Capital Economics.

In addition to the capacity of the construction industry, there are considerations relating to the availability of land. We have assumed open market prices for land, which should secure the land

needed. However, it is possible that supply can be limited for other reasons, including not enough sites being identified in local plans. Nevertheless, the government has policy tools available to improve land availability.

### 5.3 Impact on the economy and government finances

We have examined the future impact of the scenarios on gross domestic product and public sector debt and borrowing by assessing:

- Additional expenditure by government to pay for the new building programme, which is funded through borrowing by central government
- Savings in welfare expenditure generated by moving families receiving housing benefit from private rented accommodation into social rent tenure<sup>43</sup>
- Social rent paid by households moving into social rent tenure who don't receive housing benefit, net of the costs of operating social rent housing<sup>44</sup>
- Higher tax revenues generated through increased construction activity
- Impact on interest payments on outstanding government debt

Assuming that the construction sector can increase its capacity over time and does not displace other economic activity, the housebuilding programme has a material impact on gross domestic product. In either scenario, nominal gross domestic product is 1.3 per cent or £61 billion higher by 2038-39 than it would have otherwise been.

Meanwhile, the impact on public sector finances varies by scenario. In the first scenario, where the government builds and subsequently owns the social rent homes, additional public sector net borrowing as a share of gross domestic product should peak in 2032-33 at 0.7 per cent, with the peak in absolute terms coming in 2038-39 at £29 billion in nominal terms. After allowing for inflation, the real terms increase in 2038-39 is £19 billion (2017-18 prices). Subsequently, the impact on net borrowing will decline with improvements to the welfare bill accumulating each year and the government receiving a net rental income stream from housing tenants in new social rent homes who aren't receiving housing benefit.

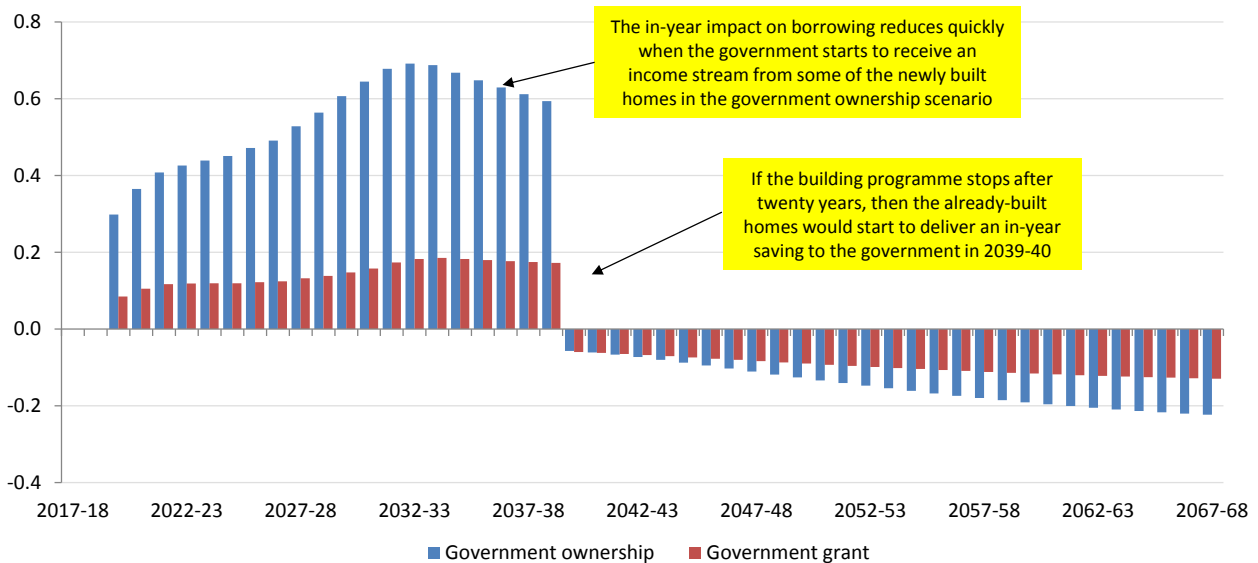
In the second scenario, where the government provides grant funding for housing associations to build the new homes, the impact on public sector net borrowing as a share of gross domestic product should peak in 2033-34 at an additional 0.2 per cent, with the peak in absolute terms

<sup>43</sup> Our analysis is conducted on the basis that the difference between housing benefit paid to tenants in the private rented sector increases in line with real earnings growth from 2022/23. This is consistent with the Office for Budget Responsibility's assumption in its *July 2018 Fiscal Sustainability Report*.

<sup>44</sup> This only applies to the scenario in which the government builds and subsequently owns all homes.

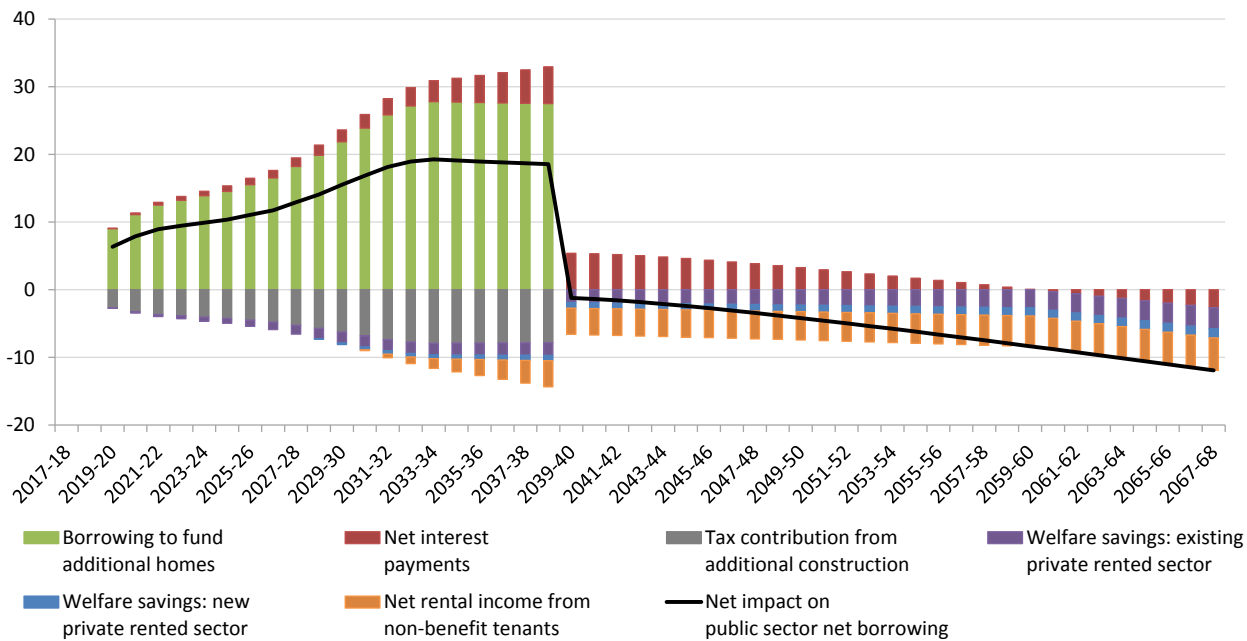
coming in 2038-39 at £8 billion in nominal terms and £5 billion in real terms. Thereafter, its impact starts to decline slowly as improvements to the welfare bill accumulate each year. The policy starts to deliver in-year savings to the government in both scenarios in 2039-40 if we assume that the building programme stops at this point after twenty years. (See Figure 36, Figure 37 and Figure 38.)

**Figure 36: Impact on annual public sector net borrowing as a percentage of nominal gross domestic product**



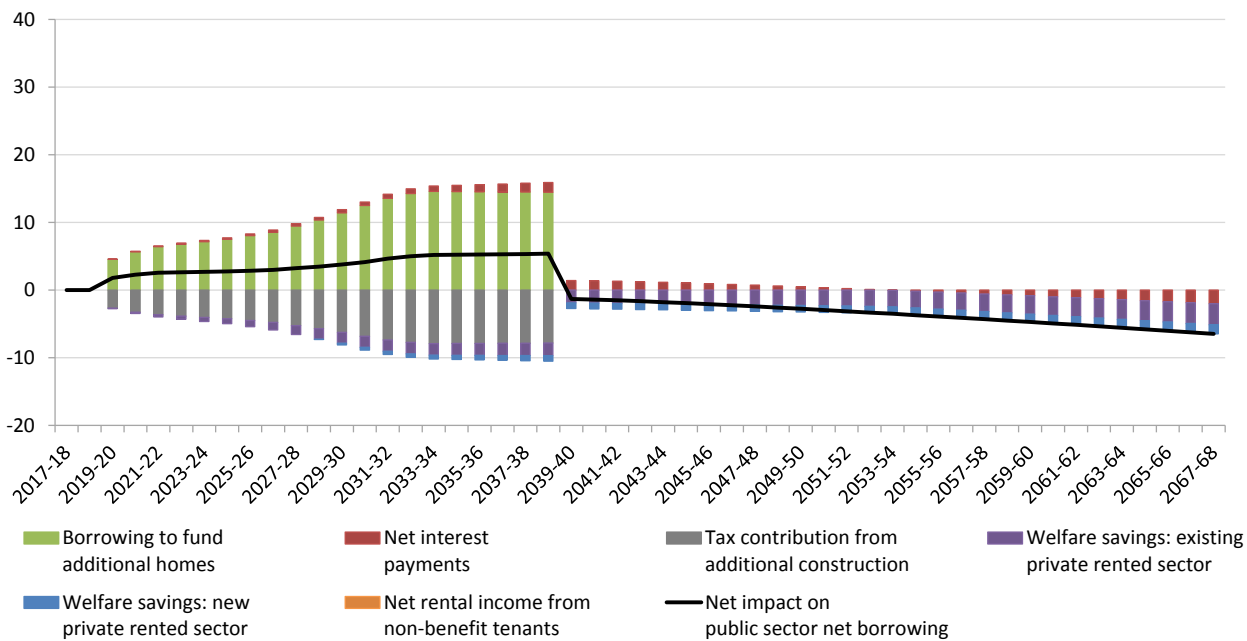
Source: Capital Economics.

Figure 37: Impact on annual public sector net borrowing in the government ownership scenario (£ billions, 2017-18 prices)



Source: Capital Economics

Figure 38: Impact on annual public sector net borrowing in the government grant funded scenario (£ billions, 2017-18 prices)



Source: Capital Economics



The cumulative impact on public sector net borrowing in the periods 2019-20 to 2038-39 and 2019-20 to 2067-68 under each scenario is shown in Figure 39. The cost of building new homes accounts for the bulk of the additional government outlays in each scenario. In the government ownership scenario the tax contribution as a result of additional construction activity is the largest contributor to government coffers in both scenarios in the period to 2038-39; there is no additional contribution after 2038-39 as the social house building programme is assumed to end. In the ownership scenario net rental income is the single biggest contributor to government receipts in the period to 2067-68. In the grant funded scenario the government does not receive the net rental income; welfare savings from housing in the social rented sector the existing number of households that are living in the private rented sector (and are in receipt of housing benefit) are the main source of government receipts.

**Figure 39: Cumulative impact on public sector net borrowing in each scenario (£ billions, current prices)**

	Government ownership scenario (£ billion, current prices)		Government grant-funded scenario (£ billion, current prices)	
	2019-20 to 2038-39	2019-20 to 2067-68	2019-20 to 2038-39	2019-20 to 2067-68
<b>Borrowing to fund construction of additional homes</b>	536	536	280	280
<b>Net interest payments</b>	58	144	15	-4
<b>Sub-total</b>	594	680	295	276
<b>Tax contribution from constructing additional homes</b>	-154	-154	-154	-154
<b>Welfare savings, existing number of households in private rented sector</b>	-33	-192	-33	-192
<b>Welfare savings, newly-formed households otherwise in private rented sector</b>	-8	-77	-8	-77
<b>Net rental income from tenants not receiving housing benefit</b>	-25	-301	0	0
<b>Sub-total</b>	-220	-724	-195	-422
<b>Net impact on public sector net borrowing</b>	373	-44	100	-146

Source: Capital Economics. Note: i) Welfare savings are only for households in receipt of housing benefit; ii) Numbers may not sum due to rounding.

If the building programme is allowed to continue, i.e. the government continues to fund or partially fund the construction of 210,000 new social rent homes each year, then it would take until 2064-65 before the policy delivered in-year savings to the exchequer in the government ownership scenario and it never would in the government grant scenario. This is because only half of the newly built homes deliver ongoing welfare savings for the government.

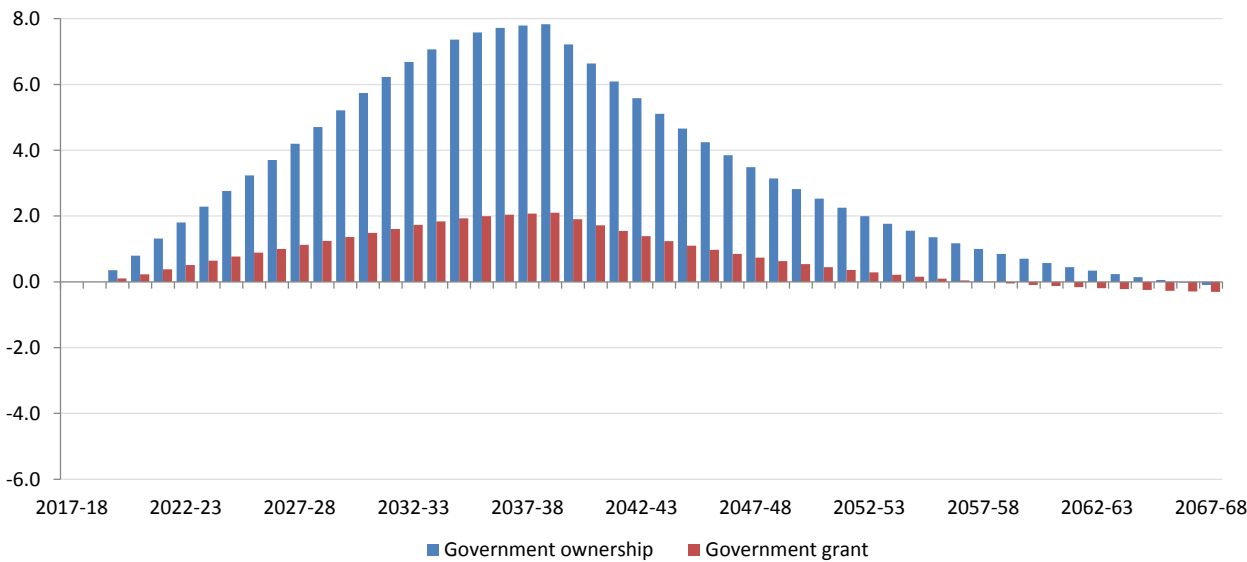
The higher levels of borrowing required in the earliest years of the policy mean that public sector net debt is higher under both scenarios. If the government funds the entire housebuilding programme, public sector net debt in 2038-39 is 7.8 per cent higher than it would be under current policies. It is 2.1 per cent higher in 2038-39 if the policy is to provide grant funding to housing associations. Of course, this measure of debt does not take account of the value of newly created assets that the government would own.

Over the very long term, with the policies delivering annual savings to the exchequer, the level of government debt is 0.1 per cent lower by 2067-68 in the government ownership scenario and 0.3 per cent lower in the government grant scenario. (See Figure 40.)

In absolute terms public sector net debt is £373 billion higher in current prices at its peak in 2038-39 in the government ownership scenario and £100 billion higher in the government grant funded scenario. By 2067-68 public sector net debt is £44 billion lower in current prices in the government ownership scenario and £146 billion lower in the government grant funded scenario. (See Figure 41.)

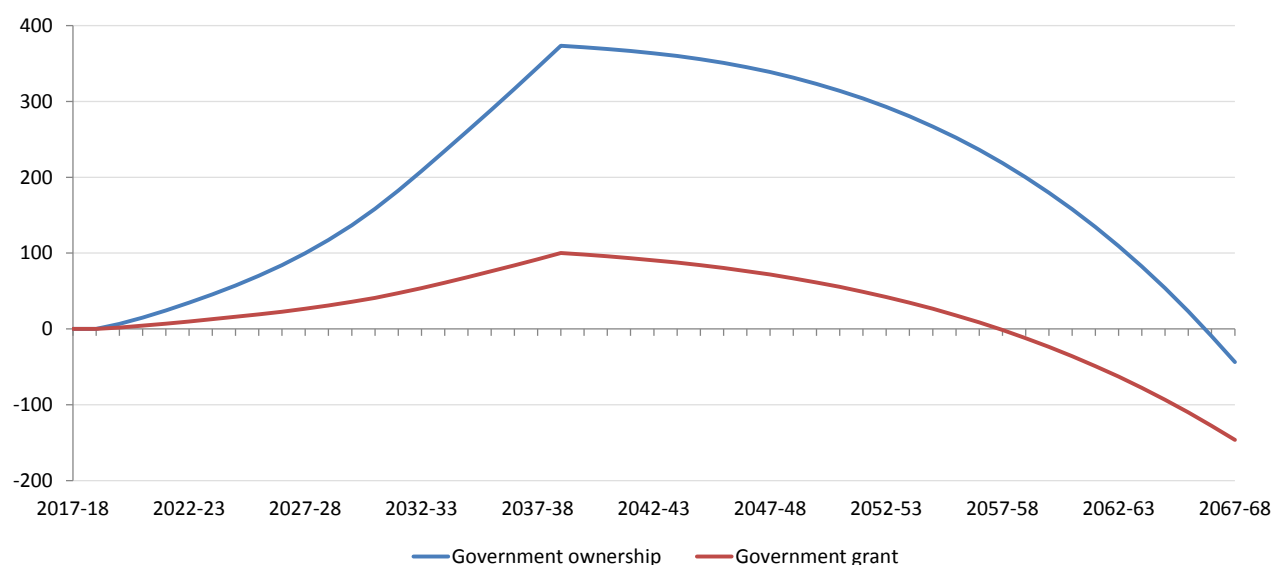
After allowing for the effect of inflation, the real terms (2017-18 prices) peak increases in public sector net debt in 2038-39 are £243 billion and £65 billion, respectively. The real terms decreases in 2067-68 are £15 billion and £51 billion, respectively. (See Figure 42.)

**Figure 40: Difference in public sector net debt in each scenario as a share of baseline public sector net debt (per cent)**



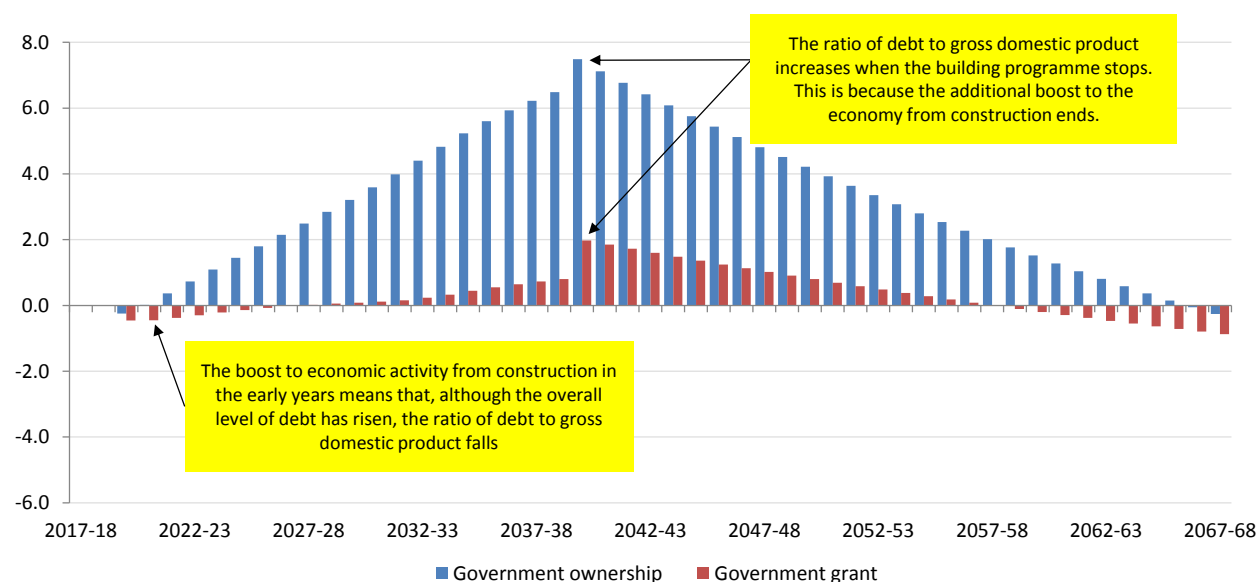
Source: Capital Economics

**Figure 41: Difference in level of public sector net debt compared with baseline in each scenario (£ billions, current prices)**



Source: Capital Economics

**Figure 42: Difference in level of public sector net debt compared with baseline in each scenario (£ billions, 2017-18 prices)**

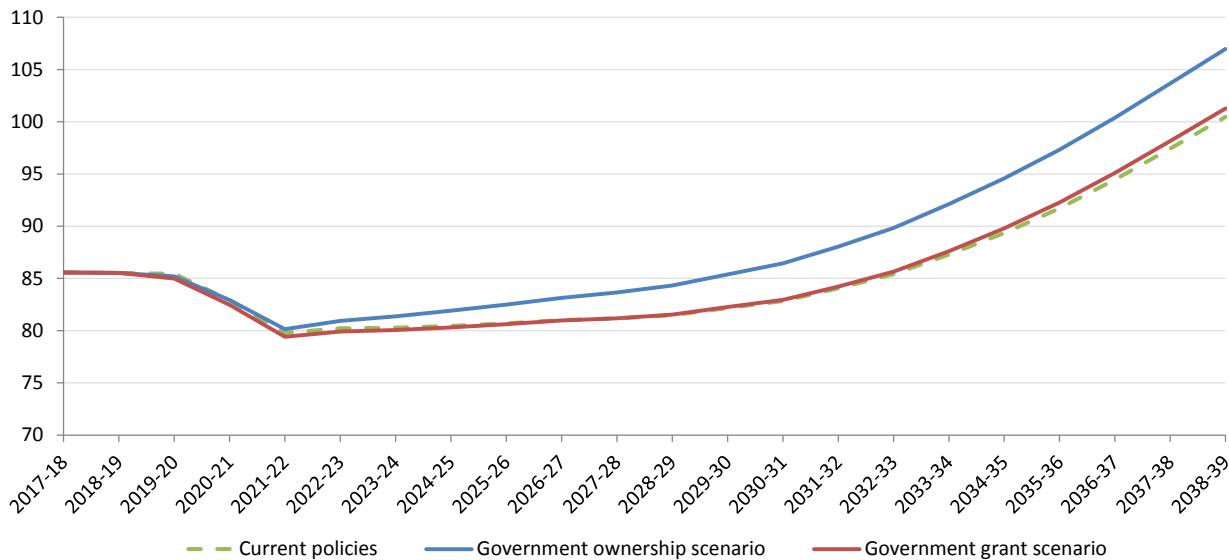


Source: Capital Economics

As a share of gross domestic product, public sector net debt is 6.5 percentage points higher in 2038-39 if the government funds the entire housebuilding programme than it would be under current policies and 0.8 percentage points higher if the policy is to provide grant funding to housing

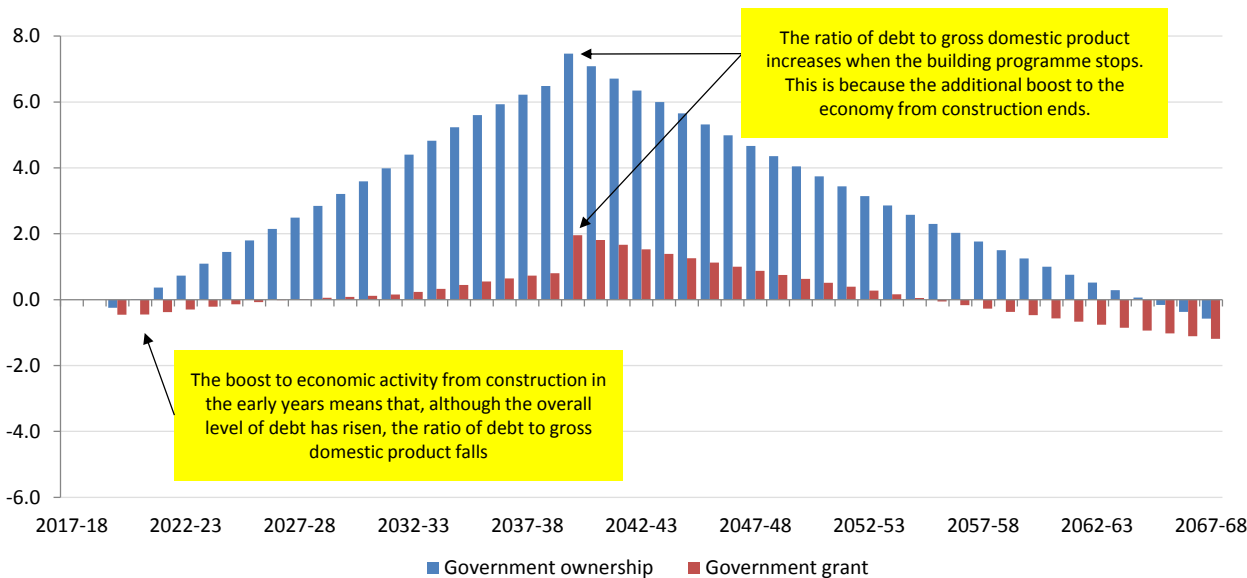
associations. By 2067-68 it is 0.3 percentage points lower in the government ownership scenario and 0.9 percentage points lower in the government grant scenario. (See Figure 43 and Figure 44.)

Figure 43: Public sector net debt as a percentage of nominal gross domestic product



Source: Capital Economics.

Figure 44: Difference in public sector net debt as a share of gross domestic product in each scenario compared to the baseline (percentage points)



Source: Capital Economics

In our analysis we have made the assumption that the additional government borrowing would not have an impact on the interest rate that debt is issued at. This is because any change is likely to be minimal. We have previously interviewed key individuals in the London bond markets and many said that they would welcome further borrowing if it were to invest sensibly into infrastructure or housing.<sup>45</sup> What's more, there is concern that the nation's dysfunctional housing market, in London in particular, is eroding economic competitiveness.<sup>46</sup> As such, it is likely that markets would welcome this additional borrowing.

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<sup>45</sup> Capital Economics, *Let's get building: The view from the City* (Capital Economics, London), 2012.

<sup>46</sup> The City of London Corporation response to Budget 2015 available at <http://news.cityoflondon.gov.uk/city-of-london-corporation-response-to-budget-2015>