Homes for Heroes

BY ALEX MORTON & ELIZABETH DUNKLEY

Centre for Policy Studies

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Executive Summary

Two weeks after the signing of the Armistice in 1918, David Lloyd George began his re-election campaign with a rally in Wolverhampton. He celebrated Britain's victory, and mourned its losses. But he insisted: 'Our work is not over yet – the work of the nation, the work of the people, the work of those who sacrificed. Let us work together first. This the appeal that I am making today. What is our task? To make Britain a fit country for heroes to live in.'

Among the chief problems that he identified was housing. It was not enough, he said, to leave its improvement to individual municipalities: 'The housing of the people must be a national concern, and must be undertaken as such.' The subsequent Housing and Town Planning Act of 1919 was intended to deliver precisely that: homes fit for heroes.

> **'The housing of the people must be a national concern, and must be undertaken as such'**

The death toll from the coronavirus crisis, while awful, has been nowhere near that of the First World War. Yet, once again, it has led us to be deeply grateful to those who took the greatest burden in terms of responding – primarily, of course, the frontline workers within the NHS, but also the care workers, public transport workers, teachers, delivery drivers, retail staff and so many others who kept our society and our economy going.

And it has not just highlighted but exacerbated many of the divisions within our society – between young and old, blue-collar and white-collar, asset-rich and asset-poor.

The Centre for Policy Studies has produced report after report in recent years, cataloguing the extent of Britain's housing crisis. But as this report will show, the situation is even worse for those most exposed to the risks of the pandemic. Key workers tend to earn less than the national average, to have fewer assets and, crucially, to have less choice about where they can work. That means they find it harder to get on the property ladder, but they also find it harder to rent – or at least to rent decent homes within a reasonable distance of where they need to work. Even before the pandemic, there were stories of doctors and nurses having to sleep at work – or slumped inside their cars outside the hospital – because they could not face the commute on top of their grueling shifts.

It is often argued that the best way to help such people is via a dramatic expansion of social housing. We disagree. It is not just that the Government is already borrowing heavily in order to fund infrastructure upgrades and the levelling up agenda, and may have little scope or appetite to swell its balance sheet further. The truth is that Britain already has one of the largest stocks of social housing in Europe. The problem is that the wider housing crisis, and a sustained lack of supply stretching back decades, has driven up housing costs, and made the path to ownership – which is still a near-universal ambition – ever more precarious.

The 2019 Conservative manifesto recognised the needs of key workers. It promised to offer more homes to local families, via a permanent discount of a third for local people – and noted that councils would be able to use this to prioritise key workers like nurses, police officers and teachers.

In the wake of the pandemic, we have a duty to ensure that key workers – and all others within society – have access to quality, affordable housing. But we also have an opportunity. It is already clear that the pandemic has resulted in serious dislocation within the property market. Meanwhile, existing concerns about the decline of high streets and town centres have been exacerbated by the shift to remote working.

‘Our core proposal is that we create a modern version of ‘Homes for Heroes’: a new class of housing that provides affordable, secure, convenient rental accommodation for key workers and others, and offers them a smooth path to ownership of those properties over the long term’

There have, over the years, been many attempts made to attract institutional investment to the housing industry – to use the holdings of pension funds and asset managers to fund the creation of new housing, answering a pressing social and economic need while generating a reliable stream of revenue. The problem is that so far, most models have worked either for the investors or for the Government, but not for both – while power over the land market has remained with the large house builders.

This paper is an attempt to change that. Our core proposal is that we create a modern version of ‘Homes for Heroes’: a new class of housing that provides affordable, secure, convenient rental accommodation for key workers and others, and offers them a smooth path to ownership of those properties over the long term. This will be attractive to investors, to key workers, and to councils and government – not least because the public is likely to look more kindly on such developments.

The evidence

The UK has seen a steady decline in new homes since a peak of over 300,000 a year in the 1960s, despite increasing population growth. This has had serious impacts on house prices, rents, and even the ability of young people to lead a normal and independent life.

It now takes the average first time buyer 6.6 years to build up a deposit, and 11 years in London. Nearly three in 10 young people now live with their parents. Four in 10 renters in the bottom half of the income distribution pay more than 40% of their income in rent, rising to 61% in London and the South East. It is no wonder that 45% of renters say their housing situation has caused them stress and anxiety.

Key workers, who the Government defines as those working in essential sectors in the pandemic such as retail, transport and health, have been at the forefront of Covid, and at greatest risk of infection. We are not just talking here about public sector workers, but also those who distribute food or keep critical services such as electricity going.

Key workers tend to have lower earnings than other workers, making it even harder for them to get on the property ladder. Even with the 30% discount under the Government's First Homes scheme, or the assistance available under Help to Buy, many of them will be unable to get on to the housing ladder.

The solution cannot only be more social housing. The UK already has the fourth highest stock in Europe, and spends the most on housing benefit – more than 1% of GDP, which is double the average. We need to build more homes. Yet the current housing market is dominated by large house builders which operate via a 'build to sell' model. Their output relates heavily to transactions (around 1 sale for 8.5 transactions without Help to Buy), since they need a market to sell to, and if they push too many homes on the market relative to potential buyers, they risk pushing prices down. This was set out in the CPS report *The Housing Guarantee*, but also the Letwin Review on build out.

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The argument of this paper is that building 'Homes for Heroes' is not only a good thing in and of itself, but can help expand, diversify and stabilise the housing market in the UK.

At the root of many of our current problems is that the large house builders are focused on ensuring they are able to cut output and overheads in a downturn (as they did in the 2008/9 crash and early stages of the Covid crisis).

This pushes them towards building a more homogenous product, using lower-skilled labour which is largely subcontracted out. (SME builders, which tend to have smaller cash reserves and higher fixed costs, suffer disproportionately during downturns and their aftermath.) *The Housing Guarantee* also showed how the large house builders dominate the land market sufficiently to control supply and that they only build as fast as they can sell. They cut output sharply in downturns, and then only slowly recover.

The financial model that the large house builders depend on links to this unstable and cyclical model, with extreme fluctuations in profit and loss. The large house builders are financed via a mix of equity and cash reserves they build up in the good times. Their shares and dividends oscillate wildly as a result.

It is too easy – and wrong – to accuse the large house builders of profiteering. The collapse of construction firms such as Carillion shows why they are right to be cautious. But what makes sense for them does not make sense for the country as a whole. A new and more stable model is needed, one that is less cyclical, which will ensure that housing output is higher, but also increase productivity and quality.

As this paper argues, one of the best ways to move beyond the cyclical build to sell model – which is increasingly unable to meet our housing needs – is an increase in different types of home, by scaling up already successful alternative types of housing delivery. One major opportunity is part ownership, and most of all shared ownership. This is where an individual or household buys a home in partnership with an investor, with a mortgage on their own share and rent paid on the part that the investor owns. Under most versions of this product, the part-owner automatically increases their equity stake over time, ending up with full home ownership.

For the shared owner, this is cheaper than renting or buying outright as the rental element is set at sub-market levels and they take on day-to-day maintenance. The landlords benefit from subsidies in the form of planning discounts or grants, and access to institutional finance at attractive rates. This allows people to get on the ladder with a lower deposit, and build up equity.

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Another key opportunity is ‘build to rent’. This is housing which has been built specifically for rent and usually consists of dense apartments in urban settings (around half is in London). There are around 180,000 units completed or under way at present. By providing a net yield of around 4-6% to investors, this allows the creation of long-term stable tenancies, which benefits renters. In other countries, this sector is much larger – in the Netherlands, around 45% of all institutional property investment is residential.

Self and custom build could also help as part of the mix, since the investor could prepare the land and pass it on to individual self and custom builders. Again, in other countries, self and custom build is a much larger part of the housing mix. But expanding this will take time.

Homes for Heroes

All of these tenure types are outside the cyclical build to sell model of the large house builders. They are also less volatile – after the financial crisis, shared ownership homes actually rose despite housing supply more widely collapsing. Because shared ownership enfranchises many more buyers, most of which have been trapped in private renting, it reduces cyclicality and provides confidence to continue building. And as shared ownership homes are funded by institutional investors with long term goals, they are much more able to withstand the ups and downs of the market.

In addition, these types of housing are likely to be politically attractive and easier to release land for – particularly if aimed at key workers.

There is in fact an excellent precedent for how policy can drive supply. The creation of a new use class for student housing, along with supportive planning policy, has driven up supply. In recent years, 30,000 units a year have been added.

The new use class meant land was carved out of the normal market. Councils were also keen on specialist student housing in order to reduce the amount of scruffy student accommodation in their area. Thus, changes in the land market helped to drive the supply of new housing.

We therefore believe that there is a perfect marriage here between public demand, what would benefit the housing market – and what would be morally right to repay those who carried us through the Covid crisis.

Following the precedent of student housing, we suggest the creation of a new category of key worker housing – 'Homes for Heroes'. This would increase home ownership, increase housing supply, and give local communities the ability to provide housing for the workers that keep them going.

We define Homes for Heroes as being sites where all homes meet the following criteria:

- At least 75% of new homes are part-ownership products, of whatever kind.
- The remainder are build to rent, with longer tenancies to give stability.
- Priority is given to local key workers while the homes are built and for the first few months on the market, before being opened to others.
- When the home is sold, it has to be passed on to a key worker if possible (or other group designated by the council).

> **'Monthly housing costs on a £300,000 home would be just over £1,000, several hundred pounds cheaper than private rents or outright purchase, and cheaper even than affordable rent or Help to Buy'**

As we show in the Annex to this report, Homes for Heroes can deliver a path to home ownership for key workers that is notably cheaper than other tenures. Monthly housing costs on a £300,000 home would be just over £1,000, several hundred pounds cheaper than private rents or outright purchase, and cheaper even than affordable rent or Help to Buy. Homes for Heroes would also count as affordable housing across the board, since at least 75% would be cheaper than typical market homes. (The Government could also choose to include these sites in its First Homes scheme.)

The definition of key worker should be consulted on, with the current definition as the starting point. But it should include those who had to keep working face to face during the Covid-19 outbreak, not just the public sector. (It is worth noting that a wider definition would ensure that there is a more liquid market when individuals move out of properties.)

A household income cap of £90,000 in London and £80,000 per household elsewhere could be used in line with shared ownership rules. Or lower caps in line with local average incomes could be used. This would be in place both for the key workers and when the property was opened up to others more widely.

Any new product needs to inspire confidence that it is backed by Government, via tangible policy changes to support that. And so it is with Homes for Heroes. Fortunately, the Government has billions in guarantees for affordable housing that are going unused. This money could be deployed towards Homes for Heroes at no short-term or long-term loss to the public purse.

We therefore propose that:

- At least initially, Government should guarantee the returns on the long-term financing of Homes for Heroes, building on the success of past schemes such as the Private Rented Sector Housing Guarantee Scheme.

- At the forthcoming Spending Review, the Government should release some of the £5 billion currently locked up but unallocated in guarantees (£8 billion was pledged in 2017 towards affordable housing, but only £3 billion has been used).

These guarantees send a signal to investors that this is a market they can invest in with confidence. And the attraction for the Treasury is that they are incredibly unlikely to be called upon. As we show, you would need more than 25% of those living in Homes for Heroes to default for the guarantees to even start to be called upon. (Even at the height of the pandemic, residential rents were seeing 96%+ payment rates, meaning that it is incredibly unlikely that 25%+ default rates will ever be seen.) This effectively means homes will be built at no cost to government – now or ever. In addition, the Government has nothing to lose from allocating these guarantees since if Homes for Heroes do not take off, the guarantees will remain unallocated.

‘Ultimately, we believe that sufficient land for 50,000 homes a year from the current goal of nearly 300,000 could be set aside nationally’

This measure alone should do much to kick-start the delivery of Homes for Heroes. But Homes for Heroes should have a supportive planning policy put in place as part of wider its reforms. Either a new use class should be created, or planning restrictions should be placed on sites to ensure land there had to be used for Homes for Heroes.

To encourage and incentivize the provision of land, we suggest that planning gain should be treated differently for Homes for Heroes, with the first £20,000 or 10% of the final value of the property counting as Section 106 or Infrastructure Levy. Ultimately, we believe that sufficient land for 50,000 homes a year from the current goal of nearly 300,000 could be set aside nationally. Local councils should also seek to encourage key workers to sign up for these homes. Only where local councils find that there is insufficient demand should councils be able to reduce the land flowing into the Homes for Heroes market.

This means that as part of the five-year land supply, there would be land for 250,000 Homes for Heroes set aside, helping many key workers onto the ownership ladder. These sites could either consist of new build homes or conversion from other uses (eg offices), as long as it was an addition to housing supply.

These changes would, we believe, bring new investors into the housing market. Both student housing and build to rent attract substantial institutional investment, at yields of around 4% (while build to rent targets 5-6%). Given current monetary conditions, we believe a return of 3.5% for Homes for Heroes is likely to be sufficient to drive investment in this class if guaranteed by Government.

'UK pension funds alone have over £1 trillion of inflation-linked liabilities – of which less than 3% is allocated to residential property'

UK pension funds alone have over £1 trillion of inflation-linked liabilities – of which less than 3% is allocated to residential property. Accessing this capital would not only drive significant new home supply, but make Homes for Heroes affordable at much reduced costs to the private market. And at the moment, gilts are returning less than 1%, while commercial property is subject to major instability. Residential rents are more reliable, and more inflation-proof. Major investors we have spoken to are convinced that this is a model that would attract investment.

In addition to bringing new investors into the housing market, these changes would also help the large house builders to diversify their output and reduce risk, moving away from just having to focus on build to sell, which as noted is very risky, especially if the Help to Buy Equity Loan is wound down as promised. This can all be done without any upfront cost to Government, while providing a sufficient return for investors and a reasonable price to house builders.

If these policies are pursued, we could see the first Homes for Heroes delivered within a year or two and many more in the pipeline – a clear thank you for the key workers who put so much on the line during the recent pandemic, while delivering the Government's goals of more ownership, greater supply and a better-quality housing sector.

Homes for Heroes – a policy that works for everyone

The policy outlined in this report is good for potential owners, house builders, investors and the Government. It does not require major expenditure, simply a more intelligent series of reforms to the way housing is delivered.

We believe that this package of reforms can provide wins to all the major stakeholders in the system – and that this can be done with no capital investment at a time when money is, understandably, very tight. Indeed, these changes fit very neatly within the existing framework for reform, responding to the moral need for homes for those that put themselves at risk throughout the Covid pandemic and the commitment to key workers and local communities in the Conservative Party manifesto.

Potential owners
✔ Affordable new family homes for key workers with a clear pathway to shared ownership ✔ Low income requirements relative to home price, and low entry costs ✔ Low weekly costs to facilitate savings and help save for home ownership ✔ The ability to buy a greater share of the same home over time ✔ Works for potential owners at scale across almost all markets
House builders
✔ Net returns that compare favourably to current outright sale business ✔ Potential for immediate scaled-up delivery through existing housing delivery channels ✔ Specific support for key worker housing in the planning system to facilitate supply ✔ Supports expansion of MMC and SME builders over the medium term
Investors
✔ Very attractive risk-adjusted returns as a result of Government guarantees ✔ Modest but meaningful spread to Gilts to drive immediate scaled investment
Government
✔ Delivers a meaningful number of Homes for Heroes in advance of the next election ✔ Supports and repays key workers in the wake of Covid-19 ✔ No capital investment required ✔ Contributes additional family housing to help reach the 300,000 a year target ✔ Supports the market-driven expansion of new housing supply

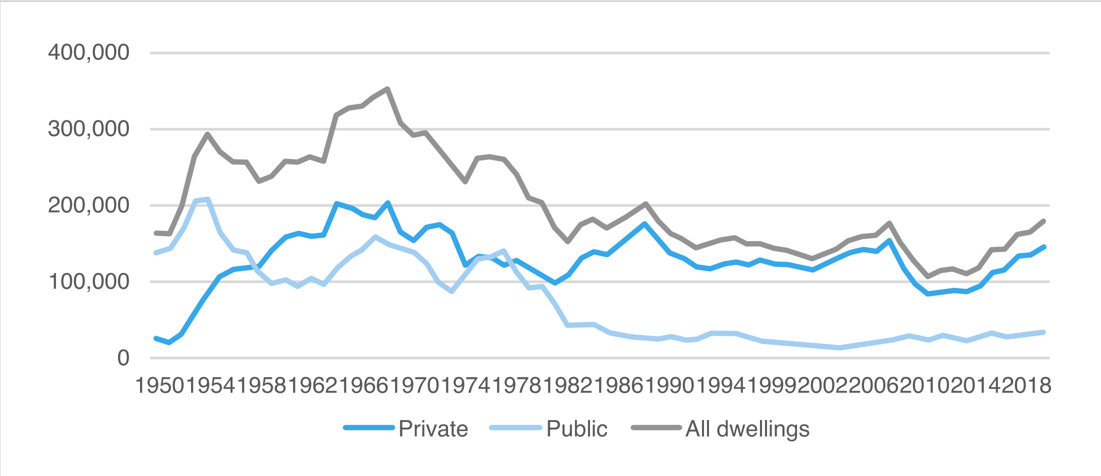
Part 1: The housing crisis

The housing crisis is not a new problem. Housebuilding in this country has been steadily declining from a peak in the 1950s and 60s, when sustained efforts from both Conservative and Labour governments had managed to increase housebuilding levels to around the 300,000 per year mark. Since then, as the Centre for Policy Studies has shown, we have been building fewer homes each and every decade – even though the population has grown substantially. The size of those new homes has also been shrinking, to the point where we have among the smallest homes in Europe.

It is often argued that this golden age of housebuilding was driven by the state – with the implication being that we need to depend on the state to reverse the decline.

It is certainly true that local authorities and housing associations were responsible for a much greater proportion of overall housebuilding in the 1950s and 60s, with the public sector building 200,000-plus new homes in both 1953 and 1954, as the graph below sets out.[1] But the actual peak of housing supply came in 1968, when public sector completions were already down 25%. It is notable that 1968 was the year in which both overall completions peaked, at 353,000, and private sector completions peaked, at an impressive 203,000. Similarly, the last time overall housing completions exceeded 200,000 was in 1988, led by private sector construction.

Housing completions, England, 1950-2019



Private sector building was also even more important before the Second World War. The official MHCLG statistics do not go back this far, but Alan Holman's *Historical Statistics of Housing in Britain* gives figures for overall completions that reach 346,000

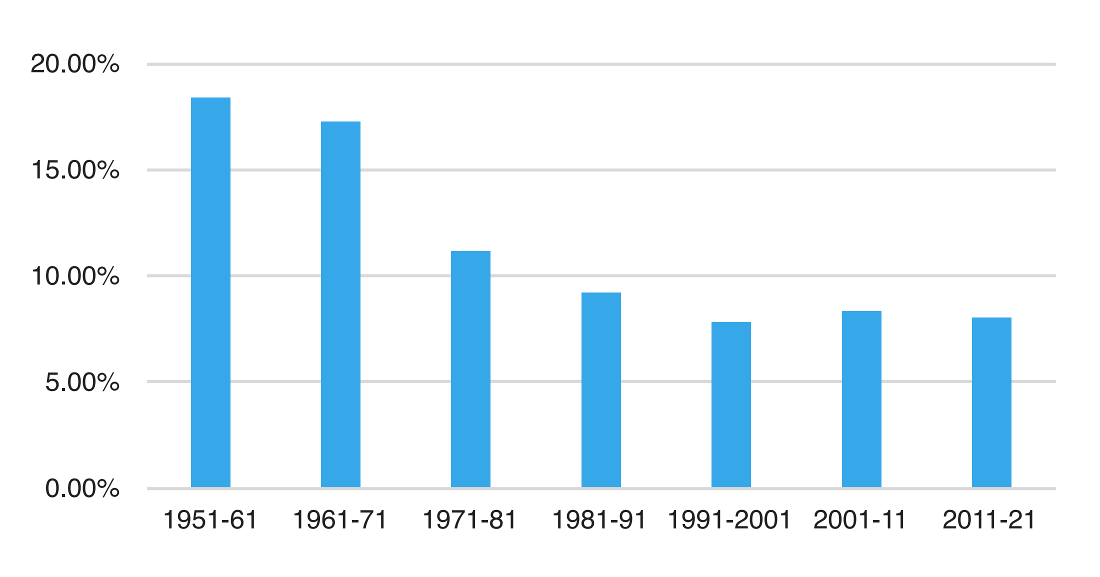
1 Ministry for Homes, Communities and Local Government, *Live Table 244 ('Public' calculated as local authorities plus housing associations.* Link

in 1936-37. Private sector construction was comfortably above a quarter of a million per year in the mid-1930s: this was a period of relaxed planning rules, low interest rates and deliberate government policies to promote private-sector housebuilding, a pattern broken only by the onset of war in 1939.[2]

But whether driven by the public or private sector, it is clear that there has been a sustained decline in UK housebuilding. And in fact, these statistics underplay its scale.

Obviously if there are 200,000 additions to a stock of 10 million homes, it represents a much bigger percentage increase than 200,000 additions to a stock of 20 million homes. If we measure additional housing as a percentage increase of the existing stock in England over the post-war period, we can see that in the 1950s and 60s, the housing stock was being increased by as much as 18% each decade. This has now fallen to around 8%. So far in the most recent decade, the total increase has been 7.75%.[3]

Percentage increase in housing stock each decade England 1951-2021



But even this is not the end of the story. Even as the growth in housing stock has been slowing, the demand has been growing. This is not just driven by population increases, or by immigration: people are living longer, with an increase in smaller and single households. But population growth certainly plays a major role: between 1971 to 1981, the population rose from 55.9 million to 56.3 million, while from 2011 to 2021 it is predicted to have risen from 63.3 million to 67.5 million.[4]

There is also the issue of the kind of houses we are building. The proportion of additional dwellings which come from actual new build housing has declined, with more of our additional housing need coming from conversion from other uses (eg retail/offices).[5]

2 Alan Holmans, *Historical Statistics of Housing in Britain.* Link

3 CPS calculations based on Ministry for Housing, Communities, and Local Government, *Live Table 104.* Link

4 ONS, *Overview of the UK population: January 2021.* Link

5 House of Commons Library, *Tackling the under-supply of housing in England.* Link

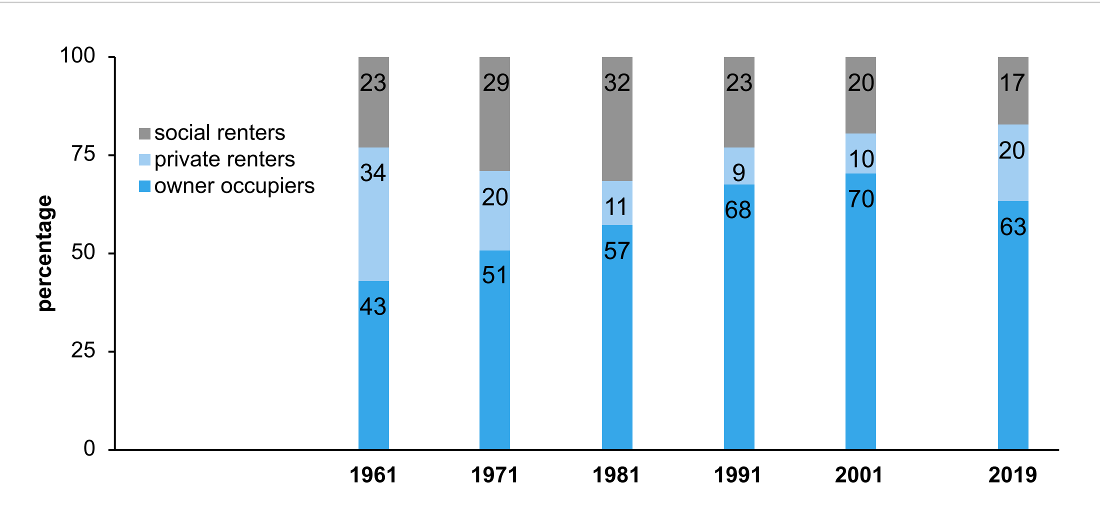
The result is that far more new dwellings are smaller properties and flats than was the case historically. Some 44% of dwellings added to the housing stock since 2005 are flats compared to just 18% pre-2005. Post-2005 properties are smaller, with 44% having three or fewer habitable rooms compared to 23% before 2005, and 54% have only one or two bedrooms compared to 37% for older properties.[6] So the figures on the graph which show a plateau are in fact even worse when you realise homes have shrunk in size.

A lack of housing to meet rising demand has meant, among other things, that the fastest growing household category over the last two decades has been households containing multiple families, which have increased by three-quarters to nearly 300,000 in 2019.[7] This is perhaps indicative of the pressure that households are under as housing supply has fallen and prices have risen – also shown by the fact that household size has actually risen slightly in recent years from 2.36 in 2011 to 2.39 in 2020,[8] with nearly three in 10 young people (those aged 20 to 34) living with their parents.[9]

A second element has been a decline in home ownership in recent years. After the war, home ownership steadily increased over time, rising from 43% to 70% between 1961 to 2001. It has since fallen back, to 63% in 2019.[10] A rising share of properties have moved into the private rented sector, which increased from 10% in 2001 to 20% in 2019. The social housing sector is also slightly smaller now than it was a few decades ago.

This matters because most people still want to own (as polls show repeatedly and overwhelmingly). What is happening is a frustration of the goal of ownership, rather than a conscious movement away from it.

Trends in tenure over time



6 Ibid.

7 ONS, *Families and households in the UK: 2019.* Link

8 ONS, *Families and households in the UK: 2019.* Link

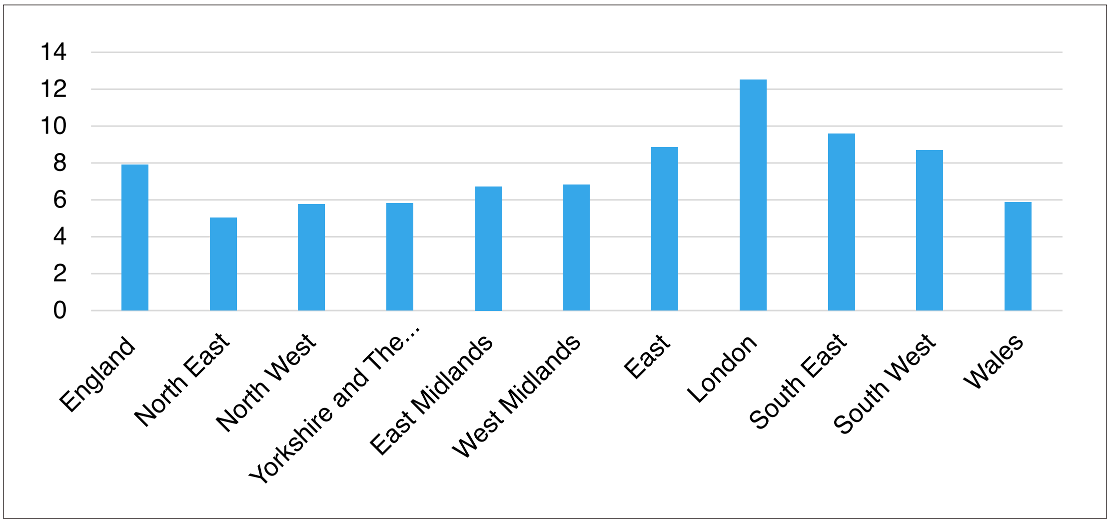
9 ONS, *Young adults living with their parents.* Link

10 *Ministry of Housing, Communities and Local Government, Table 104 Dwelling Stock by Tenure, England, Historical Series.* Link.

Regional variations in house prices and rents

Inevitably, decades of housing under-supply have fed through into prices, both for renters and homeowners. House prices in England are notoriously high – standing at £265,668 in July 2021.[11] On average, median house prices in England are now eight times median earnings. In some regions and localities this is even worse.[12] Burnley in the North West is the most affordable local authority district by this metric, with houses costing just 3.1 times the average salary. Hackney in London is the least affordable, at 12.1 the average salary. Nine of the top 10 most expensive local authority areas are in London, while the other is Oxford.

Price to income ratio by region, England & Wales 2020



The rise of house prices has made it harder and harder for many people, particularly those without access to the 'Bank of Mum and Dad', to get a deposit and take that first step on the property ladder – even in areas where house prices are less stretched. In addition, as explored in the previous CPS report *Resentful Renters*, the stress tests and deposit limits introduced after the financial crisis have inadvertently made it harder to own by reducing access to lending for those who cannot or do not have a large deposit.

Currently, it takes the average UK first-time buyer (FTB) 6.6 years to save enough for a 15% deposit and qualify for a mortgage.[13] That rises to 11 years in London, where the average FTB property costs £445,945. The South East, as is traditionally the case, is not far behind London, at 7.9 years. The East of England has also seen one of the largest increases, with new buyers now required to save for 7.7 years.

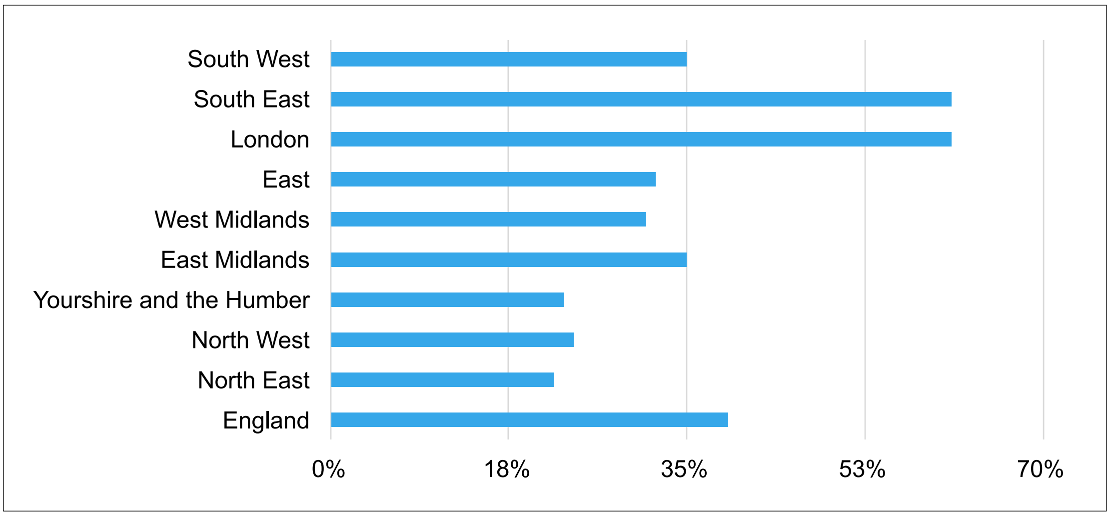
There have also been substantial pressures in the rental market – both in terms of higher rents and, just as importantly, in terms of insecurity for tenants. Statistics from the Office for National Statistics show that between 2012 and 2018, the percentage of income devoted to rent went up for the majority of renters, across all levels of income and housing quality.[14]

11 Land Registry Data, *House Price Statistics July 2021.* Link
12 ONS, *House price to residence-based earnings ratio.* Link
13 James Lockett, *Home ownership getting 'further out of reach' for FTBs.* Link
14 ONS, *Percentage of total monthly household income spent on private rent, England 2012 to 2018.* Link

Inevitably, cost pressures are highest in London and South East. As the chart below shows,[15] across England, 4 in 10 renters in the bottom half of the income distribution were paying more than 40% of their income in rent in 2019, rising to 61% for those in London and the South East. But there are renters across all regions of England suffering from significant affordability issues, with the proportion struggling standing at around 30% according to the Affordable Housing Commission.[16]

This impacts not just upon people's immediate standard of living, but the ability to get on the housing ladder by saving for a deposit, or accumulate other assets. This means that they are unable both to fully enjoy life in the short term or to aspire to home ownership in the long term.

Proportion of private sector renters in bottom half of the income distribution paying over 40% of their income on rents



Of course, people's experience of the rental market is not just about costs. Renting is by definition more precarious than ownership. This is particularly true for families, though all renters feel this. For many renters, the effect of insecurity means that they feel they could be moved on and that they cannot also 'make a house a home' by painting or decorating their home as they would want, or owning a pet – the little things that those who own their home take for granted.

While many people in their twenties are happier to rent, many renters are now older people who would want (and expect) to move into home ownership. Today, 24% of all renters are between 35-44 and 23% of all renters are between 45-64.[17]

A 2017 poll by Survation found that 35% of private tenants were worried that they would have to move home in the next year while just 43% felt their home looked the way they wanted it to.[18] Overall, the same polling found that 53% of private renters were stressed or anxious. This is not unusual: a similar poll found that 45% of private renters have experienced stress and anxiety as a direct result of their housing concerns, with nearly one in three saying their housing situation had left them feeling hopeless.[19]

15 Affordable Housing Commission, *Defining and measuring housing affordability – an alternative approach.* Link
16 Affordable Housing Commission, Ibid
17 ONS, *UK private rented sector: 2018.* Link
18 Dan Wilson Craw, *Insecure tenancies drag down quality of life.* Link
19 Shelter, *Two million renters in England made ill by housing worries.* Link

During the Covid-19 crisis rents fell in London, partly because Airbnb and other lettings entered the market, but rose elsewhere, despite a major recession. ONS data shows the median monthly rent rose from £700 to £725 in England between October 2019 and 2020 but fell from £1,450 to £1,435 in London. Other data confirms this broad trend, or offers even more dramatic figures: Hamptons suggest Inner London saw a huge 17% annual drop, while rents across the country rose around 5%. Thus overall, tenants in most places were worse off after than before the pandemic – and even in London, rents are likely to rise again as international travel resumes.

> **‘ONS data shows the median monthly rent rose from £700 to £725 in England between October 2019 and 2020 but fell from £1,450 to £1,435 in London’**

The Covid-19 pandemic has shown us how much we all owe to healthcare staff, care workers, retail and delivery workers, public transport workers, teachers and support staff, energy workers and so many others – those who kept our society moving when we needed it.

The Government definition of ‘key workers’ includes those who work for the public sector in areas such as health, education, and transport, but also energy workers and food delivery workers in the private sector.[20] Around 33% of workers fall into this category according to the ONS. And it is definitely true that this group has borne the brunt of Covid, with testing finding for example in January this year that ‘both healthcare and care home workers, and other key workers, had increased odds of swab-positivity compared to other workers at 1.48 and 1.35 [times] respectively’.[22]

This is not too dissimilar to the key worker group identified in the USA, although these were termed as those working on ‘critical infrastructure’, and this group was in some ways wider (eg it included construction workers, journalists and those in financial services).[23]

The key worker group in the UK were substantially more likely to contract Covid than other groups – because they often could not avoid face to face actions, just to do their job. And these millions of key workers, who kept the country running during some of its darkest hours, are also more likely than most to struggle to find affordable, quality and secure housing in the communities they serve – either as a renter or as an owner.

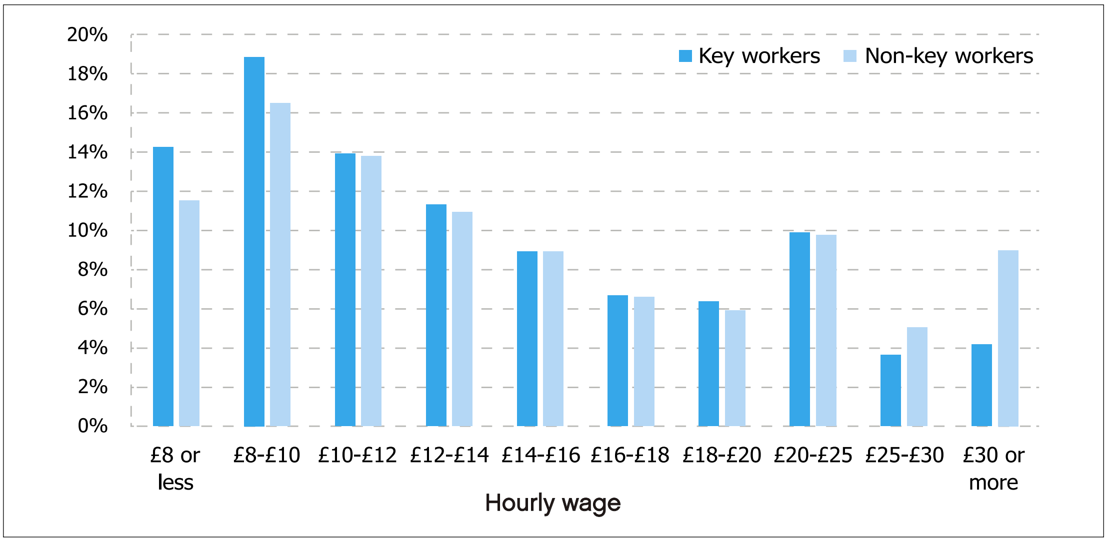
20 Department of Education, *Children of critical workers and vulnerable children who can access schools or educational settings.* Link

21 ONS, *Coronavirus and key workers in the UK.* Link

22 Department of Health and Social Care, *REACT-1: real-time assessment of community transmission of coronavirus (COVID-19) in January 2021.* Link

23 Cybersecurity and Infrastructure Security Agency, *Advisory Memorandum on Ensuring Essential Critical Infrastructure Workers' Ability to Work During the Covid-19 Response.* Link

Distribution of hourly wages among key and non-key employees in 2019



As the chart above shows,[24] key workers are more likely to be low-paid: 33% earn £10 or less an hour, compared with 28% of workers in non-key sectors. In some sectors, pay is even lower: 71% of food sector workers and 58% of employees in social care earn £10 or less an hour, which is below the National Living Wage. Conversely, non-key workers are more than twice as likely to earn £30 or more an hour.

A nurse on the median wage of £33,920 a year would be unable to raise a deposit to buy a median-priced property in almost three-quarters of local authorities nationwide.[25] Care workers face even more of a struggle. In 2020, the median salary of a senior care worker was £21,243. With a 10% deposit, a senior care worker would only be able to afford a median-priced house in six council regions in Great Britain – just 2% of the total.

Even with a partner earning the median UK salary – £31,641 – that same senior care worker would still be unable to afford a median-priced home in 40% of local authorities.

In the private sector, key workers also often struggle – the average pay of supermarket staff, who often faced higher risks of Covid, ranged from just £8.50 to £10 an hour, or £15,470 to £18,200 for a full-time job.[26]

Rental affordability is also a huge issue, given the fact that key workers are often earning less. This is particularly true for those in professions such as social care or retail, where wages are generally low. As we will see later, the build to rent sector usually targets a yield of around 5%. For a family home valued at £300,000, this would mean a starting rent of £15,000 per year – a pretty hefty sum. (It is worth remembering that the average salary is £585 a week,[27] so a family with one full-time and one part-time worker at 20 hours a week would earn around £47,000 a year before tax, or around £39,000 after tax. This would require that family to spend nearly 40% of their income on housing – and of course half of households have to make do with lower incomes than the average.)

24 The Institute for Fiscal Studies, *Differences between key workers.* Link

25 The Guardian, *Covid frontline workers priced out of homeowning in 98% of Great Britain.* Link

26 Lucy Alderson, *Wage Packet How much Tesco, Morrisons, Aldi, Asda and Morrisons pay staff as we rank supermarket wages.* Link

27 ONS, *Employee earnings in the UK: 2019.* Link

On top of this, the regional effects described above mean that for many, things are even worse. The vast majority of key workers cannot work from home. This has meant many are left trapped in expensive areas, forced into the unstable, expensive and often cramped parts of the private rented sector, and unable to save for the future.

Using the conventional benchmark that renting must cost less than 30% of gross annual income for it to be considered affordable, the table below shows that for many key workers, particularly those in London and the South East, median private rents are well above 30% of income. That leaves them with a choice between a tiny home or a nightmarish commute.

As the table below demonstrates,[28] nurses and midwives had the worst rental affordability ratios in the South East at 34%, with prison service officers and primary teachers at around 33%. In London, the figures are predictably worse with nurses and midwives having to spend 39% of their salary on rent, with the figure rising to 45% and 40% for prison officers and primary school teachers respectively.

Table 1.2: Rental affordability ratio by region and key worker profession, 2018

Indicator (%)	Police officers	Secondary school tearchers	Social workers	Fire service officers	Primary & nursery teachers	Nurses & midwives	Prison service officers
Wales	15	15	18	N/A	16	19	N/A
North East	14	15	20	18	18	18	19
Scotland	15	17	17	20	18	22	15
Yorkshire and The Humber	14	18	19	17	17	19	24
North West	15	17	18	19	19	21	25
West Midlands	17	18	20	20	22	25	24
East Midlands	17	18	21	N/A	24	23	26
South West	19	21	28	25	27	29	N/A
East	20	22	26	26	26	20	30
South East	23	27	30	27	33	34	33
London	29	33	34	36	40	39	45

Source: ONS, PwC analysis based on ratio of median private rents to median income. Note that comparable data are not available for Northern Ireland.

Similarly, house prices in London mean home ownership is even more unaffordable for key workers there than the rest of the country. The median average price of a flat in London is £426,000 – more than 11 times a firefighter's annual wage, more than 12 times a teacher's, and nearly 13 times a nurse's.[29] And of course these flats will be too small for families, so even if a key worker can move onto the property ladder, they are stuck in a small flat suitable for a single person or childless couple.

These affordability problems are already taking their toll, with London and the South East having the lowest percentage of key workers in health and social care. They also have lower percentages of key workers in food and necessary goods than other regions, showing the pressures that housing is imposing.[30]

28 PWC, *Key workers being priced out of London as rental affordability ratios deteriorate.* Link

29 Mayor of London, *Mayor to prioritise housing for key workers.* Link

30 ONS, *Coronavirus and key workers in the UK.* Link

A 2016 report from the Royal College of Nursing found that 66% of nurses were considering leaving London due to the pressure of housing costs, with 40% saying they would probably or definitely leave London in the next five years.[31] However, it also showed that if the government could address the issue of affordable housing, three-quarters (75%) of nurses would be more likely to stay in London.

It is not just key workers, of course, who have been driven out of London by high house prices. But not only are these workers on lower salaries, but they are less likely to have jobs that can be moved to other parts of the country – or, in the post-pandemic age, to be able to move towards flexible and remote working.

Something has to change – not just to do the right thing by these workers, but to ensure that these areas can still function.

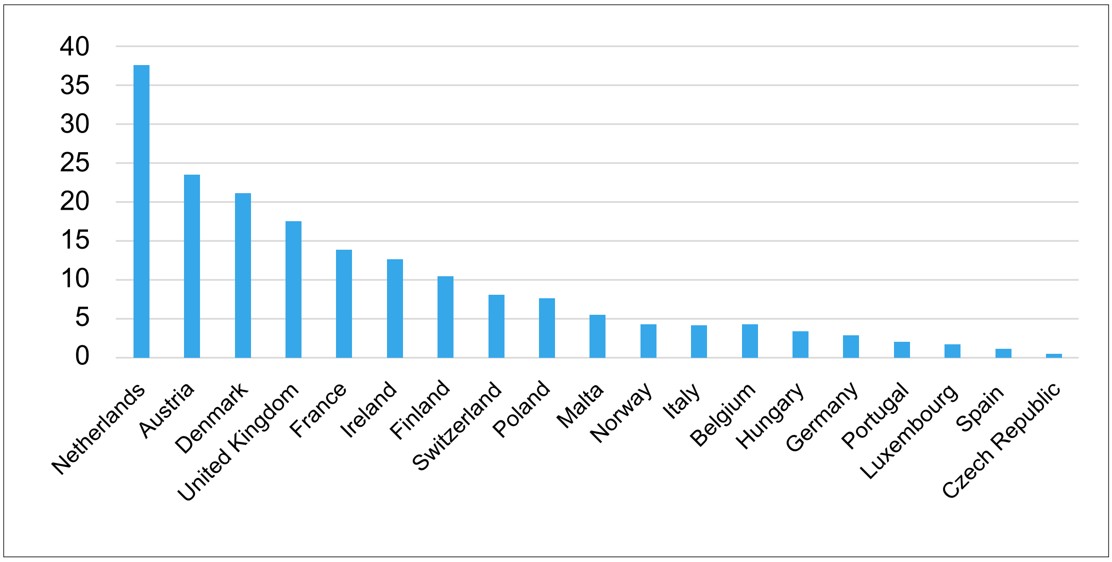
Why social housing is not the solution

One of the most common 'solutions' to issues of housing affordability is to argue that we should have more social housing – properties built and owned by the Government which offer sub-market rent to their occupants.

But there are two problems here. The first is that, by and large, people do not want to live in social housing: as previous CPS research has shown, waiting lists are driven entirely by wider housing costs, because people tend to treat it as a last resort.

The second is that the UK actually has some of the highest rates of social housing in Europe, as the graph below shows.[32]

Social renting stock across European countries as a % of total housing stock



31 Royal College of Nursing, *Better Homes for Nurses.* Link
32 OECD, *Social rental dwellings stock.* Link

Despite having a very large social housing stock, the UK remains one of the least affordable countries in Europe. The problem is clearly related to the market price of housing.

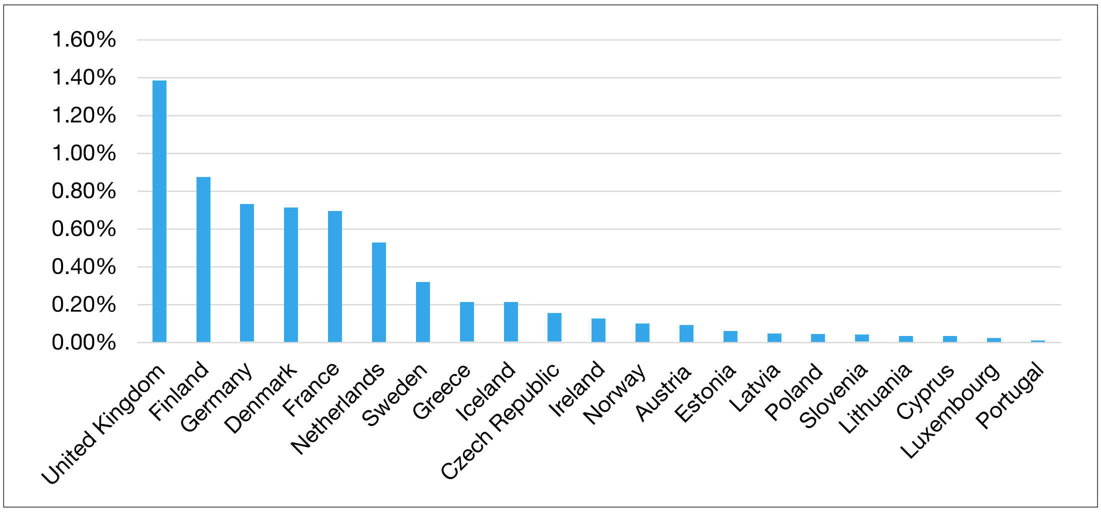
The 2020 Commission on Affordable Housing advised the Government to adopt the definition of affordable housing as 'an affordability threshold at the point when rents or purchase costs exceed a third of net equivalised household income'.[33] The Commission notes that the problem of affordable housing is particularly acute for renters, with approximately two million private renters spending more than 40% of their income on rent. Many of these people will be the key workers that we identified above.

The EU uses the housing cost overburden rate – that is, the percentage of the population living in households where total housing costs represent more than 40% of disposable income – to measure affordability.[34] On this metric, the UK is one of the least affordable countries in Europe, with 15.1% of the population facing unaffordable housing. This compares to the EU average of 10.1%. Our nearest neighbour, the Republic of Ireland, has a cost overburden rate of just 4.2%. France, which has a very similar tenure make-up to the UK, has a cost burden rate of 5.5%.[35]

In short, the UK's housing affordability problems are not created by a lack of social housing – and will not be solved by this alone.

It is also hard to see what more could be done in terms of housing support through welfare provision. The inexorable increase in housing costs in recent decades has pushed the Government to spend ever more to help people cope. At 1.4% of GDP, the United Kingdom spends the most on housing support of any OECD country by a significant margin. By contrast, public spending on housing allowances is close to 0.5% of GDP in the Netherlands and New Zealand, and between 0.1 and 0.3% of GDP in Sweden, Greece, Iceland, the Czech Republic, Ireland and Norway.[36]

Public spending on housing support as % of GDP



33 Affordable Housing Commission, *Defining and measuring housing affordability – an alternative approach.* Link
34 Eurostat, *Glossary: Housing cost overburden rate.* Link
35 FEANTSA and The Abbé Pierre Foundation, Sixth Overview of Housing Exclusion in Europe 2021. Link
36 OECD, *Public Spending on Housing Allowances.* Link

The UK, in other words, spends over £24 billion on housing benefit each year, much higher than the police or overseas aid budget and more than many entire departments.[37] Over four million households currently receive support from the state in paying their rent, showing just how far government already goes in this area – and why substantial increases in such support are unrealistic.

Current support schemes – Help to Buy and 95% mortgages

Since 2010, the Government's interventions in the housing market have largely focused on supporting people into ownership, in particular by ameliorating the soaring costs of deposits – driven both by higher house prices and tighter financing requirements in the wake of the financial crisis.

The Help to Buy Equity Loan scheme was designed to allow first-time buyers and home movers in England to buy new-build homes priced up to £600,000 with a 5% deposit. Buyers could benefit from a 20% equity loan from the Government (40% in London) and get a mortgage for the remaining 75% with a 5% deposit. The loan was provided interest-free for the first five years.

> **'The Help to Buy Equity Loan scheme was designed to allow first-time buyers and home movers in England to buy new-build homes priced up to £600,000 with a 5% deposit'**

The scheme has helped fund 272,852 property sales since it was introduced in 2013, with more than 35,000 people having now repaid their loans. From its introduction to the end of 2020, 257,520 properties were bought by first time buyers, including 21,026 in Q4 2020, at the height of the pandemic.[38] On the surface, the scheme has undoubtedly achieved its aims of boosting house-building and homeownership.

However, evidence suggests that the introduction of Help to Buy has led to a direct increase in house prices. In 2020 the average purchase price of a house using Help to Buy was £296,925,[39] which is significantly more than the average purchase price of £252,000 on the open market.[40]

There are also concerns that the housing market has become too reliant on Help to Buy. In Northampton, the scheme has funded 97% of new build sales. In Burnley, Derby and Warrington, more than 90% of new builds were purchased with the scheme.[41] Even in places where the scheme was least used — Cambridge, Portsmouth and Norwich — it still accounted for about one in five new builds. Overall, the most recent data shows approximately 50% of all new builds in England were funded by it.[42]

37 Department of Work and Pensions, *Autumn 2020 Expenditure and Caseload forecasts.* Link

38 MHCLG, *Help to Buy (equity loan scheme): data to 31 December 2020.* Link

39 MHCLG, *Help to Buy Tables.* Link

40 ONS, *UK House Price Index: December 2020.* Link

41 What Mortgage, *Hotspots where housing market is 'too reliant' on Help to Buy.* Link

42 The most recent data from MHCLG show that 42,110 new builds were completed Q4 2020. Link. In the same period 21,026 Help to Buy Equity Loans were issued. Link

In addition, as new-build house prices have risen, along with the share of new builds sold using Help to Buy, so have developer profits. The National Audit Office says the total combined housing sales of five of the six largest developers in England – Barratt, Bellway, Persimmon, Redrow and Taylor Wimpey – have increased by more than half since Help to Buy was launched.

Overall, between 36% and 48% of these developers' new homes were sold via Help to Buy in 2018.[43] Their share price increases have significantly outstripped those of the FTSE 250 since the scheme's launch. In 2019 Persimmon became the first housebuilder in the UK to announce profits of more than £1 billion a year – and almost half of their homes were sold through the help-to-buy scheme.

In other words, the Help to Buy Equity Loan has concentrated market power in the hands of the large house builders – which as we will see in the next chapter has negative consequences for housing supply.

Concerns about the over-reliance of the property market on Help to Buy have prompted action from the government. From April 2021, loans will only be available to first-time buyers, and the maximum amount that can be borrowed will also be regionally capped.

The second element of Government support was the Help to Buy mortgage guarantee, which set out mortgages that were guaranteed in part by the state, allowing those with a 5% deposit to buy. The UK Government announced the Help to Buy Mortgage Guarantee at the end of Q1 2013 and it began operation that October. The announcement emphasised the large scale of the scheme, supporting 'up to £130 billion' in lending focused on those with smaller deposits.[44] The scheme ran from Q3 2013 to early 2017, supporting £15 billion in lending, running at around £4-5 billion a year.[45] A very similar scheme was re-introduced in 2021, in the wake of the pandemic.

> **'Overall, between 36% and 48% of the big developers' new homes were sold via Help to Buy in 2018'**

Again, the original scheme did help people into home ownership. But its key impact was its indirect effect on banks and lending. Coupled with a general recovery in the economy, mortgage lending, which had run at around £11-12 billion a month in the run-up to the scheme's start, peaked at £18 billion by December 2013, and then after some fluctuations settled down in mid-2015 at around £20 billion a month.[46] Largely due to this, house price inflation, which in early 2013 was running at an annual rise of just 0.2%, shot up. By mid-2014 monthly house price inflation rose to double digits – peaking at over 11%.[47]

Due to the surge in lending, the number of first-time buyers in 2014 rose by 20%, or around 70,000, and around 35,000 new Help to Buy mortgages were issued.[48]

43 Which?, *One in seven Help to Buy homes lose value despite local house prices soaring.* Link

44 Department of Housing, Communities, and Local Government, *Delivering new homes for hard-working people.* Link

45 HM Treasury, *Help to Buy: mortgage guarantee scheme Quarterly Statistics.* Link

46 Bank of England Database, Monthly value of total sterling approvals for secured lending to individuals (in sterling millions) seasonally adjusted. Link

47 Nationwide, *House Price Index.* Link

48 Claer Barrett, *Number of first-time UK homebuyers hits 7-year high, says Halifax.* Link

However, rising prices ultimately choked off the ability of first-time buyers to enter the market, so first-time buyer numbers fell back over time. This is why the new 95% mortgage scheme, while being useful for those on a reasonable income without a deposit, has to be carefully handled to avoid boosting prices.

‘A review by Which? found that the best rate available in May 2021 for a 95% mortgage on a two-year contract was 3.5% with a fee of £1,499’

The current scheme is also less likely to be useful to those on average incomes or below, which as we saw includes many key workers. A review by Which? found that the best rate available in May 2021 for a 95% mortgage on a two-year contract was 3.5% with a fee of £1,499.[49] This, like other 95% mortgages, was available for up to four and half times the borrower's income, and so would help some key workers, but not suit others. It would also come with a fairly heavy price tag attached, given the high rate of interest.

Who is building the houses?

One of the most interesting aspects of the current housing crisis, explored in more detail in subsequent chapters, is that alongside a particularly acute housing shortage, the UK has a fairly unique housing supply model. The construction sector in England – and the wider UK – has come to be dominated by a relatively small circle of larger developers. As set out in previous CPS research, these huge companies find our complex planning system easier to traverse and have the land reserves and cash to take on the risks involved. This is quite different to how things used to be here, and how things are in other countries.

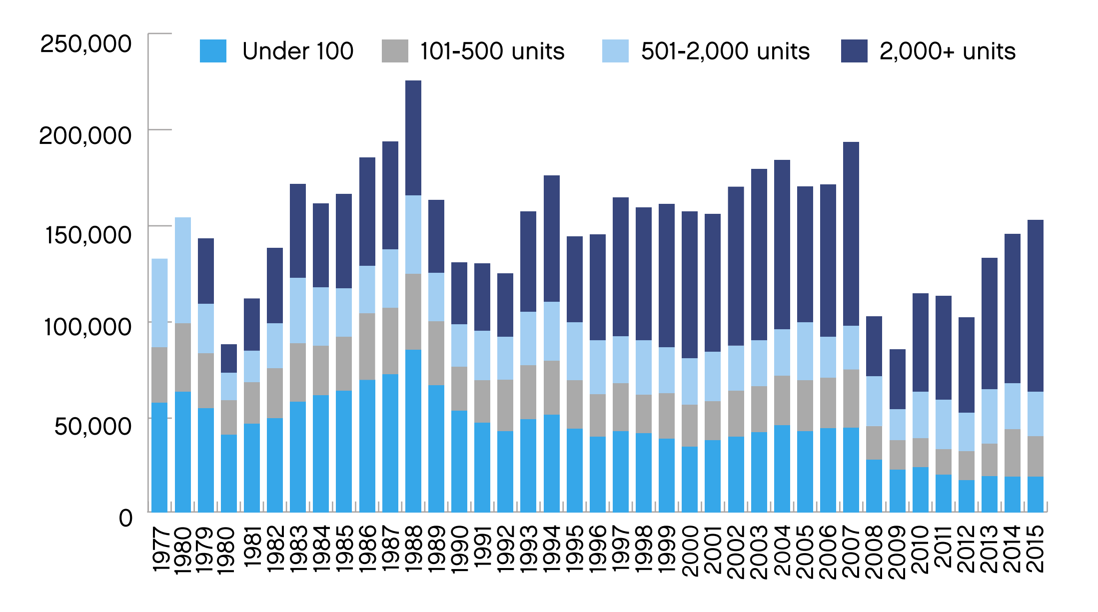
According to the Home Builders Federation, in 1988 small builders were responsible for around 40% of new build homes, compared with just 12% in 2017. The number of active small builders (delivering less than 100 units per year) fell by nearly 10,000 over that period, a fall of 80%, while the number of medium-sized builders (constructing 100-2,000 units per year) fell by more than half.[50] The industry was dealt a further blow when, as a result of the financial crisis, approximately one third of active companies stopped building homes.[51] The downturn disproportionately hit smaller house builders as they found it increasingly difficult to access finance because lenders perceived them to be higher risk. In addition, as we will see, the large house builders are financed by retained cash and equity rather than debt, which means they can run down their cash piles and switch off equity. Small and medium sized house builders are often trapped into debt repayments which cannot be switched off, which makes their position more precarious.

49 Which?, *First-time buyers: how to get the best deal on a 90% or 95% mortgage.* Link

50 Home Builders Federation, *Reversing the decline of small housebuilders: Reinvigorating entrepreneurialism and building more homes.* Link

51 The Lyons, *Housing Review 2014.* Link

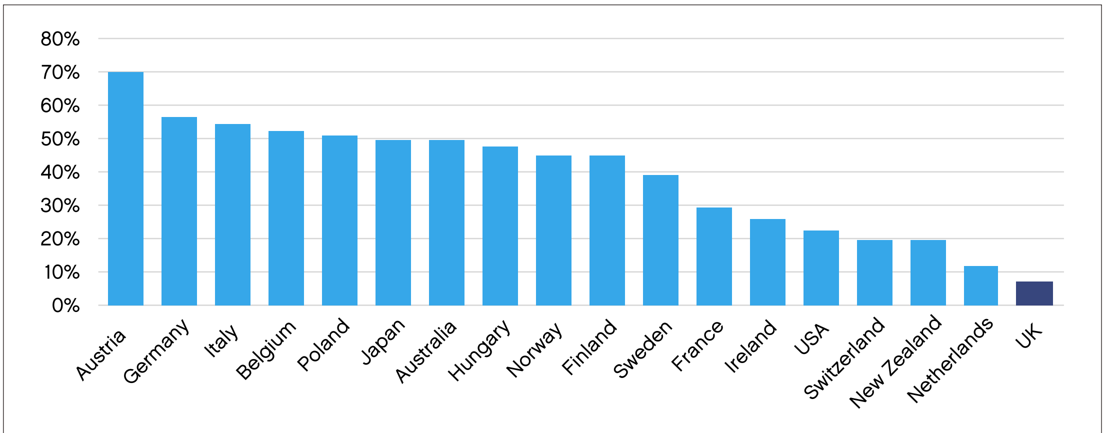
Housing starts by size of developer



Local authorities have also increasingly looked to smaller numbers of large developments to meet their housebuilding targets in their local plans. The size of the average permissioned site in a local plan has increased by 17% in the last decade.[52] Thus we see a pattern of concentration – larger sites, being built by larger house builders – going hand in hand with the low level of supply.

Another indication of the dominance of larger developers in the UK construction market is the incredibly low level of self-built and custom-built housing here compared to other developed nations. Most comparable countries have self- and custom-build rates of between 40% and 50%. However, as the graph below shows, in the UK that number is less than 10%, lower than any other comparable country.[53]

International comparison of self-build and custom housebuilding



As will be discussed in the next chapter, the uniquely low level of housing supply that the UK faces is linked to the way that new homes are built and delivered in the UK. If we want to improve the supply of new homes – both for key workers and others – we need to put in place new ways to support housing delivery.

52 Home Builders Federation, *Reversing the decline of small housebuilders: Reinvigorating entrepreneurialism and building more homes.* Link

53 House Planning Help, *How Does Self Build in the UK Compare to Germany?* Link

Part 2: Our unstable housing model

The first part of this report has shown that Britain's housing crisis has been coming down the track for decades – and that the key workers who carried us through the Covid crisis are disproportionately suffering as a result.

In this part of the report, we will examine how the housing industry works – and why it is not set up to deliver for key workers, or indeed for many other people beyond them. In doing so, we will show why building Homes for Heroes requires us to go beyond the current model to create something new: new thinking, new delivery models, new planning rules and new sources of financing.

As outlined in our recent CPS report *The Housing Guarantee*, the delivery structure for house builders – particularly the larger house builders who are growing steadily more dominant – is both caused by and reinforces the undersupply of homes in this country. The key points are:

1. The large house builder model is built around 'build to sell'
2. The large house builder model cannot meet housing needs
3. Large house builders prioritise output flexibility, which hits quality and supply
4. Financing homes is built around a boom-bust cycle
5. Financing, volatility and under-supply are all inextricably linked
6. A more stable finance and delivery model is needed

1. The large house builder model is built around 'build to sell'

Large house builders, as we saw, are key to the English system. The main thing to understand is that their model is 'build to sell' – understandably, they will build homes only when they can sell them. This was set out ably in the Letwin Review of large sites and build out. As Letwin put it in his interim analysis, commissioned for the Treasury in 2018:

'The open market value of a marginal newly constructed home (the price that can be reached between a price-maximising willing seller and a price-minimising willing buyer) ***will bear some close relation to the price of a comparable second-hand home in the same location****. There is, however, a crucial assumption lying behind this method of valuation: namely,* ***that the supply of new homes in the locality is not going to be sufficiently large to have any noticeable effect on the supply and demand balance in that local housing market****, and is therefore not going to have any noticeable impact on the open market value of second-hand homes in that locality. Only if this assumption holds good, will the marginal valuation principle hold true. In other words, the standard method of valuation for new housing used by all reputable valuers in the UK bakes in*

the assumption that local housing markets will not be 'flooded' with new homes to the point where the current prices of second-hand homes in the local market are forced downwards.'[54] (Our emphasis.)

In other words, house builders will only build at the rate the local market can absorb. Their best business strategy is therefore to build and sell at the fastest speed possible consistent with maintaining existing house prices for new build properties.

> **'On average, for every 8.5 transactions taking place in any year, one home is built'**

The Letwin analysis is backed up by data first set out in our paper *Stamping Down*, which showed that transactions and new build completions tend to track each other very strongly. The higher transactions are, the higher sales are; the more sales there are, the more homes will be built. On average, for every 8.5 transactions taking place in any year, one home is built.[55]

Up to a point, a house builder can attract new sales by lowering the price of their homes compared to existing homes. But obviously this cuts into the profit of each home. A more attractive option is to cut output and wait until they can sell at a higher price.

This also explains why Help to Buy has been so valuable to the larger house builders – because it makes it cheaper and easier to buy an Equity Loan new build property when compared to an equivalent second-hand property requiring a higher mortgage. This explains why a very large number of new builds are purchased using the Help to Buy Equity Loan support and why it dominates supply.

Transactions more than land availability drives new supply

As was shown in the CPS report *The Housing Guarantee*, the large house builders control most of the land that is easily available for permissions in the five-year land supply. They manage the flow of land in order to create a product to sell. Thus, the causal chain is not that housing supply is low because there is insufficient land. The number of planning permissions applied for, and granted, is driven by how many houses the large house builders think they can sell.[56] As the graph below shows, from 2011 to 2019, there was a fairly consistent upswing in planning permissions, with a steady increase in almost every year.[57] This was not caused by a major change in planning regulations: what was happening was a greater push by house builders for land as the economic climate meant they could comfortably increase sales.

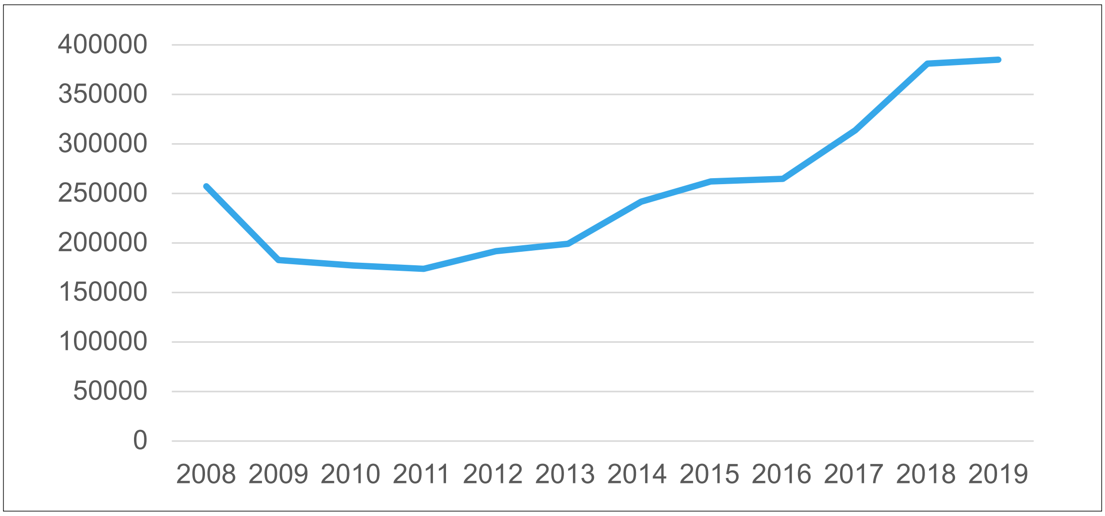
54 Ministry of Housing, Communities and Local Government, *Independent review of build out: draft analysis.* Link

55 Alex Morton, *Stamping Down: Why Cutting Residential Stamp Duty is Easier than You Think.* Link

56 Ministry of Housing, Communities and Local Government, *Planning Applications in England: January to March 2019.* Link

57 Ministry of Housing Communities and Local Government, *Units granted planning permission on all sites*, England. Link

Units granted planning permission on all sites, England



What is important to grasp here, as explained more fully in our paper *The Housing Guarantee*, is that simply increasing the supply of potential permissions by say 50,000 or 100,000 will not have a major impact on supply, because it won't charge the model of the large house builders. Supply primarily relates to build out rates, not land availability.

2. The large house builder model cannot meet housing need

The Letwin Review noted that the large house builders tend to build out quite slowly and so could not meet housing need in each area. As the Review noted, 'the homogeneity of the types and tenures of the homes on offer on these sites, and the limits on the rate at which the market will absorb such homogenous products, are the fundamental drivers of the slow rate of build out'.

Thus, the issue of who owns the permission and what the permission consists of are critical variables, since the more homogenous the supply and the smaller the number of sites, the slower the overall build out rate in an area will be, because the pool of potential buyers will be smaller.

Letwin also noted that different types of home, and different (or to put it less politely, better) quality homes, could impact the effective demand for new homes:

'I conclude that if either the major house builders themselves, or others, were to offer much more housing of varying types, designs and tenures (and, indeed, more distinct settings, landscapes and street-scapes) on the large sites and if the resulting variety matched appropriately the desires of the people wanting to live in each particular part of the country, then the overall absorption rates – and hence the overall build out rates – could be substantially accelerated.'

Currently just 20% of people say they would consider a new build property.[58] Given this, the figure above of around 12.5% of all private homes being sold being a new build is not that bad – the large house builders clearly do a good job of translating potential demand into sales. But across the system we need a greater tenure mix and new routes to market.

58 From the regular HomeOwners Report by the HomeOwners Alliance from 2015-17 which finds only around 1 in 5 wanting a new build home, or in the past, see Adam, R. (2005), *Architectural preferences in the UK – a digest of the evidence*, pp.1-3.

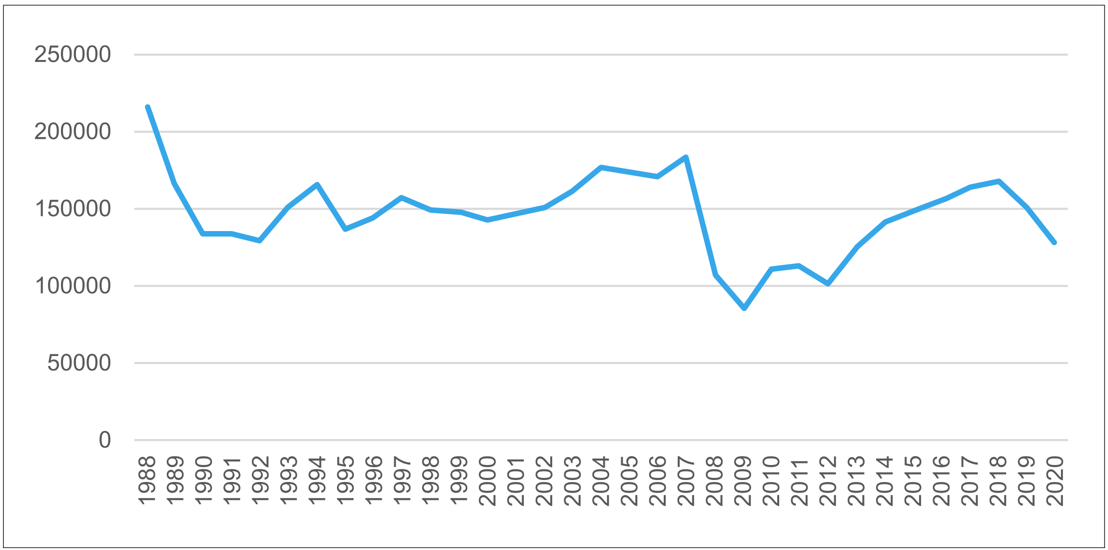
3. Large house builders prioritise output flexibility over quality and supply

One of the core problems with the housing model described above – and one of the reasons it exists in the first place – is because the housing market is acutely sensitive to booms and busts. In any downturn, demand for housing tends to fall far more sharply than the accompanying GDP contraction, and then recover far more slowly. This indeed was the justification for the stamp duty cuts introduced by Rishi Sunak, which proved far more successful than anyone expected in keeping the market moving, to the point that overheating became the bigger risk.

As the graph below shows, new housing starts were broadly steady from the mid-1990s until late 2007. Starts were strongly affected by the economic downturn from the start of 2008, when there was a period of rapid decline. From 2009 starts began to recover and between 2013 to 2018, they grew again gradually.

More recently there has been a decrease in starts, with 2020 seeing the sharpest decline since the global financial crisis – although this was almost all in the first part of the year, with numbers in the second half of 2020 close to their long-run average as the stamp duty cuts took effect and confidence revived.[59]

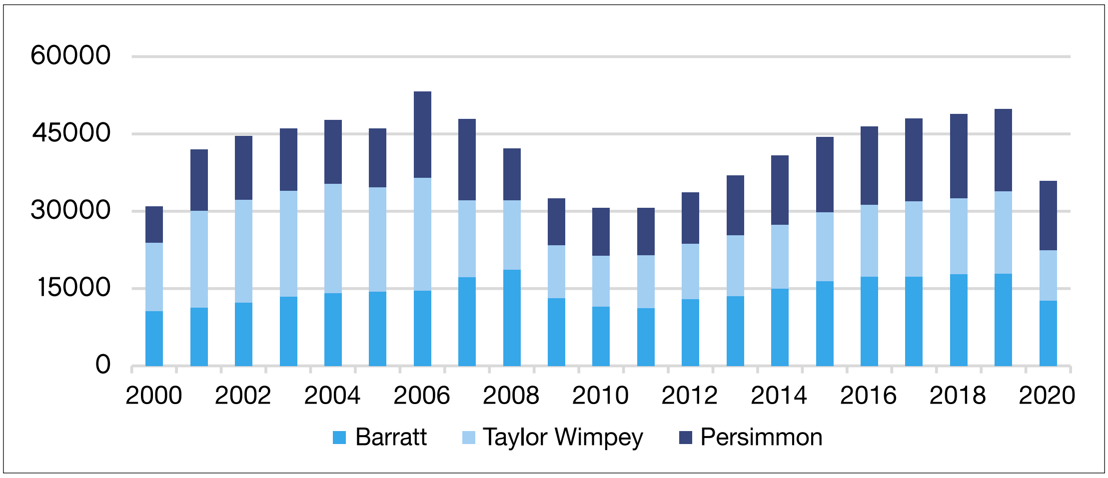
Annual housing starts in England



This boom-bust cycle is as true of the largest house builders as it is of the sector as a whole. The table below shows the three largest house builders' output over the past two decades. From 2006 to 2010, their contribution to supply falls from over 50,000 to around 30,000. It then rises back to the 50,000 level from 2010 to 2019 before falling again in the Covid crisis.

59 Ministry of Housing, Communities and Local Government, *Live Table 213*. Link

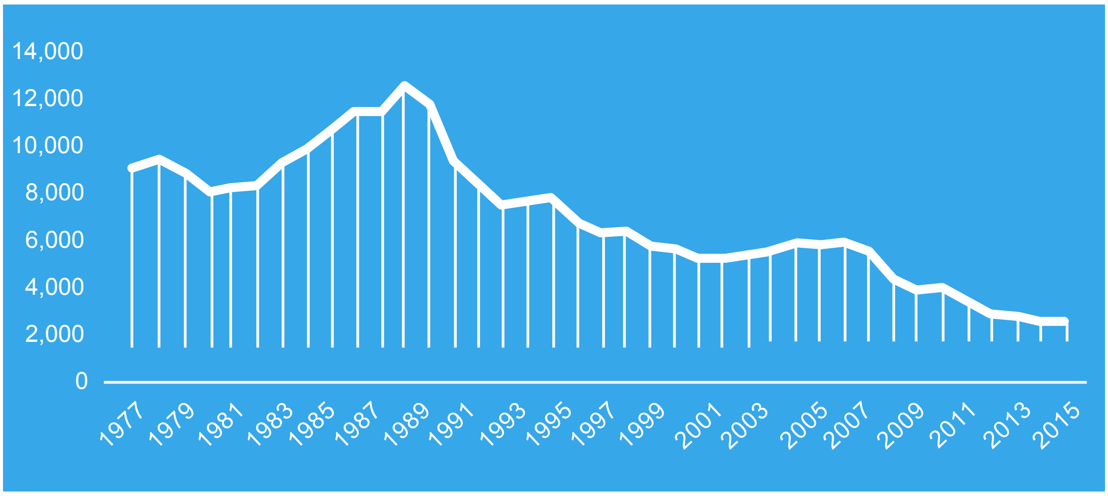
Annual output from Barratt, Taylor Wimpey and Persimmon



The large house builders have to be ready to scale back supply fairly quickly when the market takes a downturn and sales fall rapidly – for example, the number of homes they were building fell by 20,000 from 2006 to 2009.[60] In a recession there is often a double whammy, with a slump in the price of existing units accompanying a fall in the demand for new ones.

As a result, house builders have to operate on an incredibly flexible basis. Their model is geared to minimising fixed costs, so they can easily reduce the number of new homes they need to sell in a downturn. If they did not do this, they would risk selling large numbers of homes at below cost, and go bankrupt. Indeed, this is what happens to many smaller house builders. These often have only a single or few sites, and are usually based around a family involved in construction. As the chart below shows,[61] in the last two booms there was a small increase in small house builders, but this was more than wiped out by the sharp fall during and after the downturns of the early 90s and late 2000s.

SME house builders (1-100 units)



60 Authors own calculations taken from Barratt Developments, *Annual Report and Accounts 2001 – 2020*; Persimmon, *Annual Report and Accounts 2001 – 2020* and Taylor Wimpey *Annual Report and Accounts 2007 – 2020*. Prior to 2007 the figure shows net combined output from Taylor Woodrow and George Wimpey, taken from their respective Annual Report and Accounts 2001 – 2006.

61 Taken from the Home Builders Federation, *Reversing the decline of small housebuilders: Reinvigorating entrepreneurialism and building more homes.* Link

To slash output like this requires outsourced labour. To quote the Home Builders Federation:

'Direct employment of trade labour by home builders is relatively low, with a recent Workforce Census carried out by the HBF and its members indicating that just over 20% of on-site surveyed workers were employed directly by the developer.'[62]

The large house builders have also avoided investment in fixed plant and other costs (eg investment in modern methods of construction) which would mean having to invest in large and expensive factories, which would be difficult and costly to turn off. To quote a recent study:

'The construction sector today is characterised as being 'labour-intensive' – it employs more people to produce each £1 of output than most other sectors and it generally employs less capital eg plant, machinery, computers etc. And it hasn't changed or 'innovated' its productive processes as much as other sectors over the years.'[63]

'Because the large house builders are very reluctant to increase output too rapidly, they will only slowly start to build up supply after any recession'

The reality is that the sector is unwilling to sink capital into skills or capacity that may well end up underused, which is why productivity remains low.

Because the large house builders are very reluctant to increase output too rapidly, they will only slowly start to build up supply after any recession. This makes the boom much less sharp than the bust that precedes it. So, we have sharp downturns and sluggish increases, an asymmetrical system of housing supply.

The volatility of the housing supply model does not just mean that the timing of when homes are delivered moves. It is also the case that the total level of housing is lower than it would be in a more stable system.

On top of that, there are various unhelpful feedback loops. The amount of land that is released for housing falls over the cycle, because as housing numbers fall, household formation falls, which then feeds into future household growth projections. Even when the large house builders want to increase supply, they find that the supply chains have withered, making it harder to ramp up, or for new entrants to enter a clearly unstable market.

4. Financing new homes is built around a boom-bust cycle

This boom-bust model is inevitably reflected by the housing industry's financing models. The large house builders in England are mainly financed by equity, and they build large cash reserves for the difficult periods to support this. In the good years, the profits are very high (notoriously so), but in the lean years they are zero or even below.

62 Home Builders Federation, *The Economic Footprint of Housebuilding in England and Wales.* Link
63 Mace, *Construction productivity: the size of the prize.* Link

Consider the profit cycle involved in constructing a small three-bed new build home outside the South East. The cost of the land and build is approximately £125,000,[64] and marketing and sales add another £10,000. Section 106 is £20,000 per unit, and the cost of internal infrastructure (eg utilities and the roads within the development) is £20,0000.

If the homes sell for £215,000, the profit per home will be a healthy £40,0000, a rate of return of around 20%. But this figure is extremely volatile.

Consider a situation where demand drops locally – either due to a local downturn or a national recession. House prices on site drop 15% while wages and other costs rise by 5%. Suddenly the homes cost £131,250 or so to build, with other costs at £50,000, but the new home can only be sold for £182,750. The profit per home is now just £1,500. If costs continue to rise, then the entire development is unviable, as each home built will be sold at a loss. Given the additional fixed overheads around a central office and the need to find and pay for new sources of land, the company will become unviable and unable to raise new capital.

These are all indicative prices, but they show the essential issue: that land prices, Section 106 and other costs are fairly fixed, while the sale price of a house is fairly volatile. Of course, in the upswing, if house prices rise from £215,000 to say £235,000 on the imagined site above, the profits per home would rise by 50% from £40,000 to £60,000. The builder makes a very large gain in the good times, but profits vanish rapidly in a downturn. (And of course, not only is the profit much lower per property, but the number of transactions will have fallen sharply as well.)

This helps explain not just the nature of the large house builders' balance sheets, but why banks, pension funds and institutional investors have generally sought to limit their exposure to the sector. Shareholders also tend to flock to the sector when the market is doing well only to depart when it gets into difficulty.

The resulting volatility is clear, as the table below sets out. Just ahead of the 2007 economic peak, Taylor Wimpey saw share prices hit over £5, and yet within a couple of years they bottomed out at less than 60p, around former 10% of the value. Barratt saw a peak of £8.62 and a low of just 47p, or around 5% of the former value, while Persimmon saw a peak of £14.88 and a fall to just £2.15, or just under 15% of peak value. This compares with a fall in the FTSE 250 from over 10,000 to over 6,000. The house builders are incredibly volatile compared with companies of a similar size in other sectors.

Large house builder share prices over time

House builder	*Peak share price*	*Slump share price*	*Price in early 2020*
Barratt	£8.62	£0.47	£8.63
Taylor Wimpey	£5.18	£0.58	£1.97
Persimmon	£14.88	£2.15	£32.82

The result is that housing is very much a 'boom-bust' sector. Those who tend to pile in are not looking for long term steady returns (sometimes termed patient capital). They are looking for rapid returns, and many exit the sector in a downturn rather than hold on.

Related to this, dividends are very unstable. Below is the crude dividend rate per share for the three companies above in the 2009-11 period, then in 2019 during the upswing. There were several years with zero or minimal dividends, yet in the upswing, fairly large dividends are payable in a single year.

Dividends per share across some of the larger house builders

House builder	*2009-11 total dividends*	*2017-19 total dividends*
Taylor Wimpey	0	47.41p
Barratt	0	131.9p
Persimmon	7.5p	505p

The sector is, in most periods, fairly desirable. But in the downturn, profits will shrivel to zero (or below zero, forcing the large house builders to live off cash reserves).

Pre-tax profits in 2019 for selected house builders versus overall revenues

House builder	*Taylor Wimpey*	*Barratt*	*Persimmon*
Revenue	£4.341 billion	£4.763 billion	£3.649 billion
Pre-tax profit	£835.9 million	£901 million	£1.041 billion
%	19%	19%	28.5%

The problem is that this model makes the large house builders even more cautious in the upswing – they only want to build homes if their build to sell model can be run at high rates of profit per unit in order to generate the profits that they need to be attractive for investors, and to survive the downturns. It also makes the large house builders feel even more nervous and reduce output even faster when the downturn does come, since they will see their share prices collapsing and investors pulling out.

5. Financing, volatility and under-supply are inextricably linked

There is a real circularity at play:

1. The large house builders need to cut their homogenous output rapidly as and when necessary, and need high margins in an upswing.

2. The capital attracted to the sector wants high returns in a boom in order to justify the risk of investing and will exit in a downturn.

3. This exacerbates a focus on slow build out to sell at high margins in the boom and a lack of supply in the bust, making supply more volatile.

Given all these issues, it is easy to argue that the house building industry should operate on lower profits. This might be termed the Corbynite solution. Why should we tolerate such excessive margins in the upswing – surely we should just intervene to lower them?

But the industry cannot simply be told to operate on lower margins – as this would result in a sector that was even less viable and probably lower output yet further. Putting aside the huge moral and practical consequence of trying to work out what a reasonable rate of return would be, there is strong evidence that would fail, in the form of what has happened in the construction sector.

The construction sector is large – roughly £48 billion in 2018,[65] which was slightly larger than the house building sector at £43 billion.[66] Like house building, it also tends to be dominated by publicly listed companies. Commercial private development makes up over 60% of the sector's revenue.[67]

However, the construction sector has much lower returns than the large house builders. The result is the same extreme instability, but with occasional bankruptcy added into the mix. One study by the sector press found that margins for the top 10 construction firms from 2017-19 – a period of economic uncertainty following the Brexit vote, but also of generally positive growth across the economy – were negative.[68] In this period Carillion, one of the top three contractors by revenue, collapsed entirely; another of the largest firms, Kier, fell out of the FTSE 250; and others struggled to maintain any kind of profitability. The construction sector is certainly not guilty of excessive profit. And its experience suggests that lowering margins in the upswing for the housing sector while retaining the cyclical and unsustainable development model will create an even worse situation.

6. A more stable finance and delivery model is needed to boost supply and quality

As we have seen, the UK system of housing delivery is based around a volatile boom-bust model that is failing to deliver sufficient homes.

Changes to the planning system will not boost supply unless these are linked to new models of delivery. And these in turn require supporting new and less volatile models of financing.

By finding new ways to build and finance the homes that key workers need, we can help to improve the stability and diversity of the wider housing system, as well as its output. The demand for these homes is not cyclical – there is a stable group of people who need to have good quality homes and who are a constant market, if the right product can be developed for them. This will create a stable market and more steady supply.

A more stable model would also ensure that house builders can start to invest in modern methods of construction and increased skills, an agenda that the Government has been pushing for nearly two decades. The big question is what that new model might look like in practice, and what it would need to help those currently locked out of the market.

65 ONS, *Construction statistics, Great Britain: 2018.* Link
66 ONS, *Construction statistics, Great Britain: 2018.* Link
67 ONS, *Construction statistics, Great Britain: 2018.* Link
68 David Price, *Top 10 see first margin improvement in five years.* Link

Part 3: Moving beyond build to sell

As the Queen's Speech this spring made clear, the Government sees its planning reforms – and the creation of more homeowners – as a core political priority.

Yet as we set out in Part 2, simply increasing the number of permissions moderately, or even substantially, will not by itself mean a major increase in supply, particularly if the land goes to the large house builders.

The planning White Paper published by Government is currently being turned into a set of proposals, including a Planning Bill. The Government has committed to:

- A move toward 'zoning', i.e. local plans will set out in greater detail the type of development that is permissible when a local plan sets out sites for development.
- A shift away from a long checklist of policies that will be applied to each particular development to see if they work.
- Greater control over design for local people.

These are changes that should be strongly welcomed. The Government also appears to be moving toward a greater focus on delivery – which is also extremely welcome. This could – and must – fundamentally change how both local planning and housing delivery works.

'The planning White Paper published by Government is currently being turned into a set of proposals, including a Planning Bill'

But to meet our housing supply challenge, and support those key workers on lower and middle incomes, we must think more deeply about the type of housing we are building. One of the dangers of the current system is that we focus purely on the number of units being constructed. The result of that, as outlined above, is a large number of cookie-cutter homes which appeal only to a limited section of the market, with land captured by the large house builders and set aside for these homes, and other parts of the market neglected.

Britain has, for example, a longstanding issue in terms of an undersupply of specialist retirement housing. And councils and communities have long complained that are unable to do enough to help ensure that groups such as key workers can find affordable homes, which in turn has a knock-on impact on public services. Hence the Conservative Party's manifesto commitment to enabling councils to prioritise local key workers for discounted housing under the First Homes initiative.

One way to increase the quality and diversity of housing supply would be via a greater focus on SME house builders and an increase in the number of sites being brought into play, as set out in *The Housing Guarantee*. But there is also a need for new types of housing delivery, or the expansion of existing alternatives.

Expanding the land supplied to different tenures is critical to expanding supply

First things first. To increase housing delivery from 250,000 to 300,000 homes a year, the target set by the Government, there is a clear need to increase the diversity of supply. As the Letwin Review set out, one of the biggest issues is the fairly homogenous type of housing built to sell by the large house builders. There needs to be a greater focus on different products other than the new-build, build-to-sell market.

Land therefore needs to be allocated to a *range of builders who span a mix of different supply types and homes.* That means a new approach, with different tenures being used in each local plan – not just assuming that allocating more land to the handful of large house builders to provide more of the same product will be sufficient. It also means seeking new sources of finance to pay for the construction of these new homes.

‘To increase housing delivery from 250,000 to 300,000 homes a year, the target set by the Government, there is a clear need to increase the diversity of supply’

It is also critical that these new types of housing are less pro-cyclical than the existing build to sell approach – that they provide a constant source of housing demand that would allow greater building out in a downturn. This means looking at models which share the risk of house price falls (essentially, in downturns, people rightly hold off buying in case there is a fall in price – if you think you can buy the same house for 10% less in a year, you are likely to hold off).

Below, we discuss what some of these tenure models might look like. What is common to all of them is that they are not just a typical build-to-sell model, under which house builders sell only new homes at full market price (or via Help to Buy Equity Loan). It is important to note that most of this is about *expanding existing and successful models* which cannot currently obtain land given the domination of the land market by the build to sell model.

Some of the markets that could be fairly easily created or expanded are:

- Part-ownership tenures – particularly shared ownership
- Build to rent – including but not limited to discounted rent
- Self- and custom-build homes

Part ownership models – particularly shared ownership

One of the greatest opportunities to expand the housing market is part ownership models. The most common of these, and a perfect example, is shared ownership.

Shared ownership is a way for individuals and families to take an equity stake that builds over time and helps people into ownership. Instead of buying the entire property, you buy a stake in it (probably taking out a mortgage to do so). The owner-cum-tenant then pays rent on the remainder, usually based on a flat percentage of the capital share remaining, often with a link to inflation.

The name, in other words, comes about because someone is 'sharing' ownership of the home with the occupier. Usually this is a housing association, though there are an increasing number private sector providers who are bringing in new partners, so you could, for example, be sharing the property with a pension fund, which owns the rest of the property and receives rent on it.

The attraction of shared ownership is that, for many people, full ownership is not possible in a single bound – and unless the Government is prepared to see a massive crash in property prices (which would obviously have serious macroeconomic implications), will not be for a long time. Indeed, it is a measure of the scale of the housing affordability crisis that if we wanted to make it so that the average household with a full-time and part-time worker at the 75th income percentile owned a home together, then they would need to be able to buy a family home for just under £130,000.[69] That is clearly a long way from happening given an average house price of around £250,000. This is also why shared ownership can sit comfortably alongside the Government's First Homes scheme, as even the 30% discount offered under that policy would leave many people with good jobs and good prospects unable to afford a property – with key workers worse off than most.

The Government has currently set out that in all new shared ownership homes, the essential structural expenses are covered by the landlord (i.e. the non-resident). But the owner-occupier is responsible for minor repairs and maintenance, painting and decorating a home to make it feel like their own – in other words, they enjoy the same rights and responsibilities as a homeowner.

How does this work in practice? A typical example might be buying 50% of a £300,000 property in London. You need a mortgage on £150,000 and then to pay rent on the remaining £150,000, usually based on 2.75% of the capital value of the property, with any rental element going up based on RPI each year.

This will usually be more affordable than owning from Day 1 – but it also gives the shared owner the benefit of building up an equity stake over time as they pay down their mortgage, which obviously helps to reduce their costs over time. Usually, it enables the shared owner either to move into full ownership of that property or to purchase another home, transferring equity out when they move. It also allows the individual or household to move into ownership with a smaller deposit – for example, if they start by purchasing a 40% stake in a property, then to obtain a 90% LTV mortgage, they only need to have a 4% deposit, rather than the usual 10%.

Not only is shared ownership less expensive than buying a property with a low deposit, it is usually as cheap as or cheaper than renting a property. A recent survey of rental buy to let properties found that at the end of 2020 the average rental yield (the income generated compared to the value of the property) was 5.8%.[70] This means that if you were living in a property worth £300,000, you would pay a rent of around £17,400. Even on a more conservative 5% yield (achieved in new build style 'build to rent' homes as discussed below), your rent would be £15,000 a year.

Thus, as the table below sets out, shared ownership is cheaper for most people than either renting or buying for a £300,000 property – because the tenant escapes some of the financial obligations of ownership and many of the costs of renting.

69 HM Revenue and Customs, *Shares of total income (before and after tax) and Income Tax for percentile groups, 1999-00 to 2020-21.* Link. Assumes 1.5 workers at 75th per centile for household income.

70 Paragon, *Private Rented Sector (PRS) Trends – Q4 2020.* Link

Shared ownership versus full ownership

	Full ownership	*50% shared ownership*	*Rental property*
£300,000 property	£15,360	£11,808	£15,000

(Assumes 2% interest rate over 25 years on mortgage element and 2.75% on rented element vs a 5% yield, with no deposit.)

Giving people a stake via shared ownership is, understandably, very attractive to renters. Polling by ComRes found that 78% of private renters would choose shared ownership over renting if the cost each month was the same (which, in the current monetary environment, it is for the majority).[71]

Over time, some people in shared ownership 'staircase' up, where they take over a steady increase in the share of the property. So they might initially purchase 40% but five years later buy another 10%, and another five years later buy another 10%. But you could structure the scheme so that they earn a smaller proportion of the home with every monthly rental payment.

Shared ownership supply has grown in recent years, rising from 11,128 new shared ownership properties in 2014 to 17,998 in 2019/20.[72] This was as a direct result of Government policy from 2015 onward, which pushed for a more even split between shared ownership and other types of affordable housing, and which also deregulated the provision of shared ownership, bringing in new players such as SAGE, heylo, L&G and others. This has allowed new financing of housing via pension fund investment, allowing government grant to go further and deliver more homes.

However, shared ownership is still a relatively small proportion of the market, at around 157,000 households, or less than 1% of all households.[73] Demand is highest in the South and London, but the supply of people who would move into it rather than remain renting outright is certainly higher than the 18,000 or so homes built in 2019/20. In many ways the Government's Help to Buy Equity Loan operates in the same way that shared ownership does – splitting the cost and benefit of ownership, allowing more people onto the housing ladder.

It is also important to note that shared ownership currently requires grant funding, which supports the fact that it is more affordable. The most recent data showed that the grant for shared ownership was £32,000 per unit.[74] Some of this is because the shared ownership grant goes to housing associations, who use it to cross-subsidise other activities.

71 ComRes, *Shared Ownership Poll – Survey of Private Renters: September 2017.* Link

72 Ministry of Housing, Communities and Local Government, *Affordable housing supply statistics (AHS) 2019-20.* Link

73 House of Commons Research Briefing: *Shared ownership (England): The Fourth Tenure?* Link

74 Homes England, 2016 to 2021 *Shared Ownership and Affordable Homes Programme summary: end of September 2019.* Link

Part ownership models – other paths to ownership

Shared ownership is not the only type of part ownership model that could or should exist. There are various options, most based on one of the following three ideas:

- Deposit build-up schemes
- Equity build-up schemes
- Staircase schemes

The first of these, deposit build-up schemes, usually sees tenants being given a medium-term tenure (eg 3-5 years) with a discounted rent, with the savings from their rent going into a deposit saving scheme. Then when the tenant comes to the end of their lease, they can either renew for another term, or use their savings to purchase the property.

‘The equity build-up scheme would see the couple being charged £1,500 a month for the same property, again on a long-term four-year lease’

Thus, a couple might move into a property that normally cost £1,500 a month to rent. This would be discounted by 20% to £1,200, with the remaining £300 being put into a high yield saving account. After four years they would have saved £14,400 plus interest to put towards a deposit to buy their home.

The equity build-up scheme would see the couple being charged £1,500 a month for the same property, again on a long-term four-year lease. But part of this would go toward building up an equity stake in the property (eg £3,000 a year). At the end of this period, this equity could be bought out by the owner of the rest of the property, giving them a deposit worth 5% of its value – for example, if this was a property worth £300,000, the tenants would get £15,000 in cash to then use as a deposit.

In both of these cases, the scheme is a clear short-term stepping stone to moving out to full ownership. This is also a key difference with shared ownership, where the individual may stay for many years in the property.

The third type of scheme that has been delivered on a small scale by creative types within the sector is where you ‘staircase’ each year – starting with a very low share of ownership (eg 1%) and then use your savings to buy in 1% slices, paying a rental yield of 2.75% on the remainder of the property. This could either build up to a deposit, or at some point would move closer to what might be seen as a shared ownership product. In fact, it is essentially the shared ownership model described above, but with the proportion owned by the occupier starting at zero, and the increases in the stake more gradual than is generally the case.

These types of schemes are not the only ones that could be imagined, or even possible. The problem is that the market has never been allowed to develop in this area. A major issue, as discussed earlier, is that most land is controlled by the large house builders, which have both deeper pockets and better connections within the land market. On top of this, most affordable housing support, either in terms of land or government grant, is captured by the housing associations, which are not always as innovative as they could be (in fairness, this is partly because their regulator has discouraged innovation in the past).

Build to rent

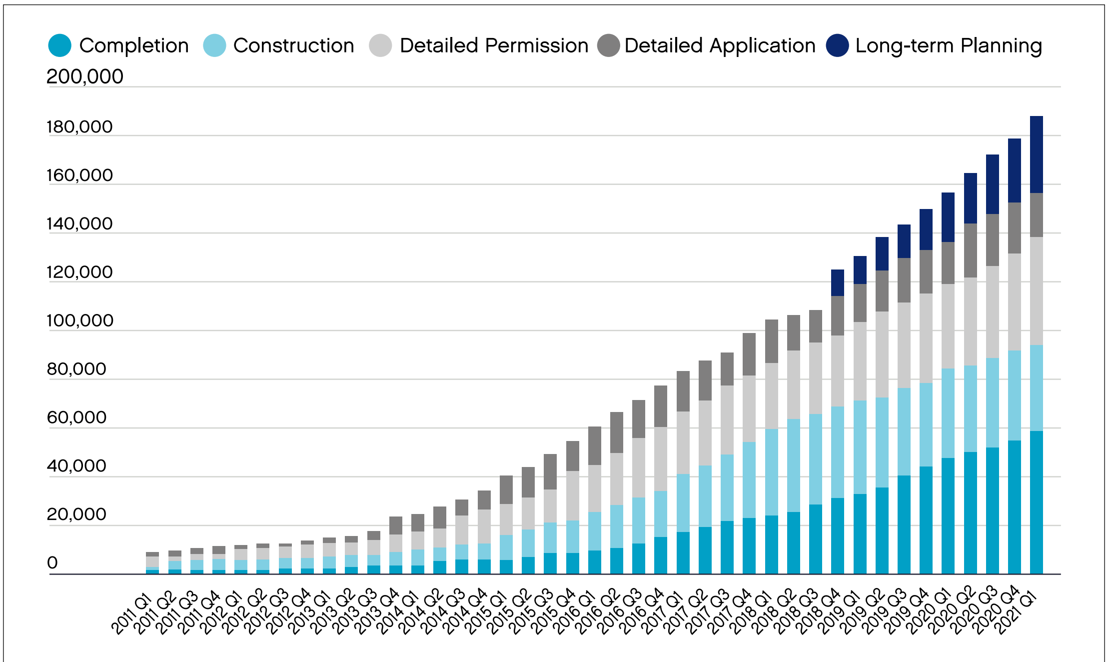
Another housing type which makes up a smaller share of the UK market than it potentially could – and than is the case in other countries – is what is termed 'build to rent'.

There will always be millions of people who want or need to rent, particularly in their younger years, and of course millions who want to own are currently locked out of the market. What renters need, especially young renters, is a good quality offer, with good landlords, and facilities onsite.

Some are unlikely to be attracted to part ownership products because they may not stay in the area, and are less likely to be in a couple, which makes buying more affordable. There are also many for whom the current market failure has gone on so long for that they are too old to be able to realistically buy – those who do not have family wealth and who do not earn enough to be able to move into ownership, even with the schemes set out above.

Against this background, build to rent has grown steadily, while remaining only a small part of the wider market. Between 2016 and 2021, cumulative build to rent completions are forecast to have quadrupled to 60,000. As the graph below shows, at present there are around 57,700 completed build-to-rent properties across the UK, with 36,000 under construction, with an additional 94,700 homes with planning permission.[75] The number of completed build-to-rent homes increased by 23% from 43,598 in Q4 2019 to 53,750 in Q4 2020. Additionally, 22% more projects were in the planning process and 5% more were under construction.[76]

Number of Build to Rent homes



75 Savills for the British Property Federation, *Build to Rent Q2 2021*. Link

76 Savills for the British Property Federation, *Build to Rent Q4 2020*. Link

Even with coronavirus, the build-to-rent sector has remained robust. More than £1.2 billion was invested in Build to Rent across the UK during Q1 2021, which represented the highest first quarter on record. Build to rent has mostly been denser developments in urban areas (London alone has almost half of all build to rent units built or in the pipeline). The general yield that was being achieved in the latter part of the 2010s was around 4% pre-Covid, while the yield in regional markets reached 5%.[77]

Data suggests that build to rent delivered 4% of all new homes in England and Wales in Q4 2020.[78] This suggests there is scope for this to continue and grow. In North America, the 'multifamily' sector delivered 250,000 new units across the key markets in 2017 alone; and in Germany and the Netherlands, fully 45% of institutionally held property is residential.[79] Instead, in the UK, the growth of renting in the past few decades has largely been delivered by 'buy to let' – which has seen owner-occupiers squeezed out of the existing housing stock.

There is not just scope to increase the size of the build to rent sector substantially, but to improve the experience of renters. As we saw in polling earlier, for almost all renters, increased stability and security is a key part of improving their lives. Those who want to rent longer term do not want to feel that they could be moved on at any point. So we would argue that unless tenants explicitly request shorter tenancies, the default offer around most built to rent should involve a minimum tenancy of, say, 30 months or three years. This would allow tenants to decorate a home when they move in knowing that they are not going to be asked to leave after less than a year has passed, and that as long as they pay their rent, they are able to have some measure of stability.

Build to rent could include a moderate discount

One further option is build to rent with a moderate discount. Currently, the definition of affordable housing requires at least a 20% discount compared to the market rate. While it is right that the discount should be substantial to count as affordable, developments are currently split between full-price and discounted properties. There is an argument that a smaller discount that covers more homes would do just as much good: for example, a build to rent development where all of the properties come at a 10% discount to the market, but also with longer tenancies as described above.

This would be particularly useful for some groups of key workers who are unlikely to be able to obtain affordable or social rent housing (because this is allocated via a needs-based system), while at the same time wanting good quality, stable, but affordable rents that allow them to either have a reasonable quality of life, or start to save for a deposit, or simply to be able to live within a reasonable commuting distance of their work. This could also be more attractive politically, since there is a risk that build to rent is seen as developers looking after the affluent with private gyms and pools, yet asking for lower planning levies.

77 Knight Frank, *Residential Investment Yield Guide.* Link

78 Kaylene Isherwood, *Build-to-rent sector sees strong growth across the UK.* Link

79 Ashurst, *Unlocking the potential of Build to Rent housing: the key to solving the UK's housing crisis?* Link

Self- and custom-build

Self- and custom-build are, as mentioned earlier, a much larger part of the market in most countries than in the UK. Because the people who use them are often different from those who might want a conventional new home, they contribute towards diversity of tenure and supply. And because the homes do not have the same profit requirements as those built by the industry, they are also cheaper for most people (while often allowing a home better suited to that individual or family's needs, because they have designed it themselves). Again, these would be perfect for key workers and others in similar situations.

Most people have difficulty obtaining what is termed a 'serviced plot', meaning a plot which has all utilities connected and road access. The cost of this is also around £10,000 to £30,000 per plot.[80] In some other countries, councils have taken a positive approach and will install such infrastructure on a large scale, passing the cost on to those who purchase a plot at the end of the process.

'Given the cost of a serviced plot in most of the country will range from £50,000 to £100,000, this would create a steady income stream for most investors'

Earmarking land for self- and custom-build would require someone to pay for any remediation on site, and then for the land to be parceled up and sold on. But there is scope for a single large investor to take an option on a large site, and then divide the site up into multiple plots, releasing these plots over time.

For example, on a large brownfield site of 3,000 homes, the council might agree with an investor that they can release 100 homes a year each and every year, with the site being built out over three decades, starting at the fringe where the homes are adjacent to other properties and then slowly working their way in. The investor could then put in the necessary roads and utilities and then sell on the plots to those who want to build their home, paying the original landowner each year.[81]

An alternative would be for councils to sign agreements with an investor that they could provide a minimum of X plots each year, and then ensure land with planning permission was released to the investor, who could then put in the utilities and roads and pass on the plots as serviced land. So a council would sign an agreement that they would provide land that could deliver 200 homes each and every year for the next 25 years if an investor would commit to then taking that land for 200 homes and getting it 'shovel ready'.

Given the cost of a serviced plot in most of the country will range from £50,000 to £100,000, this would create a steady income stream for most investors. The long-term nature of such an agreement would also help insulate against any short-term market fluctuations.

80 National Self and Custom Build Association *Briefing Note on How to Deliver Serviced Plots.* Link

81 This could work very well with the fact councils are in theory meant to find a self or custom build plot for all those with a local connection who sign up to a register for self or custom build homes, creating a ready market these serviced plots could be offered to.

Going beyond the cyclical house building model and creating a moral argument in planning

A key point here is that none of these types of housing require outright purchase by a single individual. This means that they are much less likely to be impacted by cyclical downturns. For example, in the case of London, while house building fell from over 21,000 in 2014/5 to just over 12,340 in 2019/20,[82] build to rent continued to go strong.

Shared ownership, too, continued to be built out even in the aftermath of the last recession. From 2006/7 to 2009/10 affordable home ownership (almost always shared ownership) actually rose from 18,429 to 22,244 homes, as house builders switched from outright build to sell into shared ownership. Only a political switch to support affordable rent led to a decline in shared ownership after 2011/2.[83]

Self- and custom-build are also likely to be more resilient (though less than the other types), because risk is shared and many custom builders are building with a long-term perspective.

If there are institutional investors involved, then build to rent or shared ownership (or similar schemes) can build through downturns, since the return is not just about an immediate price but about a long-term asset (which is likely to be less affected by temporary fluctuations in value). This allows a more constant and consistent housing supply, which in turn could also create a much better-quality housing sector – allowing investment in skills and capital which is currently lacking and a step change in productivity and quality.

On top of this, focusing on these new types of housing this should create a clearer moral case for new homes. The Conservative Party's manifesto acknowledged the desire among many communities to ensure that key workers are not driven out by rising house prices. As we saw earlier in the report, they also tend to be those who took the greatest risks and greatest strain during the pandemic – and those who are most disadvantaged by the unaffordability of housing at present.

The incomes of many of this group are fairly stable, but not high enough to allow them to move easily into ownership. And often they are not able to support saving for a deposit while paying high rents. Demonstrating a clear link between the new local plan for an area and the provision of homes for key workers would give local plans – which are often dry documents – a moral overtone. It would also make it harder to oppose new homes being proposed, because those benefitting would clearly be deserving.

The precedent of student housing

Fortunately, there is a case study which shows perfectly how supporting new housing and financing models, and ensuring that they have access to land, can drive up supply: student housing.

82 Ministry of Housing, Communities and Local Government, *Live Table 217.* Link

83 Ministry of Housing, Communities and Local Government, *Live Table 1000.* Link

The key reason for the growth of student living as an asset class in recent years is that student accommodation and land for student accommodation is not categorised as residential, but is instead 'sui generis'. This means that land designated for student accommodation cannot be taken over by the traditional housing industry. It created a separate route for land to come forward that then led to an increase in supply. This new route also enabled lower Section 106 payments for this land (though not always – the London Plan for example now requires that student accommodation makes a similar contribution to residential developments).

The supply response here has been incredibly impressive. In 2013, there were around 500,000 purpose-built units available for students. By 2019, this had increased to 660,000, an increase of just under 30,000 a year.[84] For the 2019/20 academic year alone, the total went up by 32,000. Of these, around 87% were being delivered by the private sector.

The development of student housing was made possible by land being earmarked for this specific use, but it was also a response to political pressures. Growing student numbers meant more students living together in what are termed Houses of Multiple Occupation (HMOs). These are often seen as scruffy and unloved, since most student households are fairly temporary.

'In 2013, there were around 500,000 purpose-built units available for students'

This dislike of students living in houses of multiple occupation led to two developments. First, in 2010, the rules were tightened to allow councils to designate areas where those wanting to create an HMO had to apply for planning permission, then tightened yet further in 2016 to require a planning permission for the creation of any HMO.

Second, this dislike of student flats in existing areas facilitated land being allocated for student accommodation. Councils were keen to see an expansion of student numbers locally (as their spending supported the local economy), but disliked the growth of HMOs. By creating purpose-built accommodation, they could have the benefits without the downsides.

The growth of student housing, in other words, came about as a result of both politics and policy. It is only the fact that land with student accommodation did not come within the residential use class that allowed it to take off. And it was only the fact that student housing in large purpose-built developments was preferred to allowing students to take over existing properties that meant councils were prepared to allocate more land to this use than they would otherwise.

Any push for new market types therefore needs to go along with a political push to ensure delivery and tenures that are attractive to people. And a focus on key workers can give a moral and political push towards councils having to do the right thing, in the same way that the politics of student housing pushed land toward this specific use.

What is needed is a combination of new land with support for new finance, in a way that is politically palatable both locally and nationally. Which is where we turn to our proposal for 'Homes for Heroes'.

84 Cushman and Wakefield, UK Student Accommodation Report 2019 – 2020. Link

Part 4: Homes for Heroes

There is an urgent need to increase housing supply, through building a more diverse range of housing. There is also a morally urgent need to help those who put themselves at risk in helping to deal with the pandemic. These two issues can have one simple solution: creating 'Homes for Heroes'. Just as we increased housing supply after the First World War, for returning soldiers, so Homes for Heroes will allow us to help key workers who have played a critical role in responding to the Covid crisis. They can also help increase the supply of new homes overall – the Government's key objective from its housing and planning reforms.

'There is also a morally urgent need to help those who put themselves at risk in helping to deal with the pandemic'

Fortunately, it is also possible to do this at no cost to Government – using money it has already committed to affordable housing guarantees, but which remains unused.

We therefore propose two key policy changes to make Homes for Heroes a reality:

1. To help give confidence to investors in these new homes, and to encourage the necessary diversification of housing supply, we propose that **at the Spending Review, the Government should unlock existing unused guarantees for Homes for Heroes.** This will help boost supply and show how far this model can increase the numbers of homes.

2. To help ensure that land is not just captured by the large house builders, we propose that **as part of its upcoming planning reforms, the Government should require councils to set aside land for 'Homes for Heroes' to deliver 50,000 homes a year or 250,000 homes over five.** This will show how different tenure mixes can increase housing supply.

What should Homes for Heroes look like?

In terms of what the precise 'Homes for Heroes' product should look like, we do not want to be overly prescriptive. One reason that previous schemes to attract institutional funding into the housing sector have not been as successful as possible is that they tend to work only for two of the triad of government, investors and would-be customers – or sometimes, only for one of those. This is often because they have been extremely tightly drawn, with little scope to adapt to the market or to the desires of real-life owners and renters. This has also been true of some affordable housing products controlled by the housing association sector.

However, given the Government's admirable desire to increase home ownership, and the fact that it remains the ultimate ambition of the overwhelming majority, we propose that any attempt to create new housing tenures across the country should be built around shared ownership and other pathway to ownership products. However, there should be space within the product and category for rental products too rather than exclusive ownership.

'Homes for Heroes should also count as 'affordable housing', which removes the regulatory barrier that increases uncertainty and makes it harder to build new and innovative schemes'

We propose therefore that 'Homes for Heroes' should be not a single product, but a category – a widely accepted 'wrapper' around developments that deliver according to a certain set of criteria, in particular the delivery of low-cost pathways to ownership for key workers.

In other words, like student housing, we want key worker housing and Homes for Heroes to develop into a robust segment within the market, rather than a standalone scheme associated with particular politicians or even Governments – for it to become a cross-party and accepted part of the housing market.

Homes for Heroes should also count as 'affordable housing', which removes the regulatory barrier that increases uncertainty and makes it harder to build new and innovative schemes. This would also allow land to be earmarked to support these new Homes for Heroes (we discuss how this could be boosted further on). Thus any scheme which was put forward within this wrapper would be affordable housing. This would make it more attractive to institutional investors, who would be more easily able to engage with councils and local communities on this basis.

To meet the Homes for Heroes criteria, we think that such schemes should have to abide by the following rules:

- A significant proportion of the homes (at least 75%) should be offered under shared ownership or other 'pathway to ownership' products. However, 'pathway to ownership' products should include build to rent with a discount of at least 15%, where this saving can be put aside in order to help build a deposit to buy the property.

- The remaining homes would be 'build to rent' with longer tenancies available for those who live there to give them the security and stability they desire. These would be capped at CPI+1% in order to give a fair return to investors while avoiding rents escalating too fast for those who move into them.

- These would be offered to key workers while they were being constructed, with a salary cap of £80,000 outside London and £90,000 inside London, and for a period of, say, three months upon completion, after which they would be opened up to any worker with a household income below the set threshold.

- When the key worker moved out, the property would have to be leased or sold to another key worker, so that this type of tenure was retained. This both ensures that key workers continue to benefit and avoids complex developments where maintenance is partly private and partly the responsibility of the institutional investor.

- We would be agnostic about whether these developments were new-build or created by converting existing non-residential buildings, for example office space. This could be particularly attractive given that there is likely to be an oversupply of commercial property in urban centres in particular post-Covid 19. But new Homes for Heroes should not be delivered by switching use class from typical homes – this would have to be about increasing new supply.

Obviously, key workers should be a major target for this approach. However, as discussed in Part 1, different definitions of key worker exist – with the USA's version being more open-ended than the UK version. We propose that the Government should consult on who is included within the 'key worker' programme, as the existing definition may well be too tight – though we would see this as about adding additional groups, particularly private sector workers, rather than reducing the numbers eligible. For example, many in the construction sector had to keep building and working during the pandemic – they could not 'work from home' as others were able to. It seems strange to say that those who were building the homes we need do not count as key workers.

> **'We propose that the Government should consult on who is included within the 'key worker' programme, as the existing definition may well be too tight – though we would see this as about adding additional groups, particularly private sector workers, rather than reducing the numbers eligible'**

In addition, keeping the definition of key workers broader could help ensure that this product does not suffer from some of the issues around other similar housing categories. Sometimes, because a home has to be put on the market with restrictions and rules, it can be difficult to sell on, which makes the purchaser frustrated and can undermine the popularity of a scheme which is meant to help people rather than make things more difficult. However, since the Government's definition of key workers already covers around 33% of workers, this should not be a major a problem for the Homes for Heroes product.[85]

To make sure this scheme is not used by those who have a high enough salary to buy in the open market, we would - as mentioned above - apply the shared ownership salary threshold of £80,000 in most of the country, or £90,000 in London, though this could be lower if the Government chooses.[86] An alternative option would be to put in place local thresholds based on a link to average income in each area.

Using unallocated guarantees to help unlock delivery

A crucial and cost-effective way to boost Homes for Heroes would be for the Government to provide guarantees for new housing types directed to key workers. Such guarantees can be a real help in boosting the development of new homes.

85 Department of Education, *Children of critical workers and vulnerable children who can access schools or educational settings.* Link

86 See shared ownership current eligibility rules available at Link

A prime example of this is the build to rent sector, which as we saw has grown from nothing to over 50,000 homes built and several hundred thousand more in the pipeline. One of the key drivers of this has been the creation of the £3.5 billion private rented sector housing guarantee scheme. This has helped directly, but even more crucially, it also helped to encourage investment in the sector.

Despite being created back in 2012, this facility has still not been drawn down in full. (And as outlined below, is at very little risk of losing the Government money.) Its primary impact has been to lower the cost of capital. And by encouraging capital into this sector, it helps the sector grow to the point where the main constraint, as market participants admit, has become lack of land rather than lack of investment.

The political support given to the build to rent model through the creation of the guarantees was – and is – valuable, signaling that the Government supported the creation of this type of tenure. This support helped encourage investment into the sector – since despite various new housing ministers, secretaries of state, and Prime Ministers, there has been a constant commitment to supporting the build to rent sector.

‘For every £100,000 of capital the rent would be £3,000 or £2,750’

Such a commitment to Homes for Heroes would also be fairly cheap for Government, achieved via guarantees rather than outright spending. In fact, it could even be cost-free. The 2017 Budget committed to delivering ‘up to £8 billion’ in guarantees to help boost housing supply[87] – but so far, we have only seen £3 billion in affordable housing guarantees.[88]

We propose that such a guarantee would not apply to risks taken during the build stage. Instead, as happens with Network Rail, it would apply to the returns being offered to investors in order to ensure bond issuance. (A detailed single-home example of rents and guaranteed issuance payments can be found in the Appendix.)

As we show below, and in more detail in the Appendix, the likelihood of any default would be very small, because levels of non-payment would have to reach 20 or 25 times the levels usually observed.

Let us say the value of the rent payable each year would be based on a 3.5% return, or 2.75%, depending on if it was fully rented or shared ownership. For every £100,000 of capital then the rent would be £3,000 or £2,750. (Assuming no management costs for the sake of simplicity.)

Given that the rate of interest likely on government guaranteed bonds will be 2%, this means that each £100,000 would generate a guaranteed return of £2,000. This creates a huge buffer between the guaranteed payments and the actual returns, which means that there would have to be a huge upswing in defaults for the system to require any government payment.

87 HM Treasury, *Autumn Budget 2017: Building the homes the country needs.* Link

88 Ministry of Housing, Communities and Local Government, *Affordable Homes Guarantee Scheme 2020.* Link

To show how ironclad this is, consider the fact that with a rented property, **even if the investor saw 1 in 3 properties not paying rent, they would not need to draw on the government guarantee.** A simplified example is set out below with three £200,000 properties, collectively worth £600,000. In this example, the total rent at 3.5% would be £21,000. But the total guaranteed would be £12,000. Even if one of the three tenants didn't pay – cutting the rent paid to £14,000 – the guarantee would still not be triggered.

Total invested	Total rent	Total guaranteed	Default of 1/3
£600,000	£21,000	First £12,000	£14,000 collected £12,000 paid £2,000 return above this Guarantee not triggered

The figure is slightly lower for shared ownership, but it still works out at a default rate of more than **one in four** being required to trigger any payment. To give some idea of how unlikely this is, consider that at the peak of the Covid-19 crisis, residential rent payment rates in the UK were running at over 96%.[89] This contrasted with rates for one large investor, British Land, of 78% for commercial property and 64% for retail.[90] Most people really do prioritise paying the rent and other housing costs above over almost all else other than food or extreme necessities (understandably, since they can lose their home).

Obviously, Government would have to issue guarantees only at a reasonable rate of return. Making the guarantees index-linked would greatly assist the market, given the underlying indexation of rents, but this is something that we believe will be fairly easy to do (it is discussed more in the next chapter).

Furthermore, because this would only be a contingent liability, it would not count against the deficit in the way that normal debt does, and it would – and should – be able to be phased out over time once the Homes for Heroes product and market were established.

This would mean an affordable path to ownership for buyers at no cost to Government

If the Government put a guarantee in place, it would create an affordable path to ownership for buyers at no cost to the state. As set out in the Appendix to this report, the Homes for Heroes model, which assumes a cost for the household at 3.5% (the return necessary to get the Homes for Heroes model off the ground if there is a government guarantee), would be cheaper than a new mortgage, private rent, or affordable rent model, making plausible assumptions around the rate of return required under different approaches.

89 JLL study shows multifamily rent collection and occupancy rates remain resilient on both sides of the Atlantic, JLL, July 2020. Link

90 *British Land, Half Year Results*, November 2020. Link

This would mean that there would be an affordable path to ownership deliverable at no cost to Government – without any additional spending by the Treasury, since the finance would be provided privately. It would also mean a major new source of supply alongside the build to sell model of the larger house builders.

Getting the large house builders interested in this model right now is a clear opportunity

The Government therefore does not have to wait for its planning reforms to come into effect to deliver a major increase in housing – indeed if it did, then it might well end up having to wait until the middle of this decade or more before changes take place, given the need to put in place new local plans following the legislation. Yes, planning reform is useful and necessary – but we need action now for the key workers who did so much in the pandemic.

By supporting Homes for Heroes, the Government can send a signal now that it wants to diversify the housing supply in this country. It can do this while helping those who had to risk their health to keep society moving during the pandemic.

By amending the definition of affordable housing, opening up the guarantee programme for Homes for Heroes, and starting to consult on planning changes below, the Government will encourage the large house builders to start to engage on these products. Indeed, while part of our ambition is to bring new sources of finance into the housing market – in particular from institutional investors – developing Homes for Heroes and key worker housing as a category would create a different route to market for the large house builders that they could use both now and, crucially, in a downturn. It would also begin to create something that might be able to replace the Help to Buy Equity Loan programme, which in theory is meant to be ending in 2023.

This would mean that by the next election, there would be new developments going up and new homes being sold under the Homes for Heroes programme. This would also help ensure that if the sector does face difficulties as the after-effects of Covid-19 work their way through the system, the country can keep building.

The house builders are very aware they need to take new forms of housing delivery seriously, and move beyond the build to sell model. And institutional investment around Homes for Heroes can help them and other firms in the sector deliver homes at a faster pace, and in a better way, than just relying on their existing models. Ideally, the guarantees described above would encourage institutional investors and the house builders to work together to increase housing delivery beyond the 'build to sell' model – while acting as a proof of concept for this new style of development.

Unlocking land via the planning process

Once the Government has accepted the need for our Homes for Heroes and created a 'wrapper' for the product setting out what it consists of, we need to translate that vision into delivery on the ground. This means councils will have to ensure that sufficient land is made available to those prepared to build Homes for Heroes.

The simplest way to do this is by creating a formal use class that sets land aside for the purpose of Homes for Heroes. Just as with student accommodation, which has seen a massive increase in the size of the purpose-built accommodation, taking out land from the general residential market creates an opportunity to ensure that homes are actually delivered through different routes.

Creating a new use class for Homes for Heroes would also make clear that planning gain policies for key worker housing should be different. This would mean that Section 106 policies or infrastructure levies would – and should – be able to differ from the mass market, particularly since Homes for Heroes should be counted as affordable housing.

Once these homes were built, then the use class would remain in place for at least 25 years. In the longer run, this would make sure these homes could then enter the wider market at some stage (for example, if the original shared owner purchaser wanted to move house, they would find it easier to sell if the property was just a typical home in terms of use class). But the institutional investor would have the stability and security of knowing that the product was in place for a long period, and the council earmarking land for key workers would know that this would be of ongoing benefit to their local community.

Alternatively, councils could place a planning restriction when they allocate land in local plans or when planning permission is granted, so that land can only be brought forward for Homes for Heroes. This would only allow permission for homes that met the Homes for Heroes definition. Currently, government guidance refers to covenants being placed on build to rent and this could be a useful option to explore.[91] A watered-down version of this would be to insist that a proportion of plots on major developments should be devoted to Homes for Heroes, as currently happens with affordable housing more broadly, but this is not an ideal solution as it simply displaces other affordable housing with homes for key workers.

‘Currently, government guidance refers to covenants being placed on build to rent and this could be a useful option to explore’

What would emphatically not be useful or effective would be for the Government to insert yet another phrase buried in guidance around ‘supporting’ or ‘backing’ Homes for Heroes in particular, or key worker housing in general.

If you examine the National Planning Policy Framework, you will find that there are requirements for many types of housing, which are rarely delivered. Paragraph 61 sets out that *‘the size, type and tenure of housing needed for different groups in the community should be assessed and reflected in planning policies (including, but not limited to, those who require affordable housing, families with children, older people, students, people with disabilities, service families, travellers, people who rent their homes and people wishing to commission or build their own homes)’*.[92]

In practice, the levels of land being pushed toward these other uses are limited to say the least – which is a major reason why, unlike student housing or build to rent, they have not really taken off.

91 Ministry of Housing, Communities, & Local Government, Guidance on Build to Rent. Link

92 Ministry of Housing, Communities & Local Government, National Planning Policy Framework. Link

As shown earlier in this report, the state of the land market means that attempts to support pushes toward specific types of housing have often failed, because landowners realise higher values (and often councils realise higher Section 106 payments) if they just put land into the market for residential homes. Other than build to rent, councils are therefore reluctant to put restrictions on land going into the market if it is under the general residential use class.

Ensuring land for at least 250,000 Homes for Heroes

Whether using use classes or planning restrictions, there has to be a way to ensure sufficient land is given over to Homes for Heroes over time. One way to do this is to copy the system currently used for affordable housing, and set local targets for Homes for Heroes, potentially based on the number of homes being built in each local authority. However, this would need teeth.

Rather than allocating a slice of each residential development, as discussed above, councils should as part of their local plans set aside a proportion of land for Homes for Heroes – i.e. affordable homes for key workers that meet the criteria above. This would enable key workers potentially interested in Homes for Heroes to register easily, which would help create a ready market and encourage investors.

We propose that given a national target of 300,000 homes, around 50,000 homes a year should be classed as Homes for Heroes, with councils tasked with baking this into their local plans. This would create a new route for land to come to market outside of the build to sell products usually created. Assuming that 50,000 homes a year were created, and given a requirement for a five-year land supply in local plans, this would give a total of 250,000 Homes for Heroes by the time new local plans are put in place.

Only if, during the local plan preparation process, sufficiently few key workers came forward to meet demand for these products should the local plan be able to reduce the number of Homes for Heroes proposed.

This would ensure that where demand existed, land would go toward these products, which as we set out earlier in the report are fundamentally necessary if we are to meet housing need.

Opening up new markets for these homes would create a stream of new homes backed by pension funding and not completely reliant on the fluctuation of market housing for sale. If we want each area to be building a mix of homes in order to add new strands of housing to the supply mix, then councils have to take a lead in managing this. In fact, we would argue that other products (eg retirement homes) could and should be treated the same way.

A clear planning gain policy on Homes for Heroes

A complement to the Homes for Heroes use class, or any guidance on setting planning restrictions, should be national guidance around planning gain for Homes for Heroes, which made it clear that this use should not be treated as normal housing.

The best way to do this would probably be to set it as a percentage, or as a flat level for each home, in national guidance. So, for example, if the first £20,000 or 10% of the value of each home was automatically counted as Section 106 (or, once the system is reformed, toward the new Infrastructure Levy), it would help encourage land to flow into this new market.

Say you were a landowner, and you had scope to build 50 homes. If you built these homes for the Homes for Heroes programme, you would be counted as automatically contributing £1,000,000 towards Section 106 or the new Infrastructure Levy. If you were to build these homes for market sale, this would not be the case. This would, all other things being equal, make it easier to build Homes for Heroes and would encourage land to come forward for Homes for Heroes.

‘If you built these homes for the Homes for Heroes programme, you would be counted as automatically contributing £1,000,000 towards Section 106 or the new Infrastructure Levy’

In addition, the council should not be able to demand additional payments for affordable housing, since the whole point is that Homes for Heroes are affordable housing. The only Section 106 or Infrastructure Levy payment required would be for infrastructure to support the new Homes for Heroes. This should have the side effect of making such housing more attractive to local communities – not only is it affordable housing, but the payments will explicitly support the necessary infrastructure.

The Government could also consider whether or not to apply the First Homes designation to these sites, since both First Homes and Homes for Heroes are designed to increase the supply of affordable homes. We would suggest that any First Homes on these sites should be offered first to key workers, just as with other homes in the overall scheme.

Part 5: Unlocking private financing

There is no point in the Government allowing Homes for Heroes access to its unused housing guarantees if it does not encourage new finance into the system. Fortunately, the evidence is that it should unlock substantial private financing for such housing.

There is already an encouraging precedent for investors. The yields in areas such as student accommodation or commercial property have been more than sufficient to attract new financing. These, crucially, are areas where the large house builders do not dominate the land supply, or where central or local government may be keen to encourage different types of housing supply.

‘The ONS estimates that in the past 30 years, the value of commercial property has grown at 3.8% a year – not that much higher than the rate of inflation over the same period’

In 2018 and 2019, when there was substantial investment in new student accommodation, yields usually varied from 4% to 6% depending on the exact submarket that was being supplied (eg Prime London versus Secondary Regional markets).[93] This is a far cry from the 20% return sought by the large house builders. But it worked because the rents expected from student accommodation were stable and predictable.

Similarly, commercial property – until the Covid-19 crisis – was seen a solid and attractive proposition by institutional investors. The ONS estimates that in the past 30 years, the value of commercial property has grown at 3.8% a year – not that much higher than the rate of inflation over the same period.[94] But the solidity of the returns on offer were attractive enough to secure investment: in 2018/9, the commercial property held by members of the Investment Association (consisting of large pension funds and other asset managers) stood at £205 billion.[95] Indeed, as one – pre-pandemic – study noted, the attraction of commercial property was that ‘in comparison with income from equities, property rent is generally much more predictable and certain. While conventional bonds (except those that are index-linked) also provide an insured return, they do not offer the prospect of income growth.’[96]

It is these relatively stable and predictable returns which are essential for many investors, particularly pension funds. The less stable and predictable the returns, the

93 Unite Group, *Market Review.* Link

94 Investment Property Forum, *The Size and Structure of the UK Property Market: End-2018 Update.* Link

95 The Investment Association, *Investment Management in the UK 2018 – 2019: The Investment Association Annual Survey.* Link

96 Investment Property Forum, *Understanding UK Commercial Property Investments: A Guide for Financial Advisers.* Link

higher they have to be for new financing to want to enter a market. This is part of the reason that a guarantee would be so effective.

There has of course been some interest in the residential market, as well as student or commercial property, not least in terms of the 'build to rent' sector. As we saw, this is currently delivering around 4% of total housing supply. We also saw how even in the downturn, the supply of build to rent remained strong because it is based on fairly long-term rental streams and calculations based on many decades of returns. Shared ownership also remained strong because it split risk between investor and shared owner.

A key problem that build to rent or shared ownership has faced is that it is competing in the land market with pure residential housing, which makes it harder for it to obtain land given the power of the large house builders. This is why we propose changing the planning system to try to create different flows of land to a mix of tenures, including the Homes for Heroes model.

Yet it is clear that even with just a guarantee, rather than planning changes, there would be sufficient interest to boost Homes for Heroes.

After all, in other markets, which do not have a few dominant firms, build to rent or other models (eg self- and custom-build) are much more significant. Currently, just 1% of residential real estate in the UK is owned by institutional investors, compared to between 10-15% in continental Europe.

In places such as Germany and the Netherlands, 45% of institutionally held property is residential.[97] In the US, investors have become more active in financing affordable housing over the past few years, with at least five to six new entrants who started investing in social housing debt. Overall, residential real estate investment now accounts for 6.2% of total international investment in real estate, much higher than within the UK.[98]

New models of investing in homes are an attractive option for the investment industry

The UK investment industry manages a staggering £8.5 trillion. Its members are often seeking long-term projects able to deliver a real rate of return, but which also offer stable – or relatively stable – returns.[99] By partnering with new and existing players, a new model is possible whereby homes are built by existing large firms or SMEs on commission, then purchased by institutional investors with a mix of homes for sale – including land for shared ownership, self- and custom-build, other part ownership models, and build to rent.

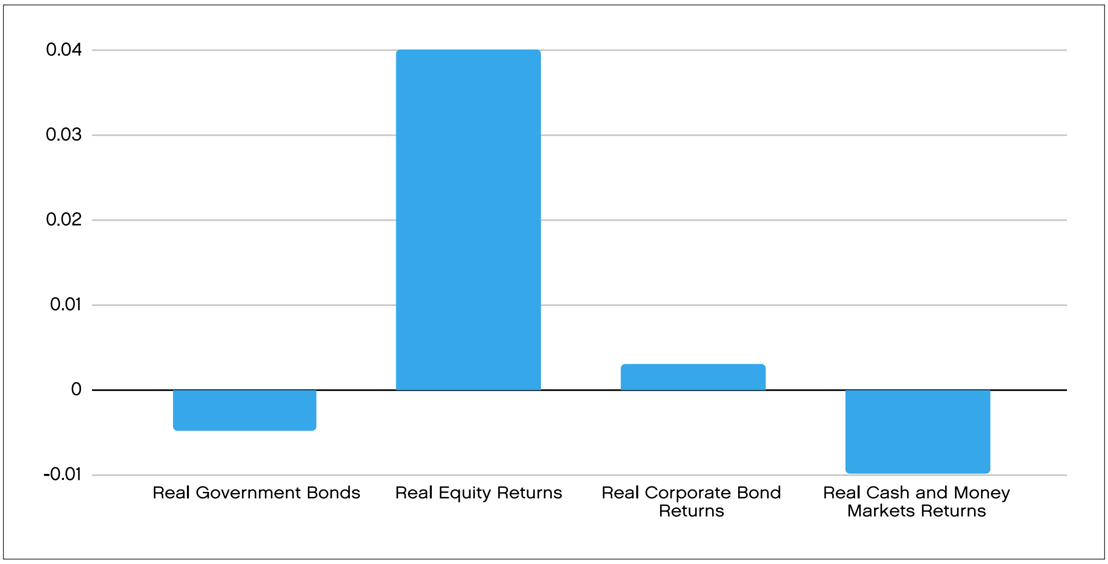
With interest rates and traditional UK gilt yields at an all-time low, a new alternative finance model would use these trillions in long-term private capital to help develop new homes. There is certainly good reason to be optimistic about the prospects of such investments. The total value of the UK property stock was estimated by the Office for National Statistics (ONS) at £8.7tn by end of 2018. Residential values are estimated to have risen at 9.3% pa from 1995 to 2018 – much higher than commercial or other property types.[100]

97 Ashurst, *Unlocking the potential of Build to Rent housing: the key to solving the UK's housing crisis?* Link
98 IPF Research Programme, *Residential Investment in International Markets.* Link
99 The Investment Association, *Who we are.* Link
100 Investment Property Forum, *The Size and Structure of the UK Property Market: End-2018 Update.* Link

Residential real estate also compares favourably with other medium-term projected annual returns over the coming years. Even if rents simply rose by 1-2% in real terms, they look good compared to similar stable assets such as bonds, cash or money markets. Only equities are likely to increase more rapidly (see graph below, which uses FCA data).[101] However, they tend to be very volatile and so can only make up part of most investment portfolios.

Of course, part of the reason that we want to increase investment in residential housing is to try to moderate the rise in real terms house prices. But to get down to the kind of returns offered by gilts etc would assume a massive slowdown in house prices. From 1971 to 2009, residential real estate generated an average annual return of 13.4%, beating commercial property (10.8%), equities (12.6%) and gilts (10.1%).[102] Currently, gilts are being issued with a coupon (ie return) of under 1% for most time periods and between 1% and 1.5% over a 30-year period.[103] Even if rents and house prices just increase at say 1% a year in real terms on average over the next 30 years, they would still turn out better than the other investments many pension funds and others are being forced into – and Homes for Heroes, with its modest but predictable returns, would represent an extremely attractive investment.

Medium term (10-15 years) projected annual returns



On top of this, any residential rental elements provide a better long-run hedge against inflation than other forms of real estate or stocks.[104] If inflation goes up, it is very likely that rents will too, which means that investing in housing in areas like Homes for Heroes acts as a hedge against rising inflation in a way that other investment strategies may not.

101 The graph below showing the medium term estimated return for different asset classes come from page 11 of the Financial Conduct Authority, *Rates of return for FCA prescribed projections.* Link

102 Hermes Investments, *UK residential property: Accessing the opportunity.* Link.

103 Debt Management Office, *Outright Gilt Issuance Calendar.* Link

104 Hermes Investments, *UK residential property: Accessing the opportunity.* Link

A final reason why investors are likely to be interested in this area is that Covid-19 has made alternative long-term assets even less desirable. While the stock market is broadly where it was before Covid-19 hit, equities are fairly volatile. The other main investments that pension funds often rely on, commercial property and gilts, have become even less attractive.

> **'Even if people only move to working from home for a couple of days a week, many firms are likely to downsize their office space'**

Commercial property is reeling from the shift to a more online retail experience, with online sales between the first and second lockdowns (when most restrictions were lifted) running at around 30% of the overall retail market – up from 20% at the start of 2020.[105] The traditionally less risky office market has been hit by the uncertainty around working from home. Even if people only move to working from home for a couple of days a week, many firms are likely to downsize their office space. This will make investing in new office space uncertain and unattractive – particularly because the shift to working from home and more remote working is likely to create uncertainty for some time to come.

Homes for Heroes could help create a new – and better – market

Given the history of strong returns and the weak current alternatives, supporting new supply of UK residential property is a hugely attractive opportunity for long-term investors, particularly when compared to other alternatives. But what we need to ensure is that this goes towards new housing supply rather than inflating the price of existing homes. This means Government needs to help find ways to channel investment – the hundreds of billions available – towards new homes, helping to tackle the housing crisis in the process.

This all should help create a stable flow of homes – with long-term patient capital being used to deliver a constant flow of new homes, helping to remedy the cyclicality of the current market. Even in a downturn, pension funds are likely to want new homes to be coming on stream – meaning new tenures being created.

This also ties in with the rise of ESG (Environmental, Social and Governance) investing, as it would be about providing quality, long-term homes, and helping key workers to get on to the path to ownership. It creates an opportunity for pension funds to optimise the social and environmental impacts of their investments, while generating a real rate of return.

Even without the pathway to ownership, Homes for Heroes would give people longer tenancies that enable individuals to integrate into the community, knowing that this is their permanent home, and not just a building in which to temporally reside. Meanwhile, investors would benefit from a stable long-term investment. The needs of those who can provide Homes for Heroes and the needs of those who would live in them are perfectly aligned. It is for government to step up to the plate and make the changes necessary for Homes for Heroes to take off.

105 ONS, Internet Sales Index: Table ISCPNSA2. Link

Conclusion

The problems with Britain's housing market are of long standing, and will not be solved overnight, or by any one policy.

But there is a quadruple win available here.

For the Government, Homes for Heroes is a cost-free programme that helps boost housing supply and affordable housing and delivers pathways to ownership to those who put themselves in the front line during the Covid crisis.

For investors, it creates an asset with an attractive, stable, long-term return while helping them show their commitment to a better and fairer society.

'Homes for Heroes can serve as a way to thank our key workers, while being part of a wider journey towards a better housing market for all'

For house builders, there is the ability to sell at, or close to, the value of homes provided for speculative purchase, thus reducing their risk.

And finally, and crucially, for the key workers who have worked so hard in the pandemic, it offers more secure and stable housing, with a pathway to ownership.

In the end, the housing market – like other markets – is about incentives. The policy changes outlined above are intended to incentivise the financing of new-build residential property over other asset classes, and Homes for Heroes as a key new offering. They are intended to incentivise councils to approve the construction of Homes for Heroes, not least because it will be politically advantageous for them to do so. And they are intended to reward key workers, and enable them to remain part of their communities.

Homes for Heroes can serve as a way to thank our key workers, while being part of a wider journey towards a better housing market for all.

Appendix

The tables below shows how Homes for Heroes could deliver a more affordable home ownership option based on the same new build property (assuming the Homes for Heroes were shared ownership).

Homes For Heroes

3.50% Rent with option to progress to shared ownership at 2.75%
Funded by Gov guaranteed long term bonds at 3.5% return

Home owner perspective

Monthly Costs						
Family Home Value	**HTB Equity Loan**	**New HTB G'Tee (95% LTV)**	**First Homes (95% LTV)**	**Private Rents**	**Affordable Rent**	**Homes for Heroes**
£150,000	£480	£760	£532	£750	£600	£438
£250,000	£800	£1,267	£887	£1,250	£1,000	£729
£350,000	£1,120	£1,774	£1,242	£1,750	£1,400	£1,021
Income Requirements						
Family Home Value	**HTB Equity Loan**	**New HTB G'Tee (95% LTV)**	**First Homes (95% LTV)**	**Private Rents**	**Affordable Rent**	**Homes for Heroes**
£150,000	£27,502	£34,835	£24,385	£28,125	£22,500	£16,406
£250,000	£45,836	£58,059	£40,641	£46,875	£37,500	£27,344
£350,000	£64,170	£81,282	£56,898	£65,625	£52,500	£38,281
Deposit Requirements						
Family Home Value	**HTB Equity Loan**	**New HTB G'Tee (95% LTV)**	**First Homes (95% LTV)**	**Private Rents**	**Affordable Rent**	**Homes for Heroes**
£150,000	£7,500	£7,500	£5,250	£750	£0	£438
£250,000	£12,500	£12,500	£8,750	£1,250	£0	£729
£350,000	£17,500	£17,500	£12,250	£1,750	£0	£1,021

Assumptions	*Old HTB Equity Loan*	*New HTB G'Tee (95% LTV)*	*First Homes (95% LTV)*	*Private Rents*	*Affordable Rent (80% of PRS)*	*Homes for Heroes*
25Y Mortgage Interest Rates	*2.00%*	*4.00%*	*4.00%*			
Stress Test Rate (for Income)	*6.00%*	*6.00%*	*6.00%*			
Income Multiplier	*4.50*	*4.50*	*4.50*			
Affordability (% Gross Income)	*32%*	*32%*	*32%*	*32%*	*32%*	*32%*
Rental Yields				*6.00%*	*4.80%*	*3.50%*
Deposit Requirements	*5%*	*5%*	*5%*	*1 month*	*nil*	*1 month*

Home Builder Perspective	HTB Equity Loan 100%	New HTB G'Tee (95% LTV)	First Homes (95% LTV)	Private Rents	Affordable Rent	Homes for Heroes
Receipt as % Private Sale	100%	100%	70%	90-95%	65-75%	100%

Investor Perspective	HTB Equity Loan	New HTB G'Tee (95% LTV)	First Homes (95% LTV)	Private Rents	Affordable Rent	Homes for Heroes
Gross Unlevered IRRs	c.2%	c.4%	c.4%	c.7%	c.6%	c.4%
Volatility Vs HTB Equity Loan		Same	Same	Higher	Lower	Lower

Government Perspective	HTB Equity Loan	New HTB G'Tee (95% LTV)	First Homes (95% LTV)	Private Rents	Affordable Rent	Homes for Heroes
Cost of supporting £300,000 New Home	c.£60,000	negligible	c.£90,000	nil	c.£60,000	nil

The tables below show the nature of the guarantee required to support Homes for Heroes and how these guarantees are clearly contingent and for market confidence purposes to establish delivery. When a resident moves from renting to shared ownership the receipts from their purchase are rolled over into additional future supply, thus increasing the number of homes supplied from the same original issuance.

GUARANTEE EXAMPLE – Rent Stage

Open Market Value of a Home for Heroes	250,000
0% Share Sold to the Key Worker	-
Inflation Linked Rent @ 3.5%	8,750
Market norm Collection Rate	98%
Collected Rent	8,575
Indicative Income Requirement	*26,797*
Indicative Deposit (@ 10% of share)	*-*
Worst Case Collection Rate	*80%*
Worst Case Rent	*7,000*
This is 10 x the Market norm non-pay rate	
Guaranteed Issuance to Finance Home	250,000
Inflation Linked Coupon (inclrepayments)	2.00%
Issuance Payment	5,000
Cover Ratio on Market Collection	1.72
Cover Ratio on Worst Case Collection	1.40
Government Guaranteed Amount	250,000
Collection Rate before Guarantee Triggered	57%

GUARANTEE EXAMPLE – Shared Ownership Stage

Open Market Value of a Home for Heroes	250,000
45% Share Sold to the Key Worker	112,500
Inflation Linked Rent @ 2.75%	3,781
Market norm Collection Rate	99%
Collected Rent	3,743
Indicative Income Requirement	*28,125*
Indicative Deposit (@ 10% of share)	*11,250*
Worst Case Collection Rate	*90%*
Worst Case Rent	*3,403*
This is 10 x the Market norm non-pay rate	
Guaranteed Issuance to Finance Home	137,500
Inflation Linked Coupon (inclrepayments)	2.00%
Issuance Payment	2,750
Cover Ratio on Market Collection	1.36
Cover Ratio on Worst Case Collection	1.24
Government Guaranteed Amount	137,500
Collection Rate before Guarantee Triggered	73%

The Guarantee is a market confidence measure and never likely to be called

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