RF12.

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Briefing note

Radical Reform of Residential Development Policy

We are in the midst of radical reform of the policy framework in which residential development takes place, creating a new dynamic that will challenge the existing assumptions of both private sector developers and housing associations. The new system frees participants from many of the uncertainties attached to the grant system and allows new development to proceed on the basis of viability rather than limits to annual expenditure or regional targets.

There is, and will be, inevitable friction as the planning system moves towards a new localist system. Moreover, we need to understand the balance of gains from the freedoms to set higher affordable rents against the loss of rents, and potentially higher funding costs from the reforms and limits to housing benefit. There will be winners and losers from such radical change. We could call for the practical details of reform but this would be misplaced. The whole direction of the Coalition is to move from a centralist position of dictats and targets to creating a system where innovation flourishes.

The opportunity exists to create new systems of working that drive forward new housing provision.

It is important to understand the scale of changes that are delivered by the Comprehensive Spending Review, together with other reforms previously announced.

What we know

- Affordable housing grant will be cut to £4.5bn over the 2011-14 period, equivalent to £1.1bn per annum (see chart overleaf). This is a cut of more than 60% from the annual average spend of £2.9bn in 2008-11.

- This will be offset by housing associations being able to set rents on new social housing at up to 80% of market rents (possibly capped in line with Local Housing Allowance, as noted below). The new Affordable Rent units will be let on fixed term tenancies of, say, five years, with the expectation that they will relet at these rents. It seems likely that when existing stock becomes vacant it will also be relet as Affordable Rent.

- No new funding has been announced for the housing market stimulus programmes Homebuy Direct and Kickstart, nor for the Housing Growth programmes that have invested in infrastructure projects in the Growth Areas, including the Thames Gateway.

- Spending on Housing Benefit will be cut. Local Housing Allowance will be capped from April 2011 (for example, at £340 per week for a three bedroom property). From October 2011, LHA will be set at the 30th percentile of market rents in each Broad Rental Market Area rather than the 50th percentile (median).

- A wider package of reforms will apply to LHA and Housing benefit, including indexation of LHA to CPI rather than RPI.

- With the exception of London, Regional Spatial Strategies (and the housing supply targets within them) have been revoked. The role of the new Local Enterprise Partnerships could include strategic housing delivery.

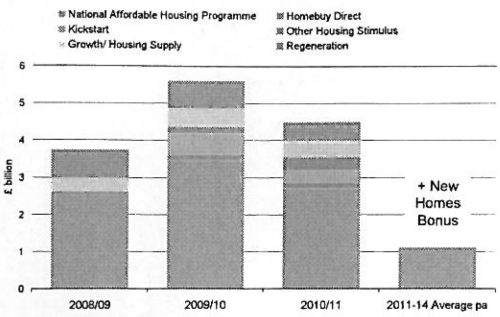
- Local authorities will set housing targets locally and will be incentivised to develop via the New Homes Bonus which will, from April 2011, match fund the first six years of council tax receipts from new homes, plus a 25% premium for affordable homes. Central funding for the New Homes Bonus is set at £900m over four years, but most of the funding will come from reallocation of local authority grant. Total local authority receipts from the New Homes Bonus could build to more than £1bn per annum by year six of the programme.

- There is a commitment to reduce the total regulatory burden on the house building industry over the Spending Review period.

- Tax Increment Financing will allow local authorities to fund infrastructure by borrowing against the future income stream from higher business rates in areas of investment.

- The new Regional Growth Fund will be worth £1.4 billion over three years, to create jobs and growth in places currently heavily dependent on the public sector. This could include support for activities such as housing growth and market renewal.

Figure 1
Grant for Housing Supply & Regeneration



Source: HCA Corporate Plan 2009, CLG Homebuy statements, CSR Settlement

Outlook

Affordable housing grant has been slashed, alongside changes designed to increase the capital value of social rented housing, via higher rents and fixed term tenancies. We are told that much of the £4.5bn settlement is already committed to development schemes in the system, so the money for units, subject to the new tenure, is likely to be more restricted than suggested by the headline figures. With so little affordable housing grant available, it would be unwise to expect any grant for new shared ownership units.

The capital value of the new tenure will vary according to the strength of local markets and the way in which rents are set to meet local needs. In many markets outside London and the south, the gap between existing social rents and market rents is not great, limiting the upside to value. Where there is a significant gap, the rents of new social rented housing is set at 20% below market rents, which could drag private rents down.

All depends on the strength of tenant demand in the private sector. In higher value markets where tenants in receipt of Housing Benefit form a significant proportion of demand, there will be additional downward pressure on rent levels.

Some of the most significant unanswered questions relate to how the new rented tenure will be used to meet local needs, where affordability for those in need points to a continuation of lower rents. Under the localist agenda, local authorities are likely to have much discretion here, so it will be crucial that the financial consequences of different options are well understood by all parties.

Section 106 Agreements

All of this means that negotiation of a Section 106 planning obligation to provide affordable housing (and other obligations to mitigate any impact of the development) will become much more complex. It will require an understanding of the strength of local markets and how 'reform proof' they are likely to be. It will also require an understanding of housing need in an area, with a clear case made for which type of need will be met by the new dwellings proposed. We can expect a focus on the needs of lower income working households.

Most, if not all, existing Section 106 agreements have been based on a very different set of assumptions, which may mean that the agreements are undeliverable. These agreements will need reviewing, with regard to both their deliverability and their impact on development viability. With so much more flexibility and choice in the system, viability appraisal is set to become much more central to assessment of development options.

Financing

Development of new social housing by housing associations has in the past been financed by a combination of debt, grant and cross subsidy, usually from development of shared ownership property. This model will evolve as development switches to the new tenure, as the drivers of performance shift away from an RPI indexed income stream underwritten by Housing Benefit, to market based income growth plus reversion to open market value. The risk and reward profile of developing social housing will change. Developing housing associations will become more market orientated, private sector investment will be drawn in and new players will emerge.

Planning

The old regional planning architecture has gone, outside London. Although the new local architecture is not yet in place, the Local Growth White Paper provides some important signposts. These include a national presumption in favour of sustainable development, a statement that the planning system should provide sufficient housing to meet demand, and the role of local authorities in ensuring a responsive supply of land that supports business growth and increases housing supply. It seems that evidence of unmet demand for housing, links to business growth and the deliverability of land are going to play a key part in the new localist system.

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