Delivering on London's Housing Requirement

interim report

G15

HOUSING DIRECTORS GROUP
LONDON COUNCILS

This is a joint report by the London Housing Directors' Group, a professional network of senior housing officers from across London's 33 local authorities, and the G15 group of London's largest housing associations. The report is supported by data and analysis provided by Savills.

This is an interim report, with comments and further evidence welcome from across the sector to inform the policy debate on unlocking housing supply in London. Please send responses to the consultation questions included in this report – and any further evidence as appropriate – to alex.sewell@londoncouncils.gov.uk by Friday 17 September.

Cover image: Bourne Estate (London Borough of Camden); architects: Matthew Lloyd Architects; photograph by Benedict Luxmoore

1. Summary

London's housing crisis is deep, prolonged, and with the current range of policies tasked with solving it, has no realistic end in sight. Households from a range of economic backgrounds are affected by the lack of decisive action, but fundamentally, London's housing crisis is an affordable housing crisis, caused by a decade long failure to build enough affordable housing options.

The Mayor of London's London Plan, adopted in March 2021, outlines a target to achieve 52,000 new housing completions per year (following the independent planning inspection); an increase from just over 42,000 in the previous London Plan. This compares to the 2017 Mayor's Strategic Housing Market Assessment, which identified a need for 66,000 new homes a year to satisfy housing need. Under the government's latest version of the Standard Method for calculating housing need, the figure for London is 85,000 homes per year. Savills estimates an even higher level of required delivery to meet need and improve affordability, suggesting that 90,000-100,000 new homes are needed each year.

These ambitious targets dwarf current rates of delivery, which MHCLG currently estimates at 41,718 in the year 2019/20.[1] Latest figures on housing delivery from Molior (who track developments comprising more than 20 private homes) shows 22,848 completions in the year to Q2 2021, an annual increase of 8 per cent, but still 13 per cent below the peak in 2017. The shortfall of affordable homes is even more acute, with an estimated 42,500 sub-market homes required each year; when considering that only 7,900 have been delivered on average per year over the five years since 2015/16, the need for action becomes clear. [2]

Without an enhanced role for the social sector, London will continue to fail to meet the housing needs of low and middle-income Londoners, particularly the growing need for more social rented homes. This paper directly addresses this reality by illustrating the very real need for a renaissance in social home building; highlighting where we are now, the failure of the market to balance supply with demand and provide affordable options, and by exploring the obstacles we must overcome to make this happen. These include:

1. **Market failure in housing**: short-term forecasts from Savills show that the market is unlikely to meet the housing delivery targets in the revised London Plan. There is also an affordable housing paradox that persists in London: high prices, low wages relative to house prices, a high demand for affordable homes, and a continuing over-supply of new homes aimed at higher earners, and an under-provision of homes for low- and middle-income households.
2. **Decline in value of the cross-subsidy development model:** the social sector's reliance on a cross-subsidy model to deliver new affordable housing, following the reduction in the proportion of scheme costs met through grant funding since 2010, is reaching a tipping point. Market prices are too high to support market sales, yet the slowing growth in house prices, coupled with pressure on social housing providers' financial covenant limits, makes the cross-subsidy model increasingly difficult.

[1] https://www.gov.uk/government/statistical-data-sets/live-tables-on-net-supply-of-housing
[2] Savills

3. **Challenges in mobilising development through the Housing Revenue Account (HRA):** despite the lifting of the HRA borrowing cap, high levels of HRA debt, restrictions on councils' ability to use Right to Buy receipts, the effects of the 1 per cent per year social rent reduction policy from 2016/17-2019/21 combined with increased requirements to invest in existing stock from a safety and decarbonisation perspective have all severely limited the sector's ability to maximise the delivery of affordable housing through the HRA.
4. **Skills shortage and wider market uncertainty**: the shortage of housing development staff in London is a constraint on boroughs seeking to create development teams, while wider challenges persist in relation to the supply of skills and uncertainty around market conditions. These risks are exacerbated by cost pressures arising from the disruption caused by the COVID-19 pandemic.
5. **Support for social housing providers to meet building safety and net-zero costs:** meeting the twin challenges of tackling the building safety crisis and ensuring social housing plays its full role in tackling the climate emergency will require significant resource investment, potentially impacting the supply of new affordable homes.

This report will make the case for greater funding and support for the social housing sector to deliver the right type of housing, at the pace and scale London needs, utilising data analysis provided by Savills, London boroughs and the G15, and building on the previous work undertaken by the Greater London Authority through its review of the Council Homes for Londoners programme. It highlights the role that both councils and the wider housing association sector can play in enabling new development.

2. The challenge of meeting London's housing need – where are we?

London particularly sees very high levels of demand for housing, driven by employment growth in excess of the UK average, population growth, and the expansion of a world class higher education sector.

London's population is projected to increase to 9.8 million people by 2041.[3] The revised London Plan outlines a requirement for a minimum of 52,000 new homes every year as part of efforts to meet existing and new housing need, along with space for tens of thousands of new jobs. Savills' analysis of demand in London estimates 90,000 to 100,000 homes need to be built per year in order to meet this demand and improve affordability; addressing the historic shortfall in supply.[4] Savills' analysis of the future pipeline of new homes shows that there will still be a continuing imbalance between supply and demand in London, with future housing delivery only forecast to be around half of what is needed.

Brexit does not yet appear to have impacted London's population growth or the requirement for more housing. While ONS data has shown a fall in EU migration to the UK since 2015, this has been offset by a rise in non-EU migration, and net migration in 2019 was at its highest level since June 2015.[5]

The outlook for London's housing supply

According to MHCLG data, there was a net total of 41,572 new Energy Performance Certificates issued over the year July 2020-July 2021 (a recognised method of estimating new home completions).[6] See figure 1 below for a timeline of total housing delivery.

According to Molior data, compared to figures from 2015 when both the number of starts and the number of planning permissions peaked, the figures for 2020 were lower, showing signs of caution. Planning consents have fallen every year since 2018 and in 2020 were down 46 per cent against 2015. The same pattern is true for starts, with a fall of 47 Per cent. As a consequence, over the next five years, London supply is expected to fall well short of both the Mayoral target and Savills estimated delivery requirements.

Savills are forecasting that completions over the five-year period 2021-2025 will average 43,000 homes per year, with around 30 per cent of units expected to be affordable or intermediate housing. Completions are expected to peak in 2022, and fall for the following three years, reflecting the lower levels of permissions and starts in 2018-2020. By 2023, Savills forecast that the number of homes under construction in London will be at its lowest level for 10 years.

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[3] Office for National Statistics population projections

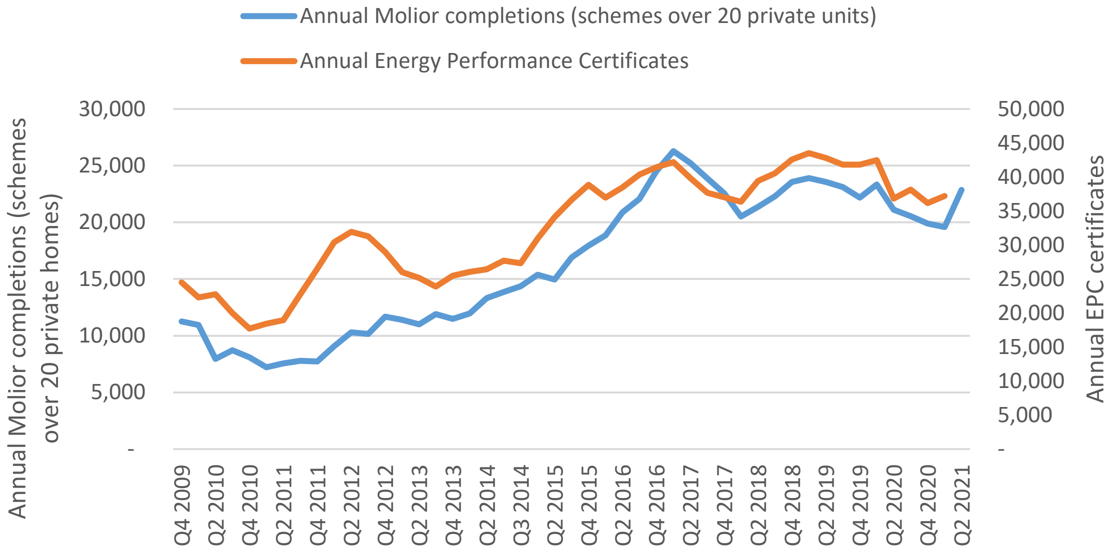
[4] This is based on analysis of projected growth in workplace employment, household projections by type and income distributions.

[5] 'Provisional long-term international migration estimates', Office for National Statistics, 27 August 2020

[6] Live tables on Energy Performance of Buildings Certificates, Ministry of Housing, Communities and Local Government

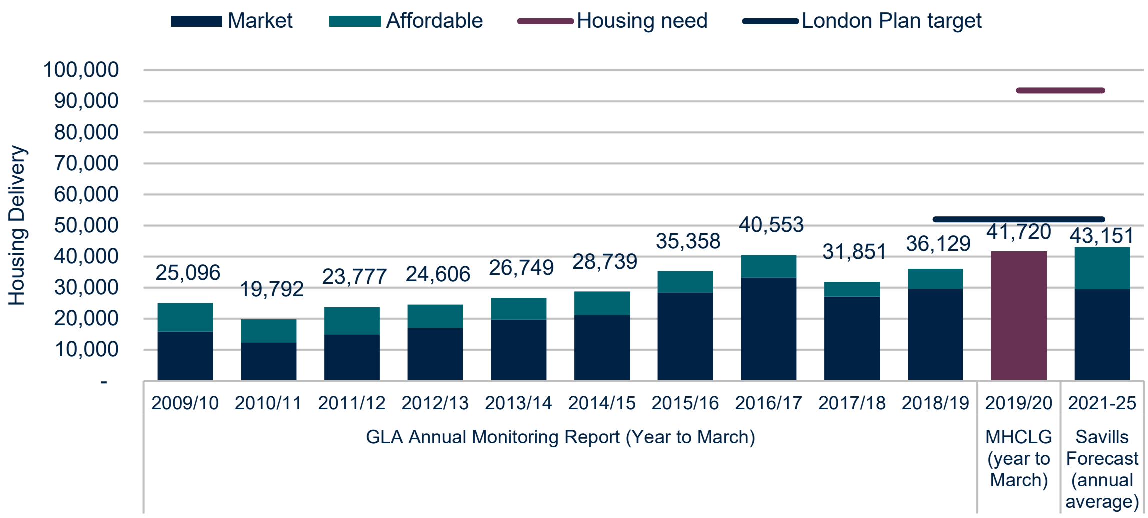
In response to a survey on new housing delivery within their local housing market, London borough Housing Directors highlighted the five main barriers to supply: (1) uncertainty in the wider economy and housing market, (2) developers not building out planning permissions, (3) the high cost of land, (4) a lack of land and (5) high building costs.

Figure 1 – Total housing delivery in London



Source: EPCs, Molior

Figure 2 – London delivery and forecasts by tenure



Source Savills, MHCLG

The consequence of the supply/demand mismatch

In this situation of demand outstripping supply, the inevitable consequence is housing hardship. The boroughs have seen significant increases in homelessness, with 10,180 homelessness acceptances in 2010/11, compared to 24,630 households that were owed a homelessness relief duty by a London local authority in 2019/20.[7] Over the same period temporary accommodation placements have also increased, with more than 60,000 households, including 88,000 children living in temporary accommodation in London at the end of 2020.[8] Research by LSE, commissioned by London Councils, found that in 2017/18 the London boroughs spent £730 million on providing temporary accommodation to residents, and £919 million in total on homelessness services.[9] Undertaken prior to the COVID-19 pandemic response, the research estimated that borough homelessness spend would increase to over £1 billion by 2021/22.

The challenge for more middle-income households in accessing affordable rented accommodation or home ownership in London is also well known, with rents and house prices both rising well above incomes over the last decade (see section 3).

The policy environment

1. How can the planning system better support the delivery of new housing supply, with reference to recent changes (such as the new London Plan and revised National Planning Policy Framework) and proposed reforms detailed in the Planning for the Future white paper?

2. Is the Housing Delivery Test an effective tool for driving increased housing supply?

3. How does the funding of the social housing sector need to be shaped to better maximise the delivery of new housing supply?

4. How long-term is your organisation's development strategy, and what resource and other conditions can support that long-term approach?

[7] Live table on homelessness: Detailed local authority level tables: financial year 2019-20 – change in terminology reflects the changes in local authorities' statutory duties following the Homelessness Reduction Act.
[8] Statutory Homelessness Live Tables, Ministry of Housing, Communities and Local Government
[9] 'The Cost of Homelessness Services in London', LSE London, October 2019

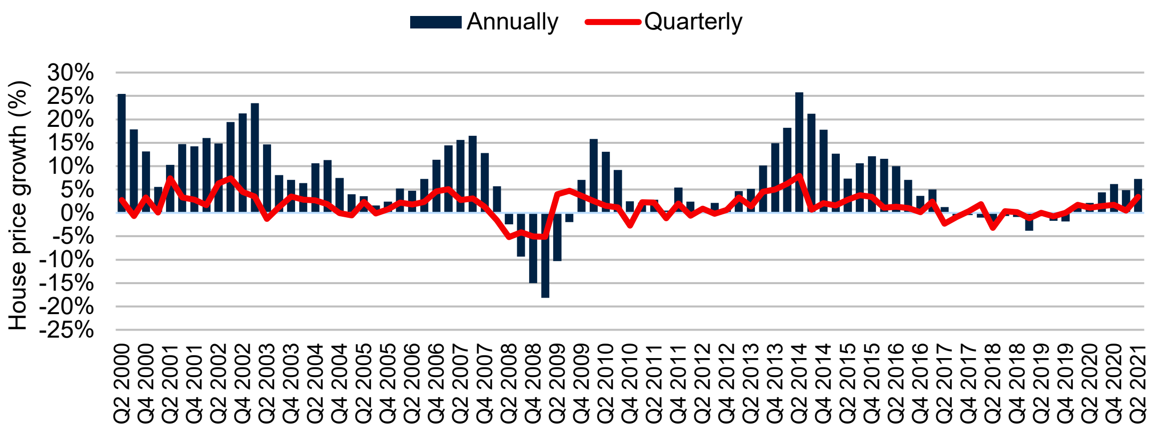
3. The affordability paradox in London's housing market

The affordability paradox in London's housing market has four facets to it, each of which is explored below.

London's rapid house price growth

London house prices currently sit at 66 per cent above their 2007/8 peak, compared to just 31 per cent across the rest of England & Wales. The average house price in London in March 2021 stood at £666,614 compared to £346,263 in England.[10] This rapid growth can be seen in figure 3 below, and while London has experienced negative growth from Q4 2017, positive price growth has returned to London following the onset of the Covid-19 pandemic. Predictions by Savills see house price growth remaining strong in 2021 before returning to more lower levels of growth between 2022-2025, limited by a forecasted rise in interest rates along with stretched affordability.

Figure 3 - Annual & quarterly London house price growth, Q2 2021



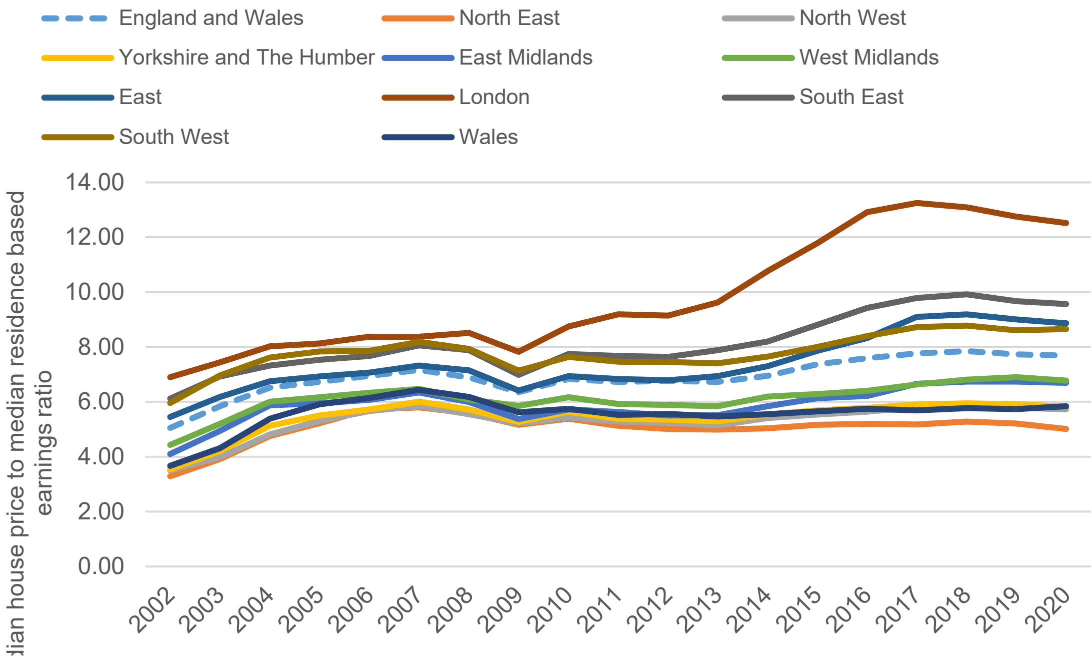
Source: Nationwide index (seasonally adjusted)

London's imbalance with wage growth and house prices

The average wage in London is £42,667 while the UK average is £31,590 (November 2020).[11] Considering this differential, the mismatch is clear; average house prices in the capital are 93 per cent higher than the UK average compared to wages that are just 49 per cent higher. Research from Savills has analysed the affordability constraints faced by households in all regions since the 2007/08 downturn. The results of which are illustrated in figure 4. This shows that while the house price to earnings ratio has been increasing in all regions, London's house price to earnings ratio has grown significantly and diverged from the national average: the house price to earnings ratio for London is 12.5, considerably above the national average of 7.7.

[10] Land Registry, March 2021
[11] Office for National Statistics, Annual Survey of Hours and Earnings

Figure 4 – House price to earnings ratio



Affordable housing demand

The need for affordable housing in London and the South East is far greater than the wider country. Based on affordability alone, the annual need for additional affordable housing in London is 7.6 times greater than supply, compared to 2.6 in England.[12] This is before considering the wide range of other socio-economic reasons for households being unable to access a suitable home in the market. These wider reasons contribute to the 246,575 households who were on local authority waiting lists in London in 2020.[13]

According to Savills' estimate of housing need, at least 42,500 sub-market homes are required in London per annum (figure 5). This compares to an average of 7,900 sub-market homes that have been delivered annually since 2015/16.[14]

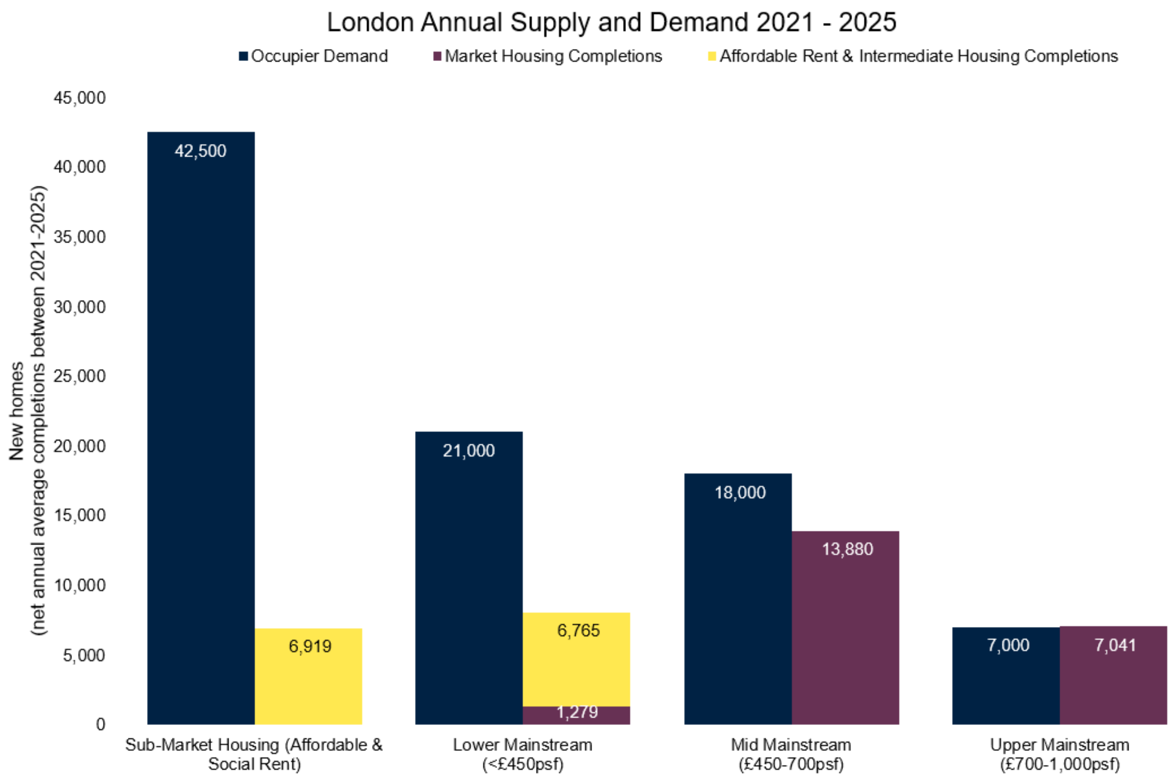
Under supply of affordable tenures

Savills' forecast of future supply against demand indicates that the largest supply shortfall will persist in the lower mainstream market segment below £450 pound per square foot (psf) and in the sub-market rent segment. These figures are illustrated in figure 5 and demonstrate the market's failure to deliver an adequate supply of homes that are affordable to low- and middle-income households (the demand in each price band are estimated based on affordability of Londoners for both renting and owner occupation). Figure 6 below shows the areas of England where affordable housing is under supplied. Contrasted with figures 4 and 5, it highlights the extent to which London's housing market has failed, and looks set to continue failing, to deliver the levels of affordable housing supply needed.

[12] Analysis by Savills
[13] Households on Local Authority Waiting List, Borough, Ministry of Housing, Communities & Local Government (accessed via London Data Store)
[14] Analysis by Savills

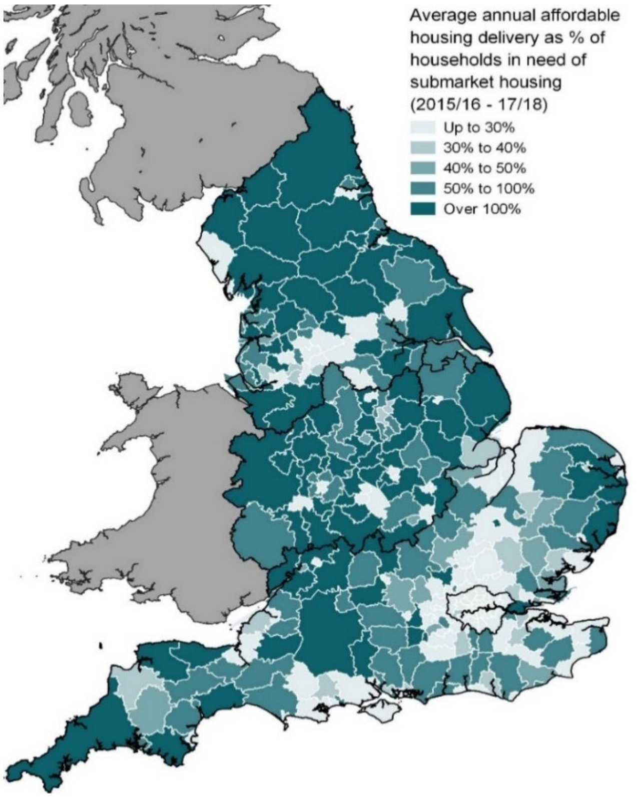
Table 4 shows the average transaction value and annual change in values of each London borough and emphasises the challenge of affordability in London. Every London borough, with the exception of City of London, has seen average values increase over the last twelve months. The three most affordable boroughs by transaction value have all seen price increases of over 4.5 per cent in the year to March 2021, putting home ownership further out of reach for many Londoners.

Figure 5 – Supply shortfall by price band (2021-25)



Source: Savills Research using Molior, CACI and Oxford Economics

Figure 6 – Shortfall in affordable housing delivery



Source: Savills using HM Land Registry, EHS, Rightmove, MHCLG

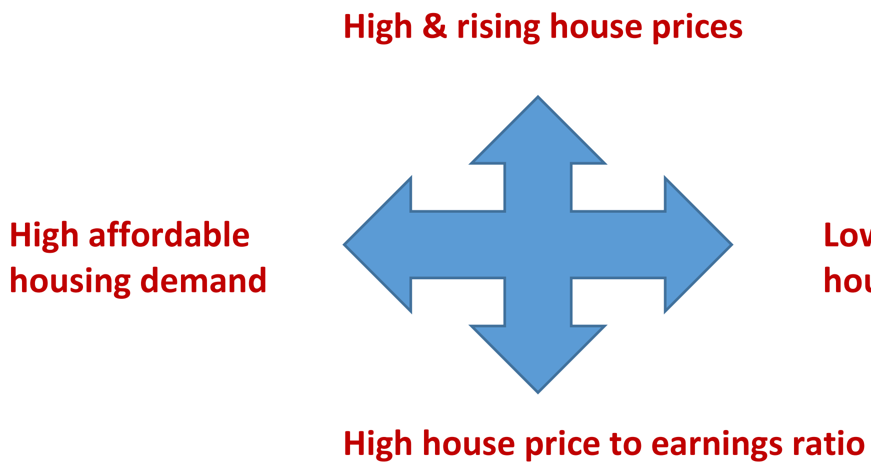
Table 4 – Values and price growth by London Borough, March 2021

	Average price (as at March 2021)	Prices above 2007/08 peak	Annual growth	Quarterly growth
Barking and Dagenham	£324,694	159%	4.5%	2.7%
Barnet	£668,519	157%	2.8%	1.0%
Bexley	£388,224	161%	4.7%	2.2%
Brent	£578,724	163%	4.4%	1.8%
Bromley	£524,954	162%	4.6%	1.8%
Camden	£1,042,420	161%	3.0%	0.9%
City of London	£960,391	160%	-0.5%	-1.7%
Croydon	£408,696	156%	3.8%	1.6%
Ealing	£601,912	160%	4.5%	1.4%
Enfield	£467,454	155%	3.1%	2.5%
Greenwich	£507,158	169%	5.6%	2.1%
Hackney	£622,476	190%	4.0%	1.3%
Hammersmith and Fulham	£924,715	160%	3.7%	0.1%
Haringey	£681,687	178%	4.5%	1.8%
Harrow	£544,890	152%	1.3%	1.1%
Havering	£415,740	159%	3.6%	1.5%
Hillingdon	£477,368	159%	4.4%	1.1%
Hounslow	£536,302	154%	3.8%	0.3%
Islington	£776,145	172%	6.7%	1.3%
Kensington and Chelsea	£1,923,559	153%	4.2%	0.5%
Kingston upon Thames	£589,701	158%	5.2%	2.2%
Lambeth	£652,017	182%	5.2%	1.3%
Lewisham	£492,818	183%	6.6%	2.0%
Merton	£676,001	168%	5.8%	2.1%
Newham	£397,806	163%	5.8%	1.7%
Redbridge	£482,994	159%	5.8%	2.0%
Richmond Upon Thames	£856,576	160%	5.0%	1.0%
Southwark	£659,494	186%	6.4%	1.4%
Sutton	£430,061	155%	4.6%	1.9%
Tower Hamlets	£536,746	152%	4.3%	0.8%
Waltham Forest	£497,492	198%	7.7%	2.5%
Wandsworth	£783,417	168%	4.1%	1.0%
Westminster	£1,461,156	158%	2.4%	0.5%

The affordability paradox

The affordability paradox follows: the situation persists where house prices are high in the capital and set to continue rising in the medium to long-term. Meanwhile, wages have not kept pace with this rise, which has left housing unaffordable for the vast majority of Londoners. Consequently, there is a huge demand for sub-market and lower mainstream housing options. Yet, market delivery is focussed on the upper mainstream price bands that are affordable to higher earners, while significantly under-delivering new homes that are affordable to households that are most locked out of London's housing market. The forecasts provided by Savills show that, left to its own devices, the market will not correct these imbalances. With this in mind, it is essential that social sector builders get the support and funding they need to fill this void and correct this market failure.

Figure 8 – the affordability paradox



4. The social sector's determination to increase supply and the importance of the social sector in meeting housing need

The analysis above shows the extent to which the private market will continue to underprovide for low- and middle-income households over future years. London's social housing sector is determined to fill this gap, and indeed, is the best and only viable option to do so. The sector has already shown significant commitment towards this end, and given the right tools, could fill the gap in private market delivery.

Enabled by recent reforms to the Housing Revenue Account (HRA), and with additional grant funding recently being made available by the Greater London Authority, London local authorities have set out ambitions plans to deliver new council housing at scale for the first time in over 30 years. From a standing start, this has involved significant change in local councils to develop the skills and institutional organisation to deliver on behalf of Londoners.

As a sign of their ambition, in October 2018 councils were awarded £1 billion of funding from the Mayor of London to deliver 11,000 new council homes across the capital.[15] The fund was significantly oversubscribed, with bids submitted by boroughs for almost 6,000 further homes that the Mayor was unable to fund.[16]

For housing associations, there has been significant increases in average delivery rates over recent years to meet stretching affordable housing targets. The number of completions achieved in 2020-2021 was 11,252 (an increase of 19 per cent from 2019-2020), with 80 per cent of these affordable housing units.[17]

Under the Mayor's funding arrangements, GLA strategic partnership status is available to housing associations committed to building substantial numbers of new homes in the capital, with at least 60 per cent being affordable. In signing GLA strategic partnerships, many G15 members increased their bids by 50 per cent during the 2021/26 Affordable Homes Programme, reflecting the attractiveness of these arrangements. In return, strategic partners are granted certain privileges, including the possibility of more flexible funding conditions and support for land acquisitions.

All eleven of the current GLA strategic partners are GI5 members, and collectively, G15 members have been awarded over £2 billion of mayoral grant funding by City Hall to build 53,700 affordable homes by March 2023[18].

Despite this commitment, and support through grant funding, serious challenges remain that make the environment challenging for social sector providers.

[15] 'Mayor agrees £1 billion plan to build 11,000 new council homes', Greater London Authority, 23 October 2018

[16] Council Homes Scheme (4), Mayor's Question Time, 22 November 2018

[17] Greater London Authority Affordable Housing Statistics

[18] https://www.whatdotheyknow.com/request/strategic_partnership_agreements

Addressing the affordability challenge

5. What interventions could better ensure that market housing is delivered at a price point the meets the needs of Londoners?

6. What strategies are your organisation taking forward to maximise affordable housing supply?

7. How are market pressures (including the weakening potential for cross-subsidy) affecting your organisation’s development programmes and the level of affordable housing that can be brought forward?

8. How could more short-term capacity be released from your borough’s long-term Housing Revenue Account business plans?

9. What impact do the recent Right to Buy flexibilities have on your borough’s local development programmes?

5. Challenges to social sector delivery

Despite some improvements in the policy and funding framework for social housing providers, there are still structural factors that make the environment for housing delivery more challenging. The consequences of these is a greater difficulty for the social sector to deliver new homes, particularly in higher value parts of London.

Threats to the cross-subsidy development model

As grant rates for new social sector housing have been cut, the sector has been encouraged to develop a greater reliance on the cross-subsidy model to fund affordable housing delivery; utilising funds raised through open market sales to fund the gap in grant funding.

Taking a longer-term view, the grant rates available to support development have fluctuated over the past decade, with a 2014 G15/Frontier Economics research paper highlighting a substantial reduction in grant rates from 41 per cent of unit costs under the 2008/11 National Affordable Homes Programme to 23 per cent under the 2011/15 Affordable Homes Programme. This cut was predicated on the introduction of Affordable Rent,[19] which replaced capital grant funding with an increased rental stream and enabled housing associations to take on more borrowing against the higher rental income to fund development.

In London, grant rates for affordable rented homes increased under the 2021/26 Affordable Homes Programme to a maximum of £70,000 for housing associations and £100,000 for local authorities. However, total scheme costs have risen to nearly £400,000 per unit in the capital on average, so current grants constitute around 17.5 per cent of total scheme costs. This means that for every £1 of GLA grant housing associations receive, they spend a further £6 from their own borrowing and resources.

Data from individual G15 members clearly illustrates this challenge. 2019 analysis by Network Homes[20] showed that 51 per cent of the cost of their home building programme was government funded between 2008 and 2011. In contrast, the government grant received for the 2016/21 programme is covering only 12 per cent of scheme costs.

The cross-subsidy model is becoming increasingly untenable in the face of market conditions and pressures on financial covenant limits. While it could be viewed as a good example of effective public-private partnership, it also increases market exposure, which brings fresh challenges, including the prospect of regulatory downgrades and poorer credit ratings as the regulator and credit agencies reflect on the higher degrees of risk.

The G15 has previously expressed serious concerns about the impact that a slowing housing market and rising development costs would have on the cross-subsidy development model.

Illustratively, one association's stress testing – conducted in June 2018 – showed that, based on a 35 per cent fall in house prices, interest rates rising to 4 per cent and a doubling of

[19] Affordable rent is no more than 80 per cent of the local market rent (including service charges, where applicable).
[20] 'Why aren't housing associations building more affordable homes?', Network Homes, 2019

unemployment, their development programme would need to be scaled back by around a quarter. In theory, housing associations have the capacity to 'flip' market sale homes to affordable rent to reduce their exposure to the market. However, this would inevitably mean fewer homes being built across tenures, given the loss of cross-subsidy from homes for open market sale or shared ownership.

Across the G15, homes for shared ownership or open market sale represent a substantial proportion of total forecast starts and completions in the capital. In 2020/21 they are expected to constitute 44 per cent of starts and 54 per cent of completions[21]. Both tenures carry a commercial risk. Shared ownership could expose social housing providers to greater risk in the event of a downturn, given it is open to buyers with comparatively low incomes who are more economically precarious. Furthermore, the government's recent changes to the shared ownership model have introduced the ability for customers to purchase initial shares from as little as 10 per cent, alongside 'micro-staircasing' in increments of 1 per cent, and a new repairs contribution from providers. These changes all require additional investment from providers in delivering shared ownership units, or for greater levels of grant funding to be made available, further reducing the level of cross-subsidy that shared ownership housing can currently generate.

For local authorities, a house price downturn would have some negative impact on the majority of councils' ability to deliver affordable housing. The extent of this impact is variable depending on the assumptions made in boroughs' development proposals and how extensive scheme proposals are (for example, estate regeneration schemes, which unlock significant levels of new supply, are likely to be more vulnerable to negative impacts on the cross-subsidy model because of the mix of tenures usually involved). However, a significant minority of boroughs identify a more limited impact, primarily because their programmes only rely on a small proportion of cross-subsidy from market sale and have taken a more cautious approach in their viability assessments that accounts for the possibility of a house price downturn.

Boroughs also identify potential remedies to a downturn, such as flipping the tenure of units in their programmes. Some also highlight the potential opportunities that may be presented by a downturn, including the acquisition of distressed private developments to increase the council-owned housing stock, while others would expect to see build cost reductions as private sector developers search for work in the public sector.

As Savills has identified, pressure on housing associations' finances is emerging in the form of interest cover.[22] Whilst the end of the government's centrally imposed 1 per cent rent reduction over recent years is welcomed, the fall in income from the rent reduction whilst costs continue to rise is adding pressure to operating margins and in turn interest cover. Similarly, the additional investment being made in planned maintenance works exacerbates this challenge. This places further pressure on the cross-subsidy model.

[21] Greater London Authority Affordable Housing Statistics
[22] ['What can housing associations do to ease financial pressure?', Savills blog post]

Challenges in mobilising development through the Housing Revenue Account

Boroughs strongly welcomed the government's removal of the HRA borrowing caps in October 2018. However, challenges remain to mobilising development through the HRA, including the difficulty of ensuring the viability of individual schemes, insufficient levels of grant subsidy and land availability. For larger schemes, councils will still find it challenging to leverage the level of borrowing needed to fund these developments, particularly where the potential for cross-subsidy is uncertain. Many council HRA's have also felt significant negative impacts as a result of the COVID-19 pandemic, with data from June 2021 projecting a £33 million hole in finances for the financial year 2021/22 as a result of lost revenue income (e.g. from higher rent arrears and longer void periods) and increased spending (such as from workforce pressures and additional personal protective equipment) alongside the pressures from investment requirements in existing stock.

Prior to the removal of the HRA borrowing caps, the aggregate borrowing cap in London totalled £7.8 billion compared to actual borrowing of £6.2 billion (i.e. leaving 20 per cent 'headroom' for additional borrowing). In 2018/19, boroughs were expected to generate £2.8 billion of HRA income, of which £722m will be spent on servicing existing HRA debt (26 per cent). This compares to £1.7bn of expected expenditure on repairs, supervision and other running costs (58 per cent) and £440m of other expenditure (16 per cent).

Modelling conducted by London Councils in 2018 suggested that additional rents generated from new housing stock would not be sufficient to cover necessary additional financing costs that would be generated over the 30-year duration of an HRA business plan. For example, 15,000 additional homes would generate £4.5bn of additional HRA income over 30 years whilst creating additional debt servicing costs of £8.5bn. As new stock would not be self-financing over a business plan period, any additional borrowing would need to be serviced by reducing spending on other areas (e.g. repairs, supervision etc.) or through the acquisition of grant funding. As an example, under the model's central assumptions, the financing costs of 15,000 additional homes would mean that aggregate 30-year expenditure on non-financing costs would need to reduce from £84bn to £81bn over 30 years.

The relatively high level of existing HRA debt and the very long time it takes for a new house to 'pay for itself' means that the removal of the HRA cap has a relatively modest impact in terms of additional housebuilding in London. The provision of grant funding, and the higher rate of £100,000 per property to reflect the boroughs' unique position as house builders, has been welcome, but further measures – discussed in the recommendations section – are needed to support councils further. The situations will be different in different boroughs, but the lifting of the cap alone will not lead to the step change in supply needed.

Social rent reduction

A particular issue remains the lasting impact of the 1 per cent a year reduction in social sector rents, introduced by government for the financial years 2016/17 to 2019/20, which forced boroughs to revise their HRA business plans and considerably scale-back plans for stock improvement and new building. Given the previous policy was to raise rents by CPI inflation + 1 per cent each year, it was expected that social rents would be 12 per cent lower than they would otherwise have been by 2019/20. Councils make HRA spending plans over 30 years, so the negative impact to local ambitions is plain to see.

For Housing Associations, the policy was estimated to have created a cumulative £3.85 billion loss in rental income nationally over the four years that it has been in place; the equivalent cost of building around 27,000 new affordable homes. It is estimated that the cut equated to a loss of around £500 million in rental revenue per year across the G15 group.

While the reversion back to a CPI+1 per cent rent policy for the five years from 2020 is welcome, the legacy of rent reduction has left significant funding shortfalls in HRA funds that will be entrenched under the new rents regime. This issue is particularly problematic for local authorities that had historically kept rents very low, as the CPI +1 per cent policies exacerbates these differences and disproportionately impacted on those councils. The ability of Government to influence rents in this way impacts on some boroughs business plan assumptions, which impacts on future long-term capacity.

Right to Buy

Another key determining factor in capacity of the HRA to deliver homes is the failure to replace social housing sold through Right to Buy (RtB). In 2012 the Government decided to ‘reinvigorate’ Right to Buy, increasing the discount on council homes to £75,000 across England. The following year the discount was increased to £100,000 in London. The Government promised one-for-one replacement, and despite the significant fall in Right to Buy sales since 2015, 13,182 homes have been sold by councils in London under RtB since 2015/16, while just 9,562 replacement homes have been started over the same period using receipts from the scheme.[23] A 2018 study by CIH’s estimated that reducing discounts by just a third could free up enough funds to deliver an extra 12,000 homes a year nationwide.[24]

In March 2021 the government introduced welcome reforms to RtB. These increased the time limit for spending receipts from 3 years to 5, increased the proportion of spending permitted on individual developments from receipts from 30 per cent to 40 per cent, and allowed councils to use receipts to deliver shared ownership and First Homes. However, reforms also introduce a cap on the number of existing properties that could be acquired by councils, which provides an avenue for quick additions to the council’s housing stock and can provide a positive strategic use of receipts (for example, to acquire properties near to existing housing stock).

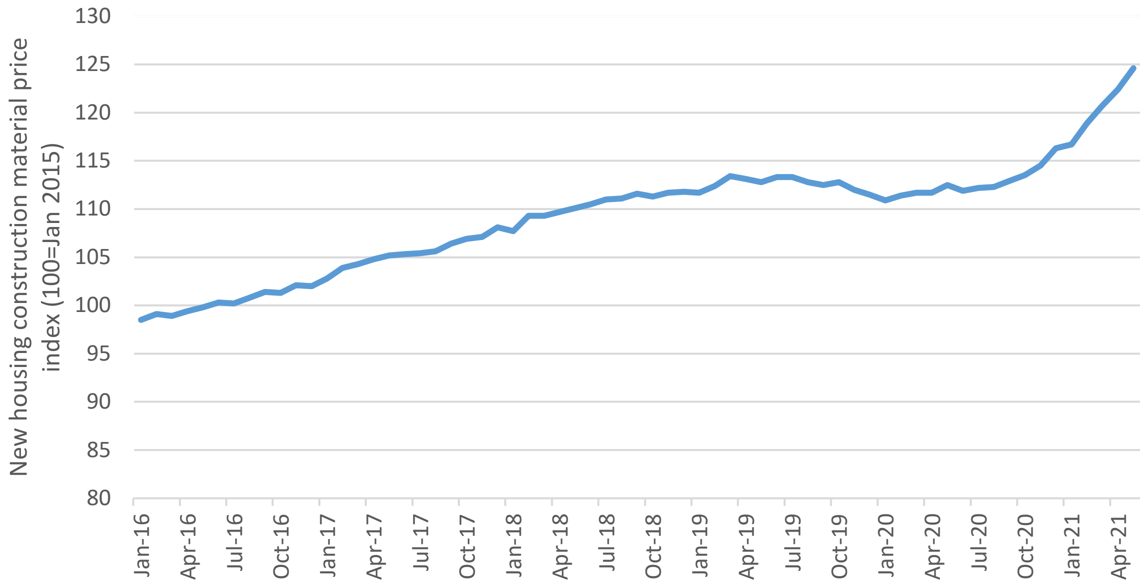
RtB has steadily eroded the council housing stock for three decades. Moreover, there are serious questions as to the social outcome of the scheme. A 2019 study found that councils in London were spending over £22m each year renting back homes sold under RtB and that number of RtB homes now in the private rented sector has risen by at least 11,825 over the preceding last five years to approximately 54,000. The stats now show that 42 per cent of homes sold through RtB in London are now let by private landlords at market rates – up from 36 per cent in 2014.[25]

[23] Live tables on social housing sales, Ministry of Housing, Communities and Local Government
[24] ‘CIH calls for right to buy to be suspended as discounts climb to ‘£1bn’’, Public Finance, 4 October 2018
[25] ‘Councils fork out millions renting back Right to Buy properties’, 21 January 2019

Build costs, material availability and skills shortages

The impact of Covid-19, Brexit and a global surge in demand as construction recovers from the pandemic have all driven build cost inflation across the sector. From its 2015 baseline to 2019, the government's Construction Material Price Index for new housing shows an average annual increase of 3.1. But in the last 6 months, costs have soared, with the latest index for May 2021 reaching 124.6.[26] The price of tender responses for construction projects is also anticipated to increase significantly over the next few years as a result, with projections of around 3 to 4 per cent inflation per year.

Figure 9: New Housing Construction Material Price Index



Source: BEIS

The availability of materials was cited as a major development constraint by 59 per cent of respondents in the Q1 2021 HBF survey, up from 26 per cent the previous quarter. Global demand for raw materials has outstripped supply resulting in disrupted supply chains and inflated prices. Material prices rose by 5.6 per cent in the year to Q1 2021 and are forecast to increase by 7.2 per cent in the year to Q2 2021, according to the BCIS Materials Cost Index, with materials such as timber, steel and concrete witnessing the greatest price increases.

Timber has experienced a significant spike in popularity driven by global demand from countries such as the US. Many developers are also using the material as an effective means to reduce embodied carbon emissions in construction and new development, tying in with the Government target of net zero carbon emissions by 2050. Material shortages are one of the most significant challenges facing the sector, as warned by RICS. Housing associations have faced unprecedented development delays of up 10 weeks on completion as a result of material shortages, according to Inside Housing.

[26] Building materials and components statistics: June 2021, Department for Business, Energy & Industrial Strategy

Labour shortages could also prove another fundamental obstacle for the sector with the construction industry facing shortages in specific trades as a result of EU workers leaving the UK, the increasing demand for construction workers to retrofit buildings and the scale of workers required for large infrastructure projects such as HS2. Analysis for the Home Builders Federation in 2017 showed almost half of all housebuilding workers in the capital are from EU27 countries, as compared to 18 per cent across Great Britain.[27] Since 2017, there has been a 42 per cent decline in the UK's EU construction workforce, according to ONS figures. Furthermore, it is estimated that the average age of a construction sector worker is 56 years, highlighting the future challenges in resourcing much needed housing development. While wage inflation within the sector was suppressed by the pandemic, there is evidence that they may be set to rise, with reported wage inflation of 4.8 per cent on London construction sites between May and June 2021 alone.[28]

For councils, there are also associated gaps in skills within local authority development teams. From a standing start, councils have had to attract and develop the necessary skills in order to start building council housing at scale for the first time in over 30 years.

While the disruption caused by the global pandemic may be short lived, material and labour shortages are anticipated to continue to impact the development sector. The Future Homes Standard will come into effect from 2022. It mandates a 75-80 per cent reduction in emissions in new build homes by 2025 and estimates of additional costs to meet the standard are predicted to be in the range of 1-2.5 per cent per house, according to figures published by some of the major housebuilders. Pressures on better design and placemaking under the National Model Design Code published at the start of 2021 will further drive up build costs.

[27] Home Builders Federation analysis
[28] 'London wage inflation attributed to Brexit factor', The Construction Index, 15 June 2021

6. Impact on delivery in locations and by products

The trends in the housing and land markets, along with the financial and structural challenges faced by social sector providers, have resulted in a changing geographic pattern of delivery and increased the difficulty of delivering particular tenures without significant subsidy.

Delivery by tenure

With the challenges of delivering new homes increasing in London, this has had an impact on the viability of particular tenures, which are explored below.

- *Social/London Affordable Rent:* Whilst boroughs place the highest priority on delivering these tenures, it also faces the greatest viability barrier due to the lack of public subsidy. Boroughs identified related barriers, such as the strain on HRAs and the need for certainty in rent policy over 30 years to enable business planning. In many instances boroughs receive an insufficient number of tender responses from the development sector when putting forward schemes including significant levels of social rent, highlighting the viability challenge for these schemes.

- *Shared ownership:* Barriers to delivering shared ownership include the lack of political support in some boroughs,[29] the insufficient level of available grant subsidy and the particular challenges for councils in holding the long-term debt on their balance sheets. Shared owners can also face difficulties in staircasing and up-sizing to larger accommodation.

- *First Homes:* The introduction of First Homes presents a particular concern in relation to the affordability of the product in London. Analysis undertaken by Savills found that the average household income required to afford a First Home across the Greater London region would typically be £67,600 for a two-bedroom property (with a 15 per cent deposit), compared to the median household income of £38,500,[30] and accessible to just 12 per cent of households. The discounts offered on properties, at up to 30 per cent of value, also raise concerns that the provision of First Homes will limit the supply of genuinely affordable homes, such as social rented housing, that can be leveraged through planning gain.

- *London Living Rent and other intermediate rent:* London Living Rent (LLR) is generally viewed as the least favoured affordable tenure to deliver locally. In many boroughs, shared ownership is favoured over LLR as an affordable home ownership option because the 'buy or leave' element of LLR caused concern, while the product also creates complexities in management and is less financially viable than shared ownership.

  Housing Associations have similarly raised concerns about the tenure, particularly highlighting that delivery levels have been low due to the uncertainty regarding the precise expectations of housing associations after a household has been in-situ for 10

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[29] While recognising the role that shared ownership can play in many parts of London to provide an accessible route to home ownership.
[30] Household income data provided by Experian.

years. At this point the tenant is expected to have purchased the home on a shared ownership basis, but it is unclear what happens if the tenant is unable to do so. It is also possible that the option to buy is never enacted if successive households move out without exercising the right to purchase, which heightens financial uncertainties within business plans.

Location of housing delivery

The increase in land values in central- and inner-London, along with the reducing viability of the cross-subsidy model, has made delivery more challenging in these areas for social sector providers. An outcome of the more challenging delivery environment in London has led to a longer-term trend whereby a greater proportion of G15 delivery is now taking place outside of London (although the number of homes being delivered have increased in both areas, and with a significant increase in starts within London in 2020/21).

Starts	London	Outside London
2015/16	69%	31%
2016/17	68%	32%
2017/18	63%	37%
2018/19	56%	44%
2019/20	59%	41%
2020/21	67%	33%

Completions	London	Outside London
2015/16	76%	24%
2016/17	76%	24%
2017/18	65%	35%
2018/19	69%	31%
2019/20	62%	38%
2020/21	65%	35%

This trend does not reflect a strategic decision to move development away from London. However, this is likely to reflect that land values continue to increase in London relative to the rest of the country, with less competition for sites outside the capital, and a greater buoyancy in the market outside of London, which better supports the cross-subsidy model.

Building safety

The 2017 Grenfell Tower disaster highlighted the devastating shortcoming of the regulatory system governing building safety. The response to the crisis has led to significant investment across the social sector to remediate buildings with unsafe cladding systems. G15 members have already invested £350m on fire remediation works between 2019 and 2021, and collectively have set aside £2.9bn over the next 10 years to fund further works. This investment is equivalent to the delivery of 58,000 affordable homes, assuming each new affordable home in London requires additional housing association investment of around £50k. The changing legislative and regulatory environment that will see the implementation of the Fire Safety Act, Building Safety Bill, and the creation of the new Building Safety Regulator, will undoubtedly have further challenge local authorities and housing associations resources to invest in affordable housing delivery.

Achieving net-zero carbon by 2050

It is widely recognised that existing and future homes will have a significant role to play in meeting the UK's ambitions to achieve net-zero carbon by 2050, with 40 per cent of UK emissions coming from households.[31]

The government has consulted on proposals to require all rented homes to meet an Energy Performance Certificate (EPC) rating of at least C by 2035 (2030 for fuel poor households), while the London boroughs have collectively set a target to achieve EPC B across all tenures by 2030.[32] Achieving these necessary but stretching targets will be a challenge and requires significant investment, but it represents a significant step on the way to a net zero carbon position, which has a statutory target to be achieved by 2050 (although many local authorities and the Mayor of London have set a shorter timeframe for this).

Housing providers are modelling the costs associated with retrofitting existing homes and progressing the development of new technologies to improve the performance of new homes. However, it has been estimated that to decarbonise the UK's social housing stock would require investment of £104bn, based on the average per property investment figure landlords have forecast of £20,742 per home.[33]

In London, the boroughs (led by LB Enfield and LB Waltham Forest) have established Retrofit London Home Action Plan to set out a collaborative path to achieving their home retrofit objectives. A further piece of work (led by LB Hackney) also seeks to ensure low carbon development is the norm across London. Limitations on resources, especially for local authorities through Housing Revenue Accounts, but also for housing associations due to financial covenants and regulatory requirements, mean that pace at which progress towards net-zero is made could have a material effect on investment in new affordable housing.

Delivery by tenure and location

10. Does your programme seek to prioritise delivery in areas with the greatest affordability challenges and how has the location of delivery changed for your organisation in recent years?

11. How can the provision of infrastructure and place-based grant funding programmes better unlock housing delivery?

12. Has your organisation's appetite for shared ownership changed with the introduction of the lower entry model?

13. To what extent can estate regeneration proposals unlock supply and improve housing conditions, and what funding programmes are needed to support this?

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[31] Committee on Climate Change fifth carbon budget analysis
[32] London Councils pages on climate change
[33] 'The cost of net zero: social landlords' decarbonisation plans revealed', Inside Housing, 23 November 2020

7. Recommendations

1. **Market failure in housing**: short-term forecasts from Savills show that the market is unlikely to meet the housing delivery targets in the new London Plan. There is also an affordable housing paradox that persists in London: high prices, low wages relative to house prices, a high demand for affordable homes, and a continuing over-supply of new homes aimed at higher earners, and an under-provision of homes for low- and middle-income households.

    - The market is not delivering the homes to meet demand. There is a clear opportunity for social housing to step up to fill more of this gap, and a clear appetite to do so. The government needs to work with and fully back social housebuilders to deliver on this agenda.
    - Government and the GLA where possible should seek to align the objectives and delivery of the multiple grant funding programmes operating in London to achieve place-based investment that will unlock new supply and improve existing housing conditions through regeneration. This will seek to ensure that these achieve the biggest impact and succeed in unlocking new development opportunities.
    - Government should commit to fund key infrastructure that supports development sites, giving confidence to the market, and bring forward further infrastructure opportunities for this, building on the success of programmes such as the Housing Infrastructure Fund.
    - Revenue funding should be provided to councils to undertake an assessment of all land opportunities for affordable housing, with a view to establishing their development potential, infrastructure requirements and suitability for development.

2. **Threats to the cross-subsidy development model:** the social sector's reliance on a cross-subsidy model to deliver new affordable housing, following the reduction in the proportion of scheme costs met through grant funding since 2010, is reaching a tipping point. Market prices are too high to support market sales, yet the slowing growth in house prices makes the cross-subsidy model increasingly difficult.

    - The government should significantly increase grant funding for affordable housing to support the delivery of genuinely affordable homes that meet local need as both a proportion of scheme costs and to expand overall supply.
    - Government should make a 30 year commitment to increase social housing rents by CPI + 1 per cent starting immediately. Flexibility on rent rises should also be granted to councils that can demonstrate a positive correlation between additional house building and reductions in housing benefit, and/or have historically low rents.
    - Government should provide financial backing to housing associations and councils to act as a 'buyer of last resort' for bulk purchase of unsold market homes at cost where they deliver value for money.

3. **Challenges in mobilising development through the HRA:**

    - Complete flexibility over RtB receipts: Government should go further in removing all caps on the proportion of RtB receipts that can contribute to new homes, the time limit on their use, and punitive interest charges that penalise councils for proper long-term planning of sustainable housing developments. Furthermore, local flexibilities should be granted to set discount rates commensurate to local conditions and needs and to enable partnering of RtB receipts with other forms of grant funding.
    - HRA flexibilities: To increase delivery and better meet local demand by direct support to enable a range of tenures to be delivered inside the HRA, including intermediate and market rent. The goal would be to meet different community needs and cross subsidise to deliver a net increase in social housing.
    - Council owned housing companies: Permit borough housing companies to access and use all forms of borough funding, including RtB receipts and s106.
    - Consider re-opening the HRA debt settlement to enable more overall housing supply through this route.
    - Government should provide a longer-term commitment to PWLB interest rates to enable longer-term planning of new development sites.
    - Councils and housing associations should be supported with grant funding for replacement homes to take forward estate regeneration schemes where these have the support of local residents and lead to an increase in overall supply, with greater certainty of funding for replacement homes either directly through the Affordable Homes Programme or outside of this to enable new supply.
    - Government should support councils to take forward complex sites through the provision of longer-term grant funding arrangements. This would provide certainty to councils when taking a position on large or complex sites, encouraging acquisition of a land pipeline for future programmes, and contribute to improved quality and cost control.

4. **Skills shortage and wider market uncertainty**: wider challenges persist in relation to the supply of skills and uncertainty around market conditions. These risks are exacerbated by post-Brexit and general market conditions.

    - Local authorities and the G15 should work together to develop opportunities for skills sharing arrangements between willing partners, that enables secondment possibilities and other forms of knowledge transfer.
    - Local authorities will work jointly to establish joint opportunities for training and development. This includes taking forward the recommendations of a recent Future of London report for the London Housing Directors' Group, including in relation to developing a new skills academy and shared graduate development and apprenticeship routes.
    - Government should develop a post-Brexit visa system for construction workers to support continued capacity within the sector.
    - Government should work with local authorities and the GLA to establish a further dedicated round of revenue funding to support local authorities to improve

capacity within development team and upskill development staff, building on the successes of the Home Building Capacity Fund.

5. **Support for social housing providers to meet building safety and net-zero costs:** meeting the twin challenges of tackling the building safety crisis and ensuring social housing plays its full role in tackling the climate emergency will require significant resource investment, potentially impacting the supply of new affordable homes.

    - Government should immediately expand the Building Safety Fund to support remediation costs facing social housing providers in addition to those that would have otherwise been met by leaseholders.
    - Government to work with the Fire Service, fire safety experts, lenders, insurers, and valuation agencies to ensure that a proportionate approach to risk prioritisation is adopted that ensures buildings with the highest risk are addressed, without trapping thousands of homes in the building safety crisis despite posing low levels of risk.
    - Government to work with social housing providers to set agreed targets for carbon reduction in existing and new homes and bring forward access to the £3.8bn Social Housing Decarbonisation Fund in a manner that supports long-term investment in home retrofit and provides certainty to the trades sector to develop capacity.
    - Government to work with councils, the Mayor of London and the wider social housing sector to develop London’s skills base in relation to home retrofit and zero-carbon development.

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