



EXPANDING CHOICE INCREASING THE SUPPLY OF AFFORDABLE HOUSING

A Report by the HBF Affordable Housing Policy Group

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Foreword

The principle argument of this paper is that the debate about improving the supply of affordable housing is too narrowly focused on state-subsidised housing, or Affordable Housing provided through S106 planning obligations agreements on private new housing sites. This narrow social housing focus ignores, and can even be at the expense of the private sector. Yet private house builders deliver around nine out of every ten new homes, including more than half of all social rented and intermediate Affordable Housing, home ownership has reached 70%, and 84% of the population aspires to home ownership, including 84% of under 25s and 86% of those aged 25-34, according to the latest CML survey.

The objective for everyone involved in housing provision, whether central and local government or house builders and RSLs, should be to work towards making housing more affordable so as to improve access to decent, affordable housing.

Concern about the worsening housing prospects of young people has become a major political issue over the last two years, as demonstrated by the quotes below from a range of senior political figures and housing experts. The fact that an estimated 38% of first-time buyers under 30 received financial help with their purchase in 2006 may be positive for the housing market, but it has undesirable social justice implications. It cannot be right that young people's housing prospects are heavily dependent on the financial wellbeing and tenure of their parents or other relatives.

In addition, the main political parties are committed to expanding home ownership. While social housing has an essential role, we must focus more attention on meeting the housing aspirations of the vast majority of young people who aspire to own a home of their own.

We hope this report will provide a useful perspective on the debate about housing affordability, a debate which is set to intensify over the next few years. We cannot claim to have all the answers, so we look forward to engaging in this debate with Government and other stakeholders.

Paul Pedley
Chairman

Home Ownership and Young People's Housing Aspirations

"A home-owning, asset-owning, wealth-owning democracy is what would be in the interests of our country because everybody would have a stake in the country. The problem is that even with the great ambitions of the 1950s or the 1980s, they did not succeed in widening the scope for home ownership to large numbers of people who want it. There is a pent up demand. More households are being created than there are houses for them. But I also recognise you have got to combine the building of housing for ownership with the building of houses for rent in a far more mobile and fluid society. I recognise that there is a challenge of modern society where young people want to buy or rent their own homes a lot earlier than previously. We have got to make it possible for that to happen. The aim is affordable housing."

Gordon Brown MP, housing policy speech, 13 May 2007

"We must be on the side of the next generation. If we are to be the Party of aspiration, we must be on the side of aspiration. And that means building more houses and flats for young people. It is our social responsibility."

David Cameron, Leader of the Conservative Party, Conservative Conference, 4 October 2006

"Nevertheless, the affordability problem is highly likely to get even worse. Under RSS [Regional Spatial Strategy] plans the ratio of lower quartile house prices to lower quartile earnings is projected to erode from around seven in 2006 to about ten by 2026.

Extrapolating these findings and focussing on the 30-34 age group (largely first time buyers), the implication is that whereas in the late 1990s over 60 per cent of this group could afford to buy an average flat, by 2006 this figure had fallen to 57 per cent. The prospect for the next generation are much worse. Based on this analysis by 2026 only 40 per cent of the 30-34 age group would be able to buy."

National Housing and Planning Advice Unit (NHPAU). Affordability Matters. June 2007

"The third challenge is making sure that no one is excluded from the benefits of owning housing assets. That is of course about social justice. And it is about allowing people to get on in life and continuing to break down the barriers to social mobility. The combined value of our homes stands today at a record £3.8 trillion.

Many homeowners, and not just the very richest, have benefited from the growth in prices in recent years. The problem is what happens to those who are unable to get a foot on the bottom of the property ladder. They do not share in the wealth generated by rising prices. And they will find it harder to help their children benefit from ownership.

We cannot be indifferent to the worrying prospect of a group being locked out of prosperity, of disadvantage passing down from generation to generation and throughout the community. It harms those individuals, and it harms our society too. It means fewer people being able to support themselves, and a growing social divide.”

‘The Future of Housing Policy’. Speech by Ruth Kelly MP to the Fabian Society, 13 February 2007

“The housing decisions we take over the next few years will be critical to the life chances of the next generation. If we ignore those rising pressures for more homes - as some would have us do - we will see rising wealth inequality, constraints on aspirations and difficulties for our economy as well. And unless we do more to improve housing for growing children, we will be denying too many of them a good start in life.

Government analysis found that if we were to carry on building at previous rates then over the next twenty years we would see the number of thirty-year-old couples able to afford to buy a home drop from over 50 per cent today to nearer 30 per cent. That is unfair and unsustainable. Over 80 per cent of 45-60 year olds are home owners. But their children will find it much harder to follow in their footsteps unless we build more homes.

Already first time buyers are facing real pressures. Almost half now rely on the 'Bank of Mum and Dad', or other family favours to help them get onto the ladder. But what about those who don't have parents and grandparents who can help them out?

I believe that building more and better homes for our children must be one of the main priorities now for the government looking forward to the next ten years. But it must also be a priority for local government and for communities in every region.”

‘Housing and Life Chances’. Speech by Yvette Cooper MP to the Fabian Society, 15 May 2007

“The burden of rising house prices falls on current and future first-time buyers. Many of these are too young to vote and many more have not been born yet.”

Martin Weale, National Institute of Economic and Social Research, quoted in the Financial Times, 30 April 2007

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Paul Pedley
Chairman

Members of the HBF Affordable Housing Policy Group

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1. REPORT OBJECTIVES

1. The following paper examines two related questions:
 - How to increase the supply of housing that is more affordable;
 - How to improve the process by which Affordable Housing is provided through planning obligations (S106) agreements on private new housing sites.
2. The principle argument of the paper is that the debate about improving the supply of affordable housing is too narrowly focused on state-subsidised housing or Affordable Housing provided on private housing sites through S106 planning obligations agreements.
3. The long-term solution to the current housing affordability crisis is to increase the supply of housing substantially, which in turn will require a substantial increase in the supply of land with residential planning permission.
4. However this will take time. In the meantime, despite current planning constraints, the private sector is already doing a great deal to increase the supply of affordable housing without any state subsidy. In addition, there is a range of measures which could be taken, both by central Government and by local planning authorities, not only directly to improve the supply of affordable housing, but also to encourage – or in some cases to avoid discouraging – private sector initiatives and innovation. Government planning policy guidance for housing (PPS3) encourages a more holistic view of housing affordability, but there is little sign yet of this broader approach being adopted by local authorities.

Note on Definitions

5. Appendix 1 contains a number of important definitions. The most important is the distinction between making housing more affordable, which is a very broad concept, as opposed to the narrow social sector and planning concept of 'Affordable Housing' which is restricted to social housing for rent and intermediate housing at below-market prices or rents.
6. This paper reviews a wide range of measures to increase the supply of housing which is more affordable. Narrowly defined 'Affordable Housing' is one source of supply within this range.

2. SUMMARY AND RECOMMENDATIONS

2.1 Summary

7. The Government has a wide range of objectives influencing the affordability of housing and the provision of affordable housing. The most important is increasing the supply of land with residential planning permission to allow house building to expand towards the 200,000 per year target by 2016.
8. The single most important message of this paper is that solving the affordability crisis must rely primarily on private sector market solutions, complemented by carefully targeted public sector intervention designed to use limited public resources to maximum effect and to achieve objectives which the private sector could not meet on its own. A narrow preoccupation with social rented housing, or S106 Affordable Housing, risks stifling private sector solutions.
9. Given strong demand pressures from economic prosperity and rapid household growth, and the time it will take to expand land and housing supply significantly, today's poor levels of affordability are likely to persist well into the future. Therefore we must encourage as many mechanisms as possible to try to overcome the effects of poor affordability.
10. Between the poorest households who will always require heavily subsidised social housing, and better-off households able to buy or rent market housing without assistance, there is a large group of low to middle income households, including many key workers in the public sector, who are priced out of today's market. Their needs could be met from a range of initiatives, some with public subsidy, some with private subsidy out of land values, and some with innovative private sector housing or financial solutions requiring no subsidy.
11. There is a wide range of solutions to increasing the supply of affordable housing, both public and private sector:
 - **Rebalancing Supply and Demand**

In the longer-term, it is now almost universally accepted that solving the affordability crisis will require a better balance between the need/demand for housing and the stock of dwellings along with more demand-responsive supply. This will require a substantial increase in the supply of land with residential planning permission.
 - **Public Subsidies for Housing**

Public subsidies for housing take three forms: personal (housing benefit), 'bricks and mortar' investment, and below-market value for public land made available for sub-market housing. Recently, private companies have been able to bid for social housing grant to supply products traditionally limited to the social sector. It is estimated that public housing support, excluding land value subsidies, totalled £16

billion in financial year 2003-04¹.

- **Private Subsidies: Affordable Housing through S106 Agreements**
Housing developers are often required to provide a proportion of the dwellings on a site for 'Affordable Housing' through S106 planning obligations agreements. These agreements have several important features: they do not increase total housing supply, and so in a general sense do not make housing any more affordable; they provide over half of local authority and RSL units; excessive local authority demands may actually reduce housing supply by damaging the financial viability of some schemes and choking off residential land supply, and so worsen affordability. Because Affordable Housing demands are usually not applied to non-residential development, thereby distorting land values, residential schemes are put at a competitive disadvantage and can lose out to alternative uses. However one major benefit of such agreements is that they lever in private land value subsidy. We do not believe there is a large pool of land value waiting to be tapped for Affordable Housing through S106 contributions, not least because 74% of new housing is now on brownfield land which is usually in need of remediation.
- **Public Sector Land's Contribution**
English Partnerships (EP) has responsibility for a large share of publicly owned land. In 2005-06, 7,389 housing starts were facilitated by EP and 3,182 units were completed, of which 2,057 starts and 1,016 completions were "affordable". By accepting a below-market land value, EP enables private developers and RSLs to offer state-subsidised below-market housing for sale or rent. The public sector, as a major land owner, has the potential to make a much greater contribution to the overall supply of land for new housing.
- **Total Public and Private Subsidies for Housing**
Combining the estimated £16 billion public housing support in 2003-04 with our guesstimate of a £2-4 billion private land value subsidy through S106 agreements, total public and private subsidy/support, including public sector land subsidies through EP, must be well over £20 billion per year.
- **Private Sector Low-cost Market Housing**
A narrow focus on largely public sector affordable housing provision ignores the contribution the private sector makes to meeting affordable housing demand, and tends to stifle private sector initiatives which can contribute towards meeting the Government's housing objectives, as well as meeting the desire for home ownership among a large section of the population. The more robust evidence base and broader approach required for the new local authority Strategic Housing Market Assessments, to replace Housing Needs

¹ *Ends and Means: the Future Roles of Social Housing in England*, by John Hills for the CLG, February 2007.

Surveys, should bring the private sector's contribution into sharper focus.

The private sector, which provides the majority of local authority and RSL affordable housing, offers a wide range of affordable products. Low-cost market housing, which already makes a significant contribution to meeting affordable housing demand without any need for public subsidy, and which could play a much larger role, was excluded from the new definition of Affordable Housing in PPS3. As a result, the role of low-cost market housing tends to be ignored by local planning authorities in S106 Affordable Housing negotiations.

In some northern areas, low-value older homes can be bought outright, without any subsidy, at mortgage payments close to, or even lower than the rents for recently built social rented units, thus effectively contributing to the supply of affordable housing.

- **Private Sector Financial Initiatives**

In addition to low-cost market housing, some housing developers and financial institutions are beginning to introduce innovative financial packages to increase the supply of affordable housing without any need for public or private subsidy.

One of the greatest barriers to further expansion of these initiatives can be the requirement for Affordable Housing units supplied through S106 agreements to be 'in perpetuity'. Private institutions or companies will usually not invest in a scheme if the original investment and any returns can never be realised.

- **Increasing the Social Housing Stock Contribution**

The social housing stock could be managed more effectively to increase the supply of affordable housing.

Tenancies are for life and for one further generation, whatever the personal or financial circumstances of the household or its successor. This can lead to under-occupation of larger social housing units, while at the same time housing developers face increasing demands to supply more family units in S106 Affordable Housing agreements

The social stock could also be used more effectively if some of the surplus one and two bedroom units were sold and the money re-invested in larger units, possibly in less expensive areas.

Private buyers and renters often have to move to lower priced areas to find more affordable housing. Social housing providers should be more flexible about where social tenants are housed so that public subsidies are used to maximum effect.

- **Right to Buy**

Right to Buy does not contribute to the supply of affordable housing.

From the private house building industry's perspective, there are two major contradictions at the heart of Right to Buy:

Social dwellings built with public subsidy are being sold at below-market prices, thereby reducing the stock of affordable housing, yet local authorities are demanding ever greater contributions of Affordable Housing on private housing developments to make up for the shortfall of affordable housing.

Local authorities invariably demand that Affordable Housing contributions through S106 agreements on private housing sites must be 'in perpetuity', which acts as a block on private sector affordable housing solutions. Yet social housing stock and funds are not 'in perpetuity': the dwellings can be sold through Right to Buy, and the capital receipts do not have to be fully recycled for investment in Affordable Housing.

2.2 Recommendations

12. We regard a substantial increase in housing supply, and therefore in the supply of residential land supply with planning permission, as by far the most important long-term solution to housing under-supply and poor affordability. Achieving this objective should be the primary goal of all stakeholders – central Government, local planning authorities, private housing developers, RSLs, EP, etc.
13. We urge the Government and local authorities to develop more realistic expectations of the scope for increased Affordable Housing contributions, and to accept that ever-rising demands will result in less housing being produced overall, and therefore less S106 Affordable Housing. We also believe a much simpler and faster method of calculating Affordable Housing contributions needs to be devised (see Section 7).
14. We would encourage the Government and its agencies to speed up the release of surplus public sector land for housing so as to help reduce long-term house price growth and improve housing affordability.
15. We support the use of subsidised public sector land to increase the supply of affordable housing at below-market prices or rents.
16. EP and other public sector agencies should restrict their interventions to achieving objectives which the private sector is unable to do on its own. Public funds and subsidies should not be employed to compete with private developers.
17. We suggest the Government should estimate the full cost of public and private sector subsidies for affordable housing in order to gain a fuller understanding of the true costs and benefits of state intervention in housing provision.
18. We urge local authorities to be more flexible in their Affordable Housing demands, focusing on the provision of such housing, not on issues such as

funding, ownership or management which should not be planning matters.

19. We urge central Government, and especially local planning authorities, to take much greater account of private sector contributions to the supply of affordable housing and to ensure their policies are flexible and encourage, rather than discourage, the contribution of the private sector.
20. We believe the public sector should not dictate housing sizes, mix or specification for private sector sites. Private individuals buying a home make choices about price, location, dwelling type and size, plot size, etc. according to their income and personal preferences. The state has no place restricting the availability of certain types of housing (e.g. small affordable market units), which in practice amounts to telling certain households what they should or should not buy. Also, by imposing minimum size standards or dictating the housing mix on private housing sites, local authorities may reduce the number of dwellings a developer can fit onto a site and so reduce housing choice, contrary to Government policy. By reducing the total supply of housing, they will effectively exclude some households from decent housing and worsen the affordability crisis.
21. The Government should re-examine the 'in-perpetuity' rule governing Affordable Housing to see if it can be redefined to continue to protect public sector subsidy, while also encouraging private sector solutions. We urge local planning authorities to focus on increasing the overall supply of housing which is affordable, and to be more flexible in their demands, so as to encourage private sector solutions.
22. We urge the Government to examine whether changes to current social housing policies could lead to more effective and efficient use of the existing social stock, and more effective use of existing financial resources, while still providing decent, affordable housing for the most needy households.
23. While we accept Right to Buy has been a very successful policy for nearly 30 years, we suggest the Government should examine whether eligibility criteria and discounts could be altered so as to stem the loss of much-needed affordable housing from the social stock. We also believe that as long as there is a severe shortage of Affordable Housing, the capital receipts raised from the sale of Affordable Housing through Right to Buy should be recycled to provide Affordable Housing to replace the stock lost through this policy. We would urge the Government to re-examine the 'in perpetuity' requirements of Affordable Housing, as defined in PPS3, and local planning authorities to be more flexible in cases where the private sector offers a solution without public subsidy.
24. S106 Affordable Housing should be applied to all forms of development, not just residential, to avoid distorting land values and to ensure all development makes a contribution towards meeting wider social objectives. We support the use of S106 agreements, including Affordable Housing, on smaller residential schemes. However such demands must be applied flexibly and sensibly to non-residential and small residential sites, if necessary accepting financial contributions towards Affordable Housing on sites where it is unrealistic to provide such housing.

25. We support the Government's proposal for a 'common starting point' for Affordable Housing negotiations to speed up the process and make it more difficult for local authorities to make excessive demands. However 'free serviced land', as suggested by the CLG in its Planning-gain Supplement consultation, is not a suitable common starting point as this would have a very damaging impact on financial viability.
26. The Government should insist that the Affordable Housing proportions and thresholds set by local planning authorities are determined in Development Plan Documents (DPDs), so that they are subject to full testing at a public enquiry and supported by a robust evidence base. Local authorities should not be able to misuse SPDs to short circuit proper planning procedures and avoid the need for robust evidence and public testing of policies. Such practices should be monitored and, where necessary, stopped by Government Offices for the Regions and CLG.
27. Local authorities must be encouraged to assess the impact of their S106 Affordable Housing demands in the context of other S106 demands and other demands outside the scope of S106 agreement, all of which reduce the scope for provision of Affordable Housing. The Government's target for all new homes to be zero carbon by 2016 will have a significant additional impact on residential development costs, and therefore on land values.
28. Where receipts are generated through staircasing in privately funded shared ownership or shared equity schemes, this money should be recycled through a Housing Corporation approved organisation so that it is used to provide more affordable housing. In at least one case recently, a local authority has required staircasing funds to be recycled to the authority itself.

3. ACHIEVING GOVERNMENT OBJECTIVES

29. The Government has a wide range of objectives which have a bearing on the affordability of housing and affordable housing:
- “Everyone should have the opportunity of a decent home at a price they can afford, in a place in which they want to live and work” (CLG housing policy objective)
 - Raise housing supply to 200,000+ net additional dwellings per year in England by 2016 to meet housing need/demand, reduce upward pressure on real house prices and improve affordability;
 - Increase the supply of land with residential planning permission to ensure housing supply meets need/demand and to improve affordability;
 - Increase public sector funding for affordable and social housing;
 - Meet the housing needs of the most disadvantaged households, who will usually require social rented housing with a substantial subsidy per dwelling and/or per household;
 - Obtain the largest number of dwellings per £ of subsidy – to ensure the most efficient use of public resources;
 - Achieve mixed and balanced (‘sustainable’) communities, including mixed tenure;
 - Expand owner occupation;
 - Social justice: extend asset ownership to provide security, support aspirations, give people a stake in their community, reduce wealth inequality and give people greater financial independence in times of adversity or once they retire;
 - Use planning policy to extract private land value – whether extracted via planning obligations (S106) agreements, some form of tariff or the proposed Planning-gain Supplement (PGS) – to subsidise Affordable Housing provision.
30. Achieving all of these objectives simultaneously with a limited number of policy tools and limited resources is clearly a very tall order. Indeed, sometimes these policies will conflict.
31. For example, taxing residential land values will tend to reduce the supply of land for housing, at odds with the objective of significantly raising housing output. Escalating demands for Affordable Housing contributions from private housing developments reduce the supply of open-market housing, and they risk making some schemes unviable, thereby reducing the overall supply of housing. In other words, a well-intentioned policy to increase the supply of Affordable Housing risks driving up real house prices and worsening affordability.
32. The single most important message of this paper is that solving the affordability crisis must rely primarily on private sector market solutions, complemented by carefully targeted public sector intervention. This is the only realistic approach, both because the vast majority of new housing is built by private developers for private buyers, and because the public sector

has limited resources which should be employed to maximum effect².

33. Pressure to achieve maximum value for public subsidy seems destined to increase. The recent Hills report concluded: “Both sides of this equation of (uncertain) long-term demand and supply factors would be expected, other things being equal, to increase the pressure on social housing over the coming years.”
34. Public policy has two broad roles: removing barriers to private sector market solutions and encouraging such solutions – a facilitating role; and direct subsidies or investment to provide solutions which the market could not provide on its own – a complementary role.
35. Too often, undue emphasis is placed on short-term public policy solutions to the affordability crisis. At the very least, this risks private sector market solutions being overlooked. At worst, it may actually restrict the ability of the market to operate properly and stifle private sector solutions.
36. By encouraging private-sector solutions, the public sector would be able to focus its limited resources on solving problems the market cannot be expected to solve, such as meeting the needs of the most disadvantaged households, while also achieving the maximum benefit for each pound of public subsidy or investment.
37. ‘Market failure’ is often put forward as the justification for policy intervention. While there are undoubtedly cases where the market does not operate properly, or has failed completely, often the problem is in fact regulatory failure, not market failure. Housing supply is inadequate in England because the supply of land with planning permission has been severely rationed, not because the housing market has failed. In genuine cases of market failure, policy intervention may be the appropriate response. But in cases of policy or regulatory failure, the correct solution should be to reformulate or reduce policy intervention.
38. A key objective of this paper is to refocus attention on the private sector’s contribution towards making housing more affordable and increasing the supply of affordable housing. Our contention is that there is too little understanding of the actual and potential roles of the private sector.
39. Given the severity of the current affordability crisis, every effort should be made to encourage as broad a range of solutions as possible, whether from the public or the private sectors, and to achieve the most cost-effective contribution from each sector. The range of solutions will extend from housing with substantial public subsidy for the lowest-income households, though housing with modest public subsidy, schemes with a mixture of public subsidy and private land value subsidy, to low-cost market housing or innovative financial solutions with no public or private subsidy. All of these

² To illustrate the limits on public subsidy and public-sector solutions, while the Government places considerable emphasis on the potential role of shared ownership, the Hills report estimates that the “total of people helped into shared ownership of one kind or another is about 150,000 since 1991”. *Ends and Means: the Future Roles of Social Housing in England*, by John Hills for the CLG, February 2007.

have an essential role to play, although the mix of solutions will vary from place to place, depending on local incomes, house prices and housing supply.

40. This approach to providing affordable housing – tapping all sectors, a wide range of solutions, making best use of scarce public and private resources - is entirely consistent with the conclusions of the recent Hills report on social housing:

“thinking through ways in which packaging support for people in different situations in ways that are not limited to traditional social tenancies, begins to suggest directions in which more modest reforms could both *increase the options available* and *make better use of very scarce and pressured resources*” (italics added).

“But if social housing is to fulfil its potential, new approaches are needed. At their root we need to move beyond an approach where the key function is one of rationing and trying to establish who is *not* eligible for social housing to one where the key question is “How can we help you to afford decent housing?” and “Here are your options”.³

41. “How can we help you to afford decent housing?” and “Here are your options” should be the starting points for all CLG and local planning authority affordable housing policies, and not a narrow preoccupation with social rented housing, or S106 Affordable Housing, which form only part of a much wider picture.

42. **Geographical Note**

The planning and housing policies of Communities and Local Government (CLG) apply to England only. The devolved authorities of Scotland and Wales have their own policies. However the broad approach outlined in this paper is equally applicable to the housing markets of Scotland and Wales, even if the individual policy suggestions may not always be directly applicable.

³ *Ends and Means: the Future Roles of Social Housing in England*, by John Hills for the CLG, February 2007.

4. WHAT DO WE MEAN BY HOUSING AFFORDABILITY?

4.1 Defining and Measuring Housing Affordability

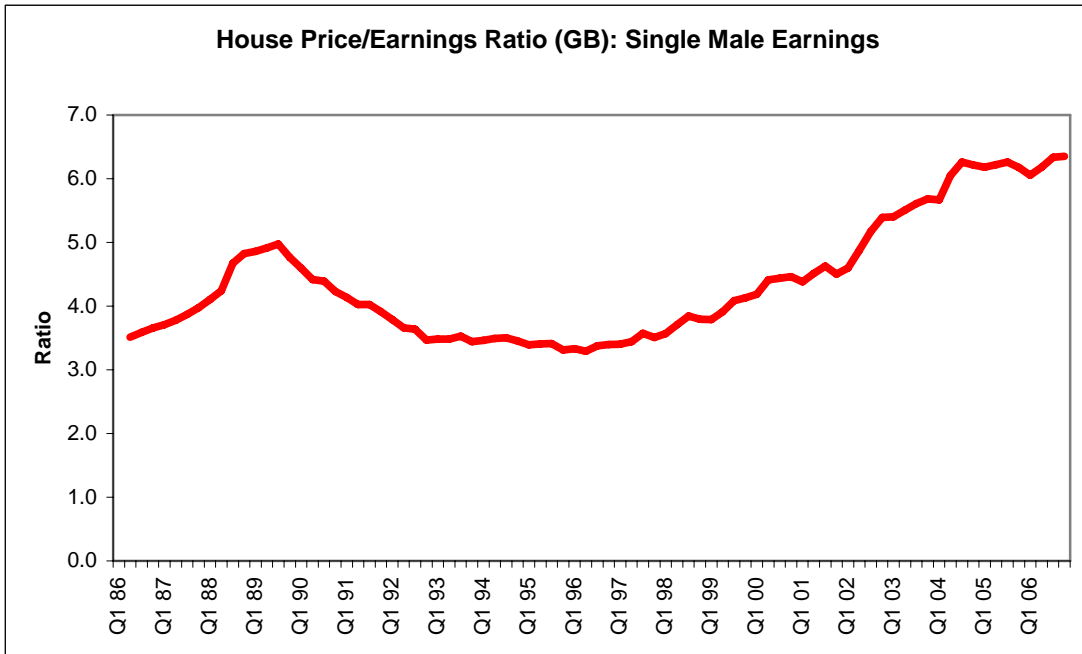
43. Housing affordability is a slippery concept.
44. In one sense, it could be argued that every dwelling is 'affordable' because someone has been able to buy or rent it. The market clears by adjusting prices and rents until the number of buyers or renters equals the supply of housing for sale or rent.
45. But clearly this is an unhelpful concept because the housing requirements of all households are not necessarily equated with the supply of housing. If there are too few dwellings compared with the number of households, households priced out of decent housing do not simply disappear. Instead they will find themselves unable to access a home of their own, overcrowded, in unsatisfactory or temporary housing or, at worst, homeless.
46. There will always be some households whose income or personal circumstances mean they are unable to access market housing, whatever the level of house prices. These will always require substantial state subsidy to obtain decent housing. However over the last decade, as house price growth has far outpaced income growth, more and more lower and middle income households have found themselves unable to afford decent housing, despite low interest rates.
47. Most economists accept that housing has become much less affordable⁴ in recent years, even if they are unable to agree on exactly how unaffordable. The house price/earnings ratio (GB) in the final quarter of 2006 reached 6.35 according to HBF estimates. By contrast, at the peak of the 1980s boom when housing affordability last reached crisis levels, the index peaked at 4.97 (Chart 1). The *Housing Market Report* affordability index, which takes account of earnings, house prices and interest rates, reveals that housing is less affordable than at any time for at least the last two decades, apart from the period of extremely high interest rates at the end of the 1980s and early 1990s (Chart 2). According to Halifax⁵, the number of first-time buyers fell to 315,000 in 2006, the lowest annual total since 1980 and down 37% since 1997 (503,000). Halifax also calculates that a typical first-time buyer was unable to purchase the average price house in 93% of towns in 2006 (482 out of 516). The number of households in temporary accommodation has more than doubled in the last decade⁶, another indicator of housing shortages.

⁴ See Appendix 1 for a discussion of measures of affordability.

⁵ Halifax press release, 30 December 2006.

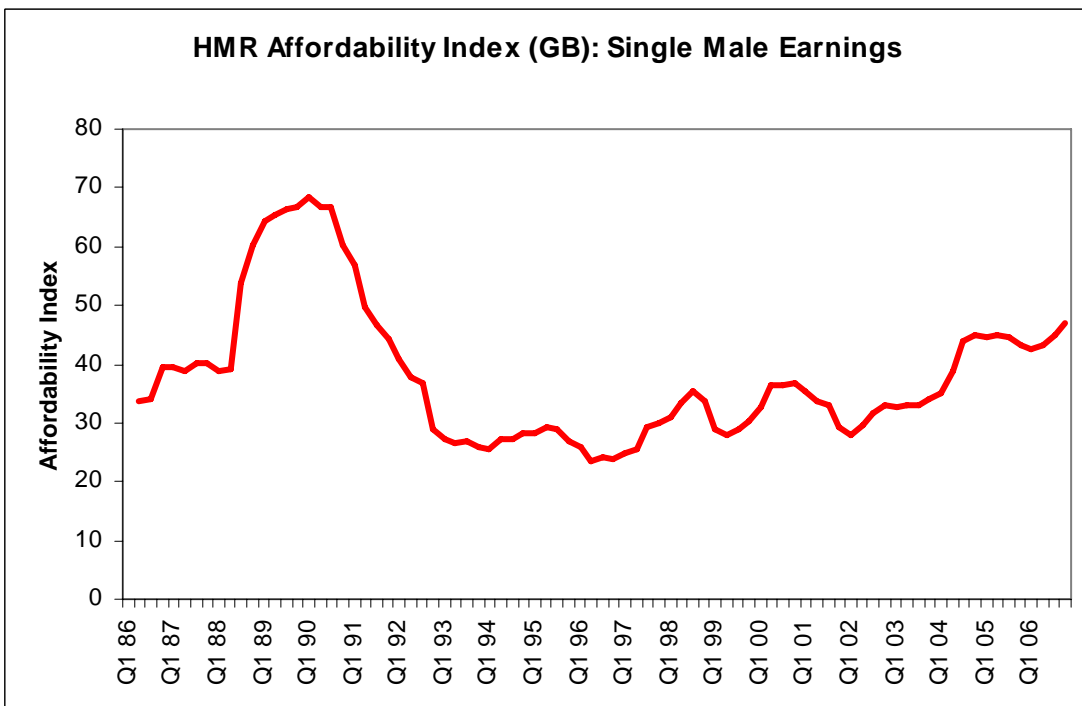
⁶ *Ends and Means: the Future Roles of Social Housing in England*, by John Hills for the CLG, February 2007.

48. **Chart 1: House Price Earnings Ratio (GB)**



Note: The ratio uses CLG house prices and official average earnings statistics.

49. **Chart 2: Housing Market Report Affordability Index (GB)**



Note: The index shows the proportion of annual post-tax income that would be spent on first-year mortgage payments for a household on average male earnings buying the average priced home in GB with an 80% mortgage. The higher the index, the worse the level of affordability. The index uses CLG house prices, official average earnings statistics and average mortgage rates.

50. We have seen the proportion of first-time buyers⁷ fall to historically low levels, at least partly as a consequence of poor affordability, although the figure may also reflect more permanent social and economic changes. As in the late 1980s, mortgage lenders have introduced extended mortgage periods and higher income multiples to try to allow more people to gain access to home ownership. Initiatives such as shared equity and shared ownership are very much in vogue, as in the 1980s, along with various Government key worker and first-time buyer initiatives. All of these initiatives try to extend the boundaries of home ownership to households priced out of the housing market.
51. Over the longer term, the balance between the number of households and the number of dwellings will also have an influence on the real price of housing⁸. If annual growth of the housing stock were to remain at current levels for the next 20 years, compared with projected rapid growth in the number of households, we would expect the price of housing to rise more than if there was a more even balance between households and dwelling supply.
52. The best way to visualise the various influences on housing affordability is to regard the supply/demand balance (or imbalance) as driving the long-term underlying level of affordability, while influences such as earnings and interest rates cause short-term fluctuations around this long-term trend. The Barker Review concluded that an imbalance between housing need/demand and housing supply over the last two decades had pushed up the real price of housing, and that therefore this imbalance needed to be corrected if we were to hold down the rate of increase in the future.

4.2 Poor Housing Affordability Likely to Persist

53. In the three housing market cycles of the 1970s, 1980s and early 1990s, when housing became increasingly unaffordable, three mechanisms restored affordability. Interest rates were cut from the very high levels that had triggered each housing recession. In addition, nominal earnings grew rapidly and nominal house prices either grew very slowly for an extended period, or in the late 1980s and early 1990s actually fell, both of which helped to restore the relationship between house prices and earnings.
54. It seems unlikely that today's poor levels of affordability will be corrected by the same mechanisms that restored affordability in previous cycles.
55. Interest rates are low by comparison with rates over the post-war period, so there is not the scope for cutting rates as there was in previous recessions.
56. The Monetary Policy Committee (MPC), which has independent responsibility for monetary policy in the UK, regards wages or earnings growth as a crucial influence on inflation. It has indicated it would regard

⁷ Halifax estimates there were 315,000 first-time buyers in 2006, the lowest since 1980 – see paragraph 46 above.

⁸ There were 160,000 housing completions in England in 2006. The official 2004-based projections, published in March 2007, suggest household growth in England will average 223,000 household per year from 2004-2026.

persistent earnings growth in excess of around 4.5% as a threat to inflation and would raise interest rates accordingly. Therefore we can effectively rule out earnings growth in excess of 4.5%. Earnings growth can at best be expected to take quite some time to correct the current poor relationship between earnings and house prices.

57. A sharp fall in house prices remains a possibility, although most commentators regard this as unlikely. The most common argument against such a correction is that it would require a 'trigger', such as sharply higher interest rates or unemployment, but that no such trigger is anticipated.
58. If we are not likely to see a sharp restoration of more favourable levels of affordability through significantly lower interest rates, rapid earnings growth or a substantial reduction in house prices, then we have to assume affordability will remain stretched well into the future.
59. And if housing affordability remains stretched, then we must seek to establish as many mechanisms as possible to try to overcome the effects of poor affordability.

4.3 Unequal Impact of Poor Affordability

60. Declining housing affordability, whatever the causes, has an unequal impact on different types of households. This uneven distributional impact is most obvious for household incomes: those on lower incomes will feel the impact much more than higher-income households. In addition, households which do not own a home will not benefit from the capital appreciation enjoyed by home owners, creating an ever widening wealth gap. In this category, younger potential first-time buyers are obvious victims. Some are excluded from purchasing a home altogether. However even those which manage to get a foot on the housing ladder will have to find a larger deposit, possibly using money handed down from parents or grandparents, borrow a larger multiple of their income, and spend a larger percentage of their disposable income on meeting their mortgage payments than would be required if housing was more affordable.
61. Existing home owners may also suffer because of poor affordability. Even though most will have some capital in their existing home, they may not be able to afford to trade up to a larger home as their family size expands, or to move to a more expensive area if this becomes necessary for employment reasons. The consequences of these two examples will be overcrowding, reduced labour mobility and the inability of some households to better their living standards by taking up a higher-paid job.
62. One complication in measuring affordability is that different households have different housing needs. A low-priced one bedroom flat may in theory be 'affordable' for a low-income family with several children, but clearly such a unit would be quite unsuitable. So simple general measures, such as 'lowest quartile house prices' or a house price/earnings ratio, are only crude guides to affordability.

5. DEFINING THE LIMITS BETWEEN OPEN-MARKET AND AFFORDABLE HOUSING

63. Household incomes extend over a whole spectrum or distribution, from those who have no income up to those who have very large incomes. In addition, there is a distribution of wealth, the value of the physical and financial assets owned by households less any debts or financial liabilities. In general we would expect some positive relationship between incomes and wealth, the obvious exception being pensioners who often have a relatively low income, but may have considerable wealth tied up in their mortgage-free home, pension entitlements and savings.
64. House prices also extend over a distribution, from low prices up to the most expensive dwellings. But of course unlike incomes, the distribution of house prices does not extend down to zero. For example, in the fourth quarter of 2006, HM Land Registry data for England and Wales show only 1.1% of transactions were for dwellings priced below £50,000, and 14% were priced below £100,000.
65. And as already noted, affordability for an individual household depends on the size and type of household, not just its income. Flats are usually unsuitable for families, even if theoretically 'affordable' in relation to the family's income.
66. There have always been some households whose income and wealth is so low that they cannot gain access to adequate housing, whatever the level of house prices, rents and housing affordability. Since the early 20th century, Governments have accepted that some form of subsidy is required to ensure such households are adequately housed, while charitable organisations provided subsidised housing even earlier.
67. Over time, as affordability improves or deteriorates through short-term changes to interest rates, prices or incomes, and longer-term changes to the balance between housing supply and need/demand, the proportion of households not able to access market housing will contract and expand. In 1996, following a sharp drop in house prices during the 1989-92 recession and then several years of house price stagnation, and with interest rates at historically low levels, affordability was exceptionally favourable. Any estimate of the number of households unable to access market housing at that time would have been much lower than today following a near tripling in house prices over the decade 1996-2006.
68. In effect, households further and further up the income distribution have been excluded from buying a home at market prices over the last decade, creating rising need for subsidised, and especially intermediate housing.
69. While households towards the bottom of the income distribution will always fall outside market prices or rents, and households at the upper end will always be able to afford decent market housing, the division between those who cannot afford market housing and those who can will not occur at a fixed point. Rather it will extend over a range of prices or rents. And it will be different for different households according to their size and individual

housing requirements. The quantity and quality of housing each household will require is flexible and adaptable. And expectations and aspirations change over time as social and economic circumstances change. For example:

- Bedsits were common in the early days of public sector sheltered housing, but are now very difficult to let;
- While many first-time buyers may have aspired to a small house in the mid 1990s when affordability was very good, many would today happily settle for a small apartment;
- A family may aspire to a larger home to accommodate children. However if a large family home is unaffordable in the area, it may be quite possible, if a little uncomfortable, for the family to live in a smaller dwelling which is within its price range;
- Or a family unable to afford a suitably sized home in the local area may move to a lower priced area where a larger home is affordable.

70. One very important area of overlap between the costs of open-market housing and affordable, or subsidised housing, is the provision of newly built small, high-density apartments and houses at relatively low sale prices, sometimes referred to as low-cost market housing. These may well be affordable for households that, had such units not been available, would have had to seek some form of subsidised (e.g. intermediate) housing from an RSL. Such low-cost market housing is not defined as Affordable Housing in PPS3 for the purposes of S106 agreements. Yet it is clearly meeting a housing need that is just as legitimate as the need met through a S106 agreement, it is meeting this need without any public subsidy, and indeed it may be offering decent, affordable housing to exactly the same households as would have obtained S106 Affordable Housing.

71. Another area of overlap is when public sector rents are at a level that puts them on a par with, or even above the mortgage costs of second-hand housing towards the bottom end of the price distribution. This is an issue in some areas of northern England where recently built social rented housing is effectively competing with owner-occupied housing from the low-value, older stock.

6. INCREASING THE SUPPLY OF HOUSING THAT IS AFFORDABLE

72. Because housing affordability is such a big problem at present, and seems likely to remain so well into the future, we should be seeking as many solutions as possible, and not just focusing on a limited number of measures requiring direct public sector subsidy.
73. In this section of the paper, we examine a range of measures to increase the supply of housing that is affordable.
74. The discussion is restricted to housing and planning solutions. It does not address interest rates or real income growth, economic factors which have a major impact on affordability, but which fall outside housing and planning policy.

6.1 Rebalancing Supply and Demand

75. In the longer-term, it is now almost universally accepted that we need to bring about a better balance between the need/demand for housing and the stock of dwellings (supply), especially in England, and make the supply of housing more responsive to demand (supply elasticity). This will require substantially higher levels of new building and conversions than achieved over the last 15 years.
76. Achieving a large increase in house building will in turn require a substantial increase in the amount of land granted planning permission each year, a primary objective of the CLG's new planning policy statement for housing (PPS3). It is striking that between 1997 and 2003 (the latest available statistics), the amount of land developed annually for housing in England fell by 7% at a time of rapidly expanding household numbers and housing demand.
77. An increase in the supply of land with planning permission would not just increase the total number of dwellings being built, and thereby reduce upward pressure on house prices. It would also expand the range of new housing. At present, because the supply of land with planning permission is restricted, the range of housing is correspondingly restricted. But if there was a 25% increase in new housing supply, in line with the Government's target for 2016⁹, competition for customers would require house builders to expand the range of types, sizes and prices of new homes on offer.

Recommendation

78. *We regard a substantial increase in housing supply, and therefore in the supply of residential land supply with planning permission, as by far the most important long-term solution to housing under-supply and poor affordability. Achieving this objective should be the primary goal of all stakeholders – central Government, local planning authorities, private housing developers, RSLs, EP, etc.*

⁹ The Government's target is 200,000 net annual additions to the stock per year in England by 2016. Net additions take account of new build, conversions and demolitions. In 2006, there were 160,000 new build completions in England.

79. However, because new dwellings add less than 1% annually to the housing stock, any significant impact from increased house building on real house prices, and therefore improvements in affordability, will take quite a long time to come through. Therefore additional measures are required, both short and long term.

6.2 Public Subsidies for Housing

80. The long-standing solution to ensuring low-income households have access to decent housing has been to provide some form of public subsidy.

81. Traditionally, these have been either personal subsidies – i.e. a low-income person receives money to help with their housing costs – or so-called ‘bricks and mortar’ subsidies, where the state subsidises the cost of house building to keep down the price or rent. Bricks and mortar subsidies are now limited to RSLs, but in the past local authorities built many millions of subsidised social dwellings and they still own some 2.2 million homes in England (2.7 million in Great Britain).

82. More recently, the state has also provided land subsidies by accepting a below-market price for public sector land so that the price or rent of housing built on this land can be kept low. English Partnerships is the primary agency through which such land subsidies are channelled.

83. In the last two years, private companies have been offered the opportunity to bid to the Housing Corporation for social housing grant. Rather than RSLs providing subsidised dwellings, these companies are able to offer products traditionally limited to the social sector.

84. Households which cannot access market housing are classified as being in ‘housing need’ and require some form of subsidy. While we would all accept a definition of ‘housing need’ based around household incomes, definitions based on categories of buyers, such as key workers or first-time buyers, are much less satisfactory. The Government’s definition of key workers is restricted to the public sector, yet low-income private sector households face the same affordability problems. Not all public sector key worker households are in housing need requiring housing subsidy. Similarly, while many potential first-time buyers are unable to get a foot on the housing ladder, this does not mean we should regard all first-time buyers as being in housing need.

85. The danger of defining specific groups as being in housing need is demonstrated by the difficulties some RSLs have faced trying to market key worker housing. Efforts to target this market appear to have been driven more by the availability of grant funding than thorough market research to establish the scale and nature of demand.

6.3 Private Subsidies: Affordable Housing through S106 Agreements

86. Under planning obligations (S106) agreements with local planning authorities, housing developers are often required to provide a proportion of the dwellings on a site for “Affordable Housing”. (The definition of Affordable Housing is given in Definitions at the end of this paper.)

87. Affordable Housing as part of planning was first introduced in 1991. It is estimated that in 2005-06, 23,869 dwellings were provided in England through such agreements.
88. In the context of this paper, the provision of Affordable Housing through planning obligations (S106) agreements has a number of important features:
- Because S106 Affordable Housing contributions do not increase the overall supply of housing, they do not by themselves make housing more affordable, although they clearly meet the needs of the households given access to these dwellings.
 - More than half (55%) of the Affordable Housing units provided by local planning authorities and RSLs in England in 2005-06 were provided through S106 agreements¹⁰.
 - Over-ambitious Affordable Housing demands may actually reduce the supply of housing, and therefore worsen overall affordability, although the impact on house prices generally is likely to be small because the numbers involved are relatively small. If an RSL demands that the developer provides lower-density housing for the Affordable Housing contribution than would otherwise have been built on a site (e.g. larger family houses on a site of flats and terraced houses), or larger floor areas than would have been built for the open market, fewer units in total will be built on a site. In addition, escalating local authority Affordable Housing demands will threaten the financial viability of some housing schemes, or may reduce land values on some sites to a level that is unacceptable to land owners or that makes the land uncompetitive compared with the current use or an alternative non-residential use, so that fewer dwellings are built.
 - Affordable Housing is effectively a system for rationing part of the scarce supply of housing. A proportion of the dwellings on any site that would otherwise have been offered to open-market buyers is taken off the market and instead rented or sold as intermediate housing to selected households. Because no additional dwellings are built under such agreements, they effectively amount to robbing Peter (those who would have bought the units if they had been offered on the open market) to pay Paul (the fortunate selected households eligible for these units as Affordable Housing). This is like changing the ship's rules determining which passengers can board the lifeboats when the real problem is that there are not enough lifeboats.
 - But Affordable Housing does have one major benefit, namely that it levers in private subsidy from land values. Until S106 agreements,

¹⁰ Yvette Cooper answer to Parliamentary Question, 22 January 2007.

housing subsidies, whether personal or bricks and mortar, came from the state. No private land owner, and no public sector land owner obliged to obtain the highest value in disposing of its land assets, would voluntarily offer a land subsidy so that dwellings could be offered for sale or rent at below the market price. Indeed, in a competitive land market this would be impossible because anyone attempting to offer a reduced price to the land owner in order to sell dwellings at below their market value would be outbid by other developers offering a full market price for the land.

By obliging developers to provide a proportion of units as Affordable Housing, the S106 system obliges land owners to provide their land at a discount to the open market value in order to gain a planning permission. In some cases, developers are also obliged to make a contribution towards the building cost of the Affordable Housing units. This cost will also be passed back to the land owner through an even lower land value.

89. There is not a large pool of land value waiting to be tapped for Affordable Housing S106 contributions. A Sheffield University study¹¹ for the CLG, which estimated that only 40% of 'major' residential (10+ units) planning permissions had a S106 agreement, has been widely misinterpreted:

A much larger proportion of housing schemes, rather than planning permissions, have S106 agreements because the statistics for planning permissions count each permission on an individual site, leading to multiple counting¹². A survey of larger HBF members found that 75% of residential developments over 10 units in 2005 had a S106 agreement. Most of those without such an agreement appeared to be relatively small schemes (between 10 and 25 units);

Of those without a S106 agreement, most will be either small developments (less than 25 units) which have very limited potential to subsidise Affordable Housing, or there will not be a S106 agreement for very good reasons, such as little or no land value on some major regeneration sites;

The greater the Affordable Housing contribution demanded, the greater the risk that housing output overall will fall: residential schemes will become unviable, or land owners will not sell at the land value being offered, or residential land values will fall below alternative use values.

Recommendation

90. *We urge the Government and local authorities to develop more realistic expectations of the scope for increased Affordable Housing contributions, and to accept that ever-rising demands will result in less housing being produced overall, and therefore less S106 housing. We also believe a much*

¹¹ CLG. *Valuing Planning Obligations. Final Report.* May 2006.

¹² An outline and a full permission on the same scheme would be counted as two permissions, but clearly they would result in only one scheme with only one S106 agreement. Similarly a scheme re-submitted for a changed planning permission, which frequently happens, would count as two permissions, but would have only one S106 agreement.

simpler and faster method of calculating Affordable Housing contributions needs to be devised – see Section 7.

6.4 Public Sector Land's Contribution

91. English Partnerships (EP) has responsibility for a large share of publicly owned land. In 2005-06, 7,389 housing starts were facilitated by EP and 3,182 units were completed¹³.
92. EP makes available some of this land for affordable housing, for example for first-time buyers or key workers. Of the units facilitated in 2005-06, 2,057 starts and 1,016 completions were 'affordable', including key worker housing. By accepting a below-market land value, EP enables private developers and RSLs to offer state-subsidised housing for sale or rent.
93. We are not aware of any statistics of the public sector's total land holdings, or of the total public sector contribution to annual residential land supply. However official figures suggest 12% of the stock of brownfield land is owned by local authorities and a further 15% is owned by other Government bodies¹⁴. In addition to its portfolio of strategic sites, EP is responsible for 96 redundant hospital sites, it acts as the Government's specialist advisor on brownfield land and it is responsible for other initiatives such as the National Coalfields Programme. The public sector clearly has the potential to make a more significant contribution to the overall supply of land for new housing.

Recommendations

94. *We would encourage the Government and its agencies to speed up the release of surplus public sector land for housing so as to help reduce long-term house price growth and improve housing affordability.*

We support the use of subsidised public sector land to increase the supply of affordable housing at below-market prices or rents.

EP and other public sector agencies should restrict their interventions to achieving objectives which the private sector is unable to do on its own. Public funds and subsidies should not be employed to compete with private developers.

6.5 Total Subsidies for Housing

95. Housing support is usually expressed in terms of Government bricks and mortar investment subsidies, or personal subsidies through housing benefit. For example, the recent Hills report put total public housing support at £16 billion in 2003-04¹⁵.
96. However this approach substantially understates the level of subsidy and support for housing. It ignores the subsidy provided through public-sector land contributed at below market price in order to allow housing at sub-

¹³ English Partnerships Annual Report, 2005-06.

¹⁴ CLG. Previously-developed land that may be available for development: England 2006. Results from the National Land Use Database of Previously-developed land. June 2007.

¹⁵ *Ends and Means: the Future Roles of Social Housing in England*, by John Hills for the CLG, February 2007.

market prices or rents. And it excludes the substantial land value subsidy contributed by private land owners through S106 Affordable Housing agreements. This latter subsidy will be the value of the land contributed for Affordable Housing and, in some cases, an additional subsidy of part or even all of the build cost of the Affordable Housing units.

97. A Sheffield University study of S106 agreements for the CLG put the cost of Affordable Housing in 2003-04 – in effect the private sector land subsidy - at £1.2 billion. The number of Affordable Housing units provided through S106 agreements rose by 46% between 2003-04 and 2005-06¹⁶. Over this same period, average house prices in England rose 15%. This suggests the current private land subsidy is well in excess of £2 billion per year. Our own guesstimate is that it is probably approaching £4 billion, taking account of the full difference between the land contributed to S106 Affordable Housing and its open market value, along with build-cost subsidies where these are also required by a S106 Affordable Housing agreement.
98. There does not appear to be any estimate of the total subsidy from the public and private sectors going into providing housing at below market prices or rents. Given Hills' figure of £16 billion in 2003-04, plus a private land value subsidy through S106 agreements of £2-4 billion, the current value of all subsidy or support, including public sector land subsidies through EP, must be well over £20 billion per year.

Recommendation

99. *We suggest the Government should estimate the full cost of public and private subsidy for affordable housing in order to gain a fuller understanding of the true costs and benefits of state intervention in housing provision.*
100. Two other important aspects of affordable housing deserve mention.

We believe the ownership of affordable housing, the ownership of any retained equity (e.g. in equity share or shared ownership schemes), and the management of intermediate and social housing, should not be matters for the planning system to determine. Planning should only be concerned with the supply of housing at below market prices or rents. House builders are particularly opposed to local planning authorities insisting on imposing their favoured RSLs on private developers for S106 agreements. Although contrary to Government guidance, this is common practice.

Recommendation

101. *We urge local authorities to be more flexible in their Affordable Housing demands, focusing on the provision of such housing, not on issues such as funding, ownership or management which should not be planning matters.*
102. In addition, it should be recognised that the higher specification or size standards required for social housing come at a cost. On public sector land, including that controlled by English Partnerships, these higher costs can be reflected in a lower land price, so that the public sector funds the additional subsidy required to meet these requirements. On private sector land, these

¹⁶ Yvette Cooper answer to Parliamentary Question, 22 January 2007.

costly demands are yet another cost to be taken out of land values, adding to the threats to financial viability and housing output already created by S106 agreements and demands such as on-site renewable energy.

6.6 Private Sector Low-cost Market Housing

103. As discussed above, there is an overlap between low-cost market housing, sold without any subsidy, and housing provided with public or private (land value) subsidy. This can occur in a number of ways.
104. Over the last year or two, a number of the larger home builders have introduced higher density, relatively small units which can be sold at prices which are affordable without any need for public subsidy to households which would otherwise not have been able to buy a home (see Box 1). The same response to declining affordability emerged in the late 1980s when house builders introduced a range of 'starter homes' and the apartment share of private housing completions rose from only 11% in 1981 to a peak of 23% in 1990. In addition, for some years a few companies have been buying low-value land in low-price areas and offering new housing, often to social tenants, at prices which are towards the bottom end of the house price distribution, again without any need for public or private subsidy.

Box 1. DEBUT BY REDROW

Debut is a totally affordable, innovative new concept developed by Redrow to help tackle the growing problem faced by first-time buyers who, according to recent reports, are now priced out of the market in 92% of UK towns.

Using modern methods of construction to improve build efficiency, and carefully crafted layouts that optimise land, Debut homes create a real neighbourly spirit.

Further, Redrow has put measures in place to prevent buy-to-let investors from purchasing a Debut home, thus ensuring that Debut homes help solve the affordability crisis faced by Britain's first time buyers as all Debut homes will therefore be owner occupied.

Debut comprises a range of quality homes that are visually appealing, using a combination of traditional and modern materials, that give a contemporary look appropriate to their target market.

Debut properties do not have private gardens. Instead, they share carefully planned communal outdoor space, tended by Redrow's own management company. The aim is to create communities with a sense of place, through clever layout of the homes around communal squares, landscaped areas and block-paved parking courts. This has the dual benefit of simulating greater community interaction and saving owners the responsibility of tending their own gardens. Through this approach to environmental management, Redrow is able to ensure the quality of Debut developments is maintained for many years to come.

105. In addition, as discussed below (Section 6.7), the private sector is beginning to offer a range of innovative financial solutions which help make housing affordable to a wider range of households without any need for public subsidy.
106. Unfortunately, low-cost market housing or innovative financial packages to reduce housing costs are generally not taken into account in any discussion of the supply of affordable housing. The new definition of Affordable Housing in PPS3, published in December 2006, specifically excluded low-cost market housing (see Definitions in Appendix 2), although PPS3 did encourage local planning authorities to include such units in taking a wider view of housing affordability:

“Local Planning Authorities should plan for the full range of market housing. In particular, they should take account of the need to deliver low-cost market housing as part of the housing mix.” (PPS3, page 10)
107. Low-cost market housing is usually not financially viable if the local planning authority also demands Affordable Housing through a S106 agreement. Also, it cannot be sensible to demand Affordable Housing on a scheme which is already providing affordable housing. By demanding Affordable Housing on such a site, the local authority will force the house builder to build higher value units on the open-market part of the site in order to cross subsidise the Affordable Housing. The end result will be that instead of the private sector offering affordable housing for sale with no public subsidy, fewer units overall will be made available, the open-market units will be at a higher price, and the Affordable Housing units will probably require public subsidy.
108. However we do not believe local authorities should adopt a prescriptive approach to low-cost market housing, or indeed to any private sector initiatives. For example, it would be enormously damaging to viability and housing output if local authorities introduced rigid policies on the mix of open-market housing. Rather, the private sector should be encouraged to bring forward innovative solutions which should be seen as falling within a range of mechanisms to supply affordable housing, rather than being rejected simply because they do not meet the narrow PPS3 definition of Affordable Housing.
109. One possible objection to sites of low-cost market housing is that they are not ‘mixed and balanced’, not sustainable. However this raises the key question whether mixed communities should be judged at the level of individual developments or on a much wider basis, such as a whole community. It is not at all clear why every housing development should have a mix of tenures.
110. As also discussed above, there are areas where low-value older homes can be bought outright, without any subsidy, at mortgage payments close to, or even lower than the rents for recently built social rented units. Where low-value housing is available from the second-hand stock, it is highly

questionable whether local planning authorities should be demanding Affordable Housing on private housing sites.

Recommendation

111. *We urge central Government, and especially local planning authorities, to take much greater account of private sector contributions to the supply of affordable housing and to ensure their policies are flexible and encourage, rather than discourage, the contribution of the private sector.*
112. A key test of local authority attitudes will be how low-cost market housing, both new build and second-hand, is treated in the new Housing Market Assessments, and whether these are genuine 'housing market' assessments, or simply slightly modified 'housing needs' studies.

Recommendation

113. *We believe the public sector should not dictate housing sizes, mix or specification on private sector sites. Private individuals buying a home make choices about price, location, dwelling type and size, plot size, etc. according to their income and personal preferences. The state has no place restricting the availability of certain types of housing (e.g. small affordable units), which in practice amounts to telling certain households what they should or should not buy. Also, by imposing size standards or housing mix on private housing sites, local authorities reduce the supply of housing, exclude some households from decent housing and worsen the affordability crisis.*

6.7 Private Sector Financial Initiatives

114. In addition to low-cost market housing, some housing developers and financial institutions are beginning to introduce innovative financial packages to increase the supply of housing which is more affordable without any need for public or private subsidy (see Box 2).

115. **Box 2. BELLWAY HOUSING TRUST**

Bellway Housing Trust (BHT), a subsidiary of Bellway plc, has been created to provide first-time buyers and those on moderate incomes with a vital step on to the housing ladder.

BHT is not a housing association, but it is able to provide affordable housing without the need for public subsidy in an efficient manner.

Bellway "standard" house types and specifications adopted elsewhere on site are used to ensure that the affordable housing is successfully integrated into the overall scheme.

The allocation of homes is carefully controlled, often using nomination procedures developed with local authorities. This ensures that all homes are made available fairly and only to genuinely qualifying purchasers.

BHT Products

BHT offers two products:

Sharebuy - This is a part buy, part rent scheme based on the conventional shared ownership model operated by housing associations. Successful applicants will normally buy between 50% and 75% of the value of their new home, and pay a subsidised rent on the remainder. The purchaser can choose to increase their share of ownership as time goes by (known as 'staircasing'), eventually achieving full ownership, if required.

Homebuy - This product is modelled on the Government's Homebuy range of schemes offered through the Housing Corporation. The purchaser pays for as much of the property as they can afford through savings and a traditional mortgage, with the minimum amount normally being 50% of the Open Market Value, and BHT provides an equity loan to cover the remainder of the purchase price. A subsidised rent for the equity loan is made and buyers have the opportunity to reduce this loan through staircasing.

In both cases BHT retains any surpluses generated from staircasing. These funds, in turn, are recycled to provide further new affordable housing.

116. However one of the greatest barriers to further expansion of these initiatives is the frequent requirement for Affordable Housing units supplied through S106 agreements to be 'in perpetuity'.
117. The PPS3 definition of Affordable Housing (quoted in Appendix 2) includes the requirement for the home "to remain at an affordable price for future eligible households or, if these restrictions are lifted, for the subsidy to be recycled for alternative affordable housing provision". Most local planning

authorities will require as a condition of the S106 agreement that the homes should remain at an affordable price in perpetuity, even when there is no public sector subsidy involved.

118. A private institution or company is unlikely to invest in a scheme if the original investment and any returns can never be realised.
119. The primary policy objective should be to increase the supply of affordable housing, preferably without public subsidy. In practice a tight definition is actually excluding private sector contributions which do not require any public subsidy, thereby reducing the potential supply of affordable units.

Recommendation

120. *The Government should re-examine the 'in-perpetuity' rule governing Affordable Housing to see if it can be redefined to continue to protect public sector subsidy, while also encouraging private sector solutions. As with our comments on low-cost market housing above, we urge local planning authorities to focus on increasing the supply of housing which is affordable and to be more flexible in their demands so as to encourage private sector solutions.*
121. Although the private sector could play a larger role, especially if the supply of land with residential planning permission was increased, private companies are always constrained by the limits of financial viability: the need to make an adequate return for shareholders, and the need to generate sufficient land value to persuade a land owner to sell for residential use. It is generally agreed that the private sector is unable to provide significant numbers of social rented housing without substantial public subsidy. However intermediate housing is more likely to be financially viable without subsidy, including through the use of privately funded financial packages.

6.8 Increasing the Social Housing Stock Contribution

122. The social housing stock could play a larger part in expanding the supply of affordable housing.
123. There is always a flow of social housing units coming available for re-let. However some experts believe that more could be done to increase the supply of affordable housing from the existing social housing stock.
124. Once rented by a household, social housing is available to this household for the life of the tenant and for one further generation, whatever the financial circumstances of the household or its successor. This means that a proportion of households in subsidised social rented housing could afford to buy either intermediate or low-cost market housing, which would free up subsidised stock for other more needy households. However because social housing is for life, and because social rents are set independently of tenant incomes and are below market rents, there are strong incentives for tenants to stay in the social rented sector, even if their circumstances improve substantially.
125. Also, although there is generally a tighter 'fit' between household size and

dwelling size in the social rented sector than in the owner-occupied stock, there is evidence of under-occupation of larger social housing units. In 2005-06, 29% of households in the social housing stock in England had one bedroom above the bedroom standard and 12% had two or more bedrooms above the standard¹⁷. (This is an official statistical standard depending on the number, age and sex of household members and their relationships.)

126. This is a particular issue at present because housing developers are faced with increasing demands for more family units in S106 Affordable Housing agreements, units which involve a very large subsidy out of the land value, and which on occasion threaten the financial viability of schemes. It seems perverse to be demanding larger units from S106 agreements, while at the same time allowing under-occupation of existing social sector affordable housing units.
127. We believe there are other ways in which the social housing stock could be used and managed more effectively.

For example, there appears to be a surplus of one and two bedroom units in the affordable stock, but a shortage of larger family units. As a family home is needed by a household for only a limited period until the children have grown up, the social stock could be used more effectively if new family units, or family dwellings coming up for re-let, were let on shorter tenancies rather than for life. In addition, positive incentives could be introduced to persuade 'empty nesters' living in under-occupied social units to move down to smaller units, thus freeing up family homes for needy families. These examples illustrate how better management could lead to more effective use of the stock without any adverse impact on social tenants.

128. The stock could also be used more effectively if some of the surplus one and two bedroom units were sold and the money re-invested in larger units, possibly in less expensive areas to make the money go further.
129. Social housing providers generally believe that households in housing need should be housed in the area in which they currently live. This makes provision very expensive in high-value areas, and requires very large subsidies to achieve truly affordable prices or rents, money which could achieve much more if redirected into lower-value areas. No such assumption is made for owner-occupiers or private renters. If a private tenant living in one of the more expensive inner London boroughs cannot afford to buy a home in this borough, he or she will move out to one of the less expensive boroughs, or even out of London altogether. It is not at all clear why there is a different rule for social tenants.

Recommendation

130. *We would urge the Government to examine whether changes to current social housing policies could lead to more effective and efficient use of the existing social stock, and more effective use of existing financial resources,*

¹⁷ CLG. *Survey of English Housing, 2005-06.*

while still providing decent, affordable housing for the most needy households.

6.9 Right to Buy

131. Right to Buy does not contribute to the supply of affordable housing because it merely involves a household changing its tenure in the same dwelling. Indeed, although the first sale to the tenant could be regarded as a form of low-cost market sale, and therefore a form of affordable housing, the dwelling can be subsequently sold, after a short period, at the full market price and therefore is no longer contributing to meeting the need for affordable housing.
132. From the private house building industry's perspective, there are two major contradictions at the heart of Right to Buy.
133. First, social dwellings built with public subsidy are being sold at below-market prices, thereby reducing the stock of affordable housing. Yet at the same time local authorities and central Government are demanding ever greater contributions of Affordable Housing on private housing developments to make up for the overall shortfall of affordable housing.
134. Second, whereas local authorities invariably demand that Affordable Housing contributions through S106 agreements on private housing sites must be 'in perpetuity', which acts as a block on private sector affordable housing solutions (see 6.7 above), social housing stock is not 'in perpetuity' because the dwellings can be sold into private ownership through Right to Buy, and the capital receipts generated by such sales are not 'in perpetuity' because they do not have to be fully recycled for investment in Affordable Housing.

Recommendation

135. *While we accept Right to Buy has been a very successful policy for nearly 30 years, we suggest the Government should examine whether eligibility criteria and discounts could be altered so as to stem the loss of much-needed affordable housing from the social stock. We also believe that as long as there is a severe shortage of Affordable Housing, the capital receipts raised from the sale of Affordable Housing through Right to Buy should be recycled to provide Affordable Housing to replace the stock lost through this policy. We would urge the Government to re-examine the 'in perpetuity' requirements of Affordable Housing, as defined in PPS3, and local planning authorities to be more flexible in cases where the private sector offers a solution without public subsidy.*

7. IMPROVING THE S106 AFFORDABLE HOUSING PROCESS

7.1 S106 Affordable Housing Process and Practice

136. S106 Affordable Housing demands on individual sites are determined by three factors:
- The site threshold above which Affordable Housing is required (e.g. above 15 dwellings);
 - The proportion of units (or bedspaces) which should be provided as Affordable Housing (e.g. 25% of units on a scheme);
 - The availability of social housing grant, either to an RSL or directly to the developer.
137. The current system of S106 Affordable Housing suffers from a number of major problems.
- Thresholds are being steadily pushed down to smaller and smaller sites, Affordable Housing proportions are being pushed up, and Housing Corporation guidance is that S106 Affordable Housing should be assessed on the assumption that social housing grant will not be available. As a result, the financial impact of S106 Affordable Housing on land values is rising, so that Affordable Housing policy risks actually reducing the supply of housing, and worsening affordability, for several reasons:
 - Some schemes will no longer be financially viable, taking into account not only any Affordable Housing demand, but other S106 planning obligations demands and rising demands for renewable energy, etc.
 - Even if schemes are still viable after all these costs, the residual land value of some schemes will fall to the point where a land owner will not be prepared to sell for residential use;
 - The difference between residential land value, net of the cost of all S106 (including Affordable Housing) and other demands, may fall below either the current use value, or the land's value for an alternative non-residential use, so that some land will not come forward for residential development solely because of S106 demands.

In these three cases, land will not be developed for housing, the number of new homes will be reduced, as will the number of Affordable Housing units, and housing affordability overall will be worsened. In other words, excessive Affordable Housing demands risk actually worsening housing affordability.

- We support the principle of spreading S106 and Affordable Housing demands across a wider base of developments, including smaller residential schemes and non-residential developments. At present, S106 demands from larger residential schemes distort land values

and risks reducing the overall supply of housing. However, because Affordable Housing can have a particularly adverse impact on the viability of smaller residential schemes, and RSLs are often reluctant to take on the management of small numbers of scattered dwellings, any extension of Affordable Housing demands to smaller residential schemes must be applied flexibly, including accepting financial contributions ('commuted sums') towards provision of Affordable Housing elsewhere.

- As already noted, Affordable Housing demands have been steadily rising. New Government figures show the number of such units jumped by 46% between 2003-04 and 2005-06. Some local planning authorities have had Affordable Housing policies as high as 70% of the housing on private sites, and in at least one case 100%. Needless to say, almost no new housing is being built in the 70% case, although this may have been the hidden objective of the policy all along, rather than delivering affordable housing.
- Affordable Housing S106 negotiations are very time consuming and cause lengthy delays to the commencement of work on residential development sites.
- Also, until these negotiations are completed, the developer and land owner face considerable uncertainty as to the eventual financial impact of Affordable Housing on the scheme, and even the scheme's viability.
- Affordable Housing policies are supposed to be included in Local Development Documents (LDD), and therefore subject to a robust evidence base and testing at a public enquiry (EIP). However many local planning authorities short circuit this requirement by setting their policy, or significantly changing an existing policy, through a Supplementary Planning Document (SPD) which is not subject to the same level of testing or public examination, and where the results of public consultation can be ignored (whereas an EIP Inspector's report is binding). This widespread problem, which is particularly common for Affordable Housing policies, is completely contrary to the requirements of Government planning policy guidance.
- The impact on the viability of residential schemes of S106 Affordable Housing demands should be assessed in the context of other S106 demands and other demands outside S106 agreements. For example, a growing number of local authorities are requiring a proportion of energy used on developments to be met from renewable sources. Some are also requiring new dwellings to meet higher levels of the Code for Sustainable Homes. Like S106 demands, all of these requirements add to development costs, have an impact on land values and scheme viability, and reduce the scope for meeting S106 and Affordable Housing demands.

Recommendations

138. *S106 Affordable Housing should be applied to all forms of development, not just residential, to avoid distorting land values and to ensure all development makes a contribution towards meeting wider social objectives. We support the use of S106 agreements, including Affordable Housing, on smaller residential schemes. However such demands must be applied flexibly and sensibly to non-residential and small residential sites, if necessary accepting financial contributions towards Affordable Housing on sites where it is unrealistic to provide such housing.*
139. *We support the Government's proposal for a 'common starting point' for Affordable Housing negotiations as a way to speed up the process and make it more difficult for local authorities to make excessive demands. However 'free serviced land', as suggested by the CLG, is not a suitable common starting point as this would have a very damaging impact on financial viability.*
140. *The Government should insist that the Affordable Housing proportions and thresholds set by local planning authorities are determined in DPDs, so that they are subject to full testing at a public enquiry and supported by a robust evidence base. Local authorities should not be able to misuse SPDs to short circuit proper planning procedures and avoid the need for robust evidence and public testing of these policies. Such practices should be monitored and, where necessary, stopped by Government Offices for the Regions and CLG.*
141. *Local authorities must be encouraged to assess the impact of their S106 Affordable Housing demands in the context of other S106 demands and other demands outside the scope of S106 agreement, all of which reduce the scope for provision of Affordable Housing.*
142. *Where receipts are generated through staircasing in privately funded share ownership or share equity schemes, this money should be recycled through a Housing Corporation approved organisation so that it is used to provide more affordable housing. In at least one case recently, a local authority has required staircasing funds to be recycled to the authority itself.*

7.2 A New Model for S106 Affordable Housing

143. The Government's proposal for a Planning-gain Supplement (PGS), accompanied by a scaled-back S106 agreement including Affordable Housing, is at least partly a response to house builders' concerns about the increasingly negative impact of S106 agreements and Affordable Housing demands on their businesses and the viability of potential housing schemes. In its PGS proposals for Affordable Housing, the CLG proposed a 'common starting point' in negotiations for the value of developer contributions to Affordable Housing. It suggested that "a contribution by the developer in the form of, or equivalent to the value of the land necessary to support the required number of affordable units on the development sites would represent a reasonable starting point for the negotiations". It also referred to the Scottish Executive's policy of requiring "discounted serviced land as a common currency for affordable housing negotiations".

Recommendation

144. *To overcome at least some of the problems with Affordable Housing demands and negotiations outlined above, we believe the Government should consider establishing a more formulaic approach, or a 'common starting point' as suggested in the recent PGS consultation.*
145. The following model is one possible approach. As well as streamlining the Affordable Housing process, a major advantage of the suggested approach is that it would increase the delivery of Affordable Housing without any need to increase public subsidy.
- The local authority would set an Affordable Housing percentage and lower threshold through its LDD, as should happen now;
 - The total value of the Affordable Housing contribution would be based on lowest quartile house prices in the local authority area for each house type in the scheme (using Land Registry data). Effectively the developer would value the whole site using lowest quartile house prices and then multiply this total site value by the local authority's Affordable Housing proportion to arrive at an Affordable Housing Value (AHV) for the site;
 - Such calculations would always start by assuming zero public subsidy;
 - The developer would then offer a menu of Affordable Housing alternatives, based on this AHV and using lowest quartile prices for each house type, such that the cost of each menu option would add up to the AHV.
146. It is assumed the land owner provides all of the 'subsidy' through accepting a lower land price.

The following example sets out how this model might work:

- Suppose we take a 50-unit scheme made up of 20 flats, 20 terraced houses and 10 large semis;
 - With lower quartile house prices of £90,000, £80,000 and £110,000 respectively;
 - With a local authority Affordable Housing requirement of 30%, and assuming a scheme of 50 units would be above the local authority's threshold.
147. The total Affordable Housing value (AHV) for the site would be £1,350,000, (i.e. 30% of 20 flats at £90,000, 30% of 20 terraced houses at £80,000, and 30% of 10 houses at £110,000). This is the value the RSL would pay the developer for the Affordable Housing units to be provided. Because the AHV would be based on the mix on the site and official house price statistics, there would be no dispute about how it was calculated.

148. The developer would then offer the RSL various mix options, with each house type valued at the lower quartile price and each mix option adding up to the AHV. So in the example above, the RSL could have 15 flats at £90,000 each; or 17 terraced houses at £80,000; or 12 semis at £110,000; or some combination such as 6 flats, 3 terraced and 5 semis. And so on, as long as each combination added up to the AHV. (A mechanism would be required to deal with any balancing payment or receipt.)
149. If the RSL also had funds from Social Housing Grant (SHG), it would be able to offer more than the AHV. It could use this additional funding to purchase more units overall, or it might adapt the mix to include more larger units which require a bigger subsidy per unit to bring down the rent to an affordable level, or to lower the shared equity or shared ownership share that has to be purchased. Alternatively the RSL could retain the SHG to provide the increased subsidy required for social rented housing compared with intermediate housing.
150. The 'subsidy' from the development, which would come out of the land value, would be the difference between the open market value of the dwellings included in the finally agreed mix and the AHV. So in the example above, if for mathematical simplicity we assume each lowest quartile price is 60% of the open market value, the open market value of the Affordable Housing units would be £2,250,000, so that the subsidy would be £900,000 (£2,250,000 less £1,350,000).
151. This model would have a number of benefits:
- *No public subsidy* would be required;
 - *Clarity*: no additional calculations would need to be undertaken;
 - *Certainty*: the 'price' the RSL must pay is known by all parties from an independent source prior to contract;
 - *Accountability*: there is no 'horse-trading' by various parties about how the figures are to be achieved;
 - *Speed*: the only time necessary for negotiation would be for the RSL to decide precisely which mix of dwellings it wanted to purchase.
152. It is worth noting that the model proposed in this paper is very similar to the old approach to Affordable Housing using Total Cost Indicators (TCI), except that we are suggesting using lower quartile house prices rather than TCI.
153. The approach outlined above is not perfect. For example it relies on Land Registry statistics which may not be robust at the local level (e.g. there may be too few transactions of a particular type to give a sensible lower quartile price). Also, Land Registry data are only available for broad types – flat, terraced, semi, detached – and not types by bedroom numbers – e.g. 1 bed flats, 2 bed flats, etc.
154. However our model does offer what appears to be a sensible, practical way to overcome many of the seemingly intractable problems developers face with S106 Affordable Housing demands. Hopefully it will be a useful contribution to the debate about Affordable Housing.

APPENDIX 1. DEFINITIONS

155. It is important to distinguish the 'affordability of housing' from the term 'affordable housing'.

Housing affordability is a general term describing how easy or difficult it is for households to buy or rent adequate housing.

The term **affordable housing** is used in two ways. The Government uses the term to describe publicly subsidised, social-sector housing. Alternatively it is used more narrowly for the social and intermediate housing provided through planning obligations (S106) agreements on private housing sites. Affordable Housing in this latter context is defined in Planning Policy Statement 3 Housing (PPS3):

"Affordable housing includes social rented and intermediate housing, provided to specified eligible households whose needs are not met by the market. Affordable housing should:

Meet the needs of eligible households including availability at a cost low enough for them to afford, determined with regard to local incomes and local house prices.

Include provision for the home to remain at an affordable price for future eligible households or, if these restrictions are lifted, for the subsidy to be recycled for alternative affordable housing provision." (PPS3, page 25)

For convenience, this paper uses the capitalised 'Affordable Housing' to refer to housing provided through S106 agreement, whereas the lower case affordable housing is used to cover all subsidised housing, with S106 Affordable Housing effectively a subset of all affordable housing.

Housing need is usually restricted to households unable to access market housing. For example, until recently all local planning authorities had to carry out Housing Needs Assessments which assessed the number of households requiring social rented or intermediate (i.e. subsidised) housing. (These have now been replaced by Housing Market Assessments which have to look at the whole market, both subsidised need and market demand.)

Housing demand, or **effective demand**, refers to demand from households able to pay a market price or rent without subsidy.

Social housing is a general term for housing provided by the public sector or by registered social landlords (RSLs), the latter including housing associations.

Social rented housing is housing provided by the public sector or RSLs at a subsidised, below-market rent.

Intermediate affordable housing is defined as: “Housing at prices and rents above those of social rent, but below market price or rents, and which meet the criteria set out above [see definition of Affordable Housing]. These can include shared equity products (e.g. HomeBuy), other low cost homes for sale and intermediate rent.

“The definition does not exclude homes provided by private sector bodies or provided without grant funding. Where such homes meet the definition above, they may be considered, for planning purposes, as affordable housing. Whereas, those homes that do not meet the definition, for example, ‘low cost market’ housing, may not be considered, for planning purposes, as affordable housing.” (PPS3, page 25)

APPENDIX 2

DEFINING AND MEASURING HOUSING AFFORDABILITY

156. Section 4 suggests that 'housing affordability' is a slippery concept. In one sense, it could be argued that all housing is "affordable" because someone has been able to buy or rent it. The market clears by adjusting prices and rents until the number of buyers or renters equals the supply of housing for sale or rent.
157. But clearly this is an unhelpful concept because the housing requirements of all households are not necessarily equated with the supply of housing. If there are too few dwellings compared with the number of households, households priced out of decent housing do not simply disappear. Instead they will find themselves unable to access a home of their own, overcrowded, in temporary housing or, at worst, homeless.
158. To judge whether decent housing is affordable, we need a measure which shows the buying or renting ability of all households at current market prices or rents, not just those already owning or renting decent housing.
159. Looking at the house purchase market, at the simplest level we have the house price/earnings ratio, relating average house prices in the market to average earnings across the whole population. Although estimates differ depending on which price and earnings data are used, the ratio is currently at a record level, suggesting housing is very unaffordable for many households. The price/earnings ratio is currently around 6, against a longer-term average of around 4. The Government and National Housing and Planning Advice Unit (NHPAU) prefer to use the ratio of lower quartile house prices and lower quartile earnings.
160. A more satisfactory measure would also incorporate interest rates, a major influence on affordability because around 75% of home purchases are made with a mortgage. We would not consider housing equally affordable at a price/earnings ratio of 6 with interest rates of 5% or 15%. So a more helpful measure is to assess the mortgage payments on an average priced home for someone on average earnings. On this measure, affordability is very stretched, although not as bad as during 1989 and 1990 when the Base Rate was 15%, against today's Bank Rate of 5.75%.
161. Economists prefer an even more sophisticated measure, the User Cost of Housing. However, as far as we are aware, there is no regular publication of User Cost estimates.
162. An important distinction in all market affordability measures is whether they relate to households who have actually bought or rented, or to all households.
163. For example, CML statistics show that interest payments represented 19.1% of the median first-time buyer income in May 2007, and 16.6% of the median home mover income. By contrast, HBF's own affordability measure, which relates to average incomes across the whole full-time workforce, shows that a household reliant on average male earnings attempting to buy

a home at the average GB house price would have had to spend 49% of disposable income on interest payments in the first year in the first quarter of 2007, and 60% on capital plus interest payments, assuming an 80% mortgage. Clearly affordability for those who have managed to buy is very different from the experience of all potential buyers.

164. There is considerable debate among economists as to exactly how unaffordable housing has become. For example, if we accept that we are now in a period of permanently lower inflation and interest rates, then the historic averages of the various affordability measures will tend to be an unreliable guide to the affordability levels that might be sustainable today. However few would deny that housing affordability has become extremely stretched in recent years, especially for first-time buyers.