LONDON metropolitan university

SPATIAL PLANNING & HOUSING STUDIES CENTRE

research consultancy courses

HOUSING AND THE CREDIT CRUNCH: IMPACT OF THE MARKET DOWNTURN ON LONDON DEVELOPMENT

HIGHBURY GROUP PAPER

Duncan Bowie

July 2009

HIGHBURY GROUP ON HOUSING AND THE CREDIT CRUNCH

The Impact of the Market Downturn on London Development

Summary
Until 2007/08 the overall picture for new net completions of homes in London was showing an increase. However the proportion of new affordable homes, which are for social rent, has been falling.

There is a significant development pipeline but over 100,000 homes with planning consent have not yet started on site. With the credit crunch, a number of new developments, which have started have construction suspended.

Homes being built are smaller and there are less three-bedroom homes compared with previous years and elsewhere in the country.

Development densities have doubled over the last five years.

In mid 2008, before the recession, land costs per hectare in London were on average 2 to 3.5 times higher than in the rest of the country

The paper includes modelling of the potential impact of falls on sales values between 5% and 30%. Recent viability assessments show schemes in deficit because of falls in sales values of between 15% and 20%.

The HCA three-year funding programme for 2008-2011 aims to provide 31,750 affordable homes compared with its own target of 44,165 and the Mayor's requirement of 50,000 new homes.

The paper discusses recent Government interventions and considers the effect on the HCA programme for new homes in London if Government capital spending is not further increased.

The London Context

a) Housing output

London's housing requirement was estimated in the 2004 London Housing Requirements Study published by the Mayor of London as 35,400 homes a year. Net housing output from all sources in London in 2006/7 was over 31,000, but this figure included hostel accommodation and vacant homes brought back to use. The figures for net conventional completions (i.e.: additions to stock from new build and conversions but net of demolitions) rose to just over 28,000 homes in 2007/8.

Table 1 Net Housing Completions in London – 2000 to 2008

	Net new affordable homes	Net new market homes	Net Conventional Completions	Affordable as % total completions
2000	7,728	11,770	19,498	39.6%
2001	7,502	10,005	17,507	42.8%
2002	6,021	11,035	17,056	35.3%

2003/04	7,173	13,872	21,045	34.1%
2004/05	7,515	15,370	22,885	32.8%
2005/06	7,696	17,117	24,813	31.0%
2006/07	9,435	18,081	27,516	34.3%
2007/08	10,394	17,805	28,199	36.9%

(Source: Mayor of London)

However, over 40% of the affordable homes completed have been shared ownership homes rather than social rented homes, with the proportion rising to 49% in 2007/8.

Table 2 Social Rented and Intermediate completions

Year	Social Rent Units	Intermediate Units	Social Rent as % affordable	Intermediate as % affordable
2004/5	4,612	3,112	59%	41%
2005/6	5,664	2,977	65%	35%
2006/7	5,982	4,712	56%	44%
2007/8	5,313	5,081	51%	49%
Total	21,571	15,822	58%	42%

(Source: Mayor of London)

There has also been an increase in the proportion of completed homes, which are smaller units In 1998/99, 31% of completed homes had 3 or more bedrooms – by 2007/8 this proportion had fallen to 14%. In 1998/9 39% of completed housing association homes had 3 or more bedrooms – by 2007/8 the proportion had fallen to 17%, having reached a low point of only 12% the year before. This trend has been in contrast with most other regions. At the same time development densities in London have doubled, with 2007/8 planning consents achieving an average density of 145 dwellings per hectare. There is evidence of falling internal space standards, especially in the market sector.

b) High housing needs

There has been a continuing increase in households on waiting lists for council and housing association housing – from 196,995 households in 2000 to 352,950 households in 2008 – a 79% increase. This latter figure represented 10.8% of the total households in London. In three boroughs – Hackney, Newham and Haringey, the proportion was over 15% (28% in Newham).

While the number of households accepted as homeless has fallen from 30,000 in 2000 to 13,850 households in 2008, the number of homeless households in temporary accommodation however increased from 50,000 in 2000 to nearly 60,000 in 2006/7 before falling back to 50,000 at the end of 2008.

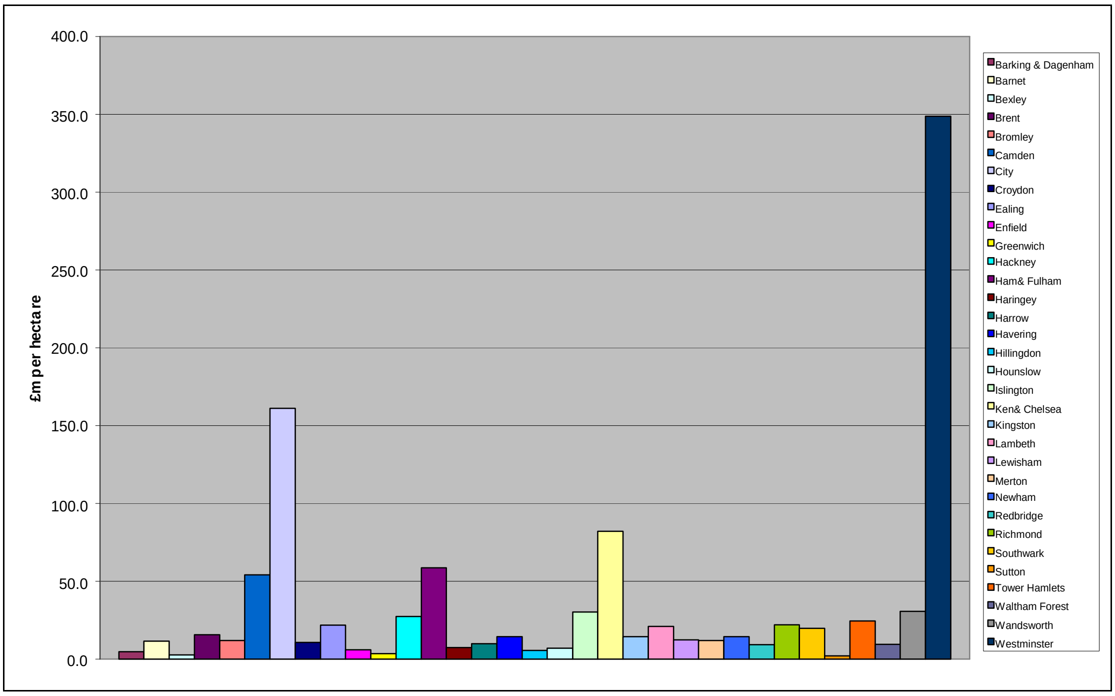
Between 2000 and 2007, the ratio between lower quartile house prices and lower quartile household income increased from 4:1.to 7.25 – as compared with the standard safe lending mortgage: income multiplier of 3.5:1. In nineteen London boroughs the house price: income ratio was over 10:1 with the ratio in Kensington and Chelsea being over 20:1. While the average London house price fell from £345,136 in June

2008 to £299,613 in March 2009, this still represented an increase of 64% on the June 2000 figure of £182,346.While the house price: income multiplier has fallen over the last year, the much more restricted availability of mortgages has meant that access to home ownership has in fact become more difficult rather than easier for marginal households. The withdrawal of mortgage products based on 6:1 loan: income ratios and 105% loan: value ratios, with a return to more traditional products based on 3.5:1 loan: income ratios and 90% loan: value ratios, has in effect reduced the borrowing capacity of a household by nearly half. In this context it is not surprising that the effective market demand for property has fallen. The mortgage famine has also had an impact on the affordability of shared ownership homes, with many Housing Corporation funded schemes no longer marketable.

c) Land Costs

Land costs are much higher in London than elsewhere. Government valuation office data for mid 2008 gave costs of £9.9m per hectare for residential land for flats in Inner London and £6.4m per hectare in outer London, compared with £2.65m for the rest of England and Wales. The data however excludes central London. An analysis of residential schemes in London by London Development Research in spring 2008 in fact gave a London average residential land cost of £19m a hectare, with the average cost in the most expensive borough of Westminster being over £300m a hectare.

Chart 1. Residential Land costs in mid 2008



Source: London Development Research dataset. It should be noted that this dataset includes conversions and mixed use schemes. Consequently the land cost will include the cost of acquiring any existing buildings on a site.

While by January 2009, the Valuation had revised down their Inner London figure to £9.2m a hectare and their Outer London figure to £5.9m a hectare, i.e. reductions of only 10%, there are relatively few land transactions in London and it is difficult to get an accurate figure on current land costs, especially in those locations which were previously regarded as premium. It should be recognised that for most developments under construction, the land cost has already been incurred by the developer and is therefore a cost that must be paid for, irrespective of whether the price paid now appears to have been excessive.

Between 95% and 98% of development in recent years in London has been on previously developed land. This means that land has an existing use value significantly higher than the value of agricultural land. A landowner will only bring forward land for residential development if that development would generate a significantly higher return than the existing use. Consequently, the cost of residential land will not fall below the value of existing or alternative uses. Residential development land is limited. The 2004 London Housing capacity study identified a potential for some 30,500 additional homes a year, of which some 28,000 could be delivered from new development or from the conversion of existing premises. It is however significant that over the last few years, residential planning consents have been running at twice this level. Much of the identified capacity is already consented, though over 100,000 consented units have yet to start on site. However the fundamental issue is not whether there is additional development capacity, but whether in the current market context, the identified capacity is deliverable.

d) Building Costs

Building costs in London in 2008/9 in £ per sq metre as derived from the Building Cost Information service data base and included in the Mayor of London's 2008/9 financial appraisal toolkit were as follows:

Table 3 Build Costs in October mid 2008

Built Form	A1 Central	A2 Urban	A3 Mixed	A4 Outer	B1 Outer	B3 Outer
Flats 40+ stories	3,700	3,700	3,700	3,700	3,700	3,770
Flats 16-39 stories	3,092	3,241	2,944	2,970	2,970	2,777
Flats 6-15 stories	2,402	2,518	2,287	2,307	2,307	2,157
Flats up to 5 stories	1,764	1,850	1,680	1,695	1,695	1,585
Houses under 75 sq m	1,313	1,377	1,250	1,261	1,261	1,179
Houses over 75 sq m	1,175	1,206	1,095	1,104	1,104	1,033

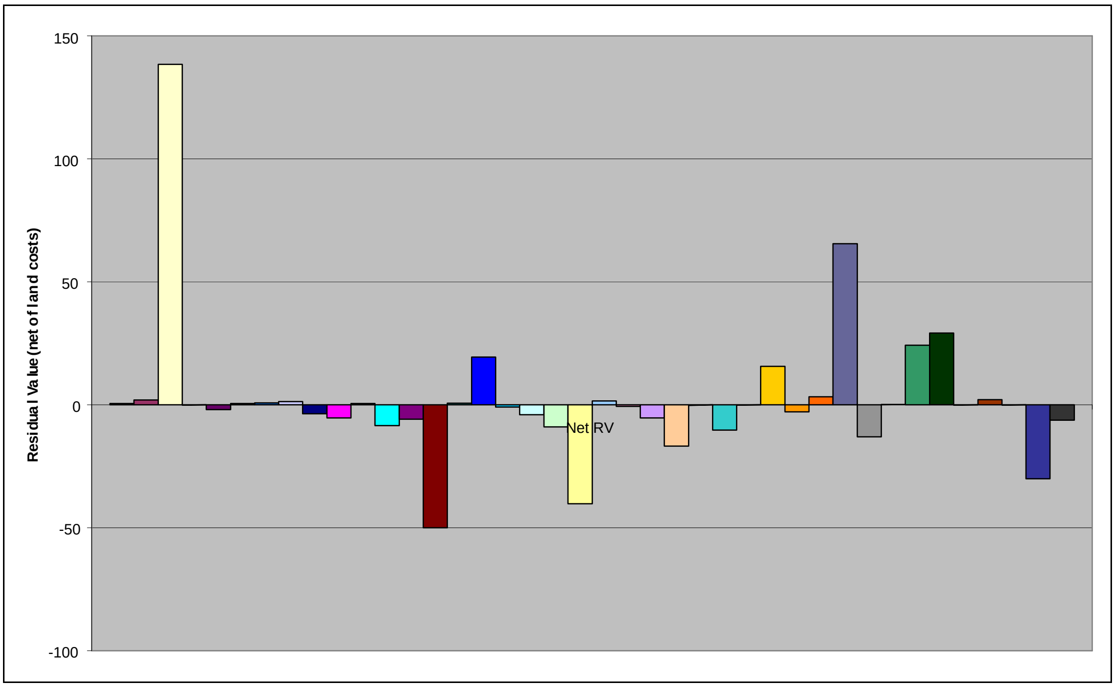
Source. 2008/9 Toolkit Defaults. Cost groups are Housing Corporation cost groups

An analysis of the costs of 40 development schemes in London in 2006/7 undertaken by and for the Mayor of London's planning team showed that build costs were generally between £250,000 and £400,000 a unit. There were however four schemes with build costs alone (ie excluding land costs) at over £500,000 a unit, including one at £1m a unit and 2 schemes over £2m a unit. These were all prestige projects in central London, including two relatively small developments. These costs excluded exceptional costs, for example site preparation, cross subsidy to non-residential development and planning obligations. House-prices had increased at 11% on average over the previous year, and developers were optimistic about this trend continuing. For most schemes planning obligations were equivalent to between £5,000 and

£10,000 a unit, though in a few cases the figure was much higher. It should be recognized that Government Housing Corporation grant per social rented unit in London averaged about £105,000, with grant per shared ownership unit being about £45,000. Grant generally does not cover more than a third of a unit build cost (excluding land cost). Many of the schemes appraised did not include any Housing Corporation grant. In no case did grant exceed £120,000 a unit.

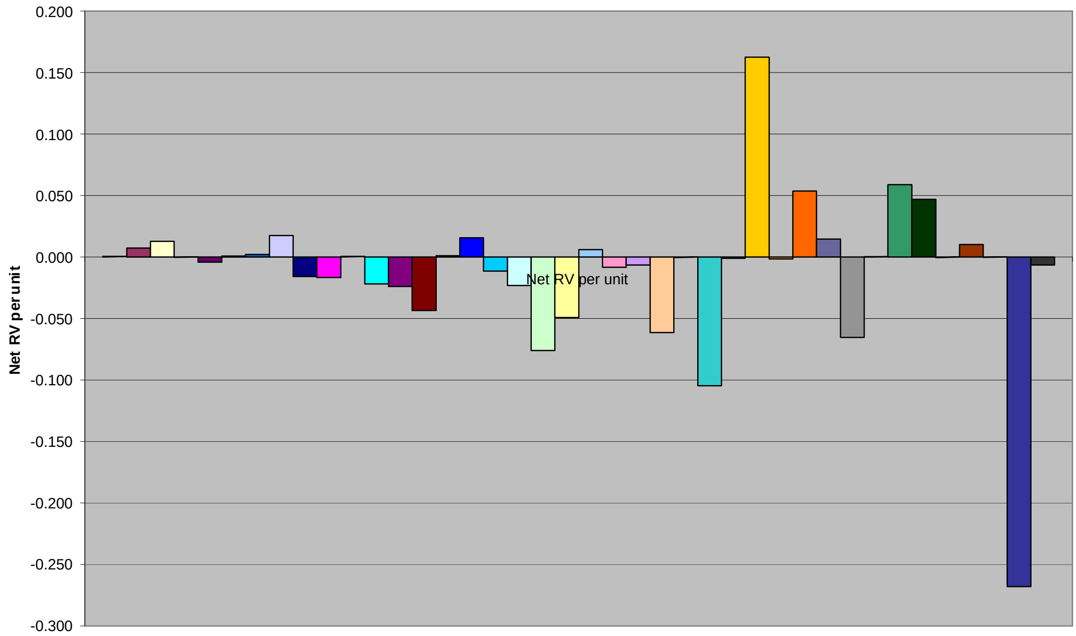
Once land costs had been taken into account, net Residual Value (RV) ranged from £138m to a negative RV of £50m. (Net RV is determined as surplus value above 'norm' developer profit of 15-17%)

Chart 2 2006/7 40 Scheme Appraisals. Net Residential Value in £m



Schemes varied significantly in terms of size. A better measure of scheme viability is residual value per unit. Once land costs were taken into account, net RV per unit ranged from £163,000 to a negative RV of – £268,000.

Chart 3 Net Residual Value per unit



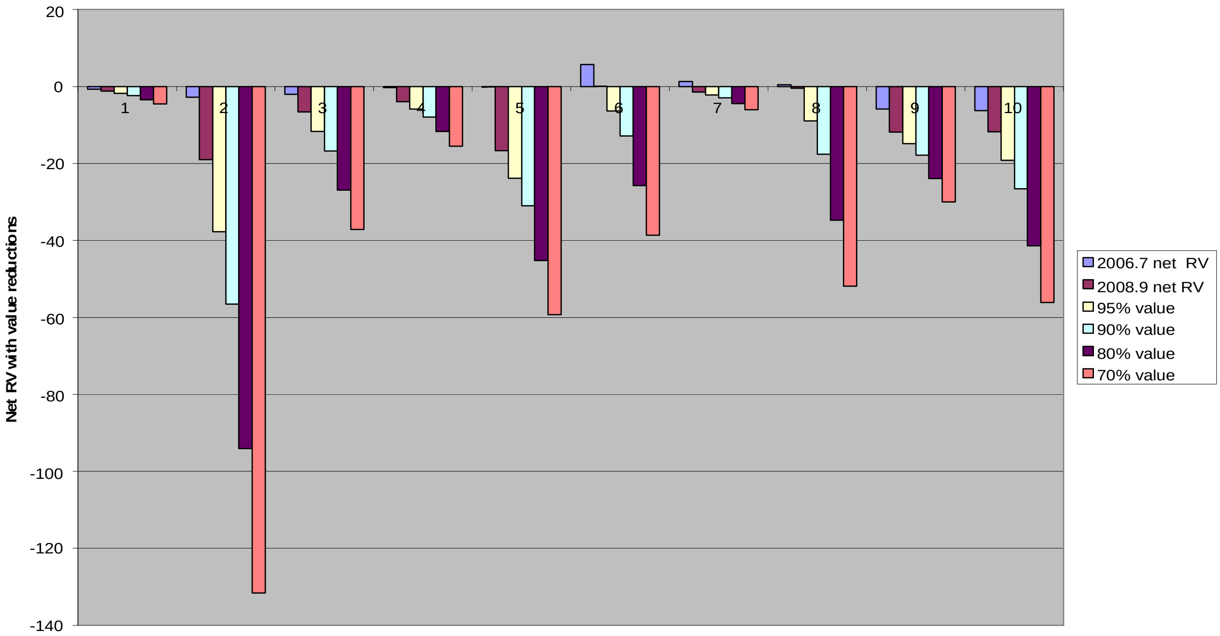
3. The Challenge of Development Viability.

In the current market context, the delivery of the Mayor's two housing targets - 30,500 net additional homes a year, and 50,000 affordable homes over 3 years, are both challenging.

The fundamental obstacle to delivery is that many of the larger development schemes with planning consent are no longer viable for the developer. With the sales values of completed homes falling and many newly completed homes, which in London are predominantly one and two bedroom flats, remaining unsold, developers are both deferring start on site of completed schemes and in some cases suspending construction on schemes started but not yet completed. Most developers are not entering into new commitments and consequently there is no incentive for landowners to bring forward new sites for residential development. The problem is most acute with the largest development proposals where significant social and transport infrastructure is required. The position is not helped by the lack of funding for critical transport projects such as the Docklands Light Railway Dagenham extension or the Cross River Tram, given development proposals were predicated on higher density development, which was dependent on significant transport improvements.

An exercise was undertaken in September 2008, to assess the impact of falling sales values on scheme viability. While sales prices had increased on average at 2.5% in the previous year, sales values in London were now falling at 2% a month. The following analysis of 10 major current development schemes in London showed the extent of potential negative value, based on different scenarios of sales value reduction, ranging from 10% to 30% per annum. The base position for 2008/9 assumed that build costs had increased by 6% per annum.

Chart 4 Ten schemes in August 2008: Impact of sales value reductions on net Residual Value



The impact in terms of deficit per unit would be as follows;

Table 5 Potential deficit per unit. Different sales value scenarios

scheme	2007/8 appraisal	2008/9 Base position	-5%	-10%	-20%	-30%
1	£11,000	£19,000	£28,000	£37,000	£54,000	£71,000
2	£1,000	£10,000	£19,000	£29,000	£47,000	£78,000
3	£4,000	£14,000	£25,000	£35,000	£57,000	£78,000
4	£1,000	£15,000	£23,000	£30,000	£45,000	£60,000
5	Break-even	£33,000	£48,000	£62,000	£91,000	£119,000
6	£30,000 surplus	Break-even	£34,000	£69,000	£138,000	£207,000
7	£17,000 surplus	£18,000	£29,000	£39,000	£60,000	£80,000
8	£1,000 surplus	£1,000	£13,000	£25,000	£49,000	£74,000
9	£26,000	£53,000	£67,000	£80,000	£108,000	£135,000
10	£7,000	£12,000	£20,000	£28,000	£43,000	£58,000

With increased cost and no increase in sales value, all but one scheme would go into deficit. With a 30% fall in sales values, all schemes would be losing more than

£55,000 per home built, while three schemes would lose over £100,000 per home built.

6. The Development Programme in 2008/9

Changes in Housing Output since 2006 peak

Over the last three years, according to Government house-building figures, there has been a fall of a third in private sector completions. Social housing completions (housing associations with a small local authority element) have increased by a third so the overall fall has been by a quarter.

a) The national position

England Completions

	2006 Q1	2009 Q1	Change
Private	32,670	21,910	- 33%
Housing Association and Local Authority	5,050	6,870	+ 36%
Total	37,720	28,780	- 24%

HA/LA proportion increases from 13% to 24%

Private sector starts have however fallen by two thirds, but social housing starts have increased.

England Starts

	2006 Q1	2009 Q1	Change
Private	43,330	13,740	- 68%
Housing Association and Local Authority	4,880	6,870	+ 41%
Total	48,180	18,270	- 62%

HA/LA proportion increases from 10% to 38%

b) The London position

The fall off in completions has been less dramatic in London with the fall in private completions almost balanced by an increase in social housing completions.

London Completions

	2006 Q1	2009 Q1	Change
Private	3,360	2,920	- 13%
Housing Association and Local Authority	1,560	1,840	+ 18%
Total	4,910	4,750	- 3%

HA/LA proportion increases from 32% to 39%

Private sector starts have however fallen by two thirds, but social housing starts have increased.

However the fall in starts in London has been significant, at over a quarter, though much less than the national fall of over two-thirds. There has actually been a small increase in social housing starts, though private sector starts have still fallen by over 40%.

London Starts

	2006 Q1	2009 Q1	Change
Private	4,680	2,750	- 41%
Housing Association and Local Authority	1,800	2,000	+ 11%
Total	6,480	4,750	- 27%

HA/LA proportion increases from 28% to 42%

In addition, there is a significant development pipeline of consented schemes not started. This may amount to over 100,000 homes. While data is not yet available for 2008/9 planning consents, 2007/8 London planning consents comprised 78,751 homes, comprising 55,414 market homes (70%), 10,207 intermediate homes (13%) and 12,936 social rented homes (16%). The Current start rate is equivalent to 19,000 homes in a full year – only 24% of the historic rate of residential consents. In recent years completions have generally been about 50% of the approvals rate.

7. The Homes and Communities Agency Investment Programme

The HCA is the national funding agency for social housing in England. In December 2008 it took over this role from the Housing Corporation, which had been established in 1964. In recent years the Government has increased the investment programme with the 3-year programme for 2008-2011 now standing at £8.4 billion. About 40% of this programme is in London. The HCA's London budget for 2008/9 was £1.0 billion. The HCA London completions target for 2008/9 was 7,561 social rented homes and 6,640 shared ownership homes. Output was 6,037 social rented homes and 5,649 shared ownership homes – 20% and 15% below target respectively. This was in contrast with previous years when generally output targets were achieved or exceeded. Starts were also under target. The fact that the spend target was achieved demonstrates that each completed home was requiring significantly more public subsidy than had been assumed. The HCA is forecasting that over the 3-year programme, 31,750 affordable homes (social rented and shared ownership) will be completed relative to their own target of 44,165 and the Mayor's target of 50,000. This is projecting a significant undershoot. Rather surprisingly given the problems of selling shared ownership homes which is considered below, the HCA is seeking to stick as close to its 60:40 social rent:shared ownership ratio – only assuming a shift of 2% from the latter to the former, despite the 2004 London Plan target being a ratio of 70% social rent : intermediate and the evidence of the 2009 Housing Market Assessment that the requirements ratio is in fact even more in favour of social rent at 80:20.

8. The position as at May 2009

The 10 sample schemes which had been appraised in August 2008, were reappraised as against current cost and value assumptions. In relation to the prior assumptions, there had been a fall off in building tender costs, with a reduction of 5% relative to a year earlier. While the reduction in sales value averaged 15% for London as a whole, reductions carried significantly between individual boroughs as shown in the table below. The table also gives comparison with the position as at October 2006 – while in most boroughs, prices had fallen below the 2006 level, in 8 boroughs prices had not yet fallen to that level.

Table 6 House price changes by borough

Borough	Subregion	Inner/Outer London	March 2008-March 2009 (1 year)	September 2006-March 2009 (2.5 years)
Camden	Central	Inner	- 13.6%	- 9.2%
Islington	Central	Inner	- 14.5%	- 4.9%
Kensington and Chelsea	Central	Inner	- 16.6%	- 21.7%
Lambeth	Central	Inner	- 15.2%	- 1.5%
Southwark	Central	Inner	- 14.9%	+ 2.7%
Wandsworth	Central	Inner	- 17.5%	- 20.0%
Westminster	Central	Inner	- 12.9%	- 5.8%
City of London	East	Inner	Not available	Not available
Barking and Dagenham	East	Outer	- 18.5%	+ 15.7%
Bexley	East	Outer	- 12.4%	+ 3.5%
Greenwich	East	Inner	- 12.3%	+ 5.6%
Hackney	East	Inner	- 17.5%	+ 9.1%
Havering	East	Outer	- 15.3%	- 8.0%
Lewisham	East	Inner	- 13.6%	+ 7.7%
Newham	East	Outer	- 15.9%	+ 2.0%
Redbridge	East	Outer	- 15.4%	- 1.7%
Tower Hamlets	East	Inner	- 16.8%	+ 6.4%
Brent	West	Outer	- 12.3%	- 2.5%
Ealing	West	Outer	- 14.1%	- 1.2%
Hammersmith and Fulham	West	Inner	- 17.5%	- 3.7%
Harrow	West	Outer	- 15.6%	- 15%
Hillingdon	West	Outer	- 11.1%	- 4.6%
Hounslow	West	Outer	- 11.9%	- 10.4%
Barnet	North	Outer	- 11.5%	- 10.6%
Enfield	North	Outer	- 13.2%	- 0.3%

Haringey	North	Outer	- 17.4%	- 3.0%
Waltham Forest	North	Outer	- 13.4%	- 2.5%
Bromley	South	Outer	- 13.4%	- 7.3%
Croydon	South	Outer	- 1.7%	- 0.3%
Kingston upon Thames	South	Outer	- 18.5%	- 16.0%
Merton	South	Outer	- 15.4%	- 2.0%
Richmond upon Thames	South	Outer	- 17.6%	- 17.4%
Sutton	South	Outer	- 16.8%	- 8.6%

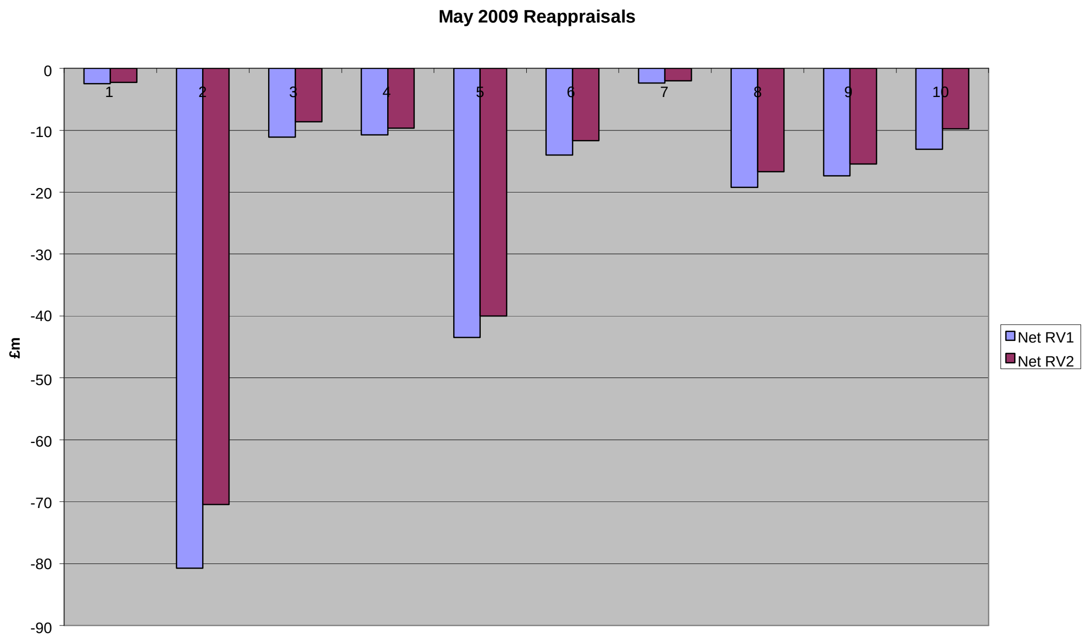
Source. Land registry House price data

In addition the Government in an attempt to stimulate investment and mortgage finance, reduced bank rate from 5% in September 2008 to 0.5% in March 2009. However in practice, while mortgage interests rates fell, financing rates for borrowing by developers and housing associations did not, In the 2006/7 appraisals, an interest rate of 6.75% was assumed – by mid 2008 this had increased to 7.25%. Some developers may be able to negotiate finance at lower rates, but for most of the appraised schemes, development finance would have already been arranged before the fall in bank rate. For the purposes of the re-appraisal, two financing options were considered – one at 7.25%, the other at 4.25%.

Table 7 Summary of basic assumptions in appraisal model

	2006/7 model (ie October 2006 midpoint)	August 2008	May 2009
Build Costs per sq m (flats 6- 15 storeys)	£1,911	£ 2,273 (+ 19%)	£ 2,159 (- 5%)
Developers return	15%	17%	17%
Contractors return	10%	7%	7%
Professional Fees	12%	12%	12%
Developers overheads	10%	6%	6%
Financing cost	6,75%	7.25%	7.25% and 4.25% 2 options
Marketing Fees	4%	3%	3%
Sales Values	As submitted by developer	4 options: -5%; 10%,-20%, -30%	Adjusted by land registry borough data

Chart 5 Scheme net deficits in May 2009 in £m's, based on two financing cost options



Note: RV1 Net Residual Value based on 7.25% financing cost
RV2 Net Residual Value based on 4.25% financing cost

Table 8 Net deficit per unit

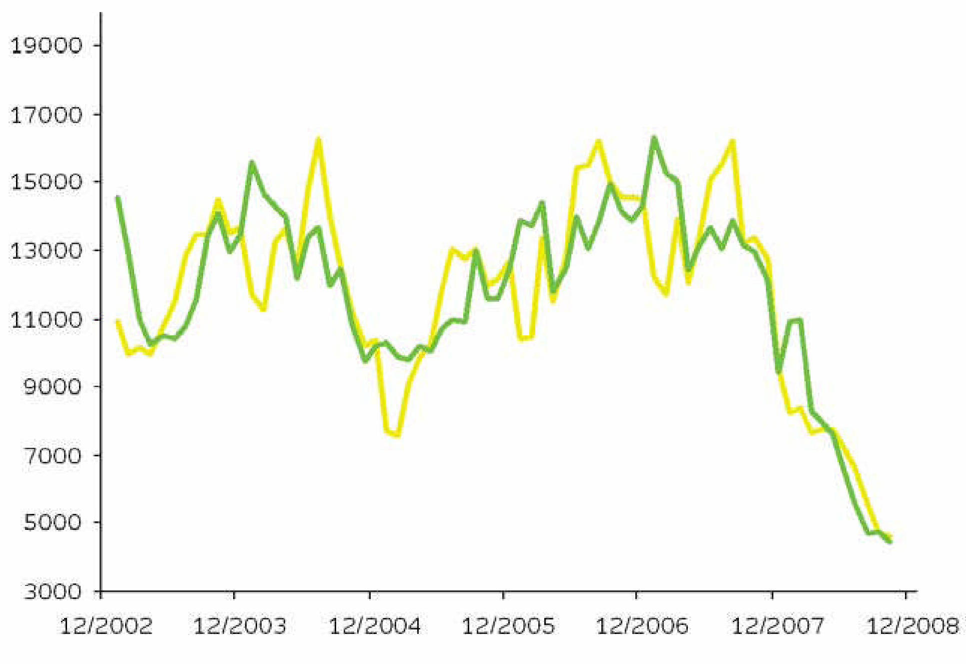
Scheme	Location	Value fall relative to March 2008	Net RV per unit. 7.25% financing cost	Net RV per unit 4.25% financing cost
1	Outer. East	- 15.9%	- £38,000	- £35,000
2	Inner. East	- 16.8%	- £40,000	- £35,000
3	Inner. Southwest	- 17.5%	- £23,000	- £18,000
4	Inner. Southeast	- 12.3%	- £41,000	- £37,000
5	Inner. East	- 16.8%	- £87,000	- £80,000
6	Inner. Southeast	- 14.9%	- £102,000	- £63,000
7	Outer. West	- 11.1%	- £32,000	- £27,000
8	Outer. West	- 14.1%	- £27,000	- £24,000
9	Inner. East	-17.5%	- £78,000	- £65,000
10	Inner. Southeast	- 12.3%	- £13,000	- £10,000

9. Government Interventions

Government interventions on the housing market since the start of the credit crunch, in summer 2008, have been relatively limited. The main focus of Government action has been to recapitalise the building societies and banks, which were in difficulty, starting with Northern Rock and then the RBS/HBOS group. The Government view is that by recapitalising banks, this would allow then to reactivate mortgage lending. This has not however been a condition of support and mortgage lending and purchase transactions have fallen to £32.9 billion a quarter from the peak of £98.5 billion of the third quarter of 2007, - a fall of 66%. With only a marginal increase in March 2009, there is little evidence of a positive impact from government intervention. It is also significant that the government has not taken any specific action to facilitate development finance. Despite the fall in the bank rate to 0.5%, obtaining development finance is if anything more expensive for developers and associations that it was a year ago. Some housing associations are over-extended, and the Tenant Service Agency has sought to encourage inter association lending to protect the weaker associations. This however is not something Government can impose.

The Government in an attempt to stimulate demand, in September 2008, increased the value threshold on which stamp duty was payable from £125,000 to £175,000. This had fairly limited impact in London, where at the time, the average house price was still over £330,000. As the following chart shows, sales transactions have continued to plummet. In January 2009, the transactions figure fell further to 3,000 – a fall of over 80% from the mid 2007 peak.

Sales transactions in London



Source: H M Land Registry. Green line- seasonably adjusted; yellow line – unadjusted.

The Government has brought some funding forward from 2010/11 to 2009/10 to try and take up some of the slack in the private housing market. There has however been a difficulty that much of the unsold private sector stock, especially in London, is unsuitable for social housing use, as it is mainly small units in high density flatted, often high-rise developments which fails to meet space and amenity standards for social housing. The main use of the additional investment has been to reduce the number of unsold housing association shared ownership homes.

Housing Associations have had difficulties selling shared ownership units in the current housing market. In London, the Homes and Communities Agency has therefore had a programme of funding housing associations to convert these homes into social rented homes. As at April 2009, there were 8,742 shared ownership homes in England, which were completed but unsold, of which 3,771 were unsold 6 months after completion. Data is not available for London. However in January the TSA reported that housing associations in London and the southeast took on average 37 weeks to sell a property compared with 22 weeks for associations across London as a whole, so it is likely that the unsold units are concentrated in London and the southeast. Tenant Services Agency reported that in the previous 3 months, housing associations had sold 4,977 homes, with 4,836 converted into social rent, added to the 3,996 homes converted into social rent in the previous quarter. In fact it was probably this programme that ensured that the HCA hit its 2008/9 spending target.

In addition the London HCA has invested funds in pump priming three major estate regeneration schemes – Aylesbury in Southwark, Woodberry Down in Hackney and Ferrier in Lewisham. This however does not deal with the long term financing requirements of these projects. It is unlikely tat either of these initiatives will be repeated as the Government recently announced its intention to reduce national government capital investment by over 50%, so it is likely that the HCA 2011 – 2014 programme will be significantly lower than current programme. This is in a context where the 2008/9outturn figures show that it costs 20% more subsidy than budgeted to fund a new affordable unit. In early July 2009, the Government announced significant additional resources for housing investment. This is welcome, though at this stage it is unclear how many net additional social rented and intermediate housing units this will support in London.

10. Conclusions

This analysis demonstrates the extent of the negative impact on the development pipeline of falls in sales values. It explains why developers were reluctant to commit themselves to going ahead with consented schemes in the current market, given the increasing cost of building including the increased costs of raising development finance. The analysis of schemes above shows the level of public investment required to make schemes viable.

In the current market, only schemes on premium sites will have the ability to provide cross-subsidy to either affordable housing or transport and social infrastructure. In London, some two thirds of affordable housing output has relied on cross-subsidy from the value of private residential development. Moreover associations have also increasingly relied on receipts from their shared ownership sales and sales of directly developed market units to support their social rented programmes in terms of making bids for HC/HCA grant competitive. In some cases associations have relied on selling existing stock, including previously social rented homes, to support their new development programmes. This has enabled the Government to make savings in terms of reducing the grant requirement for new development in terms of the 7% per annum saving target imposed by the Treasury. This financing assumption is no longer viable.

The fall in the market also has a negative impact on estate regeneration schemes. In the absence of substantive specific regeneration funds from central government, most London estate regeneration schemes are predicated on subsidy from private development funding the replacement and/or improvement of council homes. With the fall in residential values, the level of potential cross-subsidy will fall, leaving significant funding deficits. The fall in the market therefore has a negative impact on existing tenants as well as homeless households and other households waiting for their first social housing tenancy.

The poor state of the commercial market will also impacts on some mixed use development schemes, as assumptions as to cross subsidy of affordable housing from commercial or retail components become more questionable. In some recent developments, commercial and workspace components were assumed to be cross-subsidised from residential development value. In the current market, mixed-use schemes will be more difficult to achieve.

The Government is still seeing the problem as relatively short term and hopes that within three or four years housing starts will increase from the current level of approximately 75,000 a year to the target figure of 240,000 a year. However the above analysis has demonstrated that Government interventions so far have neither led to a revival in housing starts or in home purchase transactions. Falls in mortgage interest rates have benefited some existing home owners but, while house prices have fallen significantly, these falls have not made home ownership any more affordable to prospective first time buyers as the restrictions on mortgage supply both in terms of volume and terms, with deposits of 10-25% now required, have had a more negative impact than the theoretical positive impact of house price falls.

Government has failed so far to tackle the supply side of the equation. Build costs may be falling slightly, but in the case of most consented schemes, developers have already incurred land costs by buying land at the top of the market at values which now seem excessive. Moreover encouraging the reactivation of a wider range of mortgage products will just inflate house prices and recreate the sub-prime lending that caused the collapse of the market in the first place. Government has first to introduce regulation of the mortgage market to ensure the market is re-established on a more prudent basis, but it must also use both the public sector works loan board and its ownership of elements of the banking sector to generate development finance for local authorities, housing associations and private developers at preferential rates – otherwise the reduction in bank rate has no benefit.

However the key focus of Government policy must be on investing in affordable housing. While Government grant for social rent schemes in London have in some cases increased from the previous norm of £105,000 a home to over £125,000 a home, in the case of some of the schemes analysed above, much higher levels of grant are needed to make a scheme viable. In most cases, development schemes are expected to fund major social and transport infrastructure costs through planning obligations as well as cross-subsidise affordable housing provision. In most cases this is no longer feasible. While it is not necessary for the Government to provide 100% grant for social housing, the best option would be to return to the mixed funding regime which operated effective between 1988 and about 2000, before competitive bidding was introduce. The cost of each scheme should be assessed against a benchmark, which considers land acquisition costs and build costs and the ability to raise private finance from the capitalisation of the rental should be assessed. For a mixed tenure and or mixed-use development, the ability of the private development to cross-subsidise affordable housing provision should be assessed but not assumed. Except in the case of highly profitable residential schemes on premium sites, transport and social infrastructure should be funded separately - generally from taxation.

Affordable housing outputs should be determined by an assessment of requirements, rather than by the economics of a specific development, and grant should be made available to meet the scheme deficit assessed through a financial appraisal. No assumption should be made about a developer or housing association being able to cross-subsidise a specific development from its own resources. This will mean that for most schemes a much higher level of government subsidy is required than under the funding model operated under the last few years and as shown by the earlier appraisals, this subsidy requirement will vary widely between schemes. However, given the recent failure of the market either to maintain overall housing output or to deliver affordable housing in terms of quantity, quality or affordability, there is currently no alternative approach that would deliver these policy objectives.

Duncan Bowie
9.7.09