Housing Supply & Affordability

Kevin Williamson, Chief Executive
National Housing & Planning Advice Unit

15th October 2008
For many people, housing has become increasingly unaffordable over time. The aspiration for home ownership is as strong as ever, yet the reality is that for many this aspiration will remain unfulfilled unless the trend in real house prices is reduced. This brings potential for an ever widening social and economic divide between those able to access market housing and those kept out.

Kate Barker 2004
Barker found that we were amongst those nations building the least number of new homes...

![Completions per 1000 inhabitants: period 2004-2007](source: Euroconstruct)
...and that we suffer higher house price inflation relative to most other nations

Real average annual house price growth 1970 - 2006

Source: Bank for International Settlements

building awareness for the future
At a national level there is a political consensus about the need for a step change in housing supply

Government

Homes for the Future: More Sustainable, more affordable. Aim to deliver 240,000 new homes a year, 2 million by 2016 and 3 million by 2020.

Conservatives

Shadow Housing Minister [Housebuilder October 2008] “What we want is a stable housing market. Affordability is the result of supply and demand for new houses being in line. [Commenting on the shortfall in delivery of homes over the past decade]…that is a third of a million new homes that could and should have been built.”

Liberal Democrats.

Homes for All: Action to tackle the Housing Crisis. ‘The aim is to build…2.6 million new homes in 10 years…, with half being built for the open market, a quarter for the ‘affordable’ sales market, with that affordability retained when resold, and one quarter of the new homes to be social housing.’
Barker recognised the need for a balanced approach to spatial planning

Social

Environmental

Economic

Global / National / Regional / Local

Net community benefit

Sustainable development
NHPAU role is to provide independent advice on housing market affordability

Three main elements of work programme:

- Engagement with Regional Assemblies, Development Agencies and the Government Offices, through the **Regional Spatial Strategy process**, to provide advice about the impact of housing supply plans on market affordability.
- Delivery of a range of **research projects** which consider specific aspects of the affordability issue, providing advice to Government, the regional partners and others to inform the development of policy and practice.
- To provide regional planning authorities with **practical support** in meeting their obligations under Planning Policy Statement 3 on Housing to consider affordability. This will include use of econometric models and other statistical analysis relevant to the housing market.
The work of NHPAU is steered by an independent expert Board

Prof. Stephen Nickell (Chair)
(Warden of Nuffield College, Oxford and former member of the Bank of England Monetary Policy Committee)

Prof. Glen Bramley
(Professor of Housing & Urban Planning, Heriot-Watt University)

Prof. Paul Cheshire
(Professor of Economic Geography, LSE)

Bob Lane
(former Chief Exec for Catalyst Corby/North Northants Development Co.)

Max Steinberg
(Chief Executive of Elevate East Lancashire)

Dr Peter Williams
(Executive Director of the Intermediary Mortgage Lenders Association and former Deputy Director General with CML)
NHPPAU will play a full and ongoing role in the RSS process

NHPPAU advice on housing supply

HMG guidance on housing supply

Working level engagement with NHPPAU

Background research / technical work

Options stage

Development of Draft RSS

Submission of Draft RSS

Examination in Public

Proposed Changes

RSS publication

Sustainability Appraisal (including SEA)

building awareness for the future
Affordability *Still* Matters

July 2008
What are the prospects for the housing market?

‘House prices in England will begin to recover in 2010 and then rapidly grow over the following three years, increasing by an average of 25% by 2013.’ NHF – August 2008

‘Expect house prices to fall 25% from 2007 peak.’ Nationwide – September 2008

‘Over the medium and long term, the 70% of the nation who are homeowners will continue to see excess house price growth, until and unless the rarity value of housing is diminished by large quantities of additional, high quality, competitive supply.’ Savills – September 2008

‘House building grinds to a halt - and sows seeds of next boom. A sharp fall in house building, with 20 per cent fewer completions forecast for 2008 and 10 per cent fewer in 2009, is likely to be one of the key factors in prices recovering by the end of next year.’ CEBR - September 2008.
This shift in the market and sentiment is driven by problems in the finance sector

* Massive liquidity operations
* Bank bailouts & nationalisation
* Credit squeeze spreads...
* Confidence falls
* Share markets slump
* Central banks cut rates
* Govt attempts to remove toxic debt, recapitalise banks

* US house prices fell
* Mortgage rates rose
* Sub-prime mortgage defaults rose

* Large losses for mortgage lenders & insurers
* Mortgages default
* Widening spreads on BBB rated assets, collateralised by subprime mortgages

* Risk aversion/flight to quality
* Corporate credit hit
* Interbank spreads explode
* Equities hit, Treasuries rally
* Securitisation market frozen

building awareness for the future
This process has been unwinding for a year already. It will be some time before the full impact on the housing market and wider economy is known.

**Adopting the Swedish Model?** Sweden successfully tackled major banking failure in the early 1990s. They took a 6 step approach:

- Shore up market **liquidity**
- **Guarantee** bank deposits
- **Structures**: set up Swedish Bank Support Authority (SBSA)
- **Triage** – identify and separate out toxic debts and/or banks from the rest
- **Recapitalise** banks through government equity stake (about 4% GDP)
- **Transparency** – SBSA disclosed expected loan losses and asset valuations
This all makes the housing challenge faced in every region even more difficult

‘New households continue to rocket despite economic downturn
Christine Whitehead, Professor of Housing at the LSE and Director of the Cambridge Centre for Housing and Planning Research, said: “The current downturn makes achieving government housing targets very much more difficult. Yet the new population and household projections all point to long term requirements well above these targets…” TCPA – September 2008

‘Government has no chance of meeting new home building targets …while the Government wants 240,000 to be built by all sectors every year from 2016, experts believe that this year the total number of new homes [this year] could be as low as 100,000.’ NHF – September 2008

Planning regime blamed for land supply blocks
“It is our view that, on balance the evidence suggests that the planning system has acted as a constraint on land supply, especially during an upturn in the housing market.” OFT – September 2008

Rural housing shortage ‘worsens’
‘Many first-time buyers cannot afford property in rural areas in England. The number of people waiting for affordable housing in rural areas has increased by more than a third over the past 5 years. About 700,000 people were waiting for a home, 37% more than in 2003.’ CPRE – September 2008
Of course, there have always been ups and downs in the housing market, but the trend in prices over the past 30 years has been **real** annual growth of 2.9 %.

**Real House Prices**

Source: Nationwide Building Society

Base: 2008 Q3

Trend from 1975 Q1 to present

Trend = c2.9% per annum
And let’s be clear, falling prices in the short term are not improving affordability prospects in any meaningful way.
By any measure affordability remains stretched.

Nationwide First Time Buyer Affordability Indices [UK]

Mortgage payments (capital and interest) as % of take home pay

This week, this month, this year we appreciate more keenly why housing affordability matters…

- Volatile house prices lead to macro economic instability
- Boom and bust cycles create risk and speculation
- There is erosion of economic growth potential
- Young people and families unable to access quality housing
- Increases demand in the private rented sector
- Puts pressure on social housing stock
Whatever the market outlook, the level of supply will make a difference to affordability prospects in England.

Source: NHPAU Analysis using CLG Affordability Model.
Meeting the housing requirements of an aspiring and growing nation: taking the medium and long-term view

June 2008
NHPAU work on developing supply range advice was commissioned in the 2007 Housing Green Paper

‘We propose to strengthen the evidence base for those early reviews by issuing formal guidance at the beginning of the RSS preparations on the ranges of housing provision required over a 15 to 20 year period. This guidance will be based on the independent advice of the NHPAU. We will expect Regional Planning Bodies and Examination in Public Panels to test these options so that the Secretary of State can be fully informed when taking the final decisions about appropriate levels of housing provision in approving the RSS’.

‘It is Government’s role to set the overall housing ambition for the country and for the regions, acting upon the advice of the independent NHPAU and considering the national interest in the round.’
We have worked within the Government’s strategic and policy framework on housing

Main aim - everyone should have opportunity to rent or buy a decent home at a price they can afford, in a place where they want to live and work.

Key elements of strategic and policy framework we considered:

– Planning Policy Statement 3 on Housing
– Green Paper *Homes for the Future: More affordable, more sustainable* (July 2007)
– Spending Review settlement for 2008-2011
– Public Service Agreement 20 (PSA20). This set out the high level targets for increasing long-term housing supply and monitoring affordability.
– New delivery targets to be reflected in plans by 2011.
What our supply range advice *is* and what it *is not*

Our advice sets out the housing supply range that we believe should be tested by the regional partners through the planning process. *It is not a supply target.*

- Provides the ‘bookends’. Flexibility and stability.
- Non-binding advice. Regions can bring forward evidenced options outside of the range.
- Planning for land supply and all homes for delivery from 2011.
- Housing plans are important to existing communities and future generations. Our advice is focussed on the medium and long term.
- Our advice should facilitate a transparent debate about the choices to be made that will affect local communities.
- How far and how fast should the backlog of housing need and demand be addressed? What are the likely prospects for future need and demand? What would be required to stabilise affordability? What contingencies should be provided for? How are housing markets related between linked regions?
We developed our advice drawing on the best available evidence

1. CLG Affordability Model
2. Demographic (plus) Method
3. Experian macro economic modelling
An overview of the Affordability Model

- Rents
- Migration (Inter Regional, International)
- Population (n types)
- Headship Rates (n types)
- Household Formation (n types)
- Labour Supply
- Labour Demand
- Employment Unemployment Earnings
- House Prices
- User Cost
- Interest Rates
- Housing Supply
- New Construction
- Affordability
- Housing Demand
- Household Formation (n types)
- Population (n types)
- Migration (Inter Regional, International)
- Births Deaths

building awareness for the future
Understanding the market over the long run

– If real incomes rise by 1%, then house prices will rise by around 2%.

– If interest rates rise by one percentage point, then house prices will fall by around 3%.

– If housing stock increases by one percent, then house prices will fall by about 2%.

– If the number of households increases by 1%, then house prices will increase by about 2%.
Mortgage rationing would reduce prices, but the level of supply will still impact on affordability outcomes…

For illustrative purposes only

LQ Affordability Ratio

RSS supply, rationing to 2012
RSS supply, rationing to 2031
NHPAU top end, rationing to 2012
NHPAU top end, rationing to 2031
Constructing scenarios for our advice

- Income growth
- Interest rates
- Type of housing
- Tenure
- Regional distribution
- Delivery trajectory
We recognised the short term outlook for the economy and housing market and gave this weight…

<table>
<thead>
<tr>
<th>Key drivers in the CLG Affordability Model</th>
<th>Baseline Model</th>
<th>NHPAU Board Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average annual increase in income (% pa)</td>
<td>5.0% (nominal)</td>
<td>4.0% (nominal)</td>
</tr>
<tr>
<td></td>
<td>2.5% (real)</td>
<td>1.5% (real)</td>
</tr>
<tr>
<td>Average available mortgage interest rate (%)</td>
<td>5.75% (nominal)</td>
<td>6.25% (nominal)</td>
</tr>
<tr>
<td>Household projections</td>
<td>2004-based</td>
<td>2004-based</td>
</tr>
</tbody>
</table>
Supply required using revised earnings growth and interest rate assumptions

<table>
<thead>
<tr>
<th>Region</th>
<th>Affordability ratio 2007 (modelled)</th>
<th>Actual net additions 2007</th>
<th>Projected net additions from 2016</th>
<th>Average annual net additions 2008 - 2016</th>
<th>Average annual net additions 2008 - 2026</th>
<th>Total net additions 2008 - 2026</th>
<th>Affordability ratio 2026</th>
</tr>
</thead>
<tbody>
<tr>
<td>North East</td>
<td>5.34</td>
<td>7,170</td>
<td>6,600</td>
<td>6,853</td>
<td>6,720</td>
<td>127,680</td>
<td>5.01</td>
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<tr>
<td>North West</td>
<td>5.69</td>
<td>22,750</td>
<td>27,600</td>
<td>25,445</td>
<td>26,579</td>
<td>505,000</td>
<td>5.47</td>
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<tr>
<td>Yorkshire &amp; Humber</td>
<td>5.72</td>
<td>19,160</td>
<td>25,100</td>
<td>22,460</td>
<td>23,850</td>
<td>453,142</td>
<td>5.27</td>
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<td>6.57</td>
<td>22,070</td>
<td>23,700</td>
<td>22,976</td>
<td>23,357</td>
<td>443,781</td>
<td>6.13</td>
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<td>6.30</td>
<td>16,300</td>
<td>19,800</td>
<td>18,245</td>
<td>19,063</td>
<td>362,201</td>
<td>6.04</td>
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<td>East of England</td>
<td>7.83</td>
<td>24,800</td>
<td>43,016</td>
<td>34,920</td>
<td>39,181</td>
<td>744,436</td>
<td>7.82</td>
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<td>London</td>
<td>8.90</td>
<td>27,290</td>
<td>35,500</td>
<td>31,851</td>
<td>33,772</td>
<td>641,659</td>
<td>8.73</td>
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<td>South East</td>
<td>8.48</td>
<td>34,560</td>
<td>53,801</td>
<td>45,250</td>
<td>49,750</td>
<td>945,256</td>
<td>8.48</td>
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<tr>
<td>South West</td>
<td>8.71</td>
<td>25,150</td>
<td>37,351</td>
<td>31,928</td>
<td>34,782</td>
<td>660,860</td>
<td>8.71</td>
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<tr>
<td><strong>England</strong></td>
<td><strong>7.23</strong></td>
<td><strong>199,250</strong></td>
<td><strong>272,468</strong></td>
<td><strong>239,926</strong></td>
<td><strong>257,053</strong></td>
<td><strong>4,884,016</strong></td>
<td><strong>7.03</strong></td>
</tr>
</tbody>
</table>

Source: NHPAU Supply Range Advice ref scenario 2D – real earnings growth 1.5% p.a. and interest rates to average 6.25% for the whole projection period
An overview of the Demographic (plus) Method

\[ \text{Growth in number of Households} + \text{Existing Constrained Requirement} + \text{Demand for Second Homes} + \text{Vacancies in New Supply} = \text{Required Housing Supply} \]
Key variables and data sources

‘Newly arising need’
- Revised 2004-based household projections (CLG)

‘Backlog estimates’
- Sharing households (SEH)
- Overcrowded households (SEH)
- Concealed households (SEH)
- Households in temporary accommodation (CLG)
- One person households (LFS)
- Multi-person households (LFS)
- HHs with non-dependent children (LFS)

Allowance for…
- Second homes (LGF)
- Vacancy rates (HSSA / RSR)
Some indications that revised 2004-based household projections may understate position...

**Indications are that in England newly arising need / demand could be higher than indicated by the revised 2004 projections:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revised 2004-based household projections – average annual change 2004-2026</td>
<td>223,300</td>
</tr>
<tr>
<td>Holmans / Whitehead analysis of impact of 2006-based population projections on household numbers- average annual difference 2001-2026</td>
<td>+31,400</td>
</tr>
<tr>
<td>Comparison of household estimates 2004-2006 with 2004-based projections – average annual difference</td>
<td>+15,700</td>
</tr>
</tbody>
</table>

Holmans/Whitehead argue that the new household projections may overstate migration, given household formation patterns, economic outlook and recent policy changes. But important to recognise upward pressure caused by higher fertility rates.
Overcrowding in England is rising with worsening affordability…

Source: SEH, figures are three year averages including data from 2001/02 to 2006/07
...and so is the estimate of the number of concealed households.

Source: SEH, figures are three year averages including data from 2001/02 to 2006/07

building awareness for the future
### Summary table of Demographic Method results

<table>
<thead>
<tr>
<th>Region</th>
<th>Household Projections</th>
<th>Traditional constrained requirement</th>
<th>Temp.</th>
<th>Other constrained requirement</th>
<th>2nd homes</th>
<th>Vacancies</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>North East</td>
<td>6,100</td>
<td>730</td>
<td>10</td>
<td>360</td>
<td>90</td>
<td>230</td>
<td>7,500</td>
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<tr>
<td>North West</td>
<td>25,700</td>
<td>2,200</td>
<td>50</td>
<td>500</td>
<td>220</td>
<td>890</td>
<td>29,500</td>
</tr>
<tr>
<td>Yorkshire &amp; the Humber</td>
<td>23,300</td>
<td>1,500</td>
<td>30</td>
<td>560</td>
<td>200</td>
<td>790</td>
<td>26,400</td>
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<tr>
<td>East Midlands</td>
<td>22,100</td>
<td>1,100</td>
<td>30</td>
<td>490</td>
<td>120</td>
<td>740</td>
<td>24,600</td>
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<tr>
<td>West Midlands</td>
<td>18,400</td>
<td>2,300</td>
<td>20</td>
<td>960</td>
<td>190</td>
<td>680</td>
<td>22,600</td>
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<tr>
<td>East of England</td>
<td>29,900</td>
<td>1,400</td>
<td>60</td>
<td>1,480</td>
<td>340</td>
<td>850</td>
<td>34,000</td>
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<tr>
<td>London</td>
<td>33,000</td>
<td>6,300</td>
<td>290</td>
<td>1,230</td>
<td>600</td>
<td>1,230</td>
<td>42,600</td>
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<tr>
<td>South East</td>
<td>36,000</td>
<td>2,800</td>
<td>60</td>
<td>890</td>
<td>500</td>
<td>1,020</td>
<td>41,200</td>
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<tr>
<td>South West</td>
<td>28,800</td>
<td>1,100</td>
<td>50</td>
<td>970</td>
<td>620</td>
<td>860</td>
<td>32,500</td>
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<tr>
<td><strong>ENGLAND</strong></td>
<td><strong>223,300</strong></td>
<td><strong>19,400</strong></td>
<td><strong>590</strong></td>
<td><strong>7,460</strong></td>
<td><strong>2,870</strong></td>
<td><strong>7,280</strong></td>
<td><strong>260,900</strong></td>
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</table>
Experian forecasts

- Macro-economic forecasting tool
- Forecasts strongly aligned to household projections
- Full details available
### Recommended housing supply range

<table>
<thead>
<tr>
<th>Region</th>
<th>Average annual net additions to 2026</th>
<th>Minimum delivery point by 2016</th>
<th>Total net additions by 2016</th>
<th>Total net additions by 2020</th>
<th>Average annual net additions to 2026</th>
<th>Projected delivery point by 2016</th>
<th>Total net additions by 2016</th>
<th>Total net additions by 2020</th>
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</thead>
<tbody>
<tr>
<td>North East</td>
<td>6,700</td>
<td>6,600</td>
<td>61,500</td>
<td>87,800</td>
<td>7,500</td>
<td>7,600</td>
<td>66,800</td>
<td>97,300</td>
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<tr>
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<td>26,600</td>
<td>27,600</td>
<td>228,900</td>
<td>339,300</td>
<td>29,500</td>
<td>31,300</td>
<td>247,700</td>
<td>373,000</td>
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<tr>
<td>Y&amp;H</td>
<td>23,800</td>
<td>25,100</td>
<td>202,100</td>
<td>302,500</td>
<td>26,400</td>
<td>28,300</td>
<td>218,300</td>
<td>331,700</td>
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<tr>
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<td>23,400</td>
<td>23,700</td>
<td>207,000</td>
<td>301,900</td>
<td>24,600</td>
<td>25,300</td>
<td>214,500</td>
<td>315,500</td>
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<tr>
<td>West Mids</td>
<td>19,100</td>
<td>19,800</td>
<td>164,100</td>
<td>243,200</td>
<td>22,600</td>
<td>24,300</td>
<td>186,600</td>
<td>283,700</td>
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<tr>
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<td>30,100</td>
<td>32,100</td>
<td>259,600</td>
<td>388,000</td>
<td>39,200</td>
<td>43,000</td>
<td>314,300</td>
<td>486,300</td>
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<tr>
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<td>35,500</td>
<td>286,600</td>
<td>428,500</td>
<td>42,600</td>
<td>46,700</td>
<td>342,400</td>
<td>529,100</td>
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<tr>
<td>South East</td>
<td>37,800</td>
<td>38,700</td>
<td>331,500</td>
<td>486,200</td>
<td>49,700</td>
<td>53,800</td>
<td>407,200</td>
<td>622,500</td>
</tr>
<tr>
<td>South West</td>
<td>29,800</td>
<td>31,000</td>
<td>255,600</td>
<td>379,600</td>
<td>34,800</td>
<td>37,400</td>
<td>287,400</td>
<td>436,800</td>
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<tr>
<td><strong>England</strong></td>
<td><strong>231,100</strong></td>
<td><strong>240,100</strong></td>
<td><strong>1,996,900</strong></td>
<td><strong>2,957,000</strong></td>
<td><strong>276,900</strong></td>
<td><strong>297,700</strong></td>
<td><strong>2,285,200</strong></td>
<td><strong>3,475,900</strong></td>
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</tbody>
</table>
There is an obvious risk in our simple supply trajectories

‘Government has no chance of meeting new home building targets …while the Government wants 240,000 to be built by all sectors every year from 2016, experts believe that this year the total number of new homes [this year] could be as low as 100,000.’ NHF – September 2008
If pressures are not addressed we should expect social and economic consequences

- Delay in the formation of households.
- Increase in over-crowding.
- Increase in the demand for housing support from the state.
- Further concentration of wealth
- Erosion in the proportion of those aged 18-34 in owner occupation
- More boom and bust in the housing market
The impact of worsening affordability on demand for social and affordable housing: Tenure choice and household formation

July 2008
Worsening affordability has a range of consequences for households

While in principle there is no hierarchy of housing tenure – e.g. some households prefer private or social renting to owner-occupation – at the margin changes in affordability impose a hierarchy.

The main observable outcomes of worsening affordability on potential households are:

– Households continue to form in the owner-occupied sector
– Households form in the ‘intermediate’ market sector
– Households form in the private rental sector (PRS)
– Households form in the social rental sector
– Households do not form at all
Based on current housing plans affordability in England is likely to get worse leading to …

The lower quartile house price to earnings ratio deteriorating by 2026. The effect could be to **increase the mortgage and/or deposit required by first time buyers by about £23,500 at today’s prices** by 2026.

**Further pressure on intermediate and social housing.** For example, nationally there was a rise of over **500,000** on the housing register between 2002 and 2007 compared with 73,000 between 1998 and 2002.

Household formation to be inhibited by affordability pressures. Analysis suggests as affordability prospects deteriorate by 2026 around **1.2million households in England would not have been able to form**.

**The end of the downward trend in average household size established since the 1960s.** Analysis suggests this could reach 2.3 in 2026, as compared to 2.1 persons per household under the official projections.
Government guidance to regional planning authorities for future RSS reviews – 16th July 2008

NHPAU recently published independent advice on the range of housing provision for each region. As set out in PPS3 you should take this evidence into account in determining housing levels.

We would therefore require the range set out in NHPAU’s advice, to be tested through any future regional strategy process…

Where a favoured option is identified that falls outside the NHPAU range the Regional Planning Body…must provide the Examination in Public with sufficient evidence to illustrate the spatial implications of delivering a level of growth within the NHPAU supply range.

This evidence will need to include the broad locations for growth, district allocation of housing numbers and the implications for the strategic objectives of the strategy, and be accompanied by a Sustainability Appraisal and Habitats Regulations Assessment as necessary.
Will NHPAU update its advice?

While the purpose of establishing a supply range was to provide some stability and flexibility, we will keep our advice under review, in particular we will want to understand the effect of:

- Different potential outcomes for the finance markets and the impact on access to mortgages.
- New official statistics, for example the 2006-based Household Projections (due for publication early in 2009).
- The impact of the projected delivery of new homes given the short-run prospects.
- CLG Affordability Model update
- Any major directly relevant national policy developments.
NHPAU publications available at

www.communities.gov.uk/nhpau