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Capital Homes: Tenure and affordability

Roundtable report - August 2019

Credit: Emily Wang

This paper summarises key points made in discussion at the third Capital Homes expert roundtable, held under the Chatham House rule in June 2019. The first roundtable addressed trust, design and community, the second addressed land and planning and the fourth addressed finance and delivery.

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Context

Tenure in London has shifted dramatically in recent years. Since the early 1990s, the proportion of owner occupiers and social tenants has been falling, and the proportion of private tenants has been rising, largely driven by rising house prices, right-to-buy, and the growth in small landlords buying up houses and flats as an investment asset. The private rented sector (PRS) has already overtaken social renting and is set to become the majority tenure by 2050 if current trends continue.¹

These changes, alongside the stagnation of wages over the past decade, have had significant impacts for affordability. While social rents are relatively affordable and mortgage costs have been relatively low during recent years of low interest rates (once an – often prohibitive – deposit has been paid), Londoners in the PRS spend, on average, around 30-40 per cent of their income on housing. Over the past ten years the proportion of private renters living in poverty has increased from around a third to 43 per cent.²

Issues and opportunities

The need for affordable housing is outstripping supply

The rising challenge of affordability reflects not only slow housebuilding across the board, but also specifically the imbalance between the mix of housing that is needed, and that which is being provided. The Strategic Housing Market Assessment (see Table 1 below) commissioned to support the new draft London Plan estimated that London needed 65 per cent of new homes to be 'affordable', with the vast majority of these being for 'low cost rent' (essentially social rent and London Affordable Rent).

Table 1. Net annualised requirement for new homes in London, 2016 to 2041

	1	2	3	4	Total	% of total
Market	10,682	2,043	4,101	6,210	23,037	35%
Intermediate	4,334	3,434	2,409	1,693	11,869	18%
Low cost rent	21,318	5,311	2,462	1,881	30,972	47%
Total	36,335	10,788	8,971	9,783	65,878	100%
% Total	55%	16%	14%	15%	100%	

Source: https://www.london.gov.uk/sites/default/files/london_shma_2017.pdf

Almost half of assessed housing need is for low-cost rent, but as of April 2018 only 14 per cent of all home starts in this mayoral term were for social rented homes.³ Following the agreement of a five-year funding programme with the government, numbers have been increasing – more than 14,000 new affordable homes (approximately 4,000 at social rent/London Affordable Rent, 1,700 at 'affordable rent' and 8,500 at intermediate⁴) were started with City Hall support in 2018/19⁵ - but there is still a significant backlog of unmet need.

Current affordability models present challenges

Participants agreed that too much 'affordable housing' was not actually affordable.

Firstly, shared ownership, which allows participants to part buy and part rent their property, was viewed as having limited impact in the capital. The take up of shared ownership has dropped 43 per cent since 2016/17 in inner London (compared to an increase of 4 per cent in the rest of the UK).⁶ While the scheme was seen as working better in outer London, where prices are lower, many at the roundtable noted there were problems with the affordability of shared ownership schemes. In London high house prices can make the burden of

Definitions: Affordable housing in London

New affordable housing in London falls into the following categories:

- 1. Social Rent** – Owned by local authorities and 'registered providers' (often housing associations). Target rents decided through national rent regime. Characterised by longer tenancies. Councils decide who qualifies and level of need and therefore priority on the list.
- 2. London Affordable Rent** – Rents are calculated on the basis of 2016 social rent levels, and are generally 40-60 per cent of market levels, but slightly higher than social rent.
- 3. Affordable Rent** – Subject to rent controls that require a rent of no more than 80 per cent of the local market rent.
- 4. Intermediate Housing** – Homes for sale and rent provided at a cost above social rent, but below

market levels. Targeted at mid-market households who might progress to home ownership over time.

Four main approaches to intermediate market:

- Shared ownership – Part buy, part rent. Share of the property between 25-75 per cent and pay rent on the remaining share. Purchasers usually given long leasehold.
- London Living Rent – Rents based on a third of average local household incomes, with tenancies for up to ten years.
- Equity loans – Interest free or low interest loan covering portion of value of property, alongside a traditional mortgage. Purchaser full owner of the property but on selling would share any increase with equity loan provider.
- Intermediate rent – Cheaper rate than market often tied in with an intention to own, with tenant using money saved on rent to raise a deposit.

part buying and part renting a home very expensive, and ultimately, out of reach for many. Indeed, research conducted by the Institute for Public Policy Research showed that shared ownership only becomes affordable at earnings of over £60,000 a year.⁷

Participants also expressed concerns about how genuinely affordable ‘affordable rent’ (which is capped at a maximum of 80 per cent the local market rent) is for low- to middle-income Londoners. Reflecting these concerns around affordability, the Mayor of London has focused his funding for new affordable homes on the lower-cost ‘London Affordable Rent’ tenure, which is more closely aligned to government calculated target rent (an average of £153 a week for a two-bedroom property). In 2018 one social landlord moved 4,000 homes it was letting at affordable rent to London Affordable Rent.⁸

As house prices and rents have risen in London overall, these intermediate tenures have become increasingly tough to afford for many Londoners. While some around the table acknowledged that lower grant rates for these tenures compared to social rent enabled more homes to be delivered, they also commented that this was futile if the homes were unaffordable to those at whom they were aimed.

Given high private sector rents, and the knock-on effect these had on ‘affordable rents’ pegged to them, several participants discussed rents based on income.

One example discussed was an estate in Hackney, where rents are based on ensuring tenants can retain an income equivalent to the minimum income standard, with any income increases being shared between landlord and tenant, and a full review at lease renewal every three years. Others expressed concerns about the scalability of such schemes, highlighting the bureaucratic burden attached to calculating individual rents and the potentially intrusive nature of the evidence required, though the landlord in question said these issues were manageable.

Some participants suggested that the London Living Rent introduced by the Mayor and based on local incomes would help middle-income workers, such as teachers and nurses, to live in the capital. While linking rents to average local salaries is more straightforward than linking them to individual tenants’ salaries, it does leave a residual challenge for people living on relatively modest incomes in areas where average pay is much

higher. The Joseph Rowntree Foundation’s Living Rent proposal, based on 28 per cent of lower quartile earnings⁹, was also discussed, though the model also had complexities when dealing with larger family units, where the additional costs allowed might actually imply lower rents for larger homes.

The general problem of adding service costs to rents was also raised: either these were applied at a standard level to affordable and market tenants alike, which could significantly hamper affordability, or differential levels of service would be applied (leading to controversial ‘poor doors’ provision).

Other participants also mentioned schemes whereby compact one bedroom flats are sold at 20 per cent less than the local market rate to local, first-time buyers earning below a certain threshold. There had been debate about the size and quality of these flats, and the fact that they have to be sold on with the same discount and restrictions, but participants suggested that they could provide a good route to ownership for suitable groups (i.e. a professional couple without children).

Generally, participants agreed that these and similar products could help ease the symptoms of the housing crisis for some groups of Londoners, though there were elements of the regulatory framework which hampered innovation (e.g. limitation of community infrastructure levy relief to ‘traditional’ models of social housing). However, most acknowledged that such products would be unable to deliver solutions for all. Indeed, many felt that bigger, structural changes were important in addressing the affordability crisis, such as a move away from reliance on the private sector, a revitalisation of the public sector and greater grant funding for the delivery of affordable homes.

Build to Rent has the potential to drive up standards and security in the private rented sector

The UK private rented sector is dominated by ‘amateur’ buy-to-let landlords who usually own a small number of units. However, the build-to-rent (BtR) market has grown five-fold in recent years, with 60,000 units either complete or under construction in London.¹⁰ With a growing private rental market in the capital, the argument is that BtR can deliver rented homes at scale supported by institutional investment. As participants pointed out, the delivery of these types of homes can help drive up standards and security

in the private rented sector through creating a more professionalised service with an emphasis on long term renters and returns.

Build-to-rent works on a different financial model to the build-for-sale market and involves tying up capital for longer. Some participants agreed the need for different use classes to enable a level playing field, along with a different approach to viability and affordable housing requirements.¹¹

Despite its potential for improving standards and security in the rental market, BtR was not considered to be a panacea. Research has shown that rents of BtR homes are, on average, 11 per cent higher than the local market rent.¹² As one participant put it, most renters will remain in the buy-to-let properties; it is the upper end of the market that will access BtR homes.

The effectiveness of rent controls in the private sector is contested

In July (after this roundtable was held), the Mayor announced proposals for rent controls on both new and existing tenancies in the capital. The Mayor said that he would seek powers to enforce rent restraint in the short term, while a long term scheme was being designed by a newly established London Private Rent Commission.¹³

At the roundtable participants stressed the broadness of the term ‘rent controls’, highlighting that the character of controls could vary significantly. Most were in favour of some type of stabilisation, to limit rent rises within tenancies, rather than enforced rent reductions, which they felt could deter investors, and ultimately undermine supply in London. Indeed, several BtR landlords had already introduced longer-tenancies, with rent rises limited to the level of inflation within them.

At the roundtable, there was some discussion about the extent to which rent control could create perverse and unintended consequences, helping existing tenants but not new tenants, or encouraging landlords to knock-down old buildings to enjoy the exemptions granted to new-build.

To help all Londoners, there must be a renewed emphasis on the social sector

Almost all participants expressed concern over the extent to which the private rented sector (PRS) was now housing low-income families who might previously have

found social housing. Households in the bottom third of incomes now make up 38 per cent of the PRS in the UK.¹⁴ Others also observed that buy-to-let landlords were also competing with potential owner-occupiers for property.

Social housing has been lost through right-to-buy, and its replacement has been hampered by falling grant levels, and limits on how right-to-buy receipts are used. According to Shelter, grant funding over the last five years is a third lower than in the first five years of the 1990s.¹⁵ Though the government has committed £700 million per year to support affordable housing in London, the Mayor has argued that the actual funding needed is £4.9 billion per year.¹⁶ Shelter’s Affordable Housing Commission suggests that lower grant funding, combined with a transfer of grant into other affordable products like shared ownership means the delivery of genuinely affordable products has diminished, with grant funding spread thinly over more expensive products.¹⁷

Participants stressed the need for predictable long-term grants to stimulate the development of more social housing, as well as giving social landlords and local authorities alike the confidence to put long-term delivery programmes in place, to meet the affordable housing levels stipulated in the draft London Plan.

Nevertheless, some at the roundtable recognised the political constraints, particularly given the scale of investment needed. One participant suggested that there was an unwillingness among policy makers to have an honest conversation about the level of social housing we need in civil society and what we are willing to protect at any cost.

Tax reform can also play a crucial role in addressing affordability issues

Some participants emphasised the role that new methods of taxation can play. Land Value Tax (LVT), which taxes land not buildings, was cited as an important mechanism. Land Value Tax is an annual charge on the value of land (rather than the buildings sitting on the land). Proponents of LVT argue that it could encourage faster and denser development, as it would apply to development land whether or not buildings had been completed, and less under-occupation of existing dwellings, with some evidence suggesting that it could provide an incentive to build over 200,000 new homes in the capital.¹⁸

Additionally, one participant described it as the most equitable way to tax people, observing that LVT could replace other forms of taxation (such as Community Infrastructure Levy and business rates) and would in practice tax unearned gain from uplifts in land values. But, whatever the benefits, there has, thus far, been a lack of political will to undertake a significant rethink of the way we tax property and land.

Other tax issues discussed included giving partial capital gains tax relief to buy-to-let landlords who sold to their tenants (at a discount), as a way of encouraging their exit from the sector and increasing owner-occupation.

Summary

Given current house prices and rent levels in London, provision of market housing will not meet the needs of Londoners on low to middle incomes. While some ‘affordable’ products fail to provide suitable alternatives, others, such as London Living Rent, offer the promise of relieving the pressure. There was widespread support at the roundtable for more homes for genuinely affordable rent.

But the role of the private sector should also be recognised, including both small-scale buy-to-let landlords and more professional build-to-rent investors. The challenges are to improve the quality of the former – or to support their exit – while improving the affordability of the latter, without disrupting investment and growth.

Themes emerging were broad support for:

- 1. Local/personalised income-based rents**
- 2. Regulatory framework to support innovation**
- 3. Long-term funding certainty to help secure private investment**
- 4. Rent moderation (but less enforced rent reduction)**
- 5. Fewer restrictions on use of right-to-buy receipts, and limit future right-to-buy, to boost supply of social rented housing**
- 6. Exploring new tax mechanisms for London – to increase fairness and improve incentives**

This is a brief overview of our discussion on housing tenure in the capital. We will use these initial thoughts to form more detailed policy recommendations as part of Centre for London’s Housing Manifesto (due for publication in Autumn 2019).

Endnotes

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