NATIONAL HOUSING FUND

An assessment of the proposed fund's potential to increase housing supply in England

Report prepared for: ResPublica

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Contents

1 Introduction

ResPublica commissioned JLL to assess the impact on housing delivery of its proposed new £100bn National Housing Fund for England. The 10 year Fund would invest £10bn annually over its lifetime funded through 50 year gilts. The Fund would serve as a guaranteed buyer for market and submarket rented homes, managed and operated by housing associations and built by SME builders. With a National Housing Fund in place, small developers could take an option on a site and then approach the Fund with a plan for development of that land. The developer would then work up an agreement with the Fund on price, size, layout and timing. An agreement to purchase from the Fund would provide the security for SMEs to obtain development finance at a competitive rate with low equity investment.

This paper assesses the following:

- The number of new units annually that the Fund could enable.
- Geographical implications on new supply considering a selection of indicative different investment strategies
- Additionality considerations over the quantum of homes enabled by the Fund; supply that would otherwise have not been delivered towards national housebuilding targets.

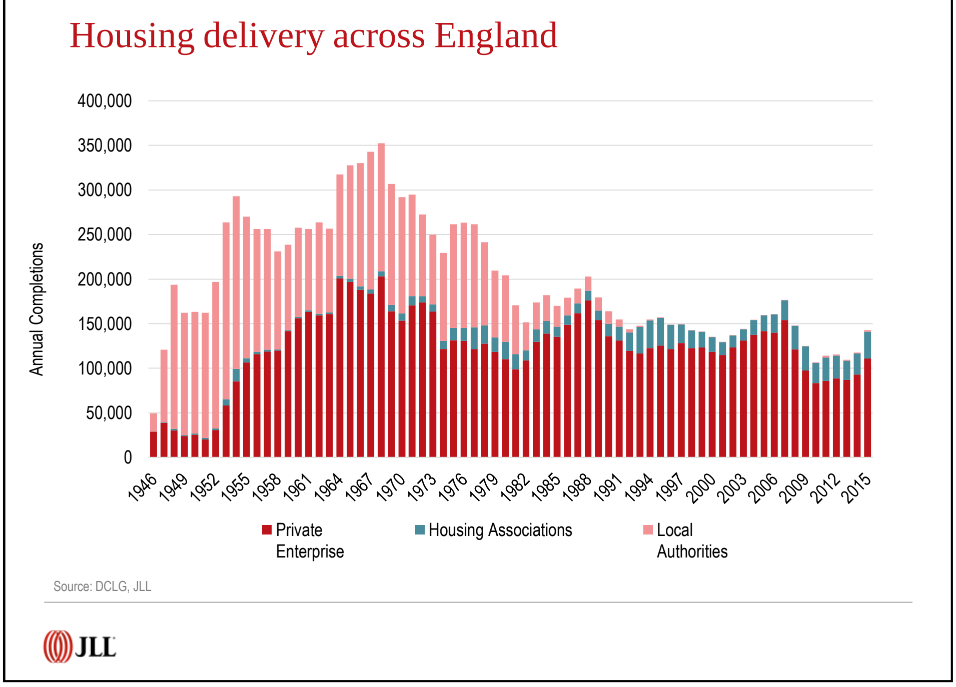
The conclusion of this paper is that it is possible to deliver between a minimum of **40,000** and a high of **75,000** additional homes per annum as a result of the proposed £100bn National Housing Fund.

2 Historic Housing Supply

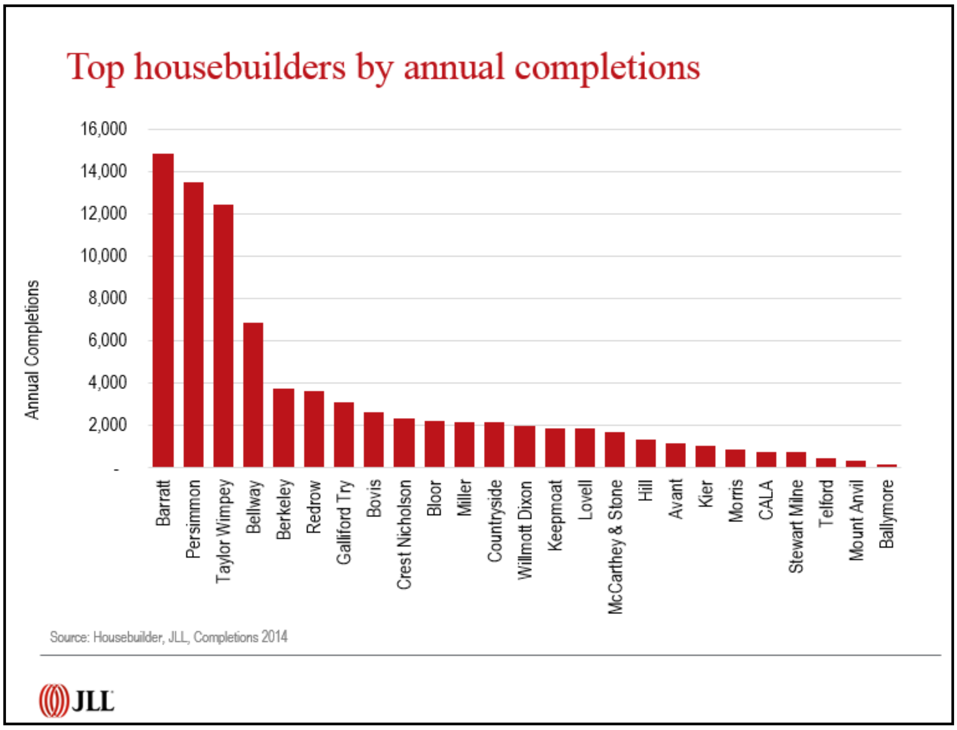
The Government has set a target to deliver 200,000 homes per annum for England over the course of this Parliament to meet the housing needs of a growing population. However, as the graph below illustrates, new housing delivery in England has averaged 150,000 homes pa since 1980.

The figures from the Department of Communities & Local Government illustrate how England used to consistently deliver in excess of 200,000 homes pa through the 1950s-1970s in a period where the public sector was a significant contributor to supply.

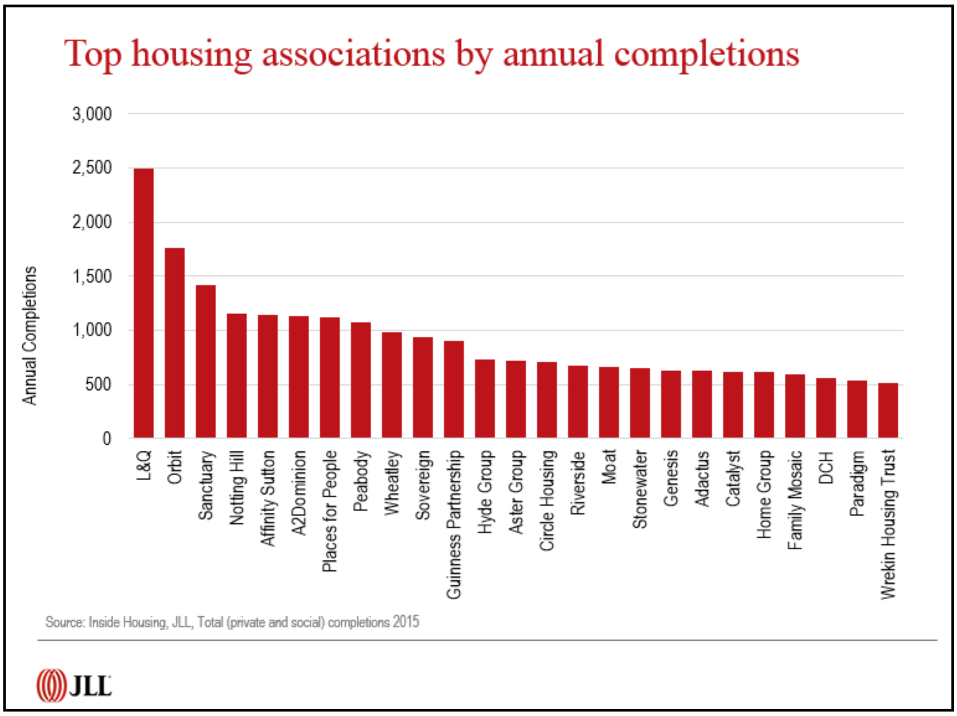
Looking at the delivery rate of the private sector over the past 37 years shows that it has been remarkably steady. Since 1978 the private sector has built on average 121,000 homes per annum, with a peak of 168,000 homes in 1988. This indicates that even with additional land supply from the public sector the rate of delivery is unlikely to dramatically improve. Part of the explanation is the 'drip-feed' nature of private sector delivery and the need to match construction completions to market absorption in order to protect margins



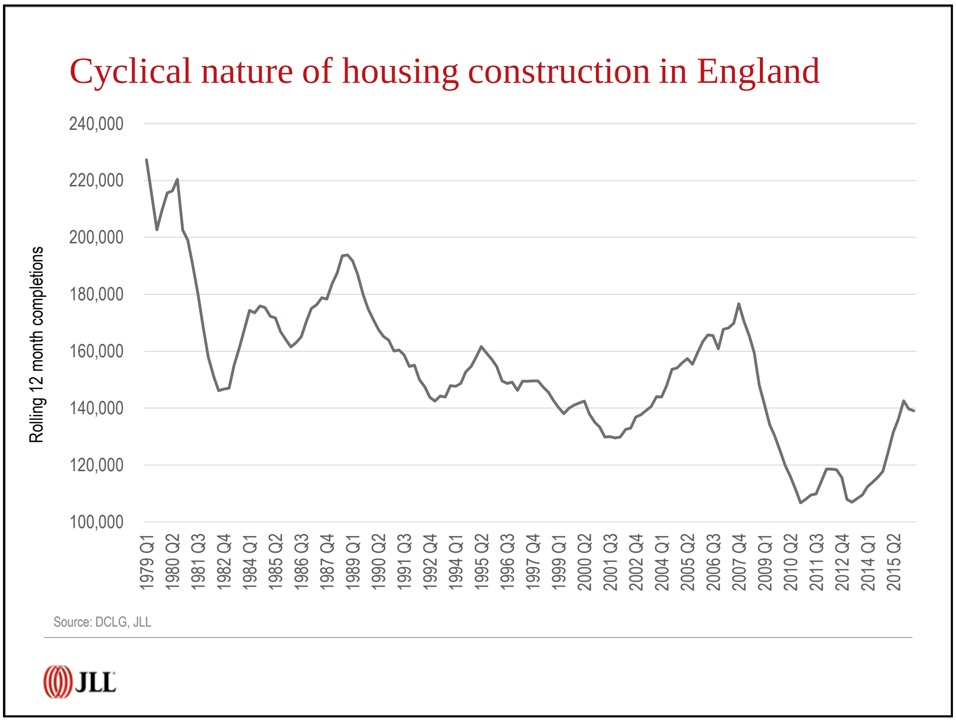
The graph below illustrates the current dominance of the listed housebuilders in terms of new housing supply. The three largest companies – Barratt, Persimmon and Taylor Wimpey currently deliver more than a third of national supply.



The volume of housing completions and disparity in the volume of delivery for the UK's Housing Associations is much less pronounced as the graph below shows.



The graph below illustrates the cyclical nature of housing construction over the past 35 years, with the overall delivery of the sector on a downward trend over the period. The cyclical nature of new housing output has ultimately been linked to the performance of the wider economy.



3 A New Approach - the UK National Housing Fund

JLL built a forward commitment investment model to assess the potential to acquire completed market rental units. The following section outlines the methodology adopted in creating the model and illustrates the potential buying power of the £10bn National Housing Fund based on a selection of indicative regional spending strategies.

3.1 Rental assumptions

Monthly median rents were sourced from the Valuation Office Agency for studios, one bed, two bed and three bed homes for each of England's nine regions. The VOA sample group includes a blend of flats and houses. The rental values are shown below.

Monthly rental sums utilised for the model

Region	Studio	One bed	Two bed	Three bed
England	£525	£550	£600	£695
North East	£325	£395	£450	£525
North West	£375	£425	£500	£600
Yorks & Humber	£368	£415	£495	£550
East Midlands	£350	£425	£525	£600
West Midlands	£390	£450	£550	£650
East	£475	£575	£675	£795
London	£925	£1,250	£1,500	£1,800
South East	£519	£650	£825	£995
South West	£450	£525	£650	£775

Source: VOA

JLL forecasts rental growth over five year periods. The latest JLL rental forecasts, released on 3 November 2016, are shown in the table below. For the purposes of the National Housing Fund forward commitment purchasing model, JLL has assumed that rental growth will average 3% in years 6-10. According to the ONS Private Rental Index, rental growth across England has average 2.3% pa over the past 5 years.

Rental growth forecasts

	2017	2018	2019	2020	2021
UK	2.5	3.0	3.5	3.5	4.0

Source: JLL

3.2 Unit mix

The model was set up to purchase schemes with the below indicative unit mix, which is typical of current Build to Rent schemes. In reality any variation on this unit mix could be purchased, but a weighting towards higher value two bed and three bed units will reduce the overall buying power of the Fund.

While it is likely that many private rental housing development schemes will include studios to comply with local authority development plans, one scenario has also been modelled with the removal of studios to assess delivery potential in line with the Fund's attempt to support the 'squeezed middle' and young families through the delivery of slightly larger mid-market rental and rent-to-buy tenures.

	Unit Mix
Studio	10%
One Bed	40%
Two Bed	40%
Three Bed	10%

3.3 Yield assumptions

The model is priced on a gross yield basis, exclusive of management and maintenance costs. In reality, the Fund will buy on a net yield basis, and this would result in a reduction in gross rent as well as the yield. This gross-to-net leakage, which JLL has typically found to be 25% in the current Build to Rent sector, will ultimately result in the same buying power for the Fund as has been modelled for this report. The model has been built assuming a linear relationship between gross vs net buying power, which is illustrated by the following example:

- Scheme A generates £100,000pa gross income priced at a gross yield of 10%. (£100,000/10% = £1m investment value).

- Apply a 25% gross-to-net leakage

- Scheme A generates £75,000pa net income priced at a net yield of 7.5%. (£75,000/7.5% = £1m investment value).

The following gross yields have been applied for each region based on JLL's database of completed Build to Rent investment transactions.

Region	Gross yield
England	7.0%
North East	8.5%
North West	8.0%
Yorks & Humber	8.5%
East Midlands	7.0%
West Midlands	7.0%
East	6.5%
London	5.0%
South East	5.5%
South West	6.0%

3.4 Transaction costs

The following costs have been factored into the model to reflect typical transactional costs that will occur in buying completed units.

- 1% agents feeds
- 0.5% legal fees
- Stamp Duty per unit less multiple dwellings relief

3.5 Scenario 1 - an even regional spending allocation

JLL modelled the potential buying power of the Fund assuming an even allocation of the £10bn pa in each of the nine English regions. By adopting this strategy a theoretical total of **804,750 units** or an average of **80,475 units pa** could be purchased.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Units PA	102,350	99,250	94,950	89,750	84,150	77,950	72,400	66,750	61,200	56,000
TOTAL UNITS	804,750									

3.6 Scenario 2 – a regional focus

JLL modelled the potential buying power of the Fund assuming the £10bn pa Fund was weighted significantly towards the North and Midlands. By adopting this strategy a theoretical total of **944,000 units** or an average of **94,400 units pa** could be purchased.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Units PA	120,100	116,300	111,400	105,500	99,000	91,700	85,200	78,500	71,600	64,700
TOTAL UNITS	944,000									

3.7 Scenario 3 – a London and the South East focus

JLL modelled the potential buying power of the Fund assuming a weighted allocation towards London, the South East and the East. By adopting this strategy a theoretical total of **593,800 units** or an average of **59,380 units pa** could be purchased.

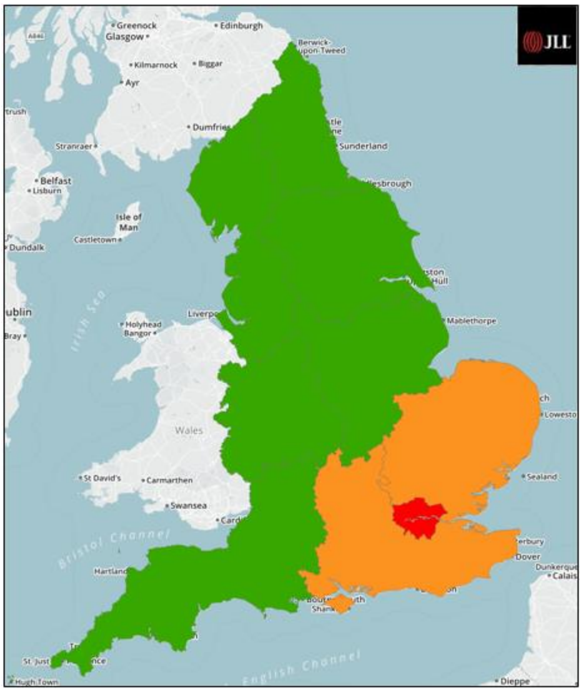
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Units PA	75,800	73,300	70,000	66,100	61,600	57,000	52,700	49,300	45,600	42,400
TOTAL UNITS	593,800									

3.8 Scenario 4 – Initial London and South East focus followed by regional focus

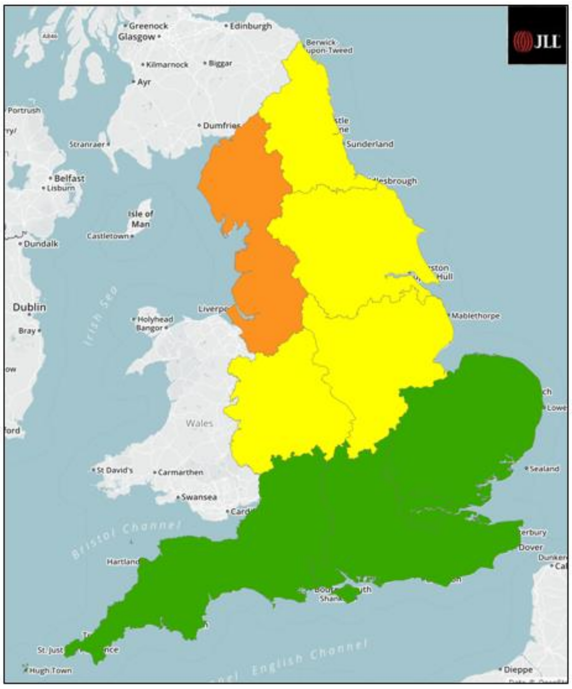
JLL modelled the potential buying power of the Fund combining an initial focus to London and the South East in the first five years, followed by a regional weighting in years 6-10. This is considered the most sophisticated of the strategies modelled allowing for greater power. By adopting this strategy a theoretical total of **738,500 units** or an average of **73,850 units pa** could be purchased.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Units PA	75,800	73,300	70,000	66,100	61,600	91,700	85,200	78,500	71,600	64,700
TOTAL UNITS	738,500									

Map 1 – Distribution of Fund Allocations Years 1-5



Map 2 – Distribution of Fund Allocations Years 6-10



Key – Green 0-5% | Yellow 5-15% | Orange 15-20% | Red 20%+

3.9 Scenario 5 – impact of removal of studios from scenario 4

JLL modelled the same as Scenario 4, but removed studios from the mix and re-adjusted to 45% one beds, 45% two beds and 10% three beds. By adopting this strategy a theoretical total of **721,800 units** or an average of **72,180 units pa** could be purchased.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Units PA	73,700	71,400	68,300	64,400	60,100	89,900	83,500	77,000	70,200	63,300
TOTAL UNITS	721,800									

3.10 Conclusions

The illustrative investment strategies shown above demonstrate the fall in purchasing power of the £10bn pa Fund as rental inflation begins to take effect. In reality the Fund could adjust the £10bn pa spending allocation upwards in line with inflation to counteract some of the fall in spending power.

The effects of this fall in spending power can also be minimised through adjusting the weighting of investment from higher value locations in the earlier years to lower value locations in later years, as is the case in Scenario 4.

In reality the Fund may allocate specific spending targets to higher demand locations such as London, the South East and Regional city centres. It would then spend its allocation as quickly as opportunities occur in those locations.

In conclusion, based on the modelling scenarios above, the £10bn pa Fund would have the capacity to purchase between 60,000 to 90,000 units pa with a likely realistic target of circa **75,000 units pa** based on more sophisticated targeted investment strategy.

This conclusion does not take account of the implications of other market factors. The next section will explore whether these units would be delivered wholly in excess of current UK housebuilding delivery.

4 Additionalilty of Supply

As the section above highlights, the proposed National Housing Fund has significant potential to deliver additional homes. However, one of the key considerations is how many of these will be delivered at the expense of units already likely to brought forward and how many will be truly additional units. The following section of the report examines this question.

4.1 Planning Environment

Across England there is currently planning permission for 460,000 homes that are yet to be implemented, an increase of 25% since 2013[1]. This offers an immediate source of supply for the Fund to access and is likely that the initial few years could see schemes within this pool being brought forward. Through this there is the potential for some cannibalisation of private units that could be brought forward on their own; however, it is likely that the Fund will result in units being delivered faster than otherwise expected.

	2013	2014	2015
Unimplemented planning permissions - England	367,484	427,893	457,573

Source: Local Government Association

4.2 Labour force and delivery rates

Labour supply is cited as one of the largest constraints on housing delivery. The house-building industry is very labour intensive and according to Aracadis[2], productivity levels have barely increased in the past 20 years. Their analysis estimates that the sector has historically employed 1.5 full time equivalent workers for a year to build a typical dwelling; consisting of 1.1 full time employees on-site for construction and 0.4 off-site for management and administration. This indicates that in order to deliver an additional 40,000 homes per annum it would require 60,000 additional construction workers or an additional 112,500 workers to deliver 75,000 homes (the previously identified realistic maximum annual output for the Fund) assuming that traditional construction methods were used.

While this will provide a slight barrier to full delivery of the c75,000 units per annum, over the short term, the Fund also offers a platform for a solution. The long term and secure nature of the Fund's investment in house-building and its guarantee to purchase schemes will allow the house-builders to take a long term strategic view in terms of their workforce development. This could drive increases in the number of apprenticeships being offered because contractors know that they will have a sufficient pipeline of work.

Additionally the long term consistent pipeline of construction, that the Fund would support, could support increased development of modular construction facilities. One of the current barriers to the sectors' expansion is the high initial set up costs and the requirement for a strong pipeline of projects. The Fund would solve the second of these and might entice new entrants to the market and provide secure pipelines for those already engaged in modular construction. The use of modular construction could in theory help solve the productivity challenge facing the industry; a report by McKinsey[3] found that manufacturing productivity has almost doubled between 1998 and 2011 compared with construction, where productivity has been flat.

[1] Local Government Association – "Mapping unimplemented planning permissions by local authority area"
[2] Arcadis, People & Money, June 2015
[3] McKinsey, The construction productivity imperative, July 2015

4.3 Housing association ambition

The largest 50 housing associations delivered a total of 31,000 homes in the last calendar year using £5.3 billion of capital. There is a desire among housing associations to increase their output to deliver up to 120,000 homes per annum by 2035[4].

This housing association strategy proposes delivery of 40,000 private homes per annum with the remaining 80,000 homes being affordable. The fact that housing associations are already looking to dramatically increase delivery bodes well for the additionality of the Fund and it is likely that the creation of the Fund will reduce the time taken for housing associations to reach their ambitions of 120,000 homes per annum. It is likely that at least some of the 40,000 private homes that housing associations plan to deliver will consequently be delivered through the Fund rather than through current methods.

4.4 Land availability and areas of housing growth

The availability of land is an additional hurdle to housing delivery. There are, however, a growing number of examples of local authorities taking proactive approaches to allocating sufficient land for housing. For example Greater Manchester Combined Authority announced in October 2016 their new spatial framework for the city region, which listed sites for the delivery of 227,200 homes over the next 20 years. The creation of the Fund will likely allow these sites to be unlocked faster than waiting for the private market.

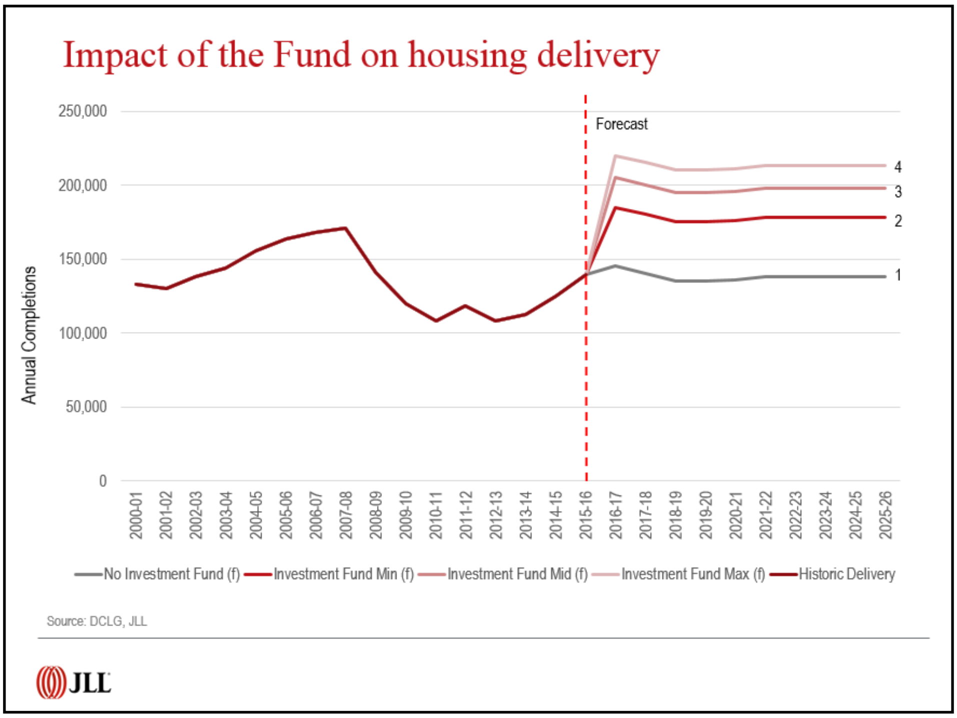
Similarly there are areas already under development that could see their delivery rate dramatically increased by the Fund such as the new garden city at Ebbsfleet. Additionally, the Fund could help bring forward development on public land over shorter time-scales; including a current HCA program targeting disposal of land for 160,000 dwellings by 2020 or the 10,000 homes identified on and around Network Rail land.

[4] National Housing Federation, Ambition to Deliver, 2013

4.5 Conclusion

In order to understand the potential housing delivery increase as a result of the Fund, the below graph has been created. Line 1 shows a baseline housing delivery forecast for the next 10 years without the introduction of the National Housing Fund. This is based upon JLL's annual housing completion forecasts.

Based upon the modelling work undertaken in the previous section it is our opinion that the realistic maximum additional housing delivery that could be created through the Fund is 75,000 homes per annum, which illustrated by line 4. Similarly it is our opinion that the lowest likely additional housing delivery as a result of the Fund is 40,000 homes per annum (line 2). Finally line 3 shows a realistic potential output based on current housing association funding-to-delivery ratios.



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