

Life after the Pre-Budget Report 2009

December 9th 2009

Alistair Darling has just delivered his pre-budget report which has confirmed some of the issues that were forecast and a few new measures. While these may provide some very short term stimuli for the development industry, we have looked beyond the rhetoric and instead examined the practicality of delivering housing in 2010 and beyond. Specifically, we would like to assess how affordable housing targets might be affected in both the short and medium terms.

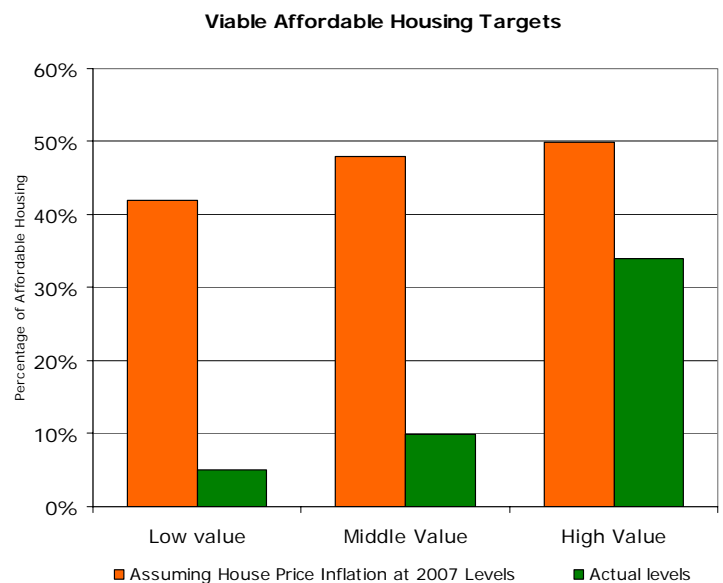
The Past year

Looking at the past year, we have seen challenging times for the development industry. Significant falls in the housing market in the first half of the year have, apparently, been halted during the second half of the year. The recently published Halifax index for November has shown a surprising monthly increase of 1.4% although the average price of a house is still 1.6% less than it was a year ago. The number of transactions has continued to fall, and despite cuts in interest rates to an historic low, access to affordable mortgage funds is challenging especially for first time buyers and movers without a decent deposit. The effect on the development industry has been devastating as access to development finance and general confidence in the future market has also been eroded.

Level has had first hand experience about how these general trends have affected viability of development and the ability of the few schemes that are coming forward to be able to deliver not just local affordable housing targets but also other infrastructure requirements. This week, Boris Johnson has announced that he is having to delay reaching his 50,000 affordable homes target by a year from 2011 to 2012.

Our assessments of viability, both on individual schemes (both large and small) and in our District wide studies as part of local authority evidence bases, shows that ambitious targets are extremely difficult to achieve in the short term. We have seen the picture from both sides - private and public – and it is clear that there is a need for some acceptance from all concerned that there has to be some acceptance that “something has to give”. Indeed, that something is not just affordable housing targets (although that has been one consequence). Developers will have to lower their expectations, the pot for infrastructure and planning gain may have to be reduced, and, importantly, land owners will have to be more realistic about their land values. We fear that this position may persist longer than many players fear and so holding off with the hope of getting a better deal any time soon may be a false hope.

If the market had not experienced a downturn from the end of 2007 onwards then it is likely that affordable housing targets could have been maintained. The difference in potential targets if this were the case are compared to currently achievable levels and are shown in the diagram adjacent.





Future Scenarios

Assessing policy viability cannot be seen as a snapshot process. As can be seen from the above graph viability is responsive to the costs and values at any particular time. Therefore, affordable housing targets must be seen within the context of long term viability so that there is protection for both the local authority and for the developer or landowner. This is so that:

1. a target can be set that is challenging for the lifetime of the policy; but
2. the target is flexibly applied in the knowledge that these targets will be difficult to achieve during economically challenging times.

Therefore it is important to seek to make a realistic assessment of future costs and values. This is not a simple process as viability at any point in time depends upon the interaction of a wide range of factors, including construction costs, cost of finance, sales rates of market housing, availability of grant, infrastructure, other planning requirements, development values and, of course, the value of land needed to bring sites forward.

The rate of increase (or decrease) of these costs and values varies. For instance, house price inflation may outstrip build cost inflation during certain periods but then may lag behind during others. The trick is not in predicting what those specific rates of increase might be, it is in making sure that the range of changes are covered in any forecast of future viability. At Levvel we use a middle scenario which is based upon past performance to set the base assumptions and then use optimistic upside assumptions and pessimistic downside assumptions as the parameters of our assessments. In this way, we have been able to assess what is the range of targets that might be achieved during the life of the Development Plan.

Predictions for the Future

In our assessments we are clear not to make any assumptions about future economic conditions. However, being in the position we are it might be useful to see what may happen bearing in mind these scenarios. Of course, the likely outcome is that the economic climate will change over the course of the next 15 years and the precise position we find ourselves will be somewhere between the upside and downside extremes.

Middle Scenario

Assumes house price inflation follows a similar route from now as happened at a similar stage of the last housing market cycle. In most cases in this scenario we have found that local authorities' expectations of affordable housing targets are not achievable in the short term. Generally we have found that viability could return to previous expectations by around 2013. However, at that time (and up to 2016) the potential increase in construction costs due to the Code for Sustainable Homes requirements serves to push forward the time by which viability is achievable at higher target levels until beyond 2018.

Upside Scenario

In most cases, we have assessed the upside as being a position about 20 to 30 percentage points above the middle position. In many cases in this scenario viability at higher affordable housing target percentages is achievable in the near future as this assumes values will reach their 2007 high point within one to two years.

Downside Scenario

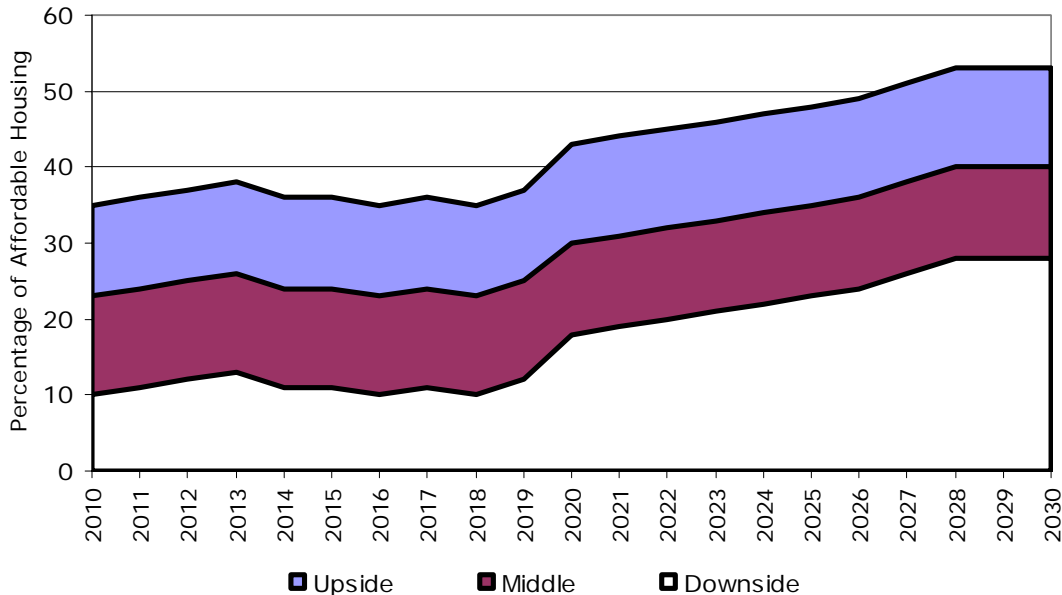
In the downside, values remain depressed and do not achieve their 2007 levels until 2018 or 2019. This is a scenario that has been predicted by some commentators recently and will assume that we have a further house price recession in 2010. We have found that in this scenario, if it persists for the long term, affordable housing targets and the ability of development to generate large contributions to infrastructure will be severely compromised.



What Lies in Store

The following graph shows the general picture over a 20 year period. What is clear is that any scenario that is close to the middle scenario (especially within the purple area below) will mean that many local planning authorities will not be able to achieve high levels of affordable housing (and other development contributions), perhaps for some time.

Affordable Housing Targets Over Time



This graph is a general one and each area's profile will be different. The graph shows the effect of the introduction of increased sustainable homes requirements between 2013 and 2018 although the ability of the industry to innovate and find more cost effective ways of providing these requirements may mitigate this effect to some extent. It paints a potentially gloomy picture about development economics and the ability of land to bring forward significant levels of affordable housing. If local planning authorities seek higher levels despite the evidence of viability then this is likely to have the effect of reducing further the amount of land that is being released by landowners.

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