Future of London: Policy in Focus
March 2011

Funding Development and Renewal:
Housing delivery and estate renewal under the affordable rent model

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Session three of Future of London's Funding Development and Renewal programme focussed on the implications of the affordable rent model on housing delivery and estate renewal in London. To set the context for the session GVA carried out a high level analysis of the potential implications for development viability and tenant affordability across London. This analysis highlighted the inherent tension between the two and the challenges this might bring.

GVA's Paul McGuinness outlines the potential impacts of these new arrangements on development viability and housing affordability.

Introduction

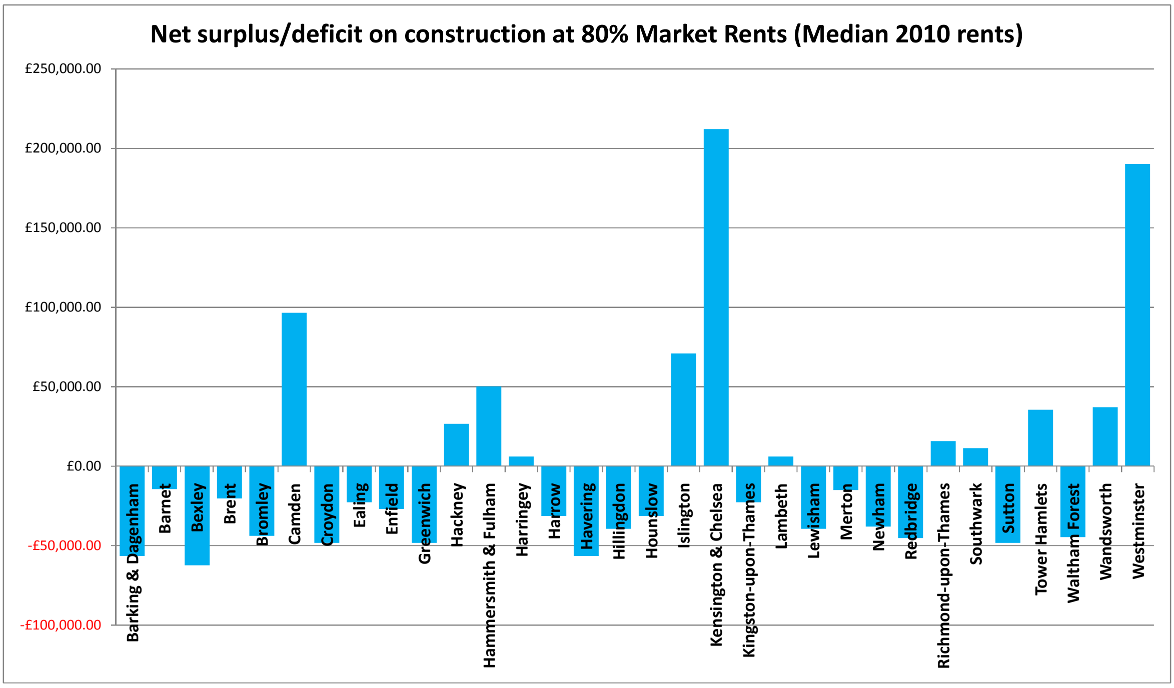
The Government's affordable housing delivery plans for the current Spending Review period were launched on 15 February with the publication of the 2011-15 Affordable Homes Programme Framework. The Framework sets out the Government's revised proposals for the delivery of affordable housing, focussed on the new Affordable Rent product. In essence, this will see the Government reducing up front capital grant for affordable housing and replacing it with ongoing revenue support (through housing benefit), an increased burden for tenants not on benefit and an expectation that Registered Providers will provide funding through surpluses on existing stock.

The main adjustment is the movement of rents from current social rent levels of typically 50% of market rent to new Affordable Rent levels of up to 80% of market rent. The new Affordable Rent product will only be available to providers who have signed a framework agreement with the HCA for the provision of new Affordable Rent units. These providers will also be able to convert re-lets of existing social rent units to Affordable Rent, so long as this additional financial capacity is directed towards supporting further new provision of Affordable Rent units.

What impact will this have on viability in London?

We have conducted an analysis of what this will mean for the viability of Local Authorities developing new units (assuming 2 bed units), maximising rentals on their new build properties to 80% of the local market rent on public land sites in London. The findings are highlighted in chart one below:

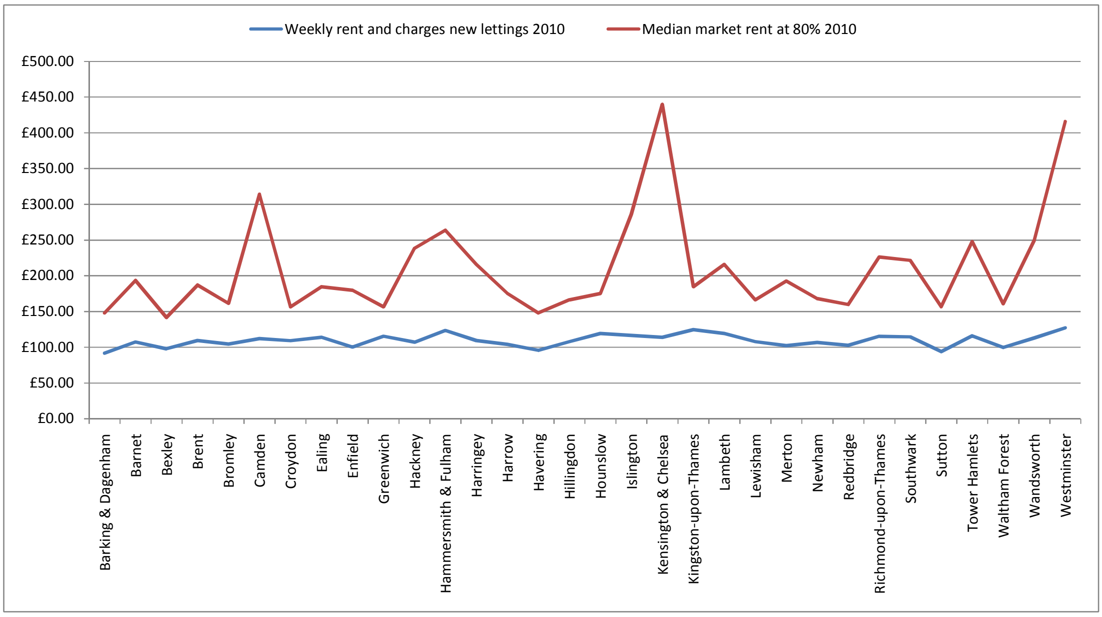
Chart one: Net surplus/deficit on construction at 80% market rents (median 2010 rents by Borough)



This analysis highlights the financial surplus or deficit generated by building new 2 bed units at a total scheme cost of £147,000 per unit, compared to a capitalised net rental stream for the new property. For a full set of assumptions underpinning this analysis, please see Appendix A.

Even with rents at 80% of market rent, and with land invested at nil cost, this analysis shows that there is still likely to be a need for grant or some form of subsidy in the majority of Boroughs across London. The analysis highlights improved viability in higher value areas of London, and consequently the ability to deliver new units under the new model. Indeed there could be scope for developments in these areas to generate surpluses to cross-subsidise provision elsewhere or to help fund alternative tenures. This is, however, predicated on there being access to public land to build on and it is, inevitably, in the higher value areas where land is particularly scarce. Those areas where there is greatest viability from a development perspective will also be where there is greatest potential to generate capacity from conversion of existing properties. Chart two below compares current 2 bed rental levels (2010 new lets) with prospective rentals at 80% median market rents were units to be converted.

Chart two: 2 bed weekly rental at 80% of market rent against weekly rent and charges for 2010 re-lets of social housing



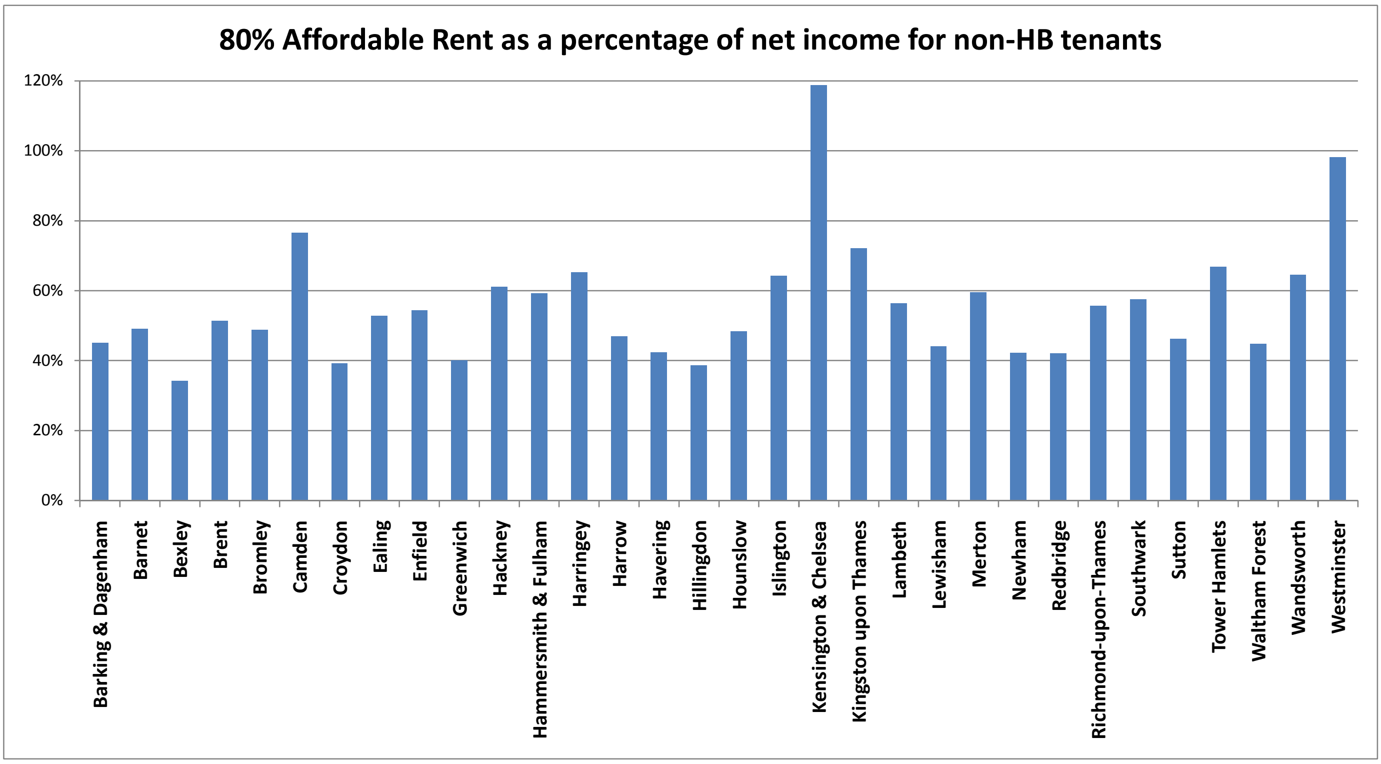
As might be expected, there is significant potential in the higher value Boroughs to create capacity through new build of Affordable Rent and through conversion of existing social units to Affordable Rent. What does this mean for the existing tenants however? The differential on rentals has the potential to impact significantly on tenant mobility, as tenants will be discouraged from moving by the higher rentals they will be required to pay on their new property. What's more, for the first time, there will be a significant variance in rent levels for social tenants between Boroughs, with inevitable pressure on tenants to move to the more affordable Boroughs.

Another uncertainty is what impact the new differential in the value of stock between Boroughs will have on conversion rates and new delivery. There has been a commitment not to cross-subsidise units outside of London from values within, but what about within London? Given the restrained funding environment and continuing housing targets there is likely to be significant pressure to allow providers to convert greater volumes of stock in the high value areas of London to cross-subsidise provision elsewhere where there is more readily available public land.

What impact will this have on affordability in London?

Viability is, of course, only one side of the coin. The other key consideration is what the new rents might mean for tenants from an affordability perspective. Looking first at those not on housing benefit, chart three below shows the new 80% Affordable Rent (at median rent levels) as a percentage of net weekly income (taken from CORE database for 2008-10) for 2 bed properties.

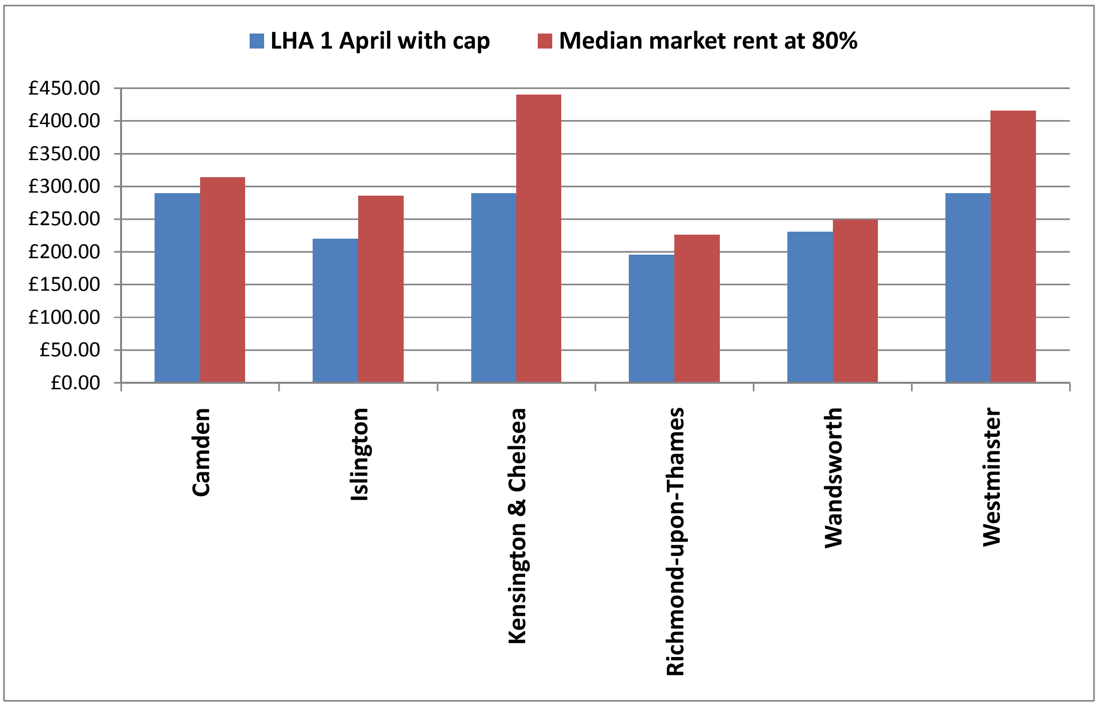
Chart three: 80% Affordable Rent as a percentage of net income for non-HB tenants (2 bed properties)



A clear affordability challenge will be created by the move to Affordable Rent in London at 80% market rent. In all Boroughs rent could exceed 30% of net income for current social housing tenants (GLA's definition of affordability) and in 16 it is likely to be over 50%. In practice therefore if Affordable Rents are pushed to the 80% limit, as expected by CLG/HCA in all but exceptional circumstances, there will be significant affordability challenges for tenants. In reality, the tenants of Affordable Rent properties will not be those who are currently in social rented housing.

Even those who are on housing benefit will face challenges from the new Affordable Rent levels in a number of Boroughs. Chart four below compares 80% Affordable Rent on a 2 bed property against LHA levels from the 1 April for a sample of high value Boroughs.

Chart four: LHA with 1 April cap compared with 80% market rent



The new rents will clearly not be affordable for tenants on housing benefit in a number of Boroughs. It will be a challenge for GLA/London HCA to decide how they address this through their negotiations with providers and Local Authorities under the new Framework.

Conclusion

The challenges that the new Affordable Rent model brings in London are significant in terms of delivery of new stock and affordability. The model generates value in the central Boroughs but is not affordable. In outer London it is on the borderline of being affordable but does not generate sufficient value to be viable. This dynamic is not new in London, but the current reform to affordable housing will crystallise the challenge for Boroughs and the GLA/London HCA in collaboration with providers. Negotiations on the framework agreements for providers will need to address some key points:

- How will GLA/London HCA look to direct surpluses on conversions in high value areas to areas of low value?

- How will the required levels of social rented housing be maintained to meet need, especially in central London Boroughs?

- How will the issue of affordability at 80% market rent be dealt with for social tenants?

- Is a new kind of tenant of affordable housing being created by the expansion of the provision of the 80% market rent unit? What does this mean for the current tenants of social housing?

- What will be the impact on Boroughs that have transferred their stock as providers convert existing stock to Affordable Rent?

- How will the GLA/London HCA allocate its limited resources from the NAHP programme for 2011-15 across the capital? Will there be any allowance for estate renewal in the allocation?

How these questions are answered are likely to have a big impact on the future social make up of a number of London Boroughs on the one hand, and on the ability to deliver the volume of new units required on the other.

In a difficult funding environment the Affordable Rent model does at least provide the potential to support new delivery of affordable units across London. It also offers the opportunity, alongside the proposed tenancy and local authority housing finance reforms, for Local Authorities to take a pro-active role in delivering these new affordable units. They may choose to work directly within the newly self-financed HRA, in partnership with existing providers, or through new partnerships with private developers or community based organisations. However it presents a real challenge for local authorities to continue to provide the necessary levels of social rented housing to meet need.

Paul McGuinness is a senior consultant at GVA. To find out more about GVA's work in this area, please contact Paul on 07946 514 218, or email paul.mcguinness@gva.co.uk

Future of London and GVA are jointly running a programme exploring the issues considered in this paper and others relevant to the future development of London. To find out more, contact Future of London Director, Ben Harrison at ben@futureoflondon.org.uk

Appendix A: Assumptions and data

Assumptions on development viability:

- 2 bed property
- 80% Affordable Rent taken as 80% of median market rents from London Rents database for 2010 on a Borough wide basis
- Land invested for nil cost
- Nil grant
- Voids at 3%
- Management, maintenance and cyclical £2,500 p.a.
- Net rent capitalised at 5.5% yield (assumes HRA prudential borrowing)
- Indicative construction, on site infrastructure and S106 cost of £147,000 per unit

Rental and income assumptions

Borough	Median market rent at 80% 2010	Weekly rent and charges new lettings 2010	2008-10 income levels (non-HB tenants)
Barking & Dagenham	£148.00	£91.72	£329.06
Barnet	£193.60	£107.44	£394.69
Bexley	£141.60	£97.97	£415.43
Brent	£187.20	£109.57	£364.40
Bromley	£161.60	£104.29	£331.94
Camden	£314.40	£112.14	£410.97
Croydon	£156.80	£109.17	£400.56
Ealing	£184.80	£114.08	£350.22
Enfield	£180.00	£100.35	£331.16
Greenwich	£156.80	£115.52	£391.46
Hackney	£238.40	£106.98	£390.79
Hammersmith & Fulham	£264.00	£123.66	£445.48
Harringey	£216.00	£109.63	£330.93
Harrow	£175.20	£104.11	£373.21
Havering	£148.00	£95.77	£349.66
Hillingdon	£166.40	£107.91	£431.57
Hounslow	£175.20	£119.22	£362.40
Islington	£286.40	£116.75	£445.75
Kensington & Chelsea	£440.00	£113.87	£370.71
Kingston-upon-Thames	£184.80	£124.67	£256.37
Lambeth	£216.00	£119.16	£383.19
Lewisham	£166.40	£107.88	£377.38
Merton	£192.80	£102.36	£324.00
Newham	£168.00	£106.84	£398.01
Redbridge	£160.00	£102.89	£381.31
Richmond-upon-Thames	£226.40	£115.44	£407.31
Southwark	£221.60	£114.71	£385.11
Sutton	£156.80	£93.77	£339.67
Tower Hamlets	£248.00	£116.04	£371.29
Waltham Forest	£160.80	£99.81	£358.85
Wandsworth	£249.60	£112.95	£387.61
Westminster	£416.00	£127.37	£424.45