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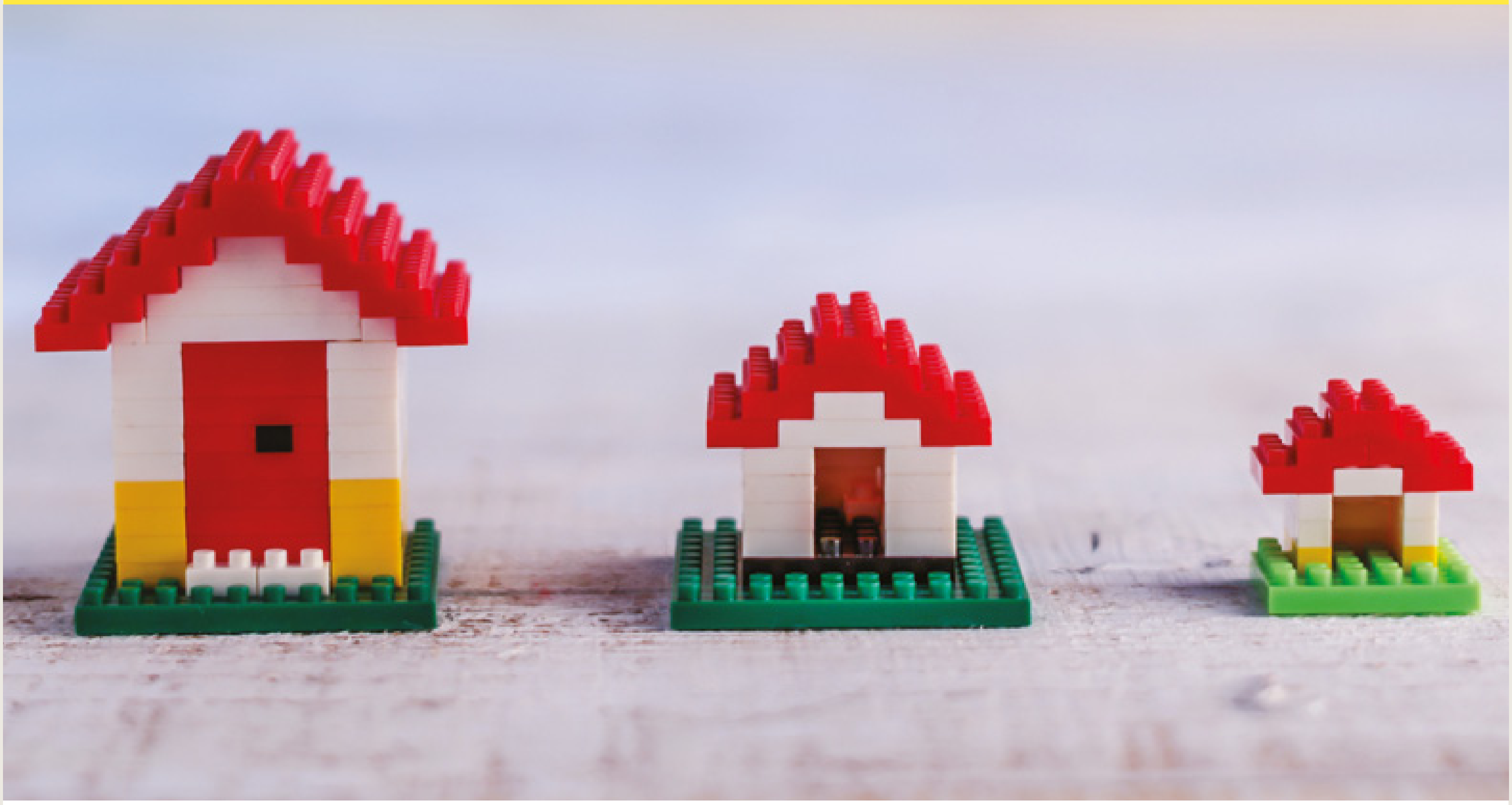
Savills World Research
UK Residential Development

Spotlight
Releasing untapped potential for more housing

2016/17



SUMMARY

Housing associations could deliver an additional 44,000 new homes a year

■ Housing associations (HAs) have the financial capacity to more than double their output and bring forward 44,000 extra new homes by 2029 through additional asset-backed borrowing.

■ Some form of subsidy is critical to deliver these homes across a range of tenures and to achieve affordability. In the absence of grant, HAs would need to secure land at zero or low value to deliver shared ownership or affordable rent housing.

■ Almost half of the additional financial capacity to become a new class of home builder rests with large scale voluntary transfer (LSVT) associations, particularly larger ones.

■ The structure of HAs also allows for continuing housing delivery through housing market cycles. Their existing stock provides an ideal asset to borrow against during periods of tighter development funding.

■ Opportunities for growth exist in most areas, particularly where there is activity linked to inward investment, infrastructure spending and the Devolution agenda. We have also highlighted areas where limited developer diversity provides opportunities for HAs to compete.

■ There are significant barriers including: skills shortage, lender attitudes and regulatory concerns. Greater collaboration within the sector is key. This is likely to include more mergers and innovative partnerships.

The potential
CAPACITY TO DELIVER MORE

Housing associations have the potential to double their current output. But this requires greater Government support and subsidy

"The sector has £7.4bn of additional borrowing capacity to deliver 44,000 extra new homes a year"
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▼ More new homes are needed

There is tremendous potential for housing associations (HAs) to make a bigger contribution towards the delivery of new homes. We estimate that England needs 300,000 new homes a year, 100,000 more than the Government target, if we are to tackle the backlog of undersupply and have an impact on affordability.

To achieve that we need a greater diversity of developer delivering a wider range of tenure. HAs have the potential to help fill the gap between housing need and what the major private housebuilders deliver.

Our analysis of the financial reports of over 175 of the largest associations suggests that the sector could bring forward an additional 44,000 new homes a year by 2029, through greater efficiencies and additional asset-backed borrowing.

Based on current rates of delivery, this approach would increase the annual output from the sector up to 84,000 new homes a year in just over a decade, bringing it closer to the aspiration set by the National Housing Federation of delivering 120,000 in England homes by 2035.

Increasing delivery rates is a long game and it will take a number of years for the sector to transition into the development space as many become more accustomed to operating with greater risk and market exposure.

Support is therefore essential. Some form of subsidy is critical to deliver these homes and to achieve affordability across a range of tenures. Delivering a mix of market and affordable housing both for sale and rent not only provides for the 70,000 new households per year that cannot afford market housing but also ensures that these new homes do not merely displace those that could be delivered by the private sector.

Additional capacity

In previous work, (see Housing Association Financial Capacity) we calculated that the sector has £7.4bn of additional borrowing capacity that could be used to deliver more homes. These funds could be released by improving cashflow capacity through better management efficiency and reduced cash interest ratio to enable higher levels of gearing against existing assets.

A more risk-averse funding strategy may involve a balance of funding sources. This could include re-investing the proceeds from sale of existing surplus stock and conventional development finance.

In this paper, our modelling shows how with an aspirational development programme, a sum of £7.4bn can be used to increase delivery by up to 44,000 additional homes per year. We estimate it would take just over a decade to reach this point at an incremental rate of annual growth of 6%.

We calculate that in an average market in the south of England outside London such as Milton Keynes, these can be spread equally across market sale, shared ownership, market rent and affordable rent with 11,000 homes in each, provided some form of subsidy is available.

In the absence of grant, the spread of tenure in our modelling relies on HAs securing land at zero value for affordable rent or at minimal land value for shared ownership. This needs muscular planning policy and strong Section 106 agreements, based on a realistic growth-oriented approach to viability testing of policy.

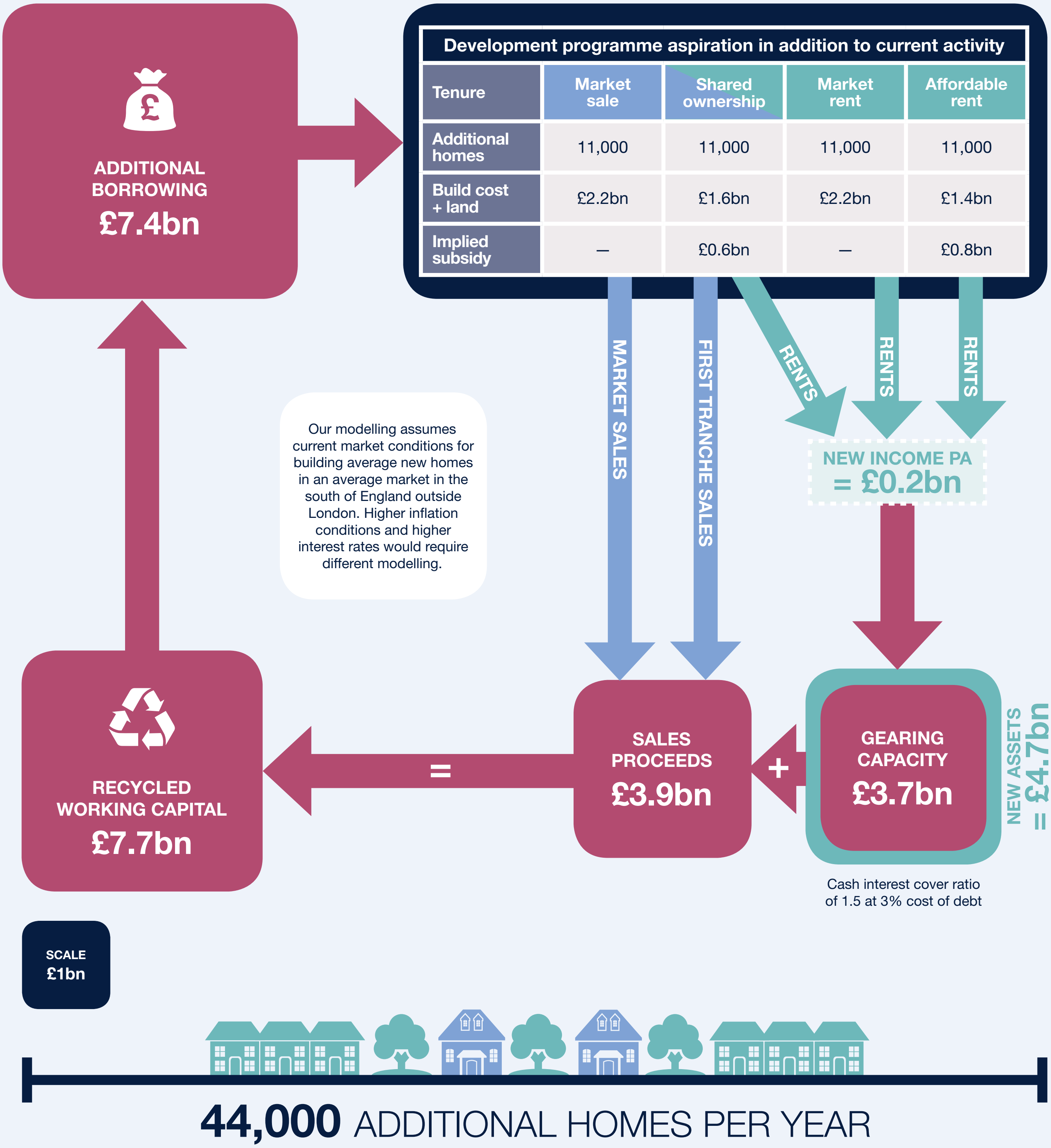
If insufficient land is available through Section 106, then grant funding would be required to allow HAs to develop independently.

300K pa
new homes needed

over 80K pa
what HAs could deliver

HOW TO FUND 44,000 EXTRA HOMES PER YEAR

£7.4bn of additional borrowing capacity can be both supported by balance sheet and funded from existing cashflow



Development programme aspiration in addition to current activity

Tenure	Market sale	Shared ownership	Market rent	Affordable rent
Additional homes	11,000	11,000	11,000	11,000
Build cost + land	£2.2bn	£1.6bn	£2.2bn	£1.4bn
Implied subsidy	–	£0.6bn	–	£0.8bn

Source: Savills Research

The opportunity
WHO CAN BUILD AND WHERE?

There is financial capacity to make a greater contribution to housing delivery across the sector but LSVTs have the greatest untapped potential

"A greater partnership approach between HAs and across regions is needed"
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Almost half of the additional financial capacity to deliver more housing rests with large scale voluntary transfer (LSVT) associations, particularly larger ones, managing 785,000 homes most of which are ex-local authority stock.

However, our analysis shows two thirds of LSVTs have limited existing development for market sale programmes despite having £2.4bn of additional financial capacity (Fig.1)

There are a number of reasons for this including funding and contract restrictions, a reluctance to invest outside their local areas, attitude to risk and size.

We also found £4.2bn of additional capacity among HAs that are already developing, particularly among the larger players of all types with more than 20,000 homes.

Whilst there is less capacity among the smaller players to bring forward substantially more development, existing output makes a valuable contribution to local housing provision.

Geographically, we found significant capacity in the HAs operating in London and the South East where the housing shortage is most acute and property values are highest. There is also substantial capacity in those based in the north of England.

However, HAs operating in the East Midlands and to a lesser extent, the South West have less additional financial capacity to support development. Therefore, to ensure that financial capacity is matched with housing need, a greater partnership approach between HAs and across regions is needed.

HAs as SMEs

The declining number of SME housebuilders is often cited as a key reason for housing delivery in England remaining stubbornly low. HAs are already contributing around a fifth of total housing output but their competitive advantages allows them to deliver more, particularly in areas of limited developer diversity (see Fig. 2).

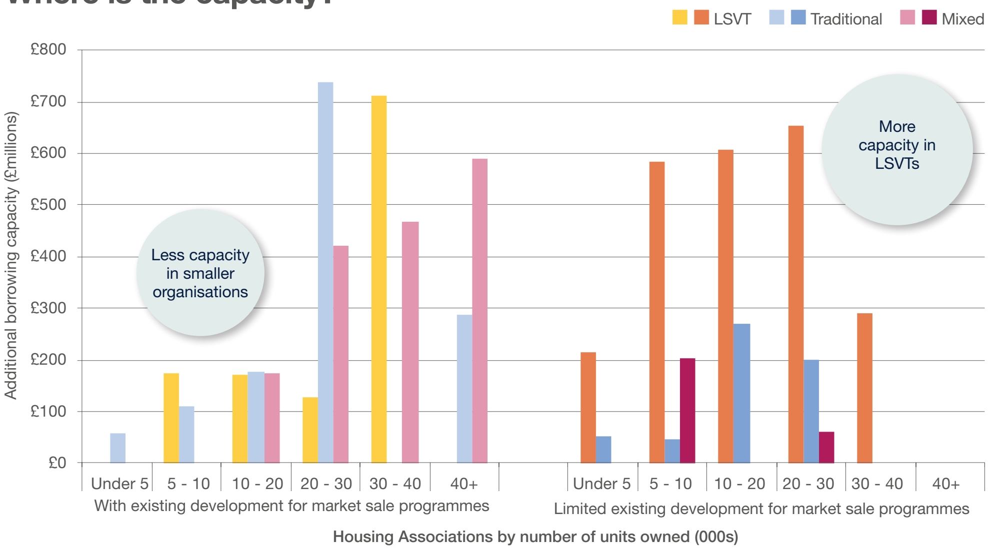
The latest figures from the Department for Communities and Local Government (DCLG) show that almost 190,000 additional homes were delivered in England in 2015-2016. Separate data from the National Housing Federation (NHF) highlight that HAs contributed 40,000 new homes, with over 40% of those homes delivered outside the Affordable Homes Programme. This brings the Government closer to reaching its target of delivering 1 million new homes by 2020.

Competitive advantage and market cycles

The structure of HAs also allows for continuing housing delivery through housing market cycles. Their existing stock ownership provides an ideal

190K
additional homes delivered in England 2015/16

FIGURE 1
Where is the capacity?



Source: Savills Research

asset to borrow against during periods of tighter development funding.

This feature is especially relevant as we face uncertainty following the vote to leave the European Union, prompting a more risk-averse position from lenders and making it harder for smaller developers reliant on finance on a scheme by scheme basis to raise debt.

HA expertise in owning and managing large rented housing portfolios also sets them apart from commercial developers. The cash flow from their existing business can help smooth out the business cycle, avoiding the boom and bust that has hurt private sector small and medium house builders in recent decades.

Flexibility to deliver a range of tenures means that HAs can react strategically to market cycles. The sector could increase the delivery of tenures that carry greater market risk, such as homes for market sale and shared ownership, during a strong market and switch to private and affordable rented housing during leaner times.

Planning flexibility and subsidy

Such an approach would require a more flexible approach from Local Planning Authorities on the timings of delivery of affordable housing by HAs to reach the goal of higher overall housing delivery over the longer term.

HAs will generally seek to limit exposure to sales products and thereby avoid the risks these tenures bring to the core business of rented housing. A development programme does need to generate sufficient sales proceeds and gearing capacity to be sustainable over the long term.

Subsidy is critical to enabling HAs to develop a mix of tenures, minimising the risk of delivering a high proportion of homes for sale.

40K
homes delivered by HAs in 2015/16

WHERE TO BUILD?

Opportunities across the country

Housing need differs across England. In many midlands and northern markets, housing quality and the need for replacement housing are equal or stronger drivers than a requirement for additional new homes than affordability pressures. Meanwhile, in many markets of the South East and London, the main issue is undersupply and unaffordability.

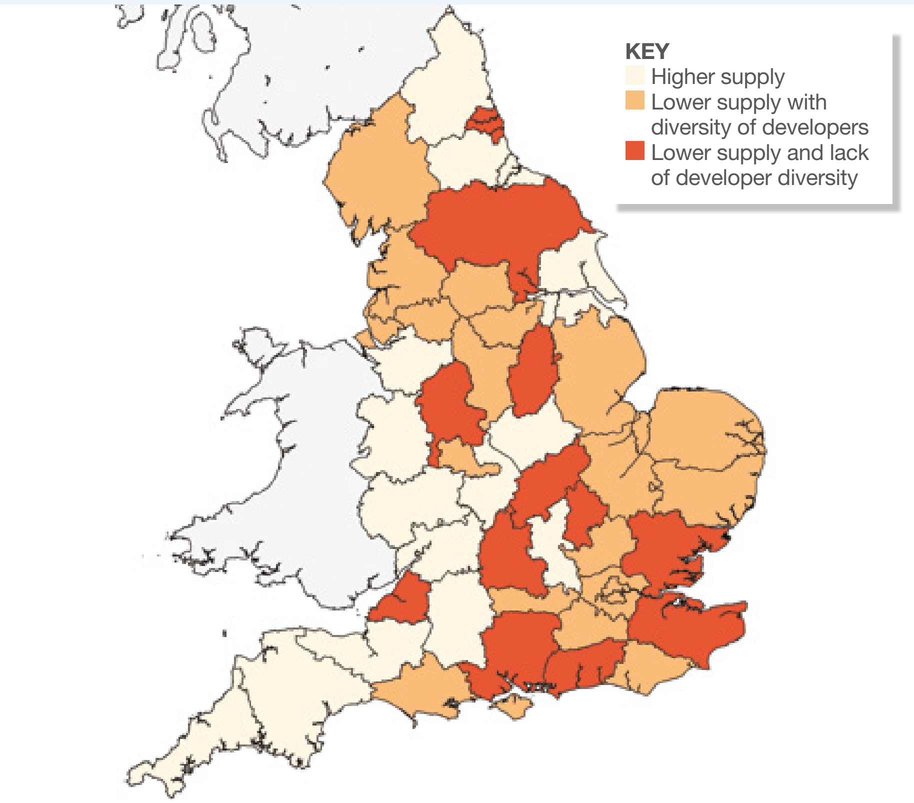
Government intervention in the form of Housing Zones, infrastructure spending and Devolution, with a focus on removing barriers to unlock larger sites, is creating opportunities across the country.

Increasing housing delivery relies on encouraging a range of different developers to bring forward a more diverse range of sites. Our map below highlights the areas that represent the greatest opportunities for the sector. Dark red marks out the counties which suffer the lowest level of housing supply and also have the least diversity of developer types.

Many of these markets would benefit from a greater diversity of supply and HAs are well placed to be part of the solution. Their contribution could come in various forms and may require working in partnership with other HAs or developers in markets where they do not usually operate.

Some HAs, especially those with development experience, could boost supply directly through increased promotion of smaller sites through the planning system. Larger associations, including those which currently do not develop, could act in partnership with a master developer to finance and bring forward large strategic sites, including funding of infrastructure. Regardless of site size, HA's ability to deliver across a range of tenures increases absorption rates, ensuring more rapid delivery of housing.

FIGURE 2



Source: Local Authority Strategic Housing Market Assessments (SHMAs), Glenigan Savills Development Database, DCLG

The obstacles

OVERCOMING BARRIERS

Expanding housing output from this sector is not without its challenges

When it comes to development, housing associations face many of the barriers that are also experienced by private developers. These include land availability, skills shortage, regulatory concerns and as grant diminishes greater exposure to market cycles.

Land availability

Competing with private developers for land can be difficult particularly when delivering affordable housing or homes for rent.

With some weakness expected in the development land market over the next couple of years, there may be a window of opportunity for associations to invest in land and start to build up a pipeline for future development.

This is where the cashflow capacity to service borrowing without short term receipts should enable associations to act in a counter-cyclical way and avoid the strongest competition for land that exists in a rising market.

"There is a window of opportunity for HAs to start to build a land pipeline"

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However, the land market is enormously varied. According to our land index, average values are stagnating or falling as land purchasers become more cautious. However, with huge variations across the market (Fig. 3) there are areas where demand has been maintained. HAs should be cautious not to pay over the odds.

Skills shortage

It is well known that there is already a substantial shortfall of skills in the development industry. It will take time to find enough people with the skills required to start up new development programmes in the 57 housing associations in our sample that have financial capacity but no existing development business.

Creating 57 new development directors to run relatively small programmes in some cases would also be an inefficient use of resources. A more effective way of accessing skills and creating a development operation of scale may be through consortia and partnerships, possibly with HAs with existing development activity.

Alternatively, it could be in the form of joint ventures with private sector developers, housebuilders or contractors. This will allow access to skilled operators already active in the private sector.

Regulatory concerns

Whilst there is political pressure to increase housing delivery, including developing for market sale, the Homes and Communities Agency

FIGURE 3

Land market – wide variation in supply v demand balance

Source: Savills

(HCA) is understandably cautious. It is important to learn the lessons of some past mistakes within the sector, which often stem from misjudging the housing market.

The existing development for market sale activity within the sector is carried out by a relatively small number of players. Some of these have stretched their business plans, but the majority have been successful.

It is critical that associations taking on additional borrowing and increasing their exposure to the housing market do so in a way that is manageable. Those that fail to do so run the risk of being downgraded by the regulator, which would affect their capacity to borrow at advantageous rates.

Autumn Statement

Measures announced by the Chancellor of the Exchequer to support affordable rent marked a clear shift away from the previous Government's focus on homeownership.

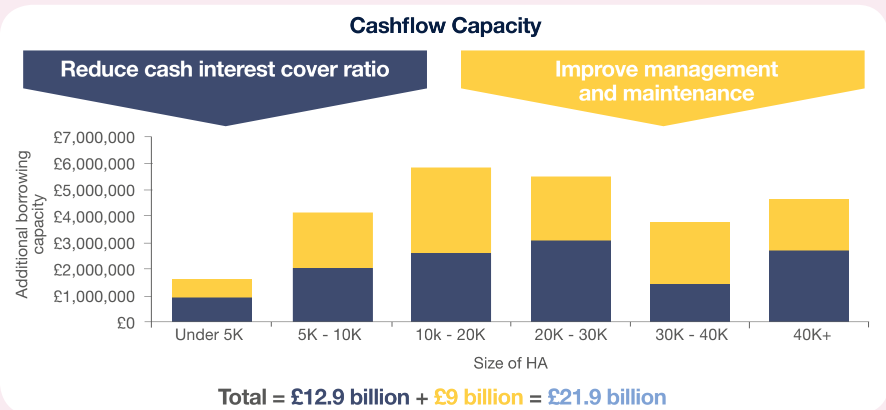
Philip Hammond's commitment to provide an additional £1.4bn of grant funding to help support 40,000 new affordable rented homes, together with more flexible use of existing funding for affordable housing, will enable the delivery of a wider variety of housing tenures aimed at different parts of the market.

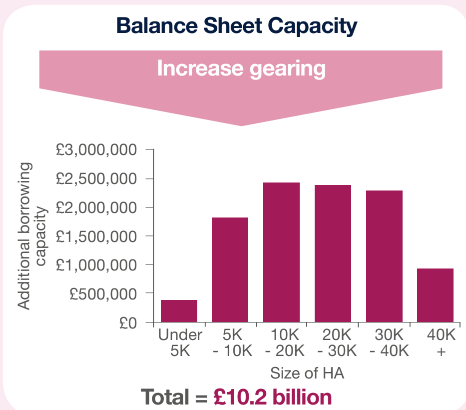
The boost for housing is part of a wider drive to increase national productivity, deal with imbalances across the country and prepare the economy for a potential slowdown ahead of Brexit. Housing featured at the top of the list for £23bn National Productivity Investment Fund which includes £7.2bn to support the construction of new homes through the Housing Infrastructure Fund and Accelerated Construction Fund.

UNTAPPED POTENTIAL

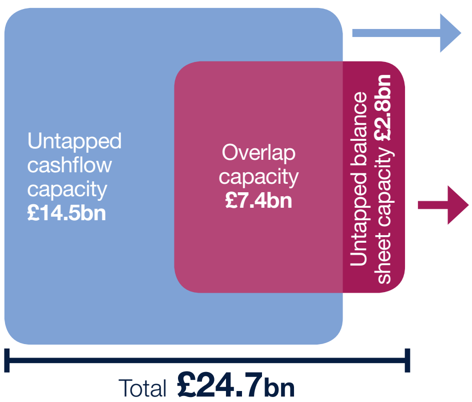
Innovative approaches could unlock further financial capacity

There is potentially a further £17.3bn of additional financial capacity that could be unlocked. But this would involve far greater collaboration across the sector, including mergers and partnerships. Our analysis identified £7.4bn additional housing association borrowing capacity that can be both supported by balance sheet and funded by existing cashflow. Here we highlight that some HA have balance sheet capacity but no cashflow capacity to service any additional borrowing. Others may have cashflow but no balance sheet capacity.





The analysis identified £7.4bn of additional housing association borrowing capacity that can be both supported by balance sheet and funded by existing cashflow. But there remains untapped potential within organisations that would require new approaches to unlock.



Untapped cashflow capacity = £14.5bn

- Lack of gearing capacity prevents use of this cashflow to service additional borrowing.
- Government could help unlock these funds by acting as a guarantor.
- This cashflow could be used to release balance sheet capacity in other associations.

Untapped balance sheet capacity = £2.8bn

- The importance of gearing makes this a valuable asset if it can be unlocked.
- Efficiency savings could open up cashflow capacity for HAs in this position.
- Another solution could involve a merger or partnership with an organisation with cashflow capacity.

Source: Savills Research

RECOMMENDATIONS

What is needed to double the number of homes HAs deliver

The Autumn Statement provides greater support for new housing through the £23bn National Productivity Investment Fund which includes £1.4bn grant funding to enable 40,000 new affordable rented homes by 2021. The funding will enable HAs to deliver more homes for affordable rent. To achieve a step change and double the numbers HAs deliver overall, a more innovative approach is needed:

1. **Subsidy is critical:** to enable HAs to double housing delivery and contribute homes across a range of tenures. It is only by building out a wider mix of housing, including affordable rented housing, that we can substantially increase numbers and meet need. Failure to do this risks displacing housing that would have been delivered by the private sector. In the absence of more grant, HAs would need to secure land at zero or low value to deliver shared ownership or affordable rent housing.

2. **More land for development:** the additional potential demand for more sites could drive up land values, squeezing margins and choking off growth. To prevent high land values compromising the viability of new schemes, more land needs to be made available for residential development in the right places. This is particularly important if we are to encourage development for a mix of tenures.

3. **Local authorities:** have the responsibility to set targets to meet housing need and to allocate sufficient land for residential development. LAs can also take a leadership role in land assembly and contribute their own assets. Targeted use of public land would help HAs to secure land at zero or low value to deliver shared ownership or affordable rent housing. LAs would need to balance the objectives of generating receipts from surplus public land and providing affordable housing.

4. **Planning flexibility:** the ability to deliver a range of tenures enables HAs to react strategically to market cycles by increasing the delivery of homes for sale during a strong market and switching to a higher number of rented housing during leaner times. This approach would require Local Planning Authorities to take a more flexible approach on the timings of delivery of affordable housing by housing associations to reach the goal of higher overall housing delivery over the longer term.

5. **Innovative partnerships and mergers:** our analysis shows that HA's additional financial capacity is not evenly spread across the sector or the country. Much of the extra potential is also in the hands of those without a development programme. Making the most of this opportunity requires greater collaboration across the sector. This may involve more innovative partnerships as well as mergers.

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