

**This briefing updates a presentation which Anna Evans recently made at an HBJ Gately Wareing conference on 'Investing in Affordable Housing'. It considers the demand for affordable housing, the likely supply response given projected levels of public subsidy and concludes that there will be change in the longer term residential landscape and a requirement for alternative means of funding affordable housing.**

**Scottish Government policy**

Firm Foundations set out a market led approach to increase the supply of new housing. Nearly 2 years later - in the aftermath of the credit crunch and mid recession the market led approach has been abandoned and there is a focus on rescue packages and increasing the supply of affordable housing. Meanwhile the long consultation on investment reform is over and the Scottish Government has confirmed that only those reaching an 'approved developer' standard will be able to develop using subsidy (whether RSLs or local authorities).

**Demand for affordable housing – short term**

Even pre-recession there was evidence of the increasing need for affordable housing: comparison of the Bramley models 2003 and 2005 showed a shift from an overall surplus of affordable housing in Scotland to an overall shortfall. Now unemployment stands at a 10 year high and is particularly bad for under 25s, repossessions were up 54% in 2008 (with projections considerably higher for 2009-2011 – see right) and RSLs and local authorities say that there is a 'strong market' for affordable housing.

**Demand for affordable housing – long term**

For the medium to longer term, the credit crunch and dramatic change in the mortgage market will drive a shift in the residential landscape. Mortgage approvals are still at very low levels in Scotland (compared to the rest of the UK – see right) and first time buyers now require on average 25% deposit: £12,000 more than a year ago. On 22nd June the Council of Mortgage Lenders stated: *"The raft of measures taken by the authorities have stabilised the economy and will sow the seeds for a recovery over time, including in the housing market. But the improvement is likely to be slow and drawn out, especially as the extensive fiscal, monetary and credit support measures are gradually unwound"*.

**Private rented sector**

At the same time demand in the private rented sector (PRS) is increasing from those unable to access the home ownership markets, or those who do not have sufficient priority to access social rented housing. According to Citylets and various agents, there was a supply injection of properties for rent in the Spring of 2009, but this is now equalising and demand for private renting relative to supply is on the increase again in the four main cities - and so are the prices. The Scottish Government's recently published research on the PRS shows that the majority of landlords are small and are seeking capital gain rather than income and so current market conditions has left this 'cottage industry' model very exposed. It argues that insitutional investment in mid-market and private rented sectors will make this sector more sustainable.

**Key facts**

**Repossessions: worse to come**

up 54% in 2008 with 2009-11 projections between 65,000 (CML) and 120,000 (CIH)

**Un-employment: 10 year high**

Scotland jobless rate 6.7%, UK at 7.6% (SG)

**Mortgage approvals: still very low in Scotland**

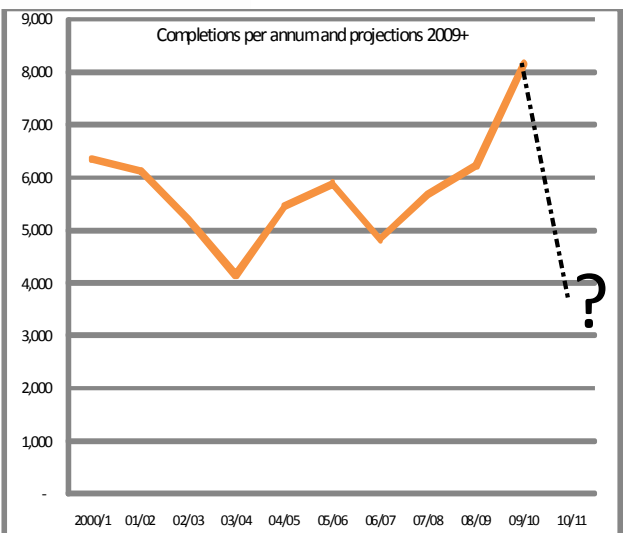
Q1 2009 down 52% in Scotland, UK down 44% (CML)

**Government spend on affordable housing:**

Likely to drop by 40% in 2010/11 75% of which is already committed (Scottish Government 24 June 2009)

**Government spend on affordable housing**

- Over the last 8 years the peaks in Government spend in Scotland have hardly changed: 6,338 units in 2000/1 and 6,221 in 2008/9
- Projections for 2009/10 suggest a 31% increase in unit output, although some of this is 'accelerated' spend that has been brought forward from 2010/11.
- A large proportion of the unit increase will be enabled through provision of council housing: local authorities have been encouraged to provide housing for a subsidy of only £25k per unit which compares to average £65k per unit for RSLs.
- Constraints on public sector expenditure will mean no infilling of the accelerated spend brought forward to this year and steep cuts from 2010 onwards: from nearly £800m in 2009/10 to £471m in 2010/11, 75% of which has already been committed (SG 24 June).



#### So what?

What does this all mean for affordable housing? The weak labour markets and limited availability of credit (both of which may go on for some time) is likely to result in a longer term change in the residential landscape. There will be an increased need for social rented housing; increased demand for subsidy / rescue packages for home owners; and increased demand for private rented and particularly mid-market rented options. But where will the funding come from to deliver?

#### Supply response

As noted above, the Government budgets (UK and Scottish) are now severely constrained and will go nowhere near delivering the required level of affordable housing. Traditionally, affordable housing has been funded by a very narrow source of funding: Government grant and private sector debt finance. These sources will continue to be scarce and in the case of debt more expensive. The scale of the problem is gradually being recognised, and both Governments and some RSLs are exploring alternative methods of funding. This was discussed in the Scottish Government's recent statement on Investing in Affordable Housing on June 25th which stated: "...The Government will continue to identify new solutions .... by identifying new funding sources or by deploying the Affordable Housing Investment Programme in different ways."

#### What could the alternatives be?

There are two 'new' funding sources: equity and institutional investment.

**Equity:** The principle of government equity loans has already been agreed through the shared equity model 'LIFT' where individuals obtain a mortgage for 60-80% and the balance is covered through Scottish Government equity loan. Any uplift or decrease in value is then shared proportionately between both parties at the point of sale. The question currently being explored is whether this principle can be applied on a scheme, portfolio or even wider development / master plan basis whether financed by government or private equity or a combination of both. The Homes and Communities Agency is already offering gap funding in the form of equity loans for infrastructure costs as part of the 'Kickstart' scheme, but as yet equity funding is untested. So far equity funding on a larger scheme or portfolio basis suggests some form of flexible tenure where housing is provided for rent initially but then could be converted to housing for sale at a later date to realise any uplift in value when the market recovers. This could enable recycling the proceeds for further affordable housing. However this raises a number of thorny issues over security of tenure and what happens if the market does not recover and, or values fall. Also, HBJ GatelyWareing experience suggests investors have traditionally adopted a five year rule for investment - this may prove to be too short or risky for some RSLs and local authorities.

**Institutional investment:** Given the change in the longer term market dynamics the UK and Scottish Government is now calling for institutional investment in the private rented sector to encourage longer term growth based on long term yield rather than capital growth. Investigations have already started with the Homes and Communities Agency market testing the appetite for institutional investment in the PRS and informal soundings suggest the Scottish Government is also moving in this direction. Initial modelling suggests there are sufficient long term yields at market or mid-market level rents in some areas. However this again raises the question as to where this leaves social renting: is it attractive enough for institutional / private investors? Will it provide sufficient long term yields? What about security of tenure? What about the length of investment period?

Assuming these issues can be navigated, a combined pot of funding may be a solution which includes grant, equity and debt and therefore helps to stretch the grant pot further.

#### The Scottish Government response

An update of the Scottish Economic Recovery Programme includes an extra £31m of UK Budget consequential to be spent on boosting affordable housing supply. This is to include: new funds to accelerate and sustain investment in new housing developments for affordable rent across the country; and funding to kick-start and unblock private developments in return for mid-market rental properties and low-cost home ownership. Ministers are due say more in the coming weeks about the specific applications of the £31m, which may include testing of some more 'innovative' funding packages.

#### Experience in this field:

- **Mid rent feasibility studies** - for RSLs and LAs researching local market prices and modelling feasibility with different assumptions.
- **Winchburgh masterplan area, West Lothian** - this will include 3,450 new houses 25% of which must be affordable. Anna is advising the developer LxB on delivery options for the affordable housing contribution.
- **Devanha - Scottish Government's 3 year evaluation** - Anna is one of the research team exploring the efficiencies achieved through this bulk procurement vehicle in the North East of Scotland (with Heriot-Watt University).

Anna Evans Housing Consultancy provides research and consultancy services for investors/housing developers, housing associations and local authorities. Anna Evans has 17 years experience working in the affordable housing sector in local authorities, Scottish Homes, housing associations and DTZ in a range of research, policy and development roles.

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This briefing also draws on comments made by other speakers at the conference on 24th June 2009: Kate Dewar HBJ Gately Wareing; Sandy Watson Scottish Government; Ewan Fraser DundinCanmore; Chris Withnall EC Harris; and Kenny Simpson East Dunbartonshire Council.