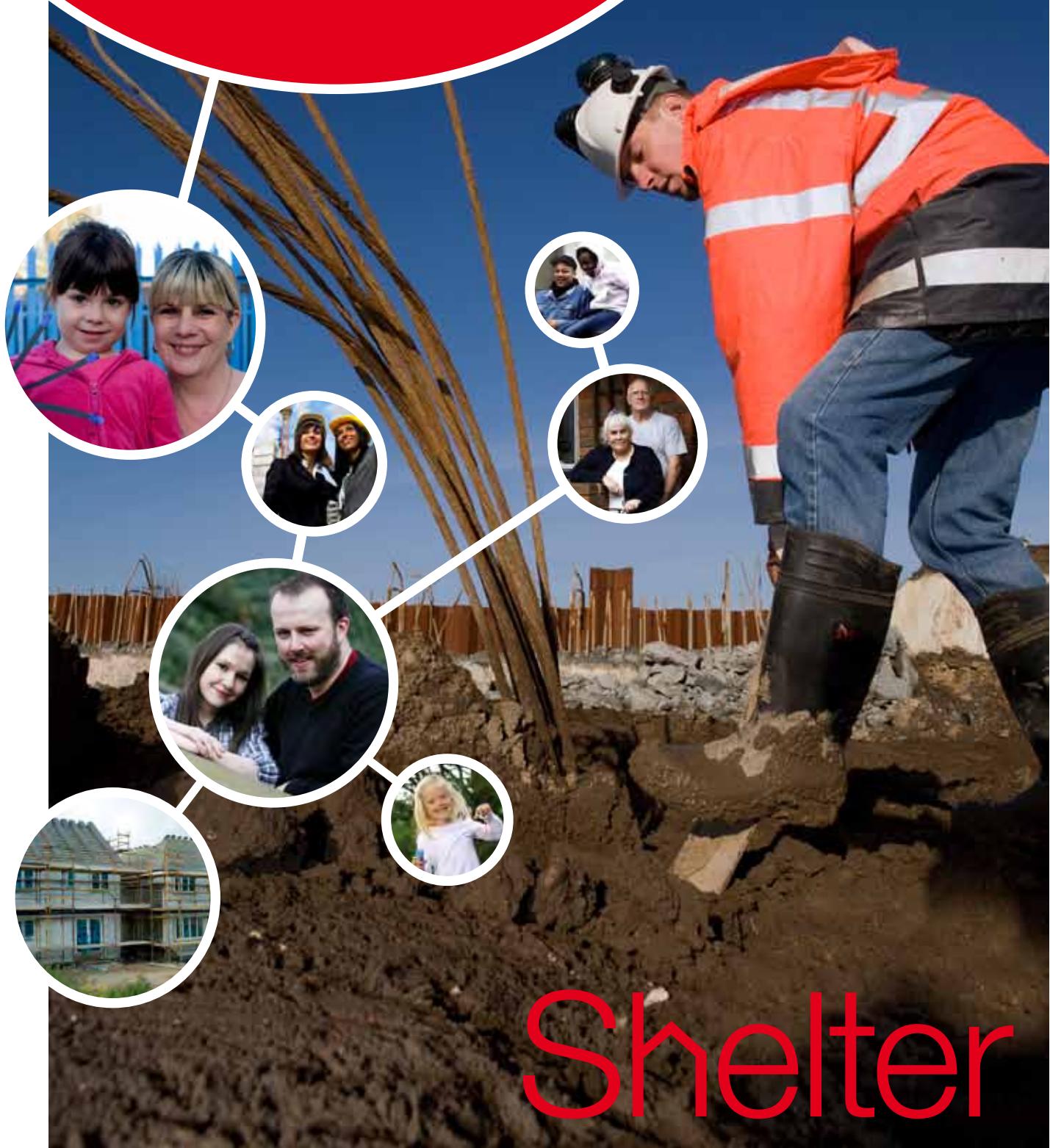


# Ground breaking

New ideas on housing delivery



**Ground breaking**  
**New ideas on housing delivery**

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To protect the identity of the individuals and families featured in this publication, models have been used in all photographs.



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# Foreword

We are in the midst of the worst economic downturn for decades. The impacts of the credit crunch and the recession on the housing market are being felt across the country, from job losses in the construction industry, to a dramatic fall in housebuilding.

Behind these headlines are the individual stories of people being repossessed, struggling to find a decent, affordable home, or suffering in overcrowded or temporary accommodation. These stories paint a devastating picture of unmet housing need.

It is clear that we must act now to ensure that the supply of new homes continues throughout the downturn and beyond. Across the housing sector, from central and local government to social and private developers, people are looking for a way forward. Shelter believes that the sector must work together, as a matter of urgency and necessity, to find solutions to how we can deliver more homes in new and more sustainable ways.

To contribute to this vital discussion, Shelter asked leading figures in the housing sector to think about two issues: what new delivery models might supply more homes and help balance out the instabilities of the housing market, and how the housing sector needs to work together to implement these new models.

This publication highlights a number of possible answers to these questions. Just as critically, we hope that it will provide a springboard for all parts of the housebuilding sector to develop and trial innovative approaches to housing delivery.

Through our advice and support services, Shelter sees the negative impact of housing need on our clients everyday. We are determined to help reinvigorate housing delivery so that this recession does not deny another generation a decent, affordable home.

A handwritten signature in black ink, appearing to read "Sam Younger".

**Sam Younger**  
Chief Executive, Shelter



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## Breaking new ground

Shelter believes that everyone deserves a decent home. Now is the time to rethink how we deliver the homes this country desperately needs.

When Shelter launched the Now is the Time campaign in June 2008, the impact of the credit crunch on the housing market was only just beginning to emerge. At that time we highlighted the harsh legacy of the boom years: people struggling to meet high housing costs, people trapped in bad housing, and the growing divide between the housing haves and have-nots. Our campaign stressed the need to build more homes as one of the ways to address the affordability crisis. We called for the Government to build more social rented housing and low-cost homes in mixed, sustainable communities, as part of its commitment to deliver three million new homes by 2020.

Although much has changed over the last year, two things remain constant: there are still not enough homes and there are increasing numbers of people in housing need.

■ **The chronic undersupply of new homes continues to affect housing affordability and choices.** Until the downturn, housing output had been increasing steadily, but was still falling short of meeting housing need. The long-term undersupply of new housing has been one of the factors fuelling rising house values and has forced a substantial number of people to suffer in poor quality, overcrowded, and temporary accommodation. Too many households have very little choice over the location of their home, affecting their ability to live near work and family, as well as the affordability of their rent or mortgage payments.<sup>1</sup>

■ **There are growing numbers of people in housing need.** Housing waiting lists provide the starker evidence of the extent of this need. In April 2008 there were nearly 1.8 million households on social housing waiting lists in England.<sup>2</sup> This figure is expected to increase as the recession continues. Shelter's recent research on housing need predicts that the collapse in housebuilding due to the economic downturn, combined with newly arising need and demand for homes, means that there will be a shortfall of almost one million homes by 2020.<sup>3</sup>

### The downturn has had a severe impact on the housing market

At any other time the basic economic concept of demand outstripping supply would be a boon for the housing industry. Yet the impact on housing output of continuing uncertainty in the financial markets and the lack of access to development and mortgage finance highlights some of the systemic complexities and interdependencies at play

**'Although much has changed over the last year, two things remain constant: there are still not enough homes and there are increasing numbers of people in housing need.'**



around housing delivery – building more homes is not simply a numbers game.

What has become clear over the last few months is that we need to develop more resilient approaches to housing delivery, in particular to deliver much needed affordable homes. Capturing increases in house and land values through Section 106 agreements and cross-subsidisation from market housing to fund affordable housing made sense when the market was booming. However, the collapse in activity in the housebuilding sector has shown that these approaches are unsustainable when economic conditions decline.

A snapshot of the housing market shows just how shaky the situation is.

- From their peak in January 2008, house prices in England and Wales had fallen 17 per cent by February 2009.<sup>4</sup> It is uncertain by how much they will continue to fall.
- Mortgage lending has seen an even more significant decline. Mortgage approvals in the UK fell from a peak of nearly 137,000 in May 2007 to around 20,500 by January 2009, although there was a rally to 46,500 in March 2009.<sup>5</sup> Where mortgages can be secured, lenders are requiring larger deposits and lending smaller overall amounts.
- New housebuilding in England is in decline. In 2008/09, only 107,800 private market homes were completed, compared to just over 143,500 in 2007/08. The picture for social housing was slightly different, with around 25,900 completions in 2008/09 compared to just over 23,400

in 2007/08<sup>6</sup>, because of building programmes that were already underway. However, the number of social homes built in 2009 is expected to fall, together with a further decline in private housing delivery. Some commentators have estimated that the total number of private housing completions in the UK will drop to 80,000 in 2009.<sup>7</sup>

#### The current picture

To understand the current situation, it is important to recognise how we got here. For the decade up to the downturn, the UK enjoyed a booming economy and rising house values. An increasing number of people were attracted into home ownership through readily available finance and the common belief that property was a secure investment that would continue to appreciate in value.

During this period housing issues moved high up the political agenda for the first time in years. In response to growing concerns about the shortage of housing in the UK, the Government commissioned the Barker Review of Housing Supply, which provided clear evidence that a long-term trend of increasing house values had created problems around housing affordability. The review recommended a substantial increase in the number of new homes being built as one of a range of ways of addressing this.

In 2007, the Housing Green Paper, *Homes for the future: more affordable, more sustainable*, recognised that housing supply had not kept pace with demand, that growing numbers of people lived in poor quality, unsuitable conditions, and increasing house values meant that first-time buyers were struggling to get on the housing ladder. The overarching response to these and other issues put forward in the Green

Paper was the Government's commitment to build three million new homes by 2020. As part of this target the number of social rented homes built would increase to 45,000 per annum by 2010/11.

Shelter, along with many other organisations, welcomed the renewed emphasis on addressing housing affordability and quality through an increase in supply. The then positive economic outlook meant that there was no reason to question the assumption that the Government's policy goals, such as raising development standards and building more affordable homes, could be funded largely by leveraging planning gain and harnessing profit from private development through Section 106 agreements.

Now, in contrast, falling land values and a lack of access to credit on affordable terms for developers and would-be buyers mean there is currently little ability or incentive to build more homes. With so little new development, much needed affordable homes are not being delivered through Section 106 agreements. Equally, the same market forces are undermining social developers' ability to use proceeds from the sale of shared ownership and market housing to subsidise affordable housing.

The longer-term prognosis for housing supply and affordability is equally worrying. When the upturn comes, there is a very real risk that unfulfilled housing demand will drive up house values once again. The hiatus in housing delivery during the downturn is likely to constrain further the ability of people to access a decent, affordable home.

History tells us that even when the economy recovers we should not expect housebuilding to pick up at the same pace. After the 1990s recession, housing output did not return to its former levels until 2001, and did not increase significantly until after 2004. While a number of factors affected the sector's recovery, a key constraint was the loss of skills and capacity during the downturn, with many of those who lost their job never returning to the sector. During the last year, there have been more than 100,000 redundancies in the construction industry. The Local Government Association<sup>8</sup> estimates that between 2008 and 2010, employment in the construction industry will decline by 20 per cent – a higher proportion than in any other sector and equivalent to around 447,000 job losses.

Another potential brake on delivery during the recovery is the planning system. Both the Barker Review and the Killian Pretty Review of the planning application process, highlighted that the planning system was a significant constraint on housing supply: from insufficient land being identified for housing development, to the complexity of the system and the time taken for planning applications to be decided. Without action to simplify the national planning policy framework and the planning application process, there is a risk that the current issues with the system will affect the house building sector's ability to increase the supply of new homes in the recovery period and beyond.

Despite the current gloom, there are several reasons for optimism about the future. Most important is the continued consensus that we need to deliver a substantial number of new homes over the long term. It may also be that the current crisis will help us tackle some of the fundamental issues

within the housing market. Many in the sector are already working to answer the question: if existing approaches to housing delivery are not functioning, what approaches might work better?

#### Purpose of this publication

Shelter wants to engage actively in this vital discussion by helping to identify and promote promising new approaches to housing development. We are committed to increasing the supply of affordable homes in places where people can thrive by ensuring that more homes of all tenures are built. With this publication, we intend to contribute towards this goal by providing a forum for a range of contributors to present their thinking on new approaches to housing delivery. As such, the opinions and ideas presented do not necessarily reflect Shelter's views, but they do provide a variety of models for how we might go about rethinking housing delivery in this country.

We asked the authors to acknowledge but step back from the extreme challenges of the current economic situation and think instead about how we need to adapt both our beliefs and practices around housing delivery to support the sustainable delivery of new homes over the long term. We wanted to enable rather than constrain contributors' ideas and so we provided a limited brief for the articles. The underlying premise for all of the contributions was to think about the delivery of affordable housing, but within the context of the wider housing market.

From rethinking issues around development finance, flexible tenure, and the private rented sector, to the role of private and social developers and local authorities in development, the contributors present practical ideas outlining the immediate and longer term actions needed to stimulate housing delivery and to improve the stability of the housing market.



## Key themes from the contributions

The contributors bring different perspectives to the discussion, but there are common themes running through the articles. What this shows is that, despite the uncertain path ahead for the economy and housing sector, key principles around housing delivery over the long term are already beginning to emerge. Collective insights from the articles include:

- **There is a need to open up the sector to enable different providers to deliver affordable and market housing.** This means ensuring that local authorities, private housebuilders and housing associations of all sizes are able to develop new homes. Potential barriers to this include access to grant funding and public sector borrowing rules for local authorities, and uncertainty about the cost of regulatory requirements for private developers. The Government needs to review and, where appropriate, address these issues.
- **The housebuilding sector must collaborate to maintain housing delivery.** There is a need for different parts of the sector to cross traditional boundaries and forge new, innovative partnerships now and over the long term. Examples include RSLs working with private developers to build private rented housing using funding from institutional investors, or local authorities entering into joint-ventures with RSLs to deliver affordable and market housing. Flexibility will be the key to successful partnership, with partners adapting their approach to the specific purpose, scale and timeframe of each development.
- **It is vital that tenures such as private renting and low-cost and mutual home ownership are supported and developed alongside the delivery of new homes for social rent and market sale.** This would help diversify people's housing options beyond the choice of either home ownership or social rent, ensure the development of mixed tenure communities and may help to combat the cyclical nature of the housing market.
- **There is a need to utilise new and varied investment opportunities to support housing development.** This will mean designing delivery vehicles that will attract financial support from sources that traditionally have been less likely to fund housebuilding. In what will be a

tight fiscal environment for the foreseeable future, it is critical that housing development is viewed as a long-term investment and that the inherent financial risk and reward of new development is clearly understood and proportionately shared by investment partners. Examples could be attracting private and institutional investors through the introduction of local housing bonds or pension funds investing in the development of mutual home ownership schemes. The Homes and Communities Agency (HCA) is already showing leadership on this by initiating an expression of interest process to attract institutional investment into developing homes for private rent.

■ **It is clear that government action and intervention is essential if housing delivery is to recover and increase.** Over the coming years central Government must use its leadership, policy and investment functions to support housing delivery. An important role for government will be to provide policy and financial backing to enable the housebuilding sector to undertake new and experimental approaches to housing delivery, especially those that will deliver affordable housing. This support needs to come from all levels of the Government, from ministers, to the HCA. Recent Budget announcements, including the allocation of £100 million for local authorities to bid for extra funding to deliver new homes for social rent, has demonstrated the Government's willingness to provide additional support for housebuilding, but more still needs to be done.

■ **It is fundamental that work continues on addressing longstanding issues that affect the delivery of new housing,** including improving the efficiency of the planning system and the rules around the disposal of public-sector land at below-market values for housing development.

■ **There are a number of promising ways that local authorities can commit to building more homes,** including undertaking development themselves, entering into joint ventures such as local housing companies, or underwriting initiatives to unlock funding for development. Many local authorities have expressed a strong interest in supporting their development programmes using the new £100 million funding allocation announced in the Budget.

## Where to from here?

This publication introduces new ideas on some of the ways to deliver much needed new, and in particular affordable, housing. In the difficult times ahead, more and different approaches to partnership-working, funding models and tenure will undoubtedly emerge to maintain housing delivery.

We must take inspiration and learn from the proven resilience of the housebuilding sector. The sector has always come through previous recessions, but it has never emerged in the same form as it entered them. Bouncing back from the double blow of the credit crunch and the recession presents some unprecedented challenges and opportunities for housing delivery.

So, while it is critical that all parts of the sector – central Government, private and social sector developers, and local authorities – focus their collective attention and thought onto how we continue to build new homes, it is even more important that these new ideas and approaches are put into practice immediately. It is only by taking action on housing delivery now that we can ensure that, over the long term, everyone has a decent, affordable home.



### Notes

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**'Many in the sector are already working to answer the question: if existing approaches to housing delivery are not functioning, what approaches might work better?'**

# No turning back

Toby Lloyd of Navigant Consulting considers a radically different future for the housebuilding sector.

## The changing world of housing delivery

The credit crunch and the ensuing market downturn have fundamentally undermined not only the dominant model for private residential development, but the primary mechanisms for delivering affordable housing and wider regeneration as well. After a decade of historically low levels of housebuilding, completions were picking up by 2004 and by 2007 had reached a peak of around 175,000 per year in England, fuelled largely by the buy-to-let boom and the revival of inner-city living in London and other core cities over the last 15 years. However, this peak was still well below the Government's target of 240,000 new homes per year and the last peak of 200,000 in 1988 – let alone the level of supply achieved in the mid 1960s, when annual completions consistently exceeded 300,000 homes. Now that the market has crashed, it is questionable whether even 80,000 homes will be built this year and next. The major private housebuilding firms, which have come to dominate the market after a wave of mergers and acquisitions, are all in trouble and retrenching fast.

Many housebuilding registered social landlords (RSLs) are facing the same difficulties in finding credit as the private developers. RSLs, like other businesses involved in development, require banking finance and lending, the availability and cost of which have become deeply problematic. RSLs' business models have become highly dependent on cross-subsidising social housing from low-cost home ownership (LCHO) products, but this model has been undermined by the reluctance of the banks to provide mortgages for LCHO purchasers.

This is not a market correction that will soon right itself – an entire business model may be dying out. The urban-flats mode of construction, with its high upfront capital costs, depended heavily on cheap credit and pre-sales – mainly to buy-to-let investors confident of future capital growth. Both these sources of cash have dried up and show no sign of returning. Some large housebuilders may go bust. Some may already be technically insolvent, as the lack of sales and the falling value of their land banks mean they are in danger of breaching their banking covenants. They are being kept alive by the banks, who do not want to foreclose on these assets because to do so would crystallise the losses. Both shareholders and creditors stand to gain by mothballing sites and hoping for an upturn.

The RSLs may not receive such favourable treatment, because the knowledge that the Government will ultimately stand behind them means that they can be more readily squeezed by their creditors. Several large, well-known RSLs are struggling to keep afloat and some may be forced into emergency mergers. All are concentrating on their existing stock and curtailing ambitions for new build.

The combination of hibernating developers and retrenching RSLs may mean we find ourselves in the worst of all worlds: a moribund housebuilding industry with no one to administer the coup de grâce that would release sites for others to build on. Only significant intervention by the public sector can prevent the nightmare scenario of a mothballed development industry waiting for a return to unaffordable house prices.

This context is hugely challenging, but it also presents huge opportunities. The time is ripe for developing innovative approaches to housing and regeneration investment that can adapt to the new market environment, appeal to the new institutional actors, and above all, avoid the mistakes of the past decades. Overall, new approaches must offer a positive vision for the long-term and sustainable transformation of homes and neighbourhoods.

There is no need to mourn the potential death of the typical housebuilder model – after all, it singularly failed to deliver the number or the quality of homes we need during years of record house-price growth and profits. We now need an active and enabling public sector to take the lead, direct the market, and shape the pattern of development for the future. If the public sector as a whole can seize the moment for action now, it could remake the market and define the types of players we want to see active in it for decades to come.

To shape a new housebuilding and development sector, the aim of public intervention should be simple: to foster a diverse, mixed economy in housing supply. The lesson from history is clear: the private sector delivered the greatest volume of homes when the public sector was also delivering most. In this industry 'crowding out' is not a problem. Diversifying the industry would improve its resilience in the face of future market fluctuations and smooth the peaks and troughs of supply. A greater number of providers in the housing sector would reduce the risks faced by each, lower the barriers to entry, and improve competition in the industry – all of which would be good for the quality of homes produced. But most of all, a diverse mixed economy would



be far more fertile ground for locally responsive innovations around the way housing gets built.

## Public sector-led approaches

The bulk of housing growth is rightly planned for brownfield sites and town centres, with a large proportion scheduled for major regeneration projects in the growth areas. These types of development are particularly difficult for the private sector to deliver because they typically require upfront investment in demolition, environmental clean-up and infrastructure. The credit crunch has rendered many regeneration projects undeliverable under the existing models – and it is in this area above all that the public sector must take the lead and have the confidence to create the market where necessary. This means public sector investment in quality development that is aimed at long-term value creation rather than short-term returns – for example, by providing infrastructure up front or counter-cyclical investment in housebuilding during the downturn. This sort of investment can represent excellent value for money over the long term, but it is expensive in the short term.

Recent events have shown that the private sector alone cannot provide the level of investment that is essential to creating vibrant new places and new housing markets. The key here is land supply. Having paid peak prices for sites, developers need high sale prices if their schemes are to be viable: when prices fall they have to stop building. Even when property prices were soaring, the process of competitive bidding for scarce sites meant that expected value gains from development were capitalised into the land price. Developers must estimate the value they will get from building out a site in order to make a viable offer to the land owner. The bidder with the most optimistic estimate will come in with the highest offer and win the site, which means that even before any work has started most of the value has been captured by the land owner, and the developer is exposed to the risk that the market will turn between buying the site and selling the homes.

In other words, the market drives land prices upwards during the good times, but little of this value goes to support infrastructure or public goods. When house prices fall, land values plummet even faster, so in theory a greater proportion of development value should be available for infrastructure. However, in practice, when land values fall, the market shuts down and sites are not released or developed – a classic

case of market failure. In these market conditions, public sector intervention is needed to bring sites forward and keep development going. Compulsory purchase of sites would be unpopular with land owners, but there is a strong financial and public-interest case for doing so. After all, land bought at the bottom of the slump should be a good investment in the long term. Acquiring land with compulsory purchase orders would force the land market to find a new floor and enable developers to start building again, but doing so requires decisive action by powerful public sector agencies that are not afraid to take risks – and the public sector has not demonstrated this sort of will power for many years.

The slow and patchy delivery of the Thames Gateway development shows how fragmented, under-resourced 'partnership' arrangements were failing even before the crunch. We should look instead to our European neighbours and our own past for lessons on how to deliver large-scale residential developments quickly and to a higher standard. Architects PRP and URBED recently studied six such developments in Ireland, the Netherlands, Germany and Sweden, all of which have far exceeded the UK in terms of the quantity, size and quality of the homes built.<sup>9</sup> The message from these examples is clear: success requires leadership by strong municipal authorities that either own or acquire the land, lead the planning process, and provide the necessary infrastructure. Private and non-profit companies may be involved from day one, but there is a clear public sector led vision that all participants must sign up to. Publicly owned regional development banks are often a key feature of this model, providing long-term finance for infrastructure and housing growth backed by bonds.

Once the overall masterplan and the enabling infrastructure is in place, land parcels can be handed on to delivery partners on the ground, whether these are retained in public ownership, leased under licence, gifted or sold. Dividing large sites into smaller land parcels, rather than leaving them to a single large housebuilder, will help increase quality and rates of delivery through competition and because different developers can sell into different submarkets.

There is nothing inherently 'un-British' about this model. It is essentially the same as that which built the New Towns between 1946 and 1970. These were built on agricultural land beyond the designated green belts of the older cities they surround. The powerful New Town Development

Corporations purchased land at agricultural prices and provided infrastructure with Treasury-bond finance, issued planning permissions and used the resulting uplift in land value to repay the loans. The New Towns' mixed reputation today, due largely to their car-centred urban design and social policy failures, should not overshadow the success of the delivery model. The 21 New Towns built in England alone are now home to more than two million people, and the entire programme was largely self funding.

#### A return to local authority housebuilding?

Housebuilding by local authorities is the most obvious example of a return to public-sector leadership. Under proposals recently announced by the former Housing Minister Margaret Beckett,<sup>10</sup> local authorities would be able to keep all the rental income from any homes they build, as well as the revenue from any of the homes that are later sold through the Right to Buy. This would remove some of the barriers to local authorities providing housing from their own resources. The Budget also provided a small but symbolically significant fund of £100m to support local authorities that wish to build new social housing.

In theory, the prudential borrowing rules would enable local authorities to borrow on the back of the rental income from council housing (that is, homes built by a local authority). At present the nature of the Housing Revenue Account (HRA) makes such borrowing complex and the scale of prudential borrowing is too small to support the major capital investment required for housebuilding. More substantial local authority borrowing has long been precluded by the Government's fiscal rules, but these could change in the wake of the credit crunch.

If the Government were to adopt the financial rules common in Europe, it would open the door to direct local authority borrowing to finance housing provision. The UK fiscal rules, which have constrained public borrowing until recently, relate to the entire public sector, but under the European system the rules relate only to 'general government' and do not restrict borrowing by public corporations (ie trading bodies owned or controlled by government).<sup>11</sup> Borrowing for expenditure on council housing would then count as part of the 'public corporate sector', rather than as part of the local government sector, whether it is under the direct management of the council or by an arm's length management organisation (ALMO).

While a return to local authority housebuilding is attractive to many local authorities and housing campaigners, its realisation remains a long way off. Local authorities cannot currently apply for social housing grant beyond the token £100m announced in the Budget. Few authorities currently have the in-house capacity to deliver development directly, and any new systems to support local authority housebuilding will take time to establish. A change of government could also derail any move back to large-scale local authority housing provision.

A further consideration is that any new generation of council housing is unlikely to create the same secure tenancies that existing council tenants have. Although the details of any tenancy reform are as yet unclear, the Government's response to the Hills report into social housing<sup>12</sup> and the Law

Commissions' proposed tenancy reforms<sup>13</sup> make the general direction of policy thinking clear: in the near future, all new social housing (whether built and managed by RSLs or local authorities) will operate under the same type of tenancy, with less security for tenants than is currently offered by local authority owned social housing. This will remove one of the main policy drivers behind a return to housebuilding by local authorities and a key distinction between RSL and local authority-owned housing.

For the foreseeable future then, affordable housing will continue to be provided mainly by private companies and RSLs, albeit with opportunities for stronger local authority involvement. It is important not to allow the prospect of a new era of council housing to distract attention from the needs and opportunities of the present, especially given the short window during which public money may be available.

#### Joint ventures

If the public sector as a whole is to take on new leadership roles within housing delivery, it will have to take its share of both the risks and rewards of development. After decades of steady disempowerment, local authorities in particular will need time to improve their capacity and skills. At the same time, market contraction means that many of these skills are now available in the private and RSL sectors, and companies are keen to find less risky approaches to development. The time is clearly right for properly designed joint ventures between local authorities and private/RSL developers to make a serious contribution, both to developing through the downturn and to building a new mixed economy in which public, private and non-profit sectors all contribute to housing provision. Combining private sector skills and finance with public sector land and powers provides all the necessary ingredients for efficient and high-quality development – providing we get the deal right.

In the past, too many partnerships have become bogged down in legal and regulatory minutiae, game-playing and mistrust. Complex overage agreements on regeneration schemes are a case in point: despite years of careful, and expensive, negotiation few ever seem to pay out. But the rules of the game have fundamentally changed, for both parties: no longer can the public sector expect a free ride on the back of development gain, nor can the private sector treat the public sector as a bureaucratic obstacle to be evaded for the sake of fast profits. When property and land values are stagnant or falling, the only option is long-term investment in value creation. Both sides now share a direct interest in building the best homes possible, making successful joint ventures a more realistic prospect.

The local housing company (LHC) model launched in the 2007 Housing Green Paper proposed a straightforward 50:50 partnership between a private firm and a local authority. The authority would contribute land to the vehicle, while the private partner would invest an equivalent value in cash. The LHC would then develop the sites to a pre-agreed plan, with the risks and rewards shared between the investor partners. This simple model looked set to take off in 2008 because a series of local authorities announced plans to set up LHCs. Interestingly, the private firms that came forward were not the major housebuilders, or those operating on



the standard business model. The offer of a long-term partnership with a local authority that could reduce the risk of development attracted a range of players, from more traditional contractors and innovative start-up developers, to new entrants from outside the UK. Unfortunately, and despite initial progress by a few local authorities, the implementation of the scheme appears to have become stuck between the rock of Treasury fiscal rules and the hard place that is the current market. If the accounting quibbles about whether an LHC's financing would be on or off the public balance sheet can be resolved, this approach could make a real contribution to the new mixed economy.

We can also expect to see new types of public/non-profit joint ventures emerging. RSLs are often best placed to partner with local authorities, especially in areas needing regeneration in which a single RSL has significant assets, because their functions include housing and neighbourhood management as well as development. An RSL/local authority joint venture would be similar in many ways to an LHC, the primary difference being that its activities could encompass refurbishment and housing management, and the development of non-housing assets such as community facilities and retail space.

#### Institutional investment

Of course, one of the main reasons for partnering with the private sector is access to private finance, which is looking scarce at present. Private debt finance is even harder to come by, which makes the holy grail of institutional investment all the more alluring. The absence of long-term investment in residential development by pension funds and other similar investments has long been a UK anomaly. In much of the world, residential is a standard investment class, and in some countries, pension funds are actually required to hold a proportion of their assets in housing developments. This is not only a potentially huge source of investment finance, it is exactly the right sort of patient equity capital that a sustainable development industry needs.

Institutional investors such as pension funds do not want the high risks of gambling on house prices: they need steady, predictable earnings linked to long-term economic trends. In other words, they want rent. Attracting institutional money requires large-scale build-to-let private rental accommodation, of the kind found around the world. While

it is hard to see private investment supporting strictly social housing, except as the price of planning permission, there is plenty of scope for private rental developments to include intermediate rents of different levels.

Institutional investors want quality homes because they intend to own and manage them for many years. This means their involvement should shift the incentives in housebuilding towards good design and environmental performance. Institutions also want to be good landlords – no insurance or pension fund wants to damage its reputation through poor treatment of its tenants. Greater protection and longer tenancies for private tenants would help give investors confidence. Contrary to expectations, the Budget failed to provide the changes to stamp duty and real estate investment trust rules that the investment industry says it needs to get involved in large-scale housing provision. But the HCA remains committed to encouraging this model and is seeking expressions of interest: we can expect to see some major build-to-let developments over the next year or so, with some degree of public support.

None of the models outlined above purports to be the solution to the complex array of problems the UK's housing sector currently faces, but some of them may hold part of the answer. Our diverse society requires a mixed housing economy, and there has never been a better time to build one. The current crisis is an opportunity to challenge established assumptions about how development should be done and allow alternative models to contribute what they can. Let a hundred flowers bloom.

#### Notes

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## Flexible housing

Richard Bayley, Director of Research and Planning at Places for People, explores the future of affordable housing development and finds an answer in flexible tenure.

This is an interesting time for any industry, even more so the residential housing sector, which has the task of delivering one of society's greatest necessities – good quality housing.

As the industry considers its position, the question on everyone's minds is: is this just another phase in the old 'boom and bust' cycle or could this be the start of a new era? The combination of tighter regulation in the financial sector, higher levels of government debt, and increasing pressure on housing affordability suggests it might be the latter, in which case the housing sector should explore the opportunities that this new era offers. Even if it turns out to be the former, the industry needs to find ways to make the delivery of new affordable housing viable in the context of lower government funding settlements.

In responding to these challenges, the Government needs to be flexible in its definition of what constitutes affordable housing; to develop a policy framework that provides financial incentives to build new homes and recycle existing stock; and to ensure that it properly coordinates the way it plans and operates at both regional and local levels.

### Affordability crisis

In her 2005 review of housing supply, Kate Barker highlighted the link between new housing production and affordability. Irrespective of whether the Government's estimates of population and household growth are accurate, the trends point clearly to sustained growth in the demand for housing. In contrast, the outlook for the production of new housing looks bleak. Rates of delivery in the short term are likely to be substantially lower than in the last two years, and in the longer term they are unlikely to recover to meet the growth in demand.

Although the market is currently experiencing a short-term improvement in affordability because of the fall in house prices, this is temporary because the demand/supply imbalance is likely to drive prices back up over the medium and longer term. Moreover, tighter regulation in the financial sector and higher levels of future government debt are going to restrict both the availability of credit and government grants or subsidy that can be used to correct this imbalance.

Affordability is likely to impact not just on first-time buyers, but also young families and older people. While various surveys continue to show that people's aspiration is to own their own home, it is likely that economic realities will lead these groups of people to accept that partial ownership or even renting will have to be their long-term housing strategy.

### The flexible-tenure model

So, what does all this mean for the residential housing sector? Essentially it means that mixed-tenure communities are not just a policy imperative for the Government, but an absolute necessity. An increasing number of people at different stages in their lives are not going to be able to afford their homes outright. In order to address that situation, the Government needs to be more flexible in its definition of, and subsequent investment into, affordable housing. This is where flexible tenure comes in.

The idea of flexible tenure is not new. The concept means that a property intended for a particular tenure can change to a different tenure according to the circumstances of the residents (both existing and new). For example, families and older people might find themselves in a financial position that requires them to revert to some form of renting or to trade some of their existing equity to release funds. What is missing from the current range of equity release or rental products is an ongoing management arrangement between the provider and the residents and their homes.

Although many new developments start with a mix of different tenures, the economic reality both for residents and developers is likely to necessitate the application of flexible tenure on an ongoing basis. This will require the residential sector to develop a model that has a long-term equity stake in both new and existing developments. It also requires the Government to put in place a planning and funding system that is capable of supporting changes in housing tenures due to adjustments to the amount of equity retained by the resident.

Essentially, the flexible tenure model requires a long-term view to be taken on returns from land investment and greater flexibility in how that land is used throughout the life of the development. This can be achieved through the creation and subsequent management of a property fund over a 20 to 30 year period. The fund would use a combination of equity and debt funding, together with either rental income and/or capital appreciation, to support the costs of holding and managing different types of affordable housing tenures. Subsidy could either be in the form of government equity or debt funding leveraged from public land or a legal guarantee to underpin agreed minimum returns, or a combination of all of the above. This type of fund combines the resources and expertise of the housebuilders, commercial companies, residential management companies including registered social landlords (RSLs), and the Government at national, regional and local levels.

The components of this model already exist; however, the way they need to be deployed is different. Residential management companies will take on a new role in their capacity as fund managers and the Government will need to employ greater flexibility in the application of planning (for example, conversion to and from social housing tenures) and funding over the life of the scheme. Places for People has been discussing the application of such a model with the Homes and Communities Agency (HCA) to kick start some large sites (of around 5,000 new homes) that would otherwise remain dormant. Each of these developments will enable residents to adjust their tenure to their circumstances, while remaining in the same property. The emerging HCA equity-funding approach – whereby the Government invests at the beginning of the development with the expectation that returns will not be forthcoming until much later in the lifetime of the project – is a good start to facilitating flexible tenure, although inevitably there will need to be further innovation and evolution in this area. In particular, the Government will need to find ways of incentivising private institutional funds to invest into these new delivery vehicles, for example through tax breaks.

#### **Policy framework**

For a flexible tenure model to work, the Government needs to create the appropriate housing policy framework to support it. In particular, reform is needed to the current application of revenue subsidy through the housing benefit and housing revenue account (HRA) mechanisms and the corresponding regulatory frameworks for RSLs and local authorities. The Housing Futures Network<sup>14</sup> recently set out some ideas for reform to housing policy along these lines; which are set out below.

Current housing policy restricts people's ability to change their housing situation over the course of their lives. Policy needs to be revised such that it enables, and encourages, people to adjust the tenure or location of their home as their circumstances change. If people decide they want to relocate, then they should also be offered a flexible tenure option in that new location. For this to be achieved, the housing benefit system and the definition of social housing need to be reformed to offer people greater flexibility in their housing choices.

Housing benefit should be structured to incentivise people moving into work and, when they are ready to, own a greater proportion of their home. The former would be achieved through a series of benefit 'run-ons', while the latter would use a combination of tax credits or save-as-you-earn mechanisms together

with revenue guarantees to the landlord that support one-off capital transfers. This would result in more effective use of government funding. In particular, it would free up funds to support disadvantaged households and ensure scarce government funding is available to help people whose situations are likely to be exacerbated through worsening affordability. This could be achieved by focusing housing benefit on the individual consumer through the application of portable allowances that are paid directly to the landlord or management company, so that cash flows and lender confidence are maintained.

In a similar vein, the Government should reform the HRA. The emphasis of policy change needs to be on providing financial incentives (eg higher HRA settlements) for local authorities to apply their funding in ways that could help develop new mixed neighbourhoods, as well as maintaining those already in existence. Government policy should ensure that local authorities are rewarded for investing their land into developing new mixed tenure housing schemes, in partnership with others, along the lines of the model outlined above. The Government should offer financial incentives to local authorities to encourage them to develop new mixed communities. Local authorities should implement initiatives that enable people to improve their earning capability, which would diversify the income mix within existing communities.

Changes in government policy need to be underpinned by reforms to the regulatory regime. The forthcoming consultation by the Tenant Services Authority (TSA) on a new regulatory framework offers a unique opportunity to implement a regime that will enable the residential sector to support the future needs of the housing market as a whole. Specifically, the new regulatory framework needs to ensure not only that standards of customer service are delivered, but also that potential operational and financial efficiency gains are achieved.

What the sector also needs is a regulatory formula that, on the one hand, rewards organisations



that are performing well by enabling them to apply their efficiency gains in a more flexible way to the benefit of their current and future customers (eg through flexible tenure products); while, on the other hand, penalising poor customer service and inefficiency. Crucially, all organisations that receive government support or funding, whether they be public or private, must be regulated in a manner that means they operate to the same development and operational standards.

#### **Financial framework**

Current and future financial circumstances within the sector are such that an injection of government equity is a key element in supporting the supply of new affordable housing. It is encouraging that the HCA has developed its thinking on equity funding, particularly in relation to kick-starting housing production during the current downturn. As the economy recovers, there is the potential for the Government to reduce its equity and for new private-equity funding from large institutional investors like pension funds to take over.

The time is now right for the Treasury to consider how it can introduce tax incentives to support the development of new affordable housing. To date, residential real-estate investment trusts (REITs) have not been attractive to institutions because the prospective returns from residential development have been too low compared to other investment options, and the entry costs too high to make it viable. However, a tax incentivised residential investment vehicle could offer an opportunity to increase significantly the scale of funding going into new affordable housing over the medium and long term. In particular, the tax framework would incentivise funds to be retained for a reasonable length of time (say 10 years), while a mix of government equity and rental guarantees would enable the homes delivered by the fund to be made affordable to lower income households.

While tax breaks will almost certainly be necessary to generate the investment returns required, pushing up housing supply to levels that can recreate the existing role of subsidised affordable housing will undoubtedly need the input of institutional funds. The cost of tax breaks would be offset by potential gains to the Government, such as lower costs of temporary accommodation, unemployment benefit costs, higher tax receipts from employment and increased spend in the economy.

The Government is best placed to encourage institutional investors into the residential market. Individual organisations such as RSLs are unlikely to have the leverage to make this

happen by themselves: this needs to be seen as a sector-wide opportunity. The ongoing financing model for delivering new subsidised affordable housing would then become a powerful mix of government equity, private equity and debt funding raised by RSLs.

#### **Stakeholder coordination**

Circumstances are dictating that the residential housing sector and the Government have to improve coordination of policy and delivery. At a national level, there needs to be clear coordination between housing policy and funding (ie between CLG and the Treasury), as outlined above. Similar levels of coordination are required at regional and local levels (ie among regional development agencies and local planning authorities) where, in particular, the planning processes surrounding new infrastructure and residential schemes need to be more efficient. On the delivery side, it is going to be vital that the TSA's new regulatory regime provides effective support for the emerging HCA funding models by building on long-term incentives for public and private sector residential providers.

The application of the policy, funding and delivery framework outlined above will provide the basis for the residential sector to work together in an effective and efficient manner to support the future provision of new affordable housing.

#### **Conclusion**

Times are changing and, whether this turns out to be the start of a new era or a reincarnation of previous recessions, it is very clear that all areas of the residential housing sector, public and private alike, need to work together better to adapt to these new and emerging circumstances.

At the same time, the Government has a crucial role to play in establishing a financial, policy and regulatory framework that incentivises the application of a long-term flexible tenure model for the development of new, and the ongoing management of existing, residential property in the UK.

History will judge whether the models and thoughts set out in this paper are successful, but whatever happens we must avoid delay through continual policy reviews – the residential sector and the Government need to work together now to implement a new framework to develop affordable housing.

#### **Notes**

14. Members include Places for People, Affinity Sutton, London and Quadrant, Gentoo and Riverside housing associations.



## Challenges and opportunities

David Pretty, former Group Chief Executive of Barratt Developments and Chairman of the New Homes Marketing Board, gives a housebuilder's perspective on the challenges and opportunities presented by the current economic crisis, and suggests measures to address and maximise these respectively.

Although I had been predicting a housing and economic downturn for some years prior to the current crisis, few people – myself included – could have forecast just how dramatic it would turn out to be, nor how damaging it would be for the housing sector.

When Gordon Brown became Prime Minister two years ago, he put housing at the centre of his new Government's agenda. The role of Housing Minister was given Cabinet status and a target was set for the industry to create three million new homes by 2020. At the time, most housebuilders were mainly concerned with how to expand their businesses quickly enough to meet that challenging target. Little did they know that in the following months those concerns would become largely irrelevant as the sheer scale of the wider banking and economic crisis unfolded.

### Feast followed by famine

Until the crash, the housebuilding industry had been steadily increasing its capacity and output. Now, almost overnight, it was shedding jobs and closing offices as output slumped. Businesses were quickly resized to match the reduced demand and bleak outlook, with equally profound effects on the contractors and suppliers that housebuilders rely upon.

The biggest impact came from the banking sector whose problems triggered the crash in the first place. The lenders, previously ready to lend freely, suddenly closed their doors due to their new liquidity problems, virtually ending mortgage availability overnight. When that funding dried up, even for credit-worthy buyers with reasonable deposits, so did consumer confidence, exacerbating the downturn. Homeowners have seen the value of their homes plummet and 'for sale' signs and people's aspirations of moving up the housing ladder have virtually disappeared.

Those not on the property ladder already have almost given up trying, making first-time buyers an endangered species. I describe them as the 'new poor' because they are worse off now than at any time in the last 30 years, despite the fact that falling house prices should have worked in their favour. What is more, much as a result of this, waiting lists for social housing are growing at an alarming rate, with the National Housing Federation predicting that the number of people waiting will reach five million by 2010.

No part of the housing market has escaped. It is not only the housebuilders who are suffering: the implications for local authorities, registered social landlords (RSLs) and homelessness charities have also become painfully clear.

Whether or not one agrees with the Government's three million housebuilding target, or the 2020 deadline, it is inescapable and widely accepted that we have been significantly under-delivering on housing for many years, many decades in fact. In so doing we have been storing up significant social issues for the future, as I have pointed out many times over the past 10 years.

Take this sobering statistic: the latest government figures show that the number of households in England is projected to grow to just under 28 million by 2031, a massive increase of 29 per cent on the figures the original three million target was based on. This figure represents an annual increase of 252,000 in household formations. The need to find

solutions to the current constraints on housing supply is frighteningly apparent.

What is also clear is that we will emerge into a different world when this downturn is over. This will pose new challenges for us – challenges for which we must be prepared. We must examine them now, and seek solutions, otherwise our recovery from the downturn – and with it our ability to deliver the range of homes that are needed – will take much longer.

### The challenges facing the housing sector

There are three critical issues challenging the housing sector today: mortgage liquidity, site viability and land availability. Unless these are addressed, there will be no real hope of significantly increasing housing output for years to come.

Mortgage liquidity is currently the most critical issue. Housebuilders can only build homes that people are in a position to buy. Without mortgages that people can realistically afford, this basic equation is insoluble and we will not solve the current crisis. And it is not just the private housing market that the lack of mortgage funding impacts upon. In the past, when local authorities built the majority of the nation's social housing, a collapse in the private sector had little or no impact on their output. Today, however, social housing provision largely relies upon contributions from the private sector through Section 106 agreements, meaning that the planning mechanism that dictates affordable housing delivery is inextricably linked to private house sales. As a result, if housebuilders fear they will not be able to sell sufficient private homes to fund the affordable homes they are required to build on their sites under Section 106, then few houses – private or social – will be built.

Of course, the Government has the central part to play in finding solutions to these issues. It now has such clout within the banking sector – owning significant portions of a number of key lenders – that it could, and in my view should, demand a rapid easing of mortgage availability to creditworthy buyers. It is also imperative that the credit guarantee scheme, as recommended earlier this year by Sir James Crosby in his report on mortgage finance, is implemented rapidly and effectively.

### National home deposit savings scheme

Over the past two years I have lobbied the Government to introduce a national home deposit savings scheme for first-time buyers. It is probably fair to say that after the recession products such as 100-per-cent loan-to-value mortgages will be extremely rare and that first-time buyers, so vital to the overall health of the housing market, are going to need to find deposits of at least 10 to 20 per cent. My scheme proposes rewarding people who make monthly savings for between two and five years towards a deposit on a first home with a tax-free 25 per cent bonus when they reach their saving target. This would not only help re-establish longer-term savings habits while encouraging people to save to buy a home, but would bring obvious benefits to the housing market at relatively little cost to the Treasury. It would also boost funds available for mortgages. This idea has been well received by the industry, housing professionals, politicians and indeed the Treasury, who are now looking at it in detail. However, it would take two to five years before the full

benefits of such a scheme would be felt, so the sooner the scheme can be implemented the better.

#### Falling house prices

The drop in house prices – now approaching 20 per cent – should have done a great deal to help first-time buyers. The vicious irony is that they cannot take advantage of the lower prices because they cannot get a mortgage or, if they can, only at punitive rates of interest that simply do not reflect current ultra-low interest rates. The national home deposit savings scheme outlined above would help address this problem too.

On the issue of falling property prices, the bargains will not last; the simple facts of supply and demand tell us that. As explained above, we have been undersupplying homes for decades and the dramatic reduction in output caused by the current downturn is only going to exacerbate the problem. Faced with the Government's new homes target of three million, the sector had been aiming to produce 240,000 new homes per year by 2016 and had been steadily increasing output to the point that 2007 saw nearly 200,000 homes delivered, including conversions – the highest number for many years. However, with output now probably less than half that figure, the undersupply problem is worsening dramatically.

Even if the market recovered tomorrow, the housebuilders, RSLs, subcontractors and suppliers will not be able suddenly to resume delivering homes at the required volume. For one thing, the ability to increase capacity would be constrained by the availability of capital. Whatever initiatives the Government might be trying in the short term, banks are not likely to restore sufficient lending to businesses overnight, anymore than they are likely to resume mortgage lending immediately. In any event, if lending did miraculously reappear, history shows us that it would be extremely difficult to increase total output by more than about seven per cent per year. But even if output was increased by, say, 10 per cent, starting from a base of fewer than 100,000 new homes per year it is clear that it is going to take a very long time to reach anywhere near the 240,000 annual figure needed to meet the three million delivery target (which we now know underestimates need).

The implications for prices are very clear: as in any market where demand far outstrips supply, strong upward pressure on prices results. Couple this with the unprecedented backlog of housing demand and need that has been accumulating for years, now probably approaching one million, we face the very real possibility that property prices could return to 2007 levels within five years. No matter how far the market actually ends up falling, or when it eventually recovers, there exist all the ingredients for a significant house price resurgence.

Some will no doubt argue that another price boom would be welcome, particularly from the housebuilders' perspective, and in the short term, while businesses struggle to repair their balance sheets, that could be said to be true. But looking to the longer term, as we must, the current downturn has again demonstrated the folly of a boom-bust market cycle and if the sector is to attract the long-term investment it needs, a more sustainable model must be found.

#### Burdened by regulation

Another problematic area is the increasing impact of regulation. The cost of this, combined with the drop in house prices, has severely damaged the viability of developing land. The property boom that preceded the downturn allowed national and local Government to demand more and more from housebuilders. Contributions from developers have been subsidising a lengthening social wish-list, funded by ever-increasing land and property values. Even before the downturn in late 2007, the cumulative impact of taxation, policy and regulation had pushed many residential sites to the margins of viability. And the subsequent sharp fall in house prices, and future policy requirements such as the community infrastructure levy and zero-carbon targets, are threatening to make the majority of future residential development unviable.

No one disputes that developers should contribute to local infrastructure. Indeed, it is in developers' interests to ensure that their developments are sustainable and have the necessary infrastructure: those without the necessary infrastructure of roads, schools and key community amenities will simply not sell. Similarly, no one would argue that we need to be providing more affordable housing as we clearly should be providing more of all types of housing. And in today's environmentally conscious world, I am not naive enough to think that we could or should shift thinking on the drive towards low-carbon housing. But we must understand how we are going to pay for all these things. At present, each of these policy requirements – and many more besides – are being looked at in isolation by a range of government departments, stakeholders and interested parties, each with their own agendas and priorities. When the cost of these various items is calculated, however, the figures are daunting: the affordable housing requirement is expected to cost around £30,000 per property, the zero-carbon requirement a further £30,000 per property, and other regulation anywhere between £5,000 and £20,000 per property. The threat these additional costs pose for the viability of developments is plain to see.

Developers assess viability by first looking at what they will have to pay for the land, then what it will cost to develop the site, and then they factor in the regulatory costs to see how much they will need to sell the resulting homes for. If they will not be able to sell them and make a reasonable margin, they simply will not build them. It is quite clear that for the foreseeable future, and on the majority of sites, it is not going to be economically feasible to build with regulatory requirements adding £80,000 to each home built.

Until very recently, the Government and local authorities appeared to have little understanding of this new reality. If they continue to push agendas and unrealistic requirements on those who will build our homes, in the current climate of falling land values, they will simply end up constraining development of all types of homes for years to come. First and foremost, local authorities need to be realistic about what they expect developers to be able to contribute. Previous assumptions about the feasible scale of planning contributions need to be reconsidered in a world of reduced land values and property prices. Local authorities need to reassess what can be delivered realistically under Section

106 and relax some of the requirements they previously insisted upon. They may also need to look at rescheduling how payments are made by builders through Section 106 agreements to take in to account the acute cash-flow pressures businesses are facing.

There is a gradual realisation of this situation among some local authorities, but while the message is filtering through, homes are not being built. This is where central Government should play its role, providing strong and clear guidance to local authorities across the country on what they should now be expecting from Section 106 contributions.

#### No land, no homes

The third significant danger to housing delivery is the lack of available land with planning permission. To build homes you need a planning system in place to provide the land on which to build them. If land does not come through the system timely enough, or in areas where people want to live, then there will be nowhere to build homes. Increasing housing density is one solution, but in city centres where this has been tried over recent years it has not made a significant impact on the overall position and has unfortunately resulted in the over-delivery of certain types of dwellings in some locations. Logic and customer demand suggest that in the future there will be a move away from higher density housing, such as flats, towards more houses at lower densities, which means more building land will be required.

I spent eight months last year co-chairing the Government's Killian Pretty Review of the planning applications process.<sup>15</sup> This is just one part of the overall planning system, but a crucial one. Over the course of my housebuilding career it has long been clear to me that the process had become unnecessarily bureaucratic, costly and much slower for both those seeking planning permission and those issuing it. The current process is certainly not fit for the purpose of supplying enough land, brownfield or otherwise, to deliver three million new homes over the coming years.

After extensive research, taking evidence and submissions across the country, Joanna Killian and I made a series of recommendations. These will require significant changes within the planning system, both in process and culture, but if implemented in their entirety they will have a considerable impact. Key areas targeted are freeing up more resource in the system to deal with the more significant applications and improving the pre-application process. The recommendations received very wide stakeholder support and the Government's response suggests it will be taking most of the recommendations on board. If we are to have any chance of delivering anywhere near the number of homes we need, these changes need to be in place as a matter of urgency.

#### A crisis brings opportunities

Where there are challenges, there are also opportunities. The current climate offers us a unique chance to shape the housebuilding industry to enable it to deliver the range of homes that we need in the future. In some cases, local authorities and RSLs may have a more direct role to play in this, but, whoever ultimately manages, funds or plans a development, be it for social or private housing, it is primarily



**'The current climate offers us a unique chance to shape the housebuilding industry to enable it to deliver the range of homes that we need in the future.'**



the private-sector housebuilders and contractors who have the capacity and skills needed to bring these homes to fruition on the necessary scale.

Homes of all tenures are needed: homes for owner-occupation, social rent, private rent and intermediate tenure. The three million, or more, new homes that we need must offer options and opportunities for all sections of our society. Many people want to own their own homes – an aspiration we prize especially highly in Britain – but there are also many who do not wish, or cannot afford, to own their own home.

#### **Boosting the private rented sector**

In the US, the private rented sector is huge and attracts substantial institutional investment. A larger private rented sector in the UK would be beneficial in creating a better balance and stability within the housing stock. As with so many housing issues in the UK, the obstacle to achieving this is land. For far too long we have allowed a shortage of land with planning consent to cause housing shortages. This means capital values are high in the UK in relation to incomes, which makes it very difficult to achieve a net-rental yield sufficient to attract institutional investors. Even with today's lower prices, it is difficult to make the sums work. Tax measures such as only levying stamp duty on the

individual dwellings in a bulk rental purchase, thereby removing the requirement for institutional investors buying a number of properties to pay the much higher rate of stamp duty that currently results from the collective purchase price, and changes to the VAT treatment of repairs, would help, but they will not be sufficient on their own. The Homes and Communities Agency (HCA) wants to act as a catalyst to implement rental schemes. This is potentially an enormously significant move, which, if successful, will encourage others to dip a toe in the water. It is hoped that we can find a viable route to developing a large-scale, professional, institutionally funded private rented sector. However, unless we address the acute shortage of residential land, this will be an uphill struggle.

#### **Developing new models of delivery**

The Government needs to look at changing its stance on taxation to create a market that could attract much-needed investment in to the whole of the housing sector, in all its facets. We now have an opportunity to look at different delivery models, regardless of tenure. This does not mean that traditional development – where a developer buys land, develops it and sells the houses – is over, but we do have a chance to look at other options.

It seems obvious that the Government, RSLs, local authorities and housebuilders should be looking at ways to develop public-private partnerships that both share the risks and benefits of housing delivery. Although it has been widely reported in the media in recent months that local authorities may start building homes again, we are some distance from this becoming a reality. Local authorities no longer have the skills capacity that would enable them to run direct labour organisations, something it would take them significant time to develop. In addition, we have moved away – thank goodness – from developing the large mono-tenure council housing estates that failed on so many fronts. If local authorities were to look to start developing the mixed communities we favour today, they would need to work with the private sector and RSLs and would face the same issues as them in terms of a lack of mortgage availability and the impact of regulation on site viability.

However, local authorities still have a huge role to play, and by working in partnership with RSLs and developers, great progress can be made. Central Government and local authorities have land; RSLs have management expertise; and builders can provide the skills and the bricks and mortar to build vibrant, sustainable new communities.

Through the HCA, with its extended remit and responsibility for joined-up thinking, we should be looking at various new ways in which public money can be used to encourage development. For example, developers can no longer afford the up-front costs required for development, especially in the current climate. We need to be flexible and inventive. That said, the considerable HCA budget – £17.3bn over the next three years – is still not going to be nearly enough to kick-start a process that will deliver three million new homes. This is where difficult questions for the Government arise.

It is an uncomfortable truth that Britain cannot currently afford the homes it needs. Whether for private sale or rent, shared equity, subsidised, low-cost social rent or special needs, housing is a fundamental human requirement and one that any developed country must ensure is available for all its citizens. This means that difficult and unpopular decisions sometimes have to be made, which is what politicians, like it or not, are paid for. If this involves increasing local and national taxes to pay for basic necessities – and shelter is undoubtedly one of these – then the nettle needs to be grasped. This would not be a popular discussion with a general election looming next year, but the sooner the difficult decisions are made, the better for the overall good it will be.

We also need to boost productive capacity by encouraging more housebuilders into the fray. We in the housebuilding industry should not be afraid of competition, either from new businesses in the UK or foreign companies. If we get the operating environment right, there will be plenty of work for all given the extent of the UK's housing needs. But it is no coincidence that so few new companies have emerged to challenge the big housebuilders over the last 40 years. Despite some public perceptions to the contrary, housebuilding is not an industry in which it is easy to flourish and make consistent financial returns. It requires a huge financial commitment, which means it will be a challenge to find the extra capacity we so badly need.

If we are to attract new entrants to the market we need to be providing some level of certainty to people assessing the potential benefits and risks of establishing a new business, and also removing the barriers that current regulatory costs and complexities present to market entry. There is a huge amount of uncertainty in terms of how the wider economic climate is impacting on housebuilding, on the future regulatory environment, on whether the technology being developed to achieve zero-carbon housing is going to be viable and on targets. While the current Government has set the three million new homes target, the Conservatives do not believe in centrally dictated national targets. With the current planning system, this generates considerable uncertainty for developers and is very restrictive compared to most other developed countries. All of these factors lead to uncertainty, cost or risk and need to be addressed if our housebuilding market is to be an attractive option for new players.

On the question of perceptions, there are still plenty of people who believe that the house price booms and the current difficulties facing the property market are actually the fault of housebuilders and, to a lesser extent, RSLs. This is a misperception.

On the contrary, the housing industry is in fact better organised, better integrated and better engaged with national and local Government than ever before. The key to our problems is the same as that afflicting the wider property market and the national and international economy: liquidity, funding for mortgages and funding for businesses large and small.

So, the housebuilding model of the future is fundamentally the same as the one that exists already. It is damaged and it will take time to recover, but it is far from irrecoverable. The harsh reality is that money will be desperately tight as Government budgets are cut and different needs compete for dwindling funding, which in turn will probably drive taxation up. This is the nature of the new world we face. But housebuilders and RSLs are capable of delivering the homes to meet the nation's housing needs if people can get mortgages; if sufficient public funding is devoted to social housing; if businesses can get loans to start up and grow; and if the planning process is streamlined and made more receptive to housing needs. The Government must facilitate these requirements if we are to succeed. If we try to carry on as before, we will fail. The consequences of failure, both for society and business, would be very uncomfortable. So, let's make sure we address the challenges and seize the opportunities the future presents by planning for them now.

#### **Notes**

15. Killian, J and Pretty, D, *The Killian Pretty review: Planning applications – A faster and more responsive system: final report*, CLG, 2008: available at <http://tinyurl.com/killianprettyreview>

# A local solution

Kathleen Dunmore of Three Dragons (writing on behalf of the Highbury Group) proposes a local housing fund to generate funding to support the delivery of housing and infrastructure and provide an alternative source of mortgage finance.



*'This is a crisis unlike any other. It's a total collapse of the financial system with tremendous implications for everyday life.' George Soros, Times, 28 March 2009.*

So what does 'a total collapse of the financial system' mean for housing? Housing starts are down to just over 100,000 a year, the lowest level since 1946. House prices have fallen, but this has brought little relief to first-time buyers. In many areas, particularly rural districts, the fall in house prices has been insufficient to make market housing affordable, while the increased deposit that mortgage lenders are demanding has in effect pushed buying a home even further from the reach of people on modest incomes. Local authorities have been finding it increasingly difficult to finance infrastructure provision through Section 106 contributions from private developers, and virtually impossible when looking at major sites. Housebuilders and registered social landlords (RSLs) seeking to secure finance for their developments are also reporting difficulties.

Clearly, the impact of the financial crisis is being felt beyond the world of housing. Private savers and investors have seen a fall in the value of shares (down by a third in 2008<sup>16</sup>) and the return on investments has fallen below the rate of inflation for the first time since the 1980s.<sup>17</sup> Banks and building societies currently offer savers interest rates ranging from 0.15 per cent to three per cent, compared with an average of five per cent a year ago. This hits people saving for retirement, living on interest from savings or buying an annuity. Both savers and borrowers have been hit by the turbulence in the banking system, which looks set to continue for some time to come.

With the financial sector in disarray, the time is right for local authorities or local delivery vehicles to explore other mechanisms for accessing funds to kickstart housebuilding and development. One obvious solution would be to tap the resources of individual private investors who are currently searching in vain for somewhere to put their funds. If it is a shortage of capital that is hindering housebuilding, and the lack of secure investment opportunities is a problem for savers, could local authorities not reinvent the role of the early building societies and find one solution for two problems? There are precedents for using private finance to fund major new housing developments. The early Garden Cities were funded using private finance<sup>18</sup> and large parts of Georgian London, Bath and Edinburgh were financed on this basis.

What would a modern version of such an initiative look like? One possibility would be for a local authority or local delivery vehicle, working either on its own or in partnership with a friendly funding institution, to set up a local housing fund.

## How would a local housing fund work?

The fund would have two components:

- The local housing bond would provide gap-funding to finance the physical and social infrastructure required to enable development to take place, as well as development finance for affordable housing including housing for both social and intermediate rent. It offers a way for the affordable housing sector to market its product to private investors in the same way that RSLs have been issuing bonds to the institutional market.
- The local housing mortgage would provide mortgages for first-time buyers and low-cost homeowners.

## Local authorities would be able to choose whether to offer both options in their area or just one

Savers could invest in the local housing mortgage or the local housing bond, or both. The local housing mortgage would provide a monthly income funded by mortgage payments. It would offer an alternative to buying an annuity, which would be of particular benefit at the present time when annuity rates have been depressed by the operation of quantitative easing. The local housing bond would provide a specified payment after a fixed term, of 10, 15 or 20 years, and would be aimed at people saving for retirement. Both products would also be attractive to ethical investors looking to invest while supporting their local community.

The local housing fund would aim to provide a risk-free investment, offering a secure return that would be guaranteed by the local authority or the Homes and Communities Agency (HCA). That return would need to be higher than returns currently available to savers on the open market, but not so high that repayment costs become prohibitive. A five or six per cent return from a local housing bond or mortgage would seem an attractive option to savers currently being offered a maximum of three per cent on an ISA.

The local housing bond would need to be held for a considerable period of time (a minimum of, say, 10 years), which means savers would need to consider long-term interest rates to assess the investment opportunity offered by the bond. This is not an easy task. Although interest rates have fallen over the past three decades – from an average of 12 per cent in the 1980s to eight per cent in the 1990s and four per cent in the 2000s – it would not be unreasonable to assume that both inflation and interest rates will have to rise to help the Government finance the recent massive fiscal stimulus. On this basis, a long-term investment yielding five per cent offers a reasonable return for at least part of an individual's investment portfolio. In the current context of financial upheaval, the secure and guaranteed return offered by local housing products would be attractive to savers and provide a better return than they can currently get from a building society or bank or through investing in the stock market.

Although local housing products would primarily be targeted at the retail market, they could also be of potential interest to pension and investment funds looking to broaden their property portfolio.

Figure 1 illustrates how the local housing fund would work.

### Funding infrastructure and development

The local housing bond would be used to fund infrastructure projects and to provide development and long-term finance at competitive rates to RSLs and developers active in the local authority area. RSLs are already issuing bonds for sale to institutional investors: Affinity Sutton, Sanctuary, Places for People and Circle Anglia have all raised bonds at rates of six to seven per cent. The local housing bond applies the

same principles, but enables small-scale private investment in housing by individuals. The infrastructure element of the bond would be financed from a roof tax on development (and ultimately on land value) payable by developers on completed new homes and modelled on the Milton Keynes tariff (see box). Private finance raised through the local housing bonds would take the place of public sector gap-funding. Careful initial costing of infrastructure projects would be required to identify whether HCA gap-funding would also be required because a realistic roof tax would still not fully cover the costs of infrastructure provision.

### The Milton Keynes tariff

The scale of development envisaged in Milton Keynes requires major investment to provide the necessary transport, educational, health and social infrastructure in advance of development. The local delivery vehicle Milton Keynes Partnership (MKP) has agreed to forward fund some of the infrastructure required by borrowing from English Partnerships (now part of the HCA) against future income from uplift in land value.

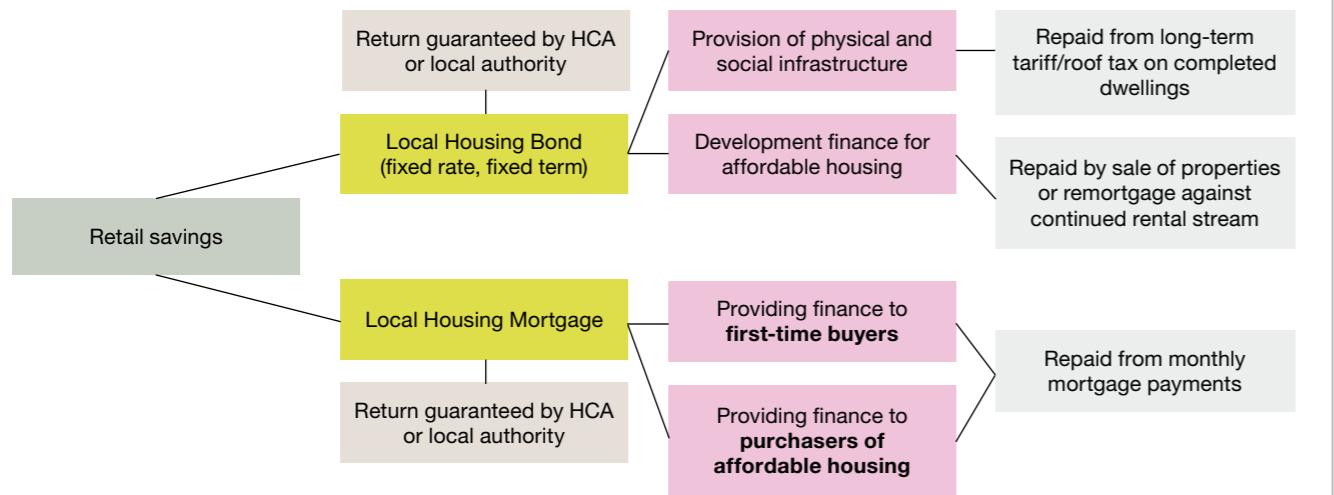
To achieve this MKP has secured a commitment to tariff-based Section 106 contributions from landowners and developers within the expansion areas (where 15,000 dwellings will be accommodated). With approval from HM Treasury, MKP (through the HCA) is acting as a bank providing advance-funding for the construction of roads, education, health, and community services, and parks, which will attract inward investment alongside the new homes.

The developers' and landowners' tariff contributions are £18,500 per residential dwelling and £260,000 per hectare of employment space. The contributions will be pooled and used to reimburse the HCA in the future once much of the infrastructure is in place.

### Financing home ownership

The local housing mortgage would be available to people buying a home in the local authority area, either in the open

Figure 1: The local housing fund model



market or as low-cost home ownership. Local authorities could restrict access to the mortgage to particular types of property or borrower – ie low-cost homes or first-time buyers – or decide to offer it to all home buyers. The idea of local authorities providing mortgages is not new: in the 1980s local authority mortgages represented 16 per cent of the overall mortgage market and a considerably higher share of the first-time buyer market. The local housing mortgage builds on the success of this model and provides an alternative, independent source of funding to reliance on the public purse.

A tried-and-tested variant to financing purely through a local housing mortgage would be a 'top-up mortgage'. A high-street lender would provide a first-charge mortgage for, say, 70 per cent of the loan required and the local housing mortgage would provide the 25 per cent secured by a second charge, thereby taking on the risk. To maintain affordability, the borrower would only have to provide a five per cent deposit. Such schemes operated successfully in the 1980s, helping many young people onto the housing ladder and contributing to the regeneration of inner-city neighbourhoods. This approach would spread the available finance further, enabling more people to be helped into home ownership through the local housing mortgage.

### Guarantees for investors and lenders

The expectation is that both the local housing bond and the local housing mortgage would be self-financing, but both products would be more attractive to investors if the loan were to be guaranteed, either by the local authority or the HCA. The loan could be fully guaranteed against a specified rate of return or partially guaranteed to a minimum rate of return with provision for a higher rate of return to investors if house-price inflation is higher than forecast.

One purpose of the local housing fund is to offer investors a secure return from a clearly specified product. If loans are not guaranteed, the private investor would have to take on the risk that the proceeds of a development are insufficient to cover the roof tax or that house prices fall and mortgagors default on loans against properties that can only be sold at a loss. More risk to the investor would force up the cost of borrowing and reduce the attractiveness of the fund.

Local authorities and the HCA already have powers to guarantee loans and have used them. The HCA is understood to be exploring the prospect of using funding guarantees to attract institutional investors into investment in rented housing. The local housing fund is based on the same principle and provides a vehicle for investment by private investors.

### Affordable housing in rural areas

A local housing fund would obviously be applicable in the growth areas and growth points, but could also be used in rural areas to provide finance for affordable housing provision. Small-scale local affordable housing providers in rural areas have found it very difficult to obtain finance at competitive rates from conventional sources and individual borrowers have also had difficulty in obtaining mortgages for low-cost home ownership. To maintain the supply of affordable housing, homes built in settlements with a

population of fewer than 3,000 are subject to a restriction that they cannot be sold into the open market. This restriction is seen by conventional lenders as presenting additional risk and in consequence has led to the withdrawal of residential mortgages from such properties. The local housing fund could provide finance for both housing providers and borrowers in this situation, either wholly or in part through the top-up mechanism described above.

### Next steps

Local authorities (or local delivery vehicles) could set up their own bank to handle local housing products (as Essex County Council is proposing to do to aid local businesses). Alternatively, they could work with a local building society or an appropriate bank, such as the proposed Post Office 'People's Bank', Virgin Group, Tesco, the Co-op Bank, Charity Bank or one of the ethical investment funds. The charity sector is already moving in the direction of local funds earmarked for specific purposes. The Charity Bank, together with Yorkshire First, offers a Yorkshire Deposit Bond, which lends money for charitable projects in the region, including the provision of affordable housing. Tomorrow's People, working in conjunction with CityLife, has pioneered a locally based Employment Bond that combines lending to RSLs with support for local employment initiatives. To date, such schemes have been targeted at philanthropic investors looking to ensure that their money is safe, but not necessarily to receive a commercial return. The local housing fund would offer a logical next step, taking advantage of the current large gap between rates available to savers and those charged to commercial borrowers to offer a product that meets both their needs.

The local housing fund could operate at local, regional or sub-regional level: a regional development agency (RDA) or the Greater London Authority would be natural bodies to spearhead such an initiative. Yorkshire First has shown that such initiatives are possible; other RDAs could follow suit.

### Conclusions

Activities to remedy the credit crunch to date have been centralised and involved directing huge sums of money at institutions. Individual savers and investors have seen interest rates fall and current policy has not resolved the problems of mortgage availability or stemmed the drop in housebuilding. Centralised solutions have conspicuously failed to meet local needs. A local housing fund would be targeted at the local level, allowing people to receive a real rate of return in exchange for funds that would be specifically targeted at meeting local housing needs.

### Notes

16. FTSE Top 100 Index.
17. Brooke, M, Clare, A and Lekkos, I, 'A comparison of long bond yields in the United Kingdom, the United States, and Germany', *Quarterly Bulletin*, Bank of England, 2000: <http://tinyurl.com/bondyields>
18. Ebenezer Howard proposed that the original Garden Cities should be financed by a mortgage at four per cent.



## Back to the future?

Anna Turley, Deputy Director of the New Local Government Network (NLGN), proposes a new role for local authorities in the provision of twenty-first century social housing.

Even before the current economic crisis, social housing was in desperate need of radical and comprehensive reform. Local authorities were already facing a severe and chronic shortage of homes. The number of households nationally has been increasing at a rate of more than 200,000 a year, yet the number of homes being built has been in decline since the 1960s.

Today's ever-lengthening social housing waiting lists are evidence of this shortfall. The number of people waiting for social housing has grown by 57 per cent over the last five years, to a current total of 4.5 million people (1.8 million households).<sup>19</sup> This figure is particularly worrying given that the total number of social tenants currently stands at nine million people. Recent reports have predicted that the recession will send waiting lists rocketing further as a growing number of homes are repossessed and fewer people are able to get mortgages to buy homes. The National Housing Federation expects the total number of households waiting for social rented homes to reach around two million by 2011.<sup>20</sup>

The current shortage means homes are only available to those most in need: social housing has become the 'tenure of last resort'. We cannot afford, financially or morally, to perpetuate a system where housing stifles rather than encourages aspiration and happiness. Social tenants

are currently the least happy with their accommodation compared with those in any other tenure, and far more likely to suffer from problems such as crime, poor health, worklessness and poor living conditions. Despite the urgency, it is not just a question of building properties – it is essential that we also build sustainable and mixed communities, neighbourhoods and homes.

Yet, counter to this need and urgency, housing delivery rates are slowing, with the number of houses registered with the National House-Building Council falling by more than half between September 2007 and September 2008.<sup>21</sup> Limited availability of finance, a tightening of mortgage markets and increasing demands on developers are all contributing factors. Increased public subsidy for the social housing element may be required to ensure private developers continue at least some developments. However, even if Section 106 requirements are reduced, the developer will be reluctant to build unless they can be certain that the homes built can be sold at the end of the project.

If we are to avoid the housing availability crisis that looms, we must ensure that all possible steps are now taken to start looking beyond the current downturn and that the potential for local strategic leadership in housing is harnessed to drive us towards the upturn.

### What is the future?

So, despite this gloomy landscape there is a moment of opportunity here. Central government's public response to the downturn is one of intervention, investment, and stimulation of markets. Prime Minister Gordon Brown has pledged to do all he can to ensure recovery and this 'all hands on deck' approach could mean that the Government is prepared to reassess some previously untouchable New Labour housing shibboleths. Not least the role that local government can play in revitalising the housing sector and in building new homes.

At this year's NLGN Conference in January, Gordon Brown said:

*'I believe that councils should be given greater opportunities to play a bigger role in housing... If local authorities can convince us that they can deliver quickly and cost effectively more of the housing that Britain needs, and if local authorities can build social housing in sustainable communities that meets the aspirations of the British people for the twenty-first century, then we will be prepared to give you our full backing and put aside any of the barriers that stand in the way.'*

We believe there is a real opportunity for councils to play a leading role in housing, and that this should start now to ensure that local authorities can play their part in leading their local communities out of the downturn.<sup>22</sup>

Many have interpreted this as an inviting return to the mass local authority housing developments of the twentieth century. After the Second World War, housebuilding increased steadily, peaking at more than 350,000 dwellings being completed in 1968. Of these, 58 per cent were built by private enterprise and 42 per cent by the social sector, primarily by local authorities. In 2007, by comparison, there were 175,000 completions, of which 87 per cent were by the private enterprise sector, with only 250 homes being built by local authorities.

Nearly two decades of Conservative government appeared to have sounded the death-knell for local authority-built housing. Regulations introduced by the Thatcher Government prevented local authorities subsidising their housebuilding from local taxes; channelled grants for the construction of new social housing to housing associations; and allowed social tenants the right to buy their homes at a large discount, leading to the sale of more than two million public sector homes, which were not replaced. This, combined with cost-cutting initiatives in local government and a housing benefit scheme that was more generous to housing associations than local authorities, led to many local authorities transferring out their housing stock.

Under the New Labour Government there was no desire to return to the days of vast, municipal housing blocks and the focus was on raising the standards of existing homes through the Decent Homes programme and the development of arms length management organisations (ALMOs). Yet insufficient attention was paid to housing supply to match the escalating demand.

So is now the time for local authorities to return to building homes? At first glance this seems an inviting proposal: they have land to build on and there are builders and construction companies in need of work. Local authorities are a safe and stable investment vehicle and can invoke their prudential borrowing powers to secure the necessary finance. They seem to be well placed to step into the breach and fill the void currently vacated by private sector developers. However, substantial barriers remain and unless central government is bold enough to undertake serious and substantial reform as a matter of urgency, this could simply be a good opportunity to ensure a multiplicity of provision that will never get off the ground.

### Avoiding potential obstacles

Local authorities face a number of potential obstacles along the path to their new housebuilding role:

- lack of capacity
- lack of funding
- lack of appetite locally or within local authorities to take on housebuilding role
- difficulty of creating mixed, sustainable communities.

Each of these issues must be addressed if local authority housebuilding is going to be a realistic and successful option.

The first issue of capacity is one that Central Government has been quick to point out. Over the last few decades, local authorities have been gradually denuded of their architects, builders, and planners. Careful attention would have to be paid to what a modern local authority housing delivery team would look like. Authorities would need to consider whether to build these teams up from scratch or to outsource where their capacity is lacking.

Funding is another barrier. It is very much the case that registered social landlords (RSLs) still reign supreme on this front with their large borrowing potential – cash that RSLs borrow on top of grant funding does not count as public borrowing. Perhaps it is time for the Government to put local authorities on an equal footing with RSLs, both in terms of access to greater borrowing, and exempting them from some borrowing rules. Some reports suggest the Prime Minister wants to change the public sector borrowing requirements: we would hope that he will reduce the restrictions on prudential borrowing to allow more local authorities to build homes. Ideally the Government would also allow them more access to grants. Moreover, the role of the Homes and Communities Agency (HCA) and how it will distribute its grant funding still remains to be seen: there could be some potential here for money to go to local authorities taking the lead in delivering social housing.

The former Minister for Housing and Planning Margaret Beckett has spoken of the Government's determination to 'keep housebuilding going in the current climate' and she launched a consultation on the barriers to local authorities delivering more homes. It indicated that local authorities will be given the green light to keep the rental of any new homes they build and the receipts of any home sold through the Right to Buy scheme. However, only properties excluded from the Housing Revenue Account (HRA) subsidy system (new-build or newly acquired properties) are currently eligible for the 100 per cent capital receipt exemption as well. In addition to the reforms suggested by CLG, local authorities should be allowed to keep 100 per cent of the capital receipts on all Right to Buy sales. This would provide an extra £1.5 billion to fund new affordable homes.<sup>23</sup>

This would be a useful first step, as well as an acknowledgement that the restrictive HRA account is acting as a barrier when it could be used as an incentive to drive more housebuilding. If local authorities could keep the money they pay to the Treasury for all rents through HRA, it would mean an additional £450 million per year for authorities to invest in better homes for their residents. It



could enable a concerted approach to alleviating local housing pressures and responding to local need. However, this is predicated on the Government agreeing to reduce Treasury income during a recession in which government borrowing has been substantial, so reform may not be imminent.

The extent of local appetite for local authorities to build more homes remains unclear, both among politicians and senior council officers,

representing another potential obstacle to their housebuilding. Some local authorities are already embracing this agenda. Birmingham, with its proud history of innovation in municipal housebuilding, has recently outlined plans to build 500 homes a year. It has identified 40 hectares of brownfield land that would previously have been sold to private developers. It has set up a trust – the Birmingham Municipal Housing Trust – to circumvent the restriction of the HRA. This will be paid for through prudential borrowing and through its innovative Bank of Birmingham.

Not all local authorities will have either the capacity or the willingness to embrace such a move, however, in which case a partnership may be a more attractive option. Plenty of opportunities should exist for local authorities to form partnerships with developers or RSLs to bid for finance for their developments. A more flexible approach to development with a variety of models and coalitions would help achieve this.

There must be recognition that Section 106 agreements will no longer provide the same quantities of affordable housing as before the downturn. Local authorities and the Government should look beyond this obstacle to new housing delivery mechanisms. The amount of affordable housing delivered via Section 106 agreements has greatly reduced over the past two years. We have moved from a situation whereby half of all new affordable housing was being provided via Section 106 contributions, at a cost to developers of around £2 billion per year, to one in which whole developments have come to a halt because developers cannot meet their Section 106 obligations. This makes the need for local authorities to start building even more imperative. Local authorities should rethink their use of planning powers and establish partnership working with developers to give the drive for new social housing greater impetus. Section 106 agreements or funds raised from the community infrastructure levy from non-housing developments could be prioritised or ring-fenced for new local housebuilding projects. This additional capital could augment other funding streams (discussed above) and make housebuilding by local authorities more viable.

There is further evidence that local authorities are already using imaginative means to kick-start housebuilding in their local areas. Sheffield City Council is planning to form a local housing company – a relatively new public/private venture in which local authorities put forward the land and a private

developer builds the homes – to deliver 2,500 homes over the next 10 to 15 years. Westminster City Council's ALMO, Citywest Homes, won social housing grant funding worth £36 million last year, which it will use to build 500 new homes, including 246 social rented homes over the next four years. The project was managed by a charitable subsidiary set up by the ALMO. Islington London Borough Council recently began building 40 homes funded by £8 million raised by the authority itself through selling 200 commercial properties in 2007.

To encourage more activity such as that exemplified above, Central Government should consider incentivising local authorities to undertake large housing developments. The Government should think creatively about what form such incentives could take. It could be a reward grant or perhaps a higher comprehensive area assessment score perhaps for local authorities who build and develop good housing in sustainable communities.

The final issue facing local authorities is the challenge of creating mixed, sustainable communities. Ensuring that new communities are sustainable is vital. Local authorities should understand that the 'one-size-fits-all' approach to mass municipal housing of last century is history and Central Government needs to trust that local authorities recognise this. The place-shaping agenda and the new comprehensive area assessment mean that authorities will have to have a far greater regard for sustainability and an understanding of 'place' and mixed communities. Plans should include facilities to cater for people's support and other needs, such as childcare facilities, drug and alcohol treatment, and mental health provision. New communities should be designed around promoting health and well-being, reducing crime, and encouraging genuinely mixed communities.

Towards this end, in addition to building for the social sector, there is the potential for housebuilding local authorities to engage in the private market. Selling properties to the private sector would improve tenure mix and help to reduce the stigma of local authority housing. Currently 75 per cent of the capital receipts from the sale of housing by local authorities go to the Treasury. If the Government gave local authorities the right to keep this income, as has been suggested above in relation to Right to Buy sales, local authorities might be encouraged to sell off more homes to private tenants and achieve communities with a better mix of tenures. However, it is vital that any potential social housing that is sold into the private sector in this way is replaced. The failure to replace social homes sold through the Right to Buy scheme over the last three decades has contributed significantly to the current shortage of social housing. There is a need to achieve a balance between the drive to create mixed tenure communities and providing a sufficient volume of social housing.

### Other roles for local authorities

Besides actually building new homes, there are plenty of other important roles that local authorities could play in shaping local housing markets. One would be through buying up empty properties. *Inside Housing* has predicted that the number of empty homes will reach one million this year.<sup>24</sup> Many local authorities are already taking steps

to bring empty properties in their areas back into use by reducing or removing the council tax discount for long-term empty homes (those empty for more than six months). Manchester City Council, for example, has recently warned the owners of 44 empty homes that it will issue an empty dwelling management order unless they take steps to bring the property back into use. Local authorities could also buy up surplus commercial properties and bring them into productive use by converting them into housing and rehabilitating them.

Both the Conservatives and the Liberal Democrats have recently announced proposals to encourage the reuse of empty homes. The Liberal Democrats have proposed a £40 million fund for short-life housing (housing pending demolition or renovation that is occupied temporarily) and a reduction in the VAT on expenses incurred renovating homes to match the VAT reduction on building new homes. The Conservative proposals suggest relaxing design and quality standards to enable vacant homes to be used as social housing. The HCA is currently looking at whether it can use its budget to support local authorities taking enforcement action to bring empty homes back into use.

The low house and land prices of today's market offer a prime opportunity for local authorities to invest in property and land. Authorities could buy up land banks and then work in partnership with private sector developers to develop the land. This would essentially involve moving more towards a local housing company model. This is a new and relatively complicated process that also relies on developers wanting to build, which could be problematic in the current economic climate. However, as a long-term investment vehicle for local authorities, this could be a prudent move.

Local authorities could also play a valuable – and some would say essential – role in stimulating the housing market by buying up unsold private properties. If sufficient flexibilities were allowed, local authorities and RSLs could use money earmarked for the construction of new affordable homes to buy unsold homes originally built for the private market. This would deliver affordable housing, while also providing much needed investment into the ailing housebuilding industry. Without such action, there is a real danger that the industry will grind to a complete halt and shed capacity, leaving it in a poor position to take advantage of opportunities when the market eventually recovers.

There is also much that local authorities could do to support individuals through the downturn. The Government's mortgage rescue and homeowners mortgage support schemes are welcome, enabling local authorities and RSLs to provide equity loans and to take on mortgages, and guarantee loans to allow borrowers to defer payments, where homes are at threat, but there is more still that local authorities could do. Authorities could play a more proactive role in stimulating local mortgage markets by offering loans themselves, as they have done in the past. There would be issues to overcome such as capacity, expertise and willingness to take on risk, but a campaign by NLGN last year resulted in the Government reducing the standard national rate of interest and allowing local authorities to borrow at a preferential rate.

Figures published in February by the Council of Mortgage Lenders showed the number of repossessions in the UK doubled to 40,000 in the last year.<sup>25</sup> All too often, local authorities are left to deal with the consequences of repossessions: more pressure on waiting lists and emergency housing obligations, as well as the social implications, including long-term poverty, poor health and well-being, and the impacts on the emotional state of children and their schooling. In short, repossessions can have serious social, economic and emotional implications for those involved. As NLGN highlighted earlier this year, there should be a greater role for local authorities in forestalling repossessions – for example lenders should be compelled to notify the local authority when a home is on the brink of repossession to enable the authority to intervene with an offer of financial support.

### Conclusion

The current economic situation and housing market downturn offer local authorities the opportunity to play a leading role in the delivery of social housing. This opportunity must not be missed. Central Government cannot afford to be dogmatic about who provides housing when the need is so urgent. It needs to untie the hands of local authorities to enable them to compete on an equal footing with the private sector and RSLs. Authorities are ideally situated to shield their communities where homes are at threat, but also to prepare for the upturn so that they can stimulate, and then play a full part in, the recovery of local housebuilding.

Whether local authorities chose to build homes themselves, or play a more strategic role through working with other investment and development bodies, it is vital that they are at the heart of the planning and delivery of new housing to ensure that housing becomes part of a wider, more sustainable approach, shaping our streets, neighbourhoods and communities.

### Notes

19. Brand, A, *Good house keeping*, New Local Government Network (NLGN), 2008.
20. National Housing Federation (NHF) [online], Latest news: 'Number of households on waiting lists projected to reach all-time high – as recession fuels demand', 19 March 2009: <http://tinyurl.com/waitinglists>
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# Mutually beneficial

David Rodgers, Executive Director of CDS Co-operatives, explores an innovative approach to affordable housing through a new cooperative housing scheme funded by pension-fund and life-assurance investments.



In January 2009, the Co-operative Party announced its vision for mutual home ownership (MHO), a new form of cooperative housing tenure that would be built on land owned by a community land trust. The vision, set out in the policy document *New foundations: unlocking the potential for affordable homes*<sup>26</sup>, is to develop a new form of intermediate market tenure that will help maintain affordable housing supply and activity in the construction sector in the aftermath of the global financial crisis. Unlike other forms of intermediate market tenure, such as shared ownership and other HomeBuy products, MHO is designed to remain permanently affordable.

The proposals in *New foundations* are based on three central propositions:

- The days of speculative house-price inflation driven by cheap, readily available, mortgage finance have gone. Real house-price inflation will only return if we fail to find new and innovative ways of meeting the demand for affordable homes and the resulting lack of supply is allowed to fuel another inflationary house-price spiral: a repetitive economically and socially damaging scenario that twenty-first century Britain should strive to avoid.
- If we are to maintain affordable housing supply despite the scarcity of mortgage finance from retail lenders (a scarcity that is likely to be a permanent feature of the post-financial-tsunami world), we need to find new sources of finance for affordable housing. The best alternative source of funding is our long-term pension fund and life-assurance investments, which would be put to better use funding affordable housing, rather than speculating in the hedge-fund or equity markets as at present.
- MHO, a new cooperative form of housing tenure, has a unique capacity to be an attractive long-term investment for pension and life-assurance funds that can be structured to guarantee investors an annual, inflation-proof yield that matches the funds' liabilities to their beneficiaries.

## How mutual home ownership works

The essential concepts behind MHO are quite simple. MHO is a new form of housing tenure that is designed to fill the growing gap between affordable rented housing and the open housing market. It is designed for households on average earnings who can afford part of the cost of their home, but who cannot afford the full expense of buying a home on the open market. It is an intermediate-market housing product that is designed to remain permanently affordable. In essence, it is a hybrid tenure in which a household funds an equity stake in their home through a mix of a deposit and monthly rental payments.

The key features of the scheme are outlined below:

- The land on which MHO homes are to be built is taken out of the market and held, in perpetuity, by a community land trust (CLT) for the benefit of the local community.
- The CLT grants a mutual home ownership society (MHOS) the right to build and occupy homes on the land. The members of the MHOS are the residents who live in the homes built by the society. Their membership gives them the right to control the financing, management and maintenance of their homes.
- Each member of the MHOS has a lease of a home giving them the right of permanent occupation. However, instead of owning and financing a percentage share of the home they live in, as in a standard shared ownership scheme, members own and finance equity shares in the value of the property portfolio owned by the society; the value of the MHOS's property being divided into equity shares with a base value of £1,000 at the date of completion of the building of the MHOS's properties.
- Instead of each member having a personal mortgage loan, which people on modest incomes cannot currently obtain, the cost of building the MHOS's homes is funded by a long-term corporate mortgage loan that is serviced by members' monthly payments. Members' monthly payments are geared to 35 per cent of their net household income. The more a member earns, the more

they pay to the society each month for their home, and the more equity shares they finance and own. Members are also expected to buy equity shares, to act as a deposit, equivalent to 10 per cent of the equity shares they can afford to buy.

- When a member leaves the MHOS, they sell their equity shares. The value of their equity shares is linked to average earnings, not to the open housing market. This treats a home as a consumer durable, like a fridge, car or washing machine, rather than as a speculative investment, the value of which can rise or fall with the vagaries of the housing market.
- As a member's income rises they will be expected to buy more equity shares. This helps ensure the scheme remains affordable for future generations. When a member leaves, some of their equity shares can be sold to existing members whose incomes have risen, allowing a smaller portfolio of equity shares to be financed by the incoming member. Equally, if a resident suffers a misfortune such as redundancy or permanent ill health, they would have the right either to sell some of their equity shares to reduce their costs, or to freeze their equity and convert their payments to standard rental payments that would be eligible for housing benefit.

The structure of the scheme outlined above immediately makes the homes more affordable. The cost of building the homes is met by a mix of 10 per cent deposits from resident members of the MHOS and a 90 per cent corporate mortgage loan. For sites with high development costs, or areas where average wages are low, additional capital funding may be required from the Homes and Communities Agency (HCA) or the equivalent national funding bodies in Scotland, Wales and Northern Ireland to bring initial entry costs in line with average local incomes. The way MHO works means that this capital funding is not a grant but an equity investment that will be released over time as the incomes of MHOS resident-members rise. The Co-operative Party aims to make MHO one of the suite of intermediate housing market products in which the HCA will invest through its National Affordable Housing Programme.

In essence, an MHOS is a mutual property unit trust. Each equity share has an initial value of £1,000 on the date the project is completed and the long-term corporate investment needed to fund it is drawn down. So, for example, if a property costs £100,000 to build, a member would buy 10 equity shares with a deposit of £10,000 and fund 90 equity shares (the remaining £90,000) through their monthly rental payments, which service the corporate loan used to build the property.

Gearing residents' rental payments to 35 per cent of net household income ensures affordability across the range of incomes within a community. The more you earn, the more equity shares you own and fund, and the more your monthly rental payments. As your income rises you are expected to fund more equity shares. A resident has permanent tenure rights, but not the right to permanent subsidy. This will enable more affordable homes to be built. When you wish to leave the MHOS, you are entitled to take the net capital value (if any) of your equity shares with you. The net capital value of equity shares is calculated in accordance with a valuation formula in the member's occupancy agreement (lease).

The rise in repossessions in the wake of the financial crisis is challenging our national obsession with individual home ownership, an obsession not shared by our European neighbours whose housing systems are faring much better in this financial crisis than ours and that of the USA. MHO offers a different way of owning a stake in the value of a home and an innovative approach to maintaining the supply of affordable housing. The concepts underpinning the scheme challenge the prevailing view that individual ownership is the only way of owning a property asset, even for households on modest incomes at risk of not being able to afford individual ownership.

MHO is also a genuinely flexible form of tenure. With capital funding support – remember, this is an equity investment not a permanent grant – a member could start off in an MHOS with a standard social housing tenancy, funding no equity shares, and paying a rent set at the same level as other social housing rents in their area. If their economic circumstances improve, they could have the right to buy equity.

## An attractive investment for pension funds

The MHO approach to equity investment in housing offers many advantages. One such is the opportunity it creates to fund environmentally sustainable design and construction – because the returns on environmental sustainability can be calculated over the whole life of the housing asset.

MHO has the potential to attract long-term institutional investment into the provision of affordable housing for three reasons:

- Legally – the type of tenure proposed by the scheme can be established within existing legislation. A fully mutual cooperative housing association can grant contractual tenancies and leases under UK housing law. This gives it the capacity to create the mutual-ownership, equity-sharing scheme that the Co-operative Party is proposing and to use the open-market asset value of the homes as security for the corporate finance invested to build it.
- Ethically – the cooperative structure of the scheme enables MHO residents to have control over the investment used to build their homes and the housing assets it has financed. Because the vacant possession value of the homes in question is used as security for the investment, it is essential that the residents are in control of their homes. This is because their rental payments service the investment and they carry the repayment risk.
- Politically – the financial crisis has eroded people's trust in banks and the ability of elected politicians to control the economy. The MHO scheme shifts control into the hands of the consumer. They are in control of the corporate debt invested in their homes, as well as the management and maintenance of them.

The biggest advantage of this approach stems from the long-term nature of the investment. The scheme requires corporate finance for the minimum lifespan of the housing asset: in common with all new housing the homes will have a minimum design-life of 60 years. This means that the corporate finance can be structured to be an attractive investment for pension funds and other long-term investors. By drawing in this new source of finance, MHO will enable more affordable homes to be built at a time when traditional sources of finance are restricted. Investing in MHO will also keep the housebuilding sector of the economy active during the recession, maintaining jobs and businesses in the construction and associated manufacturing sectors. It also means that retail lenders, banks and building societies can concentrate their limited, post credit-crunch lending capacity on their traditional market of mortgage loans for those capable of buying on the open housing market.

MHO funded through pension-fund investment offers a housing strategy that is:

- a win for local and national government – helping meet affordable housing delivery targets
- a win for communities – sustainability and a supply of permanently affordable homes which they control
- a win for families and newly forming households – access to an affordable home they would otherwise not have

- a win for the economy – by tapping a new source of funds that maintains activity in the construction sector of the economy
- a win for the environment – a way of financing carbon-zero homes
- a win for pension-fund investors – a new form of debt investment that guarantees an inflation-proof annual yield that matches their liabilities to beneficiaries.

As a response to the economic crisis, MHO is truly a win, win, win strategy.

## A new type of ethical, non-toxic, asset-backed security

Identifying an attractive form of investment for pension funds is one thing; structuring an investment in a way that entices investors remains a challenge. This is true even in the new financial context where equity investments have lost their unblemished record of sustained asset growth and pension-fund managers are looking for new secure forms of debt investment with guaranteed yields to diversify their portfolio. How, then, can we persuade investors to invest their pension fund money?

The answer is to create a new breed of asset-backed mortgage securities to finance MHO. This may seem ironic given that it was structured, asset-backed mortgage securities that brought the global financial system to its knees, but it is the right way to draw in long-term investment for MHO.

For the last 12 years, a financial intermediary for the small cooperative housing sector in the UK, the Co-operative Housing Finance Society Ltd (CHFS), has facilitated raising mortgage finance for new rented cooperative housing schemes. It has done this by offering lenders – the traditional banks and building societies – a 12-month mortgage interest guarantee as an additional security against the risk of mortgage repayment default by the borrowing housing cooperative. CHFS's mortgage interest guarantees have been supported by a cash facility provided by the Co-operative Bank plc. To date, CHFS's activities have been modest. It has guaranteed mortgage loans worth £9.4 million for nine housing cooperatives. CHFS also manages repayment default by monitoring the performance of the cooperatives which it is guaranteeing. CHFS is a successful small business, with a sound balance sheet and the capacity to do more.

To use a Darwinian analogy, appropriate during the 200th anniversary year of his birth, the changes in the financial world create the opportunity for CHFS to evolve into a financial intermediary that facilitates long-term institutional investment to fund MHO. To do this CHFS will need to metamorphose from an issuer of mortgage interest guarantees, which is an unregulated financial service activity, to become a regulated issuer of 60-year mutual housing investment bonds that guarantee investors a fixed annual yield. CHFS will use these investments to provide corporate mortgage finance to MHOS schemes, secured against the vacant possession, open-market value of the affordable homes they build.

The advantages of using a dedicated financial intermediary are fourfold:

1. It insulates investors from managing the repayment of debt and monitoring default risk. By taking a charge on properties owned by an MHOS, CHFS takes responsibility for managing default and project finance restructuring, should this become necessary.
2. The mutual housing bond becomes a tradeable, asset-backed security that provides liquidity for the investor, when required: a non-toxic, ethical asset-backed security that is transparently secured on sound, well-managed, residential housing assets.
3. Projects can be 'bundled' to create the scale of demand needed to issue mutual housing investment bonds to the financial markets, enabling yields to be set at the lowest rate possible by the market's appetite for a sound and ethical investment.
4. Mutual housing investment bonds could also be an attractive investment for personal investors who want a secure and ethical investment for some of their savings or personal pension fund investments.

This is all very well, but how will investing in MHO guarantee investors a real annual inflation-proofed yield? The answer is an elegant one. The MHO investments are on-lent by CHFS under the terms of special type of 60-year index-linked mortgage. It is structured to guarantee the annual fixed-rate yield to the investor and, for the borrower, ensures that the repayment stream rises at a rate that is tilted below the prevailing rate of inflation. This type of mortgage was developed by the Canadian cooperative housing sector and used successfully to raise 500 million Canadian dollars for rented cooperative housing developments in the late 1980s and early 1990s.

The Canadian Government also had the good sense to run a national mortgage insurance scheme to insure investors in residential mortgages against loss of their capital in the event of default. To secure insurance under the scheme, lenders had to be prudent, which is a key reason why the Canadian housing market has not suffered as badly from the collapse of the global financial markets as the US or UK housing markets. CHFS could run a similar insurance scheme for investors in mutual housing bonds at a premium of, say, three per cent of the corporate mortgage loan.

If the Government wants this new, fit for purpose, variant of permanently affordable intermediate-market home ownership to fly as a means of maintaining affordable housing supply and activity in the construction sector of our battered economy, it should underwrite this insurance fund. After all, through UK Financial Investments Ltd, it is underwriting billions of pounds worth of debt secured on toxic assets that cannot be transparently traced back to the value of the assets that secured it. Surely it is more sensible to insure an accountably managed, transparent pension-fund investment such as MHO, which will help provide the affordable housing that the UK so desperately needs and which empowers citizens to be engaged in that process?



### Notes

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# Cinderella comes to the ball

Richard Capie, Director of Policy and Practice at the Chartered Institute of Housing, discusses a resurgence of the private rented sector as one of the solutions to the UK's housing woes.

Volatility in the UK housing market is nothing new: there have been at least three cycles of boom and bust in the last forty years. Yet, despite efforts to avoid the painful impact of these cycles on families and communities, not to mention the wider economy, we have been incapable of preventing or even mitigating these periods of market instability.

Housing downturns like that faced today are usually accompanied by clarion calls for fundamental change or paradigm shifts: we need to 'reinvent housing', 'the system is broken'. In reality, by the time alternative models have been considered and evaluated, a degree of stability has usually returned and any ideas for change are put back in the 'too-hard box'. Given the severity of the current economic downturn and the central role of housing in the malaise, one wonders if this time we might be able to secure some lasting change in how we think about and are prepared to treat housing.

It is not through a lack of policy endeavour that we find ourselves in our current predicament. The changes of the past three years alone are little short of seismic. We have had a far-reaching strategy to deliver more and better homes (the 2007 Housing Green Paper) and reviews examining all aspects of housing from the social and private sectors, to housebuilding and mortgage finance.<sup>27</sup> Further to these, we are currently waiting on the outcomes of a number of other pivotal reports: a review of the housing revenue account, a review of housing benefit and the Turner work on banking regulation.

There has also been a comprehensive overhaul of the government mechanisms responsible for housing. Communities and Local Government (CLG) is the latest iteration of the lead central government department; a new investment and regeneration agency has been established in the form of the Homes and Communities Agency (HCA); there is a new social housing regulator in the Tenant Services Authority and even the creation of an embryonic statutory tenant consumer organisation – the National Tenant Voice. Government structures have also changed at the regional (single regional strategies) and local tiers (the advent of local area agreements and the local performance framework).

Taken together, these changes cover almost the entire breadth of the housing landscape. As they bed down

and new statutory instruments are applied, they could fundamentally reshape the way public policy influences housing markets and provision. However, unless the overlap between these key pieces of work is clearly understood and, critically, there is a shared vision about what we are trying to achieve, then the potential for real and lasting change sadly looks likely to remain unrealised. Although we have had a stated ambition to provide for enough affordable housing in sustainable communities for some time, there has never been a shared idea for what affordability might mean or how this would actually be achieved across tenures. As it stands our thinking appears to be locked into changing the different components of the current system, rather than in delivering a coherent, transparent new approach that brings our housing options into the twenty-first century.

Last year, the Chartered Institute of Housing (CIH) published *Rethinking housing* in response to the Government's proposals for housing reform. While much of the interest in the paper focused on proposals around change to the social sector, the ideas were much broader in their ambition, arguing that 'reforms must look at all tenures and should consider how change in one tenure can support or enable change in another'. In the present climate, as we consider approaches to stabilising and unlocking the market and housebuilding, we need to anchor our thinking firmly in these principles. Failure to do so presents a real risk that well-meaning interventions designed to address today's pressing issues could inadvertently end up further fragmenting an already flawed approach to housing provision.

The latest manifestation of efforts to rebalance housing markets is a renewed interest in other tenure options, in particular private renting. Does private renting hold the key to successful reform?

## Private rent

The private rented sector is very diverse, encompassing a wide variety of accommodation from executive housing, to bedsits. Similarly, private tenants can range from wealthy professionals, through to unemployed people receiving benefits or people on very low incomes. Landlords are also quite diverse, including large property companies managing hundreds or even thousands of properties, to an individual or couple renting out one flat.



Today around 14 per cent of households in England rent their accommodation from a private landlord (the majority of households are owner-occupiers, with social rented housing tenants coming second). This is a significant decline from its peak at the turn of the last century when some 90 per cent of housing stock was private rented accommodation. The size of the private rented sector in the UK is relatively small compared to similar economies – in France 23 per cent of people rent privately, in the US the figure is around 29 per cent, and in Germany the proportion is almost half at 40 per cent.

Despite its relatively small size in comparison to other tenures, the private rented sector has been growing and is increasingly recognised as playing an important role in both national and local housing markets – notably because of its almost unique ability to provide both flexibility and choice. Although the sector can be associated with poor condition properties and poor management standards, recent work by Julie Rugg and David Rhodes in their review of the sector emphasises the general good quality of provision, with most dwellings maintained and managed to a high standard.

Most accommodation in the private rented sector is offered under assured shorthold tenancies (AST), which means that after the initial fixed term expires (typically six to 12 months), unless it is renewed, tenants can be evicted with two months' notice. However, most landlords focus on keeping reliable tenants who will pay the rent on time and maintain the condition of the property.

Despite the Government's wish to draw large-scale company landlords and institutional investment into the private rented sector as a means of guaranteeing better standards of management and maintenance, the number of company and large-scale landlords appears to have been declining in recent years. Instead the sector is increasingly dominated by small-scale individual landlords renting out property as a sideline activity. Nearly two-thirds (65 per cent) of privately rented dwellings are owned by private individuals. Private individual landlords typically have other paid employment (65 per cent) and rarely derive more than a quarter of their income from rent (39 per cent). Most, however, see their property as an investment (73 per cent). Dwellings let by companies and other organisations account for less than one-third (30 per cent) of privately rented dwellings and of these many only have small portfolios of properties (26 per cent have fewer than 10) and only two-fifths (41 per cent) derive more than half their income from rent.

Over the past decade there has been a big increase in the proportion of dwellings owned by 'side-line investor landlords' – individuals and companies for whom renting property is not a primary occupation or source of income, but who nevertheless see their property as an investment (whether for income, capital growth or both).

### So, what might a 'healthy' private rented sector look like?

Well-managed, well-maintained, affordable private rented housing can play an important and complimentary role in housing markets. It can play a significant role in meeting both short and longer-term housing need, providing choices for a wide range of consumers that meet their needs at a given time.

In recent years, as affordability and supply issues have become pronounced, the private rented sector has taken on a more prominent role in providing a positive housing option in many parts of the country. At the same time, however, it is important to recognise that the private rented sector is a housing option that can be determined by constrained choice. While some in the private sector are lifestyle renters – that is, they have made a deliberate decision to rent over other options available – others may aspire to be homeowners or to secure a social rented home. The latter may be waiting for social housing in an area where an appropriate let is not available or where they may not actually be able to access social housing (for example, because they do not have a priority need and are unable to access any discretionary lets). They may also be households finding it difficult to secure or afford a mortgage. With mortgage availability likely to remain constrained for some time, and prospective homeowners unable to secure finance or forced to delay purchase decisions, demand for private rented homes looks set to increase.

### Growing the private rented sector

Interest in growing and developing a more robust private rented housing market is nothing new. Efforts to attract substantial, sustained investment following deregulation of the sector in the 1980s were kick-started by the Business Expansion Scheme (BES). Although the BES had some success in attracting corporate investors into residential renting, its overall impact was limited. Similarly, it was also hoped that housing investment trusts (HITs) and real estate investment trusts (REITs) would be able to attract more institutional investment into private renting by making it possible to invest through shares (and therefore avoiding the need for direct ownership). In turn it was hoped that a more flexible investment product would prove more attractive to corporate landlords, who could help professionalise the sector.

Complex operating rules and low predicted returns meant, however, that these vehicles did not achieve their aim. Instead, much of the recent investment and growth of the private rented sector has been from buy-to-let landlords. Although this has brought welcome investment and helped provide more rented housing to meet growing demand, it was principally delivered by individuals and other small investors operating on a small and local scale and largely outside a wider investment framework. As an investment and delivery model it also raised a number of concerns – around its impact on local housing markets and mix in communities, around the quality of housing management and landlords services, and around the wider sustainability of the business model itself (as verified by the recent tightening of lending practices).

With capital growth dominating the investment model at the expense of a strong rental yield, there have also been restraints on entry into the market. Although this approach may have appealed to some smaller investors, it was not attractive for institutional investors who are trying to match investments against liabilities, often pension payments, and hence prefer a steady and reliable income stream.

The latest attempt to reinvigorate the private rented sector comes in the form of the Homes and Communities Agency's

Private Rented Sector Initiative (PRSI). Launched in early 2009, the Government's housing and regeneration arm is hoping to work with institutional investors to develop a long-term funding model for new private rented housing in England. At the same time, it will be hoping that a new approach could help kick-start schemes that have stalled in the current unfavourable market conditions. The PRSI aims to deliver a significant increase in high-quality new homes for rent, managed in a consumer-focused way, which will in turn help to make private rental an option of choice for consumers and relieve pressure on the housing market.

At its heart is a new investment vehicle to attract institutional and private investors. The vehicle would be focused purely on investment – buying homes for rent from developers and housebuilders and owning the assets solely for investment purposes. The homes themselves would be managed either by professional housing management companies or registered providers such as housing associations.

As a fund, the scheme would be able to leverage its buying power to acquire entire developments or to buy up rental elements within developments. Large-scale build-to-let elements within development projects funded by the PRSI would create scope for a new approach to pricing within schemes and could potentially support a different approach to securing mixed-tenure communities.

Furthermore, the PRSI model could play an important role in shifting away from the narrow, short-term emphasis of the current private rented market, and moving towards the longer-term outlook found in the commercial property sector. A key component of this would be shifting the focus of the return on investment away from the capital appreciation to rental yield. This security of income and the prospect of longer-term capital appreciation could serve not only to attract a new class of investors, but may also appeal to buy-to-let type investors looking for a more stable approach to investing in housing.

If it is successful (and early interest from non-traditional investors appears encouraging), the PRSI could represent an important first step towards developing a private rental investment market more akin to those found elsewhere in Europe. Importantly, it could also potentially unlock much needed delivery of new housing, expand the private rented sector as a positive option for consumers and, significantly, over time it could change the balance of housing provision by opening up a wider rental market.

### Some caveats

As a first step the PRSI offers some good news. Taken hand-in-hand with the Government's response to the Rugg review<sup>28</sup> and proposals for better regulation of landlords, it shows a clear and positive shift in thinking about the role that private renting can play. However, what remains unclear is the interface between these new ambitions and the other two dominant forms of housing provision in this country – social renting and home ownership.

Home ownership remains, rightly or wrongly, the tenure of aspiration and choice for the majority of the population. In recent years considerable investment of both time and effort has focused on supporting people into home ownership

through low-cost home ownership options. If this is still the ambition, then how are people in an expanded private rented market linked in to these options? Is this seen as part of a shift towards more flexible tenure? Or are we beginning to acknowledge that home ownership is not achievable, or indeed sustainable, for a growing proportion of the population and that an expanded, and different, private rented sector is needed to cater for these people?

In a similar vein, social rented housing is under-supplied and remains a largely opaque tenure – many people simply do not know who is eligible for social housing or on what terms. What is not clear in relation to the PRSI is how new government interest in investment in private rented housing will sit alongside ongoing (and increasingly squeezed) investment in affordable rented housing.

The more difficult question here comes not around the investment model itself, but around the wider public policy aims of government intervention in expanding the private rented sector. In particular, what remains unclear is how a growing private rented market would fit with a social rented tenure that, by its very definition, should appeal and cater for many of the same people living in existing and future private rented accommodation. As it stands, social housing offers a more secure tenancy, a sub-market rent, typically more space and higher standards, not to mention a well-regulated, high performing professional management service. Any government-backed private rented initiative needs to be able to offer a product that is sufficiently differentiated from the social rented option. We need to be clear about what the different rented products offer consumers and how movement between the tenures (in both directions) could be supported better. Failure to do so arguably raises difficult and fundamental questions about the rationale and commitment to the current affordable rent model.

The PRSI is a positive development and the housing sector will look at the response to its offer with interest. A more vibrant private rented market could play an important role in bringing a wider offer to consumers, but fundamental and difficult questions remain about what a balanced housing market might look like. If a coordinated, shared vision for housing in this country is to become a reality, these questions will need to be addressed.

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# Contributors



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Toby Lloyd has worked on housing issues in the non-profit, public and private sectors. He has taught financial history at the London School of Economics, was a policy manager at the Greater London Authority under Ken Livingstone, and is currently a housing and regeneration consultant at Navigant Consulting. He writes and speaks on housing issues for Compass.



## Richard Bayley, Director of Research and Planning, Places for People

Richard Bayley is Group Director for Research, Planning and Performance at Places for People. He is responsible for developing the Group's strategy and implementing its business plan around the management of 61,000 homes and assets totaling £2.5 billion. Prior to joining Places for People in 2006, Richard held several senior management roles at BAA plc, covering strategy and planning for the development of Heathrow and Gatwick Airports. He was responsible for the overall Heathrow Masterplan, including additional runway and terminal capacity.



## David Pretty CBE

David Pretty is one of housing's best-known figures. He retired as Group Chief Executive of Barratt Developments PLC in October 2006 after 40 successful years in the industry. He was made a CBE for services to housebuilding in 2007 and was named the UK's Regeneration Champion in 2006. He remains very active in the housing sector through a number of non-executive roles, including for Shelter, and is an occasional adviser on housing issues to Government. He has been campaigning for many years to highlight the causes of the housing shortage, the plight of first-time buyers and the need for more social housing.



## Kathleen Dunmore, Three Dragons (on behalf of the Highbury Group)

Kathleen Dunmore is an economist who has worked in the housing sector since the 1970s. Formerly Chief Economist for the Building Employers Confederation and Principal Housing Policy Analyst for Milton Keynes Development Corporation, she co-founded the housing consultancy Three Dragons in 1996. She was part of the team who developed the Greater London Authority/Three Dragons toolkit, a residual valuation model which is extensively used for viability negotiation between local authorities and developers. She is a founder member of the Highbury Group and a former Chair of Midsummer Housing Association.



## Anna Turley, Deputy Director, New Local Government Network

Anna Turley was Special Adviser to Hilary Armstrong MP in the Cabinet Office with responsibility for Social Exclusion, Transformational Government and Better Regulation. Prior to that, she was Special Adviser to David Blunkett MP in the Department for Work and Pensions, focusing on child poverty and equality. She started her career as a fast-stream civil servant in the Home Office where she worked on a range of issues including youth crime, policing, immigration and community involvement in the criminal justice system.



## David Rodgers, Executive Director, CDS Co-operatives

David Rodgers is Executive Director of CDS Co-operatives, a registered social landlord that is England's largest specialist cooperative housing service agency. He is the founder secretary and board member of the Co-operative Housing Finance Society and is the UK's elected representative on the Housing Board of the International Co-operative Alliance. He is the author of the policy paper *New foundations: unlocking the potential for affordable homes* published by the Co-operative Party in January 2009.



## Richard Capie, Director of Policy and Practice, Chartered Institute of Housing

Richard Capie joined CIH in November 2007 from his post as Head of Policy at the Housing Corporation. Previously he was head of external communications and policy for a national registered social landlord and worked in strategic planning for a local authority in London. In 2006 Richard spent six month on secondment to Communities and Local Government working on the housing and regeneration review – the review that led to the 2008 Housing and Regeneration Act.

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Registered charity in England and Wales (263710)  
and in Scotland (SC002327)

# Shelter