SQUEEZED OUT

THE IMPACT OF BUILD COSTS AND PLANNING REFORM ON SOCIAL HOUSING SUPPLY IN ENGLAND

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EXECUTIVE SUMMARY

Even in benign conditions for housebuilding, the current planning system cannot provide the social and affordable homes communities need. But housebuilding is not enjoying benign conditions. The country is currently experiencing escalating build costs because a host of international and domestic events have disrupted labour markets and supply chains. As the full economic consequences of the pandemic feed through, it is highly unlikely that recent housing market price trends will be sustained in much of the country. Build costs are likely to continue rising while demand for housing cools. As a result, there is now a pressing risk that many current and planned housing schemes will become unprofitable for developers, and that social and affordable homes on these schemes will be flipped to market housing to meet profit expectations and so ensure building goes ahead.

New research from NEF, working with Altair Ltd as viability and financial modelling partners, analyses a sample of local authorities, two from each region of England, to test the resilience of social and affordable housing supply to further increases in build cost. In every region, social and affordable housing supply is at risk. In the south and east of the country, 3 out of 8 councils in our sample – Ashford, Crawley and East Cambridgeshire – risk seeing no social and affordable housing delivered through Section 106 (S106) of the Town and Country Planning Act 1990, the planning mechanism used to require social and affordable housing in market-led schemes. Meanwhile, Cornwall risks seeing delivery slashed from 35% (the level required by council policy and delivered in 2019–20) to 16%. This is despite house prices being above the national average in all these places.

However, the risks for councils in the north and midlands are of a different order of magnitude. Eight of the ten councils in our sample from these regions would see social and affordable housing supply through the planning system eliminated in the event of continuing build cost increases. In Newcastle, Northumberland, Blackpool, Doncaster, Hull, Birmingham, Nottingham, and Rushcliffe, every social and affordable home that would usually be required through the councils' S106 policies would need to be converted to market-sale housing, just to meet profit expectations of land traders and developers and so ensure schemes are built out. In Salford, protecting profit levels would allow just 2% of homes to be built as social and affordable housing, reduced from the 35% required by policy and delivered in 2019–20. The collapse of social and affordable housing delivery through S106 would remove from these communities a vital tool for supporting their recovery from the ravages of the pandemic and would undermine levelling up ambitions.

The government must act to reform the planning system in England to address the long-term undersupply of social and affordable homes in communities across the country, as well as the short-term risks to affordable supply from rising build costs. This means increasing the supply of land entering development at the right price for building many more homes that are affordable in relation to local incomes – above all social rent housing.

Unfortunately, what we have seen so far of the government's plans for reforming this system – in the form of the 2020 *Planning for the Future* white paper – is deeply concerning for the future delivery of social and affordable housing. The white paper suggests a huge range of ambitious changes to development standards that would further increase build costs, without suggesting any way of changing the price at which land enters development. Instead, the white paper suggests putting social housing supply further at risk by standardising the practice of flipping social and affordable homes to market homes to protect profit levels from the impact of rising build costs or lower-than-expected house prices.

Fortunately, the new Secretary of State for the Department for Levelling Up, Housing and Communities, Michael Gove, has paused plans for a Planning Bill to reconsider what form this should take. We urge the government to consider NEF's recommendations to ensure a revamped planning system will deliver the homes communities want and need. This can be done first by improving the design of the proposed Infrastructure Levy to maximise social and affordable housing supply, using early delivery of affordable rented tenures through the levy to de-risk development on market-led schemes. Second, more ambitious social housing policies should apply to land in public and charitable ownership, backed up by changes to law and guidance to ensure public and charitable landowners can put their land into social-housing-led schemes. Third, the Land Compensation Act 1961 should be amended to incentivise private landowners to sell their land at values that make ambitious, sustainable, well-designed, locally affordable housing schemes possible, backed up by improved HM Land Registry data.

1. INTRODUCTION: WHY PLANNING MATTERS FOR SOCIAL HOUSING

The Covid-19 crisis has brought the importance of good-quality, affordable housing with adequate space and access to services into sharp relief. Decent housing must now be seen as part of the country's civic immune system, essential for building the resilience of individual households, local communities, and the country as a whole to the impact we now know a pandemic can have on our economic and social lives. Building social homes to rent is the tried and tested way of delivering homes to higher quality, security, and affordability specifications than can be achieved through the market alone – at scale, at pace and for all.

Yet England continues to sell off and demolish social housing faster than it is built. All told, between 2012 and 2020 England saw a net loss of 209,000 social rent homes.[1] Now, there is a risk that this worrying picture will be made even worse by a collapse in the supply of social and affordable housing through the planning system in many communities, especially in the midlands and the north. First, rising build costs risk weakening social and affordable housing delivery through current planning mechanisms. Second, the government may pursue planning reforms that put yet more pressure on build costs, while cementing the practice of cutting social and affordable homes to protect developer profits from the impact of rising costs.

WHAT IS SOCIAL HOUSING?

Traditional social housing is let at social rents pegged to local incomes and house prices, making it genuinely affordable for the great majority of households, including those with low incomes and homeless people. It is managed by local authorities, housing associations, or other registered social landlords, such as housing co-operatives. A large body of research demonstrates the urgent need for many more social rent homes across England because of this tenure's unique guarantee of the combination of genuinely affordable rents, secure tenancies, and decent housing standards.[2]

Unlike social rent, prices and rents in other types of affordable housing do not take account of local incomes. According to the government's official definition, a home is 'affordable' simply because it costs less than market housing. 'Affordable rent' homes have rents capped at a maximum of 80% of local market rents – although some social landlords find ways to push rents lower. In the capital, 'London affordable rent' was also created in 2016, with rents set at levels between traditional social rents and what would be allowed for affordable rent. These various rented tenures do not meet the same needs in all parts of the country. A typical two-bedroom affordable rent home works out as

30% more expensive than an equivalent social rent home, amounting to £1,400 more in rent per year.[3] The difference between social rent and affordable rent is far starker in places where market rents are least affordable – particularly in the south. In places where market rents are closer to social rents, affordable rent is more likely to meet the needs of low-income households, though it would be far better to guarantee affordability by pegging rents to local incomes, as in social rent housing.

Affordable housing also includes 'low-cost homeownership' tenures, such as shared ownership and First Homes, targeted at those with sufficient savings to put down a deposit. Low-cost homeownership tenures cannot possibly address and prevent homelessness, or meet the housing needs of low-income households, given 60% of private renters have no savings at all.[4] What these households – and many more with limited incomes and savings living in temporary accommodation or overcrowded social housing – need is a significant increase in the supply of genuinely affordable homes to rent, ie social rent homes.

Yet, over the years, successive governments have switched funding and policy support away from social rent towards less affordable rented tenures, as well as towards low-cost homeownership. While social rent accounted for 87% of the 66,000 affordable homes built in England in 1992–93, social rent made up just 11% of the 59,000 affordable homes built in 2019–20. Similarly, social rent accounted for 100% of the 57,000 affordable homes for rent built in 1992–93, but just 17% of the 38,000 affordable homes for rent built in 2019–20. Meanwhile, the share of affordable housing supply made up of low-cost homeownership tenures rose from 13% to 35% over the same period.[5]

In this paper, the term '*social housing*' is used hereafter to refer to and capture social rent, affordable rent, and London affordable rent. It is clear that affordable rent and London affordable rent homes are often not genuinely affordable for those living in them. Nonetheless, it is important that campaigners, politicians, and commentators can describe what is happening to the supply of affordable homes for rent, as distinct from the broader concept of affordable housing. Maintaining and increasing the supply of affordable homes for rent, even through current imperfect tenures, is crucial for building future opportunities to drive up the supply of social rent homes in communities across the country.

HOW COUNCILS DELIVER SOCIAL HOUSING THROUGH THE PLANNING SYSTEM

With capital grants through the government's affordable homes programme now far less generous than in the past, England relies on private developers to deliver a large proportion of new social housing through the S106 system; in 2019–20, 51% of all the social housing delivered in England came through this route.[6] Also known as 'planning obligations', S106 agreements have been a feature of the planning system since the 1990 Town and Country Planning Act. They are legal agreements between an applicant seeking planning permission and the local planning authority (in most places, the lower-tier council), which secure affordable housing as part of a new development, as well as the local infrastructure needed to support new homes, such as roads, schools, and doctors surgeries. A separate mechanism, the Community Infrastructure Levy (CIL), is also used to require financial payments from developers to support infrastructure in some places.

Driven by high house prices, land in agricultural use can jump in value by over 200 times when it obtains residential planning permission, creating huge windfall profits for landowners and land traders.[7] In effect, S106 and the CIL channel some of this profit into subsidising new affordable housing and infrastructure. This is sometimes known as 'land value capture'. Since all developers should meet the same S106 and CIL requirements, the costs of these policies should be reflected in their bids for land and should therefore fall on the landowner.

The proportion of affordable housing required through S106 in each location, and the split between social housing and low-cost homeownership within this, should be set out in each council's Local Plan. These policies are determined by a combination of national planning rules, assessments of local housing need and – crucially – how profitable private housebuilding is in the local area.

In the south of England, where house prices are generally higher, councils are usually able to require higher overall levels of affordable housing, and higher levels of social homes for rent within this, through their Local Plans. By contrast, lower house prices in much of the north and the midlands mean councils here are generally only able to require lower levels of affordable housing and social housing – even if there is a high need for social housing in the local authority, for example, because local wages are low or because many older or disabled people in the area have specialist housing needs that cannot easily be met through market housing. In 2018–19 fewer than 10% of social homes agreed through S106 were in northern regions, compared to 52% in London and the south.[8]

While the Local Plan sets S106 policies, the precise numbers of affordable and social homes for each scheme are negotiated separately, resulting in an S106 agreement. This process is often time-consuming, costly, and frustrating for all involved, particularly as recent years have seen ambiguity added to the system through numerous exemptions and loopholes. For example, viability assessments allow developers to reduce or eliminate affordable housing on a scheme if complying with local authorities' policies would threaten the developer's ability to make 'a suitable return'. Meanwhile, 'vacant building credit' limits S106 contributions for sites containing vacant buildings and permitted development rights provide broad powers to convert offices, shops, and other buildings into housing with no affordable housing and limited infrastructure payments.

These limitations on councils' ability to set and enforce social and affordable housing requirements through S106 are reflected in our research sample. Across the ten councils in our sample in the north and midlands, the average level of social and affordable housing required as part of new development was 26%, and the average level achieved in 2019–20 was 11%. Across the eight councils in our sample from the south and east of England, the average level of social and affordable housing required through S106 was 37%, and the average level achieved in 2019–20 was 26%.

BEYOND SECTION 106: DIRECT DELIVERY OF SOCIAL HOUSING

Beyond S106, the planning system also matters for social housing delivery in a second way. It is an important part of the regulatory framework that governs the land market, and therefore influences the prices councils, housing associations, community land trusts, and other social housing providers must pay for land on which to build their own schemes prioritising social housing – so-called land-led development or direct delivery. To achieve the step-change needed in the supply of social housing in England, we need to significantly expand opportunities for this kind of development – not simply maintain and make marginal improvements to social housing delivery as part of market-led schemes. This means identifying new sources of affordable land for genuinely affordable social housing.

The years immediately following the second world war saw the social housing supply boom as (primarily) councils purchased land and built ambitious schemes to meet local people's needs. They were supported on the one hand by generous capital grants from central government, and on the other hand by legislation that allowed them to access land at an affordable price; the market for land for social housing was separate from the market for land for private housing.

The Land Compensation Act 1961 changed all this. This Act – together with a raft of problematic case law arising from it – enshrines a landowner's right to 'hope value' in cases of compulsory purchase by a public body. This means the price of land reflects the likelihood that it might one day have been used for lucrative market housing, creating a floor on the price of land based on the most profitable uses imaginable. These compensation rules for compulsorily purchased land have set a high bar for how land is valued across the market. Today, the market for land for social housing is no longer separate from the market for private housing, and social housing providers must compete for land with private housebuilders.

As a result, housing associations and councils now consistently cite the cost and availability of land as their single biggest barrier to building more.[9] Previous NEF research identified a steep drop in social housing supply of 70% in the 10% of local authorities where land values are highest between 2011–12 and 2014–15. The rest of England saw a 20% fall in social housing supply across the same period.[10]

In this context, rural exception sites have provided a marginal but important route for social housing providers in rural areas to access land that would not normally be developed (e.g., because it is protected by green belt status) at prices suitable for social-housing-led schemes. These have been particularly important for driving social housing delivery by community-led housing groups in rural areas.[11]

However, England is not making the most of other potential sources of affordable land. For example, public bodies in England still hold significant amounts of land in some places, yet rather than prioritising this land for social housing, recent governments have instead pushed policies encouraging the sale of public land for maximum value. The unsurprising result is dismal levels of social housing delivery. Following a NEF campaign, in 2019 the Ministry for Housing, Communities and Local Government (MHCLG) began publishing data on planned levels of social housing on land sold through the Public Land for Housing Programmes. Of the 131,000 homes planned for this former public land, just 5.4% will be social housing, and just 2.6% will be the most affordable homes for social rent.[12]

Similar problems can be found in the legislation governing sales of land owned by third-sector bodies. The Commission of the Archbishops of Canterbury and York on Housing, Church and Community's full report in February 2021 expressed frustration at the legal requirement to achieve the 'best terms reasonably obtainable' in disposals of its land. As this requirement is invariably interpreted as meaning 'the highest price', the Commission identified it as a barrier to the Church prioritising its land and buildings for social housing and other socially valuable uses.[13] While the Church of England is now pursuing a new 'Social Disposal Power' to change the treatment of most of its land, it remains unclear how land owned by other third-sector bodies could be prioritised for social housing while meeting legal requirements. This represents another missed opportunity to create sources of affordable land for social housing, leaving the social housing supply dependent on scraps from developers' tables through the S106 system.

2. WEAKNESS OF THE PLANNING PROPOSALS

Clearly, there is plenty of room for improvement in England's planning system; current mechanisms for providing social housing are a complex minefield and do not deliver anywhere near the levels of social housing needed. The Queen's Speech of May 2021 announced the government's intention to undertake a major shake-up of the system within the current parliamentary session, through a Planning Bill aiming to 'Create a simpler, faster and more modern planning system'.[14] The difficulty is how to create a new system that will deliver better and more certain outcomes for all stakeholders in development – councils, developers, landowners, and communities – not just a simpler process for private interests.

Initially, this Bill looked set to transform planning in England from a discretionary system –with decisions about where homes should be built made on a case-by-case basis – to one closer to the kind of 'zonal' system found in much of continental Europe and America – with decisions about where homes should be built made as part of writing the Local Plan, a process that takes place around once every 15 years. Yet the government's proposals here relied too much on demand for market-sale homes, which is far higher in some parts of the country than in others. This raised the prospect that the new system would increase developers' choice over where to build market-sale homes at current unaffordable prices, for which suburban and rural greenfield sites usually offer the highest profits, rather than rebalancing supply towards social homes and other types of housing neglected by the market (e.g., inclusively designed homes for older and disabled people) for which demand is spread across a wider range of local housing markets.

Recent reports suggest this key zonal aspect of the government's plans has been dropped, following concerns from voters and MPs in the south of England that it would lead to market-sale sprawl into rural and suburban neighbourhoods.[15] The government's unexpected defeat in the Chesham and Amersham by-election in June 2021 crystallised the threat of softening support in the Conservatives' traditional heartlands, the so-called Blue Wall.[16] With a new Secretary of State, Michael Gove, for a revamped Department for Levelling up, Housing and Communities, the government is now reconsidering which aspects of the planning white paper it will take forward.

In this process, we should not allow the political heat around zoning to distract attention from other white paper proposals to change the way decisions are made about what is built, where, and for whom. Politicians, journalists, campaigners, and other commentators must maintain scrutiny of the government's plans to reform the planning system. Beyond zoning, other white paper proposals risk shifting power in the planning system away from communities and towards private interests – not only in prosperous Blue Wall seats, but also, in different ways, in Red Wall seats, urban centres, and indeed across the country. Ultimately, if the white paper's conflicting priorities and promises are not unpicked, communities everywhere could find it even harder to build homes neglected by the market, and above all the social housing we need most urgently. This would serve to further increase pressure on local authorities and communities to allow market-sale homes to sprawl into the suburbs and countryside, where market demand is stronger, to make up overall housing numbers.

BIG PROMISES, BIG COSTS

Published in August 2020, the government's *Planning for the Future* white paper made several promises about how reforms will maintain and improve development outcomes.[17] The new system will deliver more infrastructure as part of local developments and increase the amount of land value captured (p. 23); it will secure more on-site affordable housing provision and will maintain overall affordable housing supply at current levels (p. 18); it will provide more green space as part of new development (p. 21); it will enforce net biodiversity gains and tree-lined streets as a condition of most new development (p. 43); it will raise design standards and expect new developments to be beautiful (p. 17); it will deliver homes to higher energy efficiency (p. 17) and sustainability (p. 8) standards; and it will increase the supply of land available for new homes in the least affordable places (p. 14) while maintaining green belt and other existing restrictions on development (p. 19).

The white paper's proposals are fundamentally flawed in not aiming to increase the social housing supply from current low levels. Yet there is much to welcome in the government's ambition to drive up sustainability, design, quality, and placemaking standards. What is unclear is how all of these aims can be delivered. Indeed, there are sound reasons to doubt that they can be.

First, the reforms proposed – like raising design standards – will further increase build costs, in the context of recent severe construction labour and materials shortages and accelerating build costs due to the Covid-19 pandemic, blockages at the Suez canal, global container shortages, Brexit, and an increase in North American demand for European timber as a knock-on effect of Californian wildfires, among other political and economic events. Office for National Statistics (ONS) data puts the costs of construction materials at 19.8% higher in July 2021 compared to July 2020, with further cost increases forecast.[18] Planning changes that will add to this pressure on build costs must be carefully considered.

Over the last year, house prices have been rising sufficiently to maintain the profitability of new housing supply despite cost increases in most places. Higher prices have been fuelled by higher demand borne from stamp duty land tax reductions for all buyers from July 2020, historically low base interest rates of just 0.1% from March 2020, a rush from some to buy ahead of changes to the government's Help to Buy scheme from March 2021, and a once-in-a-generation 'race for space' resulting from the pandemic and lockdown conditions. With the end of the stamp duty reduction and the coronavirus job retention scheme from October 2021, rising inflation rates and other economic changes, it is highly unlikely that recent housing market price trends will be sustained in much of the country. So, construction labour and materials costs are likely to continue rising while demand for housing cools. Going forward, this will limit the scope for development values to cover further increases in build costs – unless compromises are made in other areas, like the levels of social and affordable housing developers are required to include, or changes to the levels of landowner or developer profit guaranteed by the planning system. The government's planning promises just don't add up.

Second, as detailed in the following section, the government's proposed reforms transfer planning risk and costs to the public sector, for example by requiring councils to pay interest costs on borrowing to forward-fund infrastructure. This will reduce the funding available from development for affordable housing and other community benefits.

Third, it is not clear how the planning white paper reforms will be able to convince landowners to voluntarily accept lower windfall profits. This is what would be required to increase the share of development profits dedicated to the public interest in the form of higher quality, more sustainable, more affordable homes with better supporting infrastructure. Precedent indicates that land-market reform is needed to shift landowners' incentives and profit expectations.

LAND VALUE CAPTURE IN THE WHITE PAPER

The white paper suggests replacing S106 and CIL systems described in Chapter 1 with a new Infrastructure Levy, charged as a fixed proportion of the final value of each scheme, above a value threshold. Developers will not need to pay the levy until schemes are complete, so the government intends for local authorities to borrow against expected levy revenues to forward-fund the infrastructure needed to make development acceptable. Aside from managing the risk that development ultimately generates less value – and therefore a lower levy contribution – than anticipated when development begins, this means that councils will have to pay interest on the money they have borrowed. This will reduce the levy revenues available for social and affordable housing, infrastructure, and other community benefits, particularly on larger developments with longer time horizons.

The levy will therefore need to be set at a higher rate than current S106 and CIL planning obligations just to provide the same level of affordable housing and infrastructure as current housing schemes. This will be both technically and politically challenging. It is also not clear how planning policy can maintain affordable housing delivery in housing markets where development values are unlikely to exceed the minimum threshold for applying the levy, and indeed in housing markets where development values above the threshold are sufficient to deliver only minimal revenue through the levy.

Recent reports suggest the levy will be set by local authorities[19] and not, as suggested in the white paper, by central government. However, the intention is for one rate to apply across the whole of a local authority's area.[20] This means councils will have to set the levy at a rate that is sub-optimal for the parts of their borough with the highest development values, to avoid making development unviable in places with lower development values. By contrast, the current S106 system allows councils to operate sophisticated policies that distinguish between neighbourhoods of higher and lower market demand, maximising affordable housing supply overall. For example, Leeds City Council operates four separate affordable housing charging zones ranging from 35% in its more prosperous suburbs to 7% in inner-city regeneration neighbourhoods.[21]

Clearly, fixing the levy percentage will be complicated and subject to a great deal of political pressure: too low and not enough will be collected to allow development to proceed and make it acceptable to local people; too high and development will not proceed, especially where landowners choose to withhold sites to provoke a policy change. Given the failure of central government to ensure landowner cooperation with betterment taxes aiming to capture a higher share of land value for the public interest in the 1940s, 1960s, and 1970s,[22] it is difficult to see how less powerful local governments are supposed to fare better through the levy.

In England's current system for regulating the land market, it is landowners who decide what level of the profits from building new housing will go to the public interest, and who therefore decide what form new housing will take. In the long run, house prices (and so land prices) always rise, so holding out is often a landowner's most rational choice. If a site is to be developed for housing, the price offered to a landowner must be high enough to overcome this incentive to hold out, so the profitability of each plot of land must be maximised.

In the decades following the second world war, public bodies could force landowners to part with their land at around its existing use value, without the value of residential planning permission included in the price, through a compulsory purchase order (CPO). The threat of a CPO was usually sufficient to incentivise landowners to sell their land voluntarily at values that made ambitious, social-housing-led schemes possible. Today this is no longer an option. In the event of a CPO, a landowner is entitled to compensation that includes the value of the planning permission it might one day have received for a market-housing-led scheme. Land purchased in this way would be too expensive to develop as an exemplary, sustainable social-housing-led scheme.

This is why it is necessary to amend the Land Compensation Act 1961, as recommended in previous work from NEF and many others.[23] This would allow councils, housing associations, and community-led housing groups to acquire land at a price that would make it possible to develop homes directly to meet housing needs neglected by the market. This would also make it possible for councils to introduce more ambitious policies on sustainability, design standards, and the provision of social and affordable housing, green space and a host of other community benefits as part of market-housing-led schemes, whether through S106 or a new Infrastructure Levy.

RISKY PLANNING, OPAQUE MARKETS

It is clear that the government's planning proposals, as articulated in the planning white paper, imply significant increases in build costs for individual schemes. This is over and above recent escalations in build costs. The proposals also include ideas for reducing development costs; but while the white paper attempts to remove risk from some parts of the planning and housebuilding processes, it reintroduces risk elsewhere.

It may have been the government's intention that cost impacts could be mitigated by the reduction in planning risk brought about by the transition to a more certain and predictable zonal system, together with the replacement of negotiable S106 agreements with a fixed Infrastructure Levy. It is certainly the case that under the current planning system, the need to obtain permission for an individual scheme, and the risk that such permission will not be granted in the form expected, can add significant costs to development. Yet it does not follow that the government's proposals could ever have removed sufficient cost from this process to enable the full range of promises made in the white paper, especially in the absence of action to get more land into development at a genuinely affordable price, below what landowners will voluntarily tolerate, such as by leveraging Land Compensation Act 1961 reform.

Now that zonal system proposals appear to have been dropped, this scenario is even less plausible. The white paper also makes numerous references to the potential for its proposals to 'lower regulatory barriers to entry' and to support smaller developers. The government intends for its planning reforms to increase overall housing supply in this way, potentially compensating for lower levels of social and affordable housing on individual schemes by increasing the total amount of housing coming forward. Yet there are reasons to be sceptical that the white paper proposals are capable of having the desired impact.

First, the land market is extremely opaque. Actual ownership of land is not always clear, and private option agreements between landowners and developers, and promotion agreements between landowners and land traders, mean that a huge proportion of potential development land is tied up in private agreements hidden from competitors, residents, and public authorities. Such agreements mean that land is not recorded as being in a given developer's or trader's ownership but specify the right to purchase it at an agreed price if certain events occur – like the granting of planning permission. Opening up the development industry to small and medium-sized builders means tackling this lack of transparency in the land market, not just reducing application-stage planning risk.

Second, it is impossible to reduce market prices or to increase overall housing supply to the numbers needed by increasing the amount of land granted planning permission for market-sale housing at current prices – regardless of who is building it out. As the recent *Independent Review of Build Out Rates* led by Sir Oliver Letwin found in relation to large sites, the nature of England's land market, combined with the over-reliance on market sale housing on most large schemes, places fundamental constraints on the rate at which large housing schemes with full planning permission can profitably be completed, reigning in overall supply.[24] Developers decide how much to bid for a plot of land by targeting the highest realistic sales values for that local market. A developer who targeted lower house prices would not be able to bid as much and would lose out on land to another developer. Since there are only so many households ready, willing, and able to buy market-sale homes at current prices in each housing market in any given week, developers build as slowly as necessary to sustain prices at the levels they assumed when buying land, to make back their money on their initial land investment. This dynamic prevents developers from building so many homes that prices fall. To do so would threaten their ability to make their initial land investment pay off.

Third, the government's proposals suggest councils should be responsible for financing and providing the infrastructure to support private developers' schemes. Developers would therefore have less control over the delivery and funding of relevant infrastructure, increasing their overall financial risk. Smaller housebuilders, who tend to build smaller schemes, would risk being deprioritised for infrastructure provision by financially constrained local authorities, whose incentive in the new system – as in the current system – would be to drive overall housing supply figures to meet government targets by focusing on larger schemes. The government's proposals, as currently constituted, are likely to have the effect of removing some risks, only to replace them with others. It, therefore, remains far from clear whether this will balance out to reduce costs as intended.

3. WHY IS SOCIAL HOUSING AT RISK?

TROUBLED TIMES

The Planning Bill will itself have major implications for social housing delivery in different places, but it is far from the only change happening that presents risks for current social housing delivery mechanisms. Social housebuilders face several huge, urgent, and competing priorities and pressures on their financial and institutional resources: backed up repairs and maintenance jobs after 18 months of Covid-19; fire safety and remediation works; social housing decarbonisation, estimated to cost upwards of £104bn[25]; implementing regulatory reform following the government's 2020 social housing white paper; as well as adapting to the government's new shared-ownership model and to the introduction of First Homes. These last two changes will both deliver less cross-subsidy (which could have been used to provide social housing) compared to the outgoing shared-ownership model.

The recent fifth annual *Housing Sector Survey* from Savills reports that 85% of social housing providers see investing in existing homes as their top priority – a 29% increase on the previous year's results.[26] Given the high levels of investment required to remove unsafe cladding and address wider fire safety problems in social housing,[27] as well as the miserable living conditions in some existing social housing recently highlighted by Daniel Hewitt's *Surviving Squalor* documentary for ITV, the sector must get its house in order. However, spending on fire safety and other improvements to existing stock will undoubtedly have knock-on effects for social landlords' development programmes. A recent survey from the National Housing Federation suggests housing associations intend to build 12,900 fewer affordable homes over the next five years to prioritise spending on building safety.[28]

With social landlords' resources so stretched, how will planning policy help to maintain social housing delivery despite these risks? Unfortunately, the government's planning proposals suggest a deliberate further deprioritisation of social housing.

DEPRIORITISING SOCIAL HOUSING

Social housing is already deprioritised relative to other types of community benefit in the current planning system. Despite the clear need for social housing affordable to the millions of households with insufficient savings to put down a deposit, changes to the government's National Planning Policy Framework (NPPF) in 2018, and planning guidance issued in 2021, require almost all new housing schemes to prioritise low-cost homeownership tenures over social homes for rent.[29] With a few exceptions, new housing schemes must ensure at least 10% of all homes delivered are some form of low-cost homeownership, and that at least 25% of all affordable housing delivered takes the form of First Homes, homes for sale with a discount of at least 30%. This limits councils' opportunities to deliver social housing through the planning system, particularly in weaker housing markets where there is less profit from housebuilding that can potentially be used in this way, and on housing schemes with high infrastructure costs, where overall affordable housing levels may be reduced on viability grounds.

Despite positive steps from the government to tighten the rules around viability assessments through the 2018 NPPF, in many places it remains common practice for developers to argue down affordable housing on new housing schemes from the levels required by councils' policies.[30] If delivering a scheme in accordance with local plan policies will threaten developers' ability to make 'a suitable return', defined in national planning rules as between 15% and 20%, they can break with Local Plan policies to improve the scheme's profitability. Before the housing market crash in 2008, expected returns were commonly around 14%, but the viability system has since allowed higher profits to become accepted as a new market norm.[31]

Viability squeezes a whole range of community benefits, as well as design standards and the sizes of new homes, all of which are costs to the developer. However, compromises to overall affordable housing levels, and to the split between social housing and low-cost homeownership tenures as part of this, are attractive options for developers. While other community benefits, like investing in a new school or a local green space, are likely to increase the sales values of new private homes on a scheme, from the developer's point of view social homes just take up space that could be used for more profitable private housing. In many cases, other community benefits may also be legally or technically necessary for a development to proceed. A new development that cannot secure a road to connect it to the existing town nearby will simply not go ahead, for example. Because of this, if development costs go up – whether because of recent escalations in the costs of construction labour and materials or because of planning reforms – the likely result will be lower levels of social and affordable housing on new housing schemes.

THE INSTITUTIONALISATION OF VIABILITY

In these ways, the existing planning system in England squeezes out social homes from new housing schemes. Yet, far from using the opportunity of reform to provide certainty around affordable housing policies and so ensure development goes further towards meeting the urgent need for social homes in communities across the country, the government's proposals suggest building in the practice of flipping social and other affordable homes to market housing when housing schemes prove less profitable than expected, as a standard strategy for managing development risk.

The white paper's proposals for an Infrastructure Levy to replace S106 and the CIL envisage councils borrowing against anticipated revenues from the levy to forward-fund the infrastructure needed for a scheme to go ahead, based on estimated sales values for the homes to be built. If build costs for the scheme turn out to be higher than expected, or sales values turn out to be lower than expected, the council will have a funding gap to fill. The white paper suggests, "[I]n the event of a market fall, we could allow local planning authorities to 'flip' a proportion of units back to market units which the developer can sell, if Levy liabilities are insufficient to cover the value secured through in-kind contributions."[32] This would amount to the institutionalisation of the viability system, with social and affordable housing bearing the risk of market volatility. This is despite clear evidence of the benefits of tenure diversity for build-out rates and managing development risk.[33] For example, any social housing on a scheme will be sold in bulk to a social housing provider, which can generate early capital receipts.

The government also intends Infrastructure Levy funds to be available to meet a broader range of spending priorities compared to the existing S106/CIL system. The white paper even suggests that levy revenues could be used to reduce council tax or to fund general services.[34] Given the financial pressures most councils face, this may well be a tempting option. However, it would have consequences far beyond the levels of social and affordable housing on individual schemes. If those buying and selling land know they will be able to maximise market sale homes on new schemes, the land market will bake in the expectation of less social and affordable housing, as happened after 2012 when new government rules expanded developers' options for reducing social and affordable housing levels on viability grounds.[35] This will then make land even more expensive for community-led housing groups, councils, and housing associations seeking to deliver homes directly to meet the needs of lower-income households.

WHERE IS SOCIAL HOUSING AT RISK?

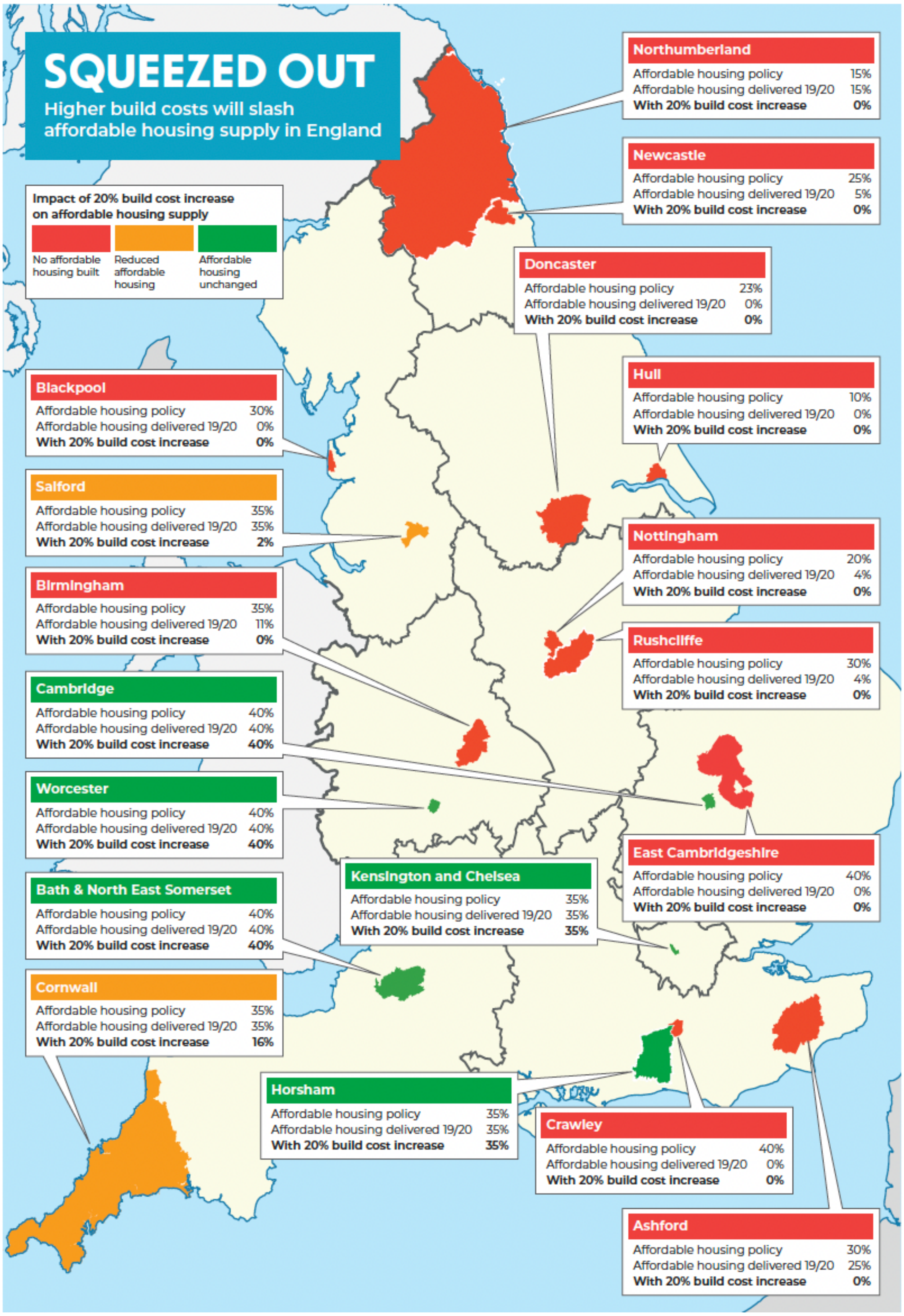
New research from NEF, working with Altair Ltd as development viability and financial modelling partners, analyses a sample of local authorities to test the resilience of social and affordable housing supply to further build cost increases. Our analysis covers one more rural local authority and one more urban local authority for each region – except in London and the South East, where Kensington and Chelsea in London is paired with Ashford in the South East to reflect the impact of London's housing demand on local authorities beyond London's boundary. In every region, social and affordable housing supply is at risk. In the south and east of the country, three of the eight councils in our sample – Ashford in Kent, Crawley in West Sussex, and East Cambridgeshire – risk seeing no social and affordable housing delivered through S106. Meanwhile, Cornwall risks seeing delivery slashed from 35% (the level required by council policy and delivered in 2019–20) to 16%. This is despite house prices being above the national average in these places.

However, the risks for councils in the north and midlands are of a different order of magnitude. Eight of the ten councils in our sample from these regions would see social and affordable housing supply through the planning system eliminated in the event of continuing build cost increases. In Newcastle, Northumberland, Blackpool, Doncaster, Hull, Birmingham, Nottingham, and Rushcliffe, every social and affordable home that would usually be required through councils' S106 policies would need to be converted to market-sale housing, just to meet the profit expectations of land traders and developers and so ensure schemes are built out. In Salford, protecting profit levels would allow just 2% of homes to be built as social and affordable housing in the event of ongoing build cost increases, reduced from the 35% required by policy and delivered in 2019–20.

Worcester is the only council in our sample across the midlands and the north where our analysis suggests social and affordable housing policies could withstand the impact of further build cost increases. Further south, Cambridge, Bath and North East Somerset, Horsham in West Sussex, and Kensington and Chelsea are all similarly resilient, with high recent house price growth in these places shielding land trader and developer profits from the impact of further build costs rises.

Now more than ever, new social and affordable homes are needed to ensure households on low incomes can afford to access work, education, and training opportunities, and to strengthen the safety net for those whose housing security has been put at risk during the pandemic, for example, because of rising rent debt and arrears on household bills.[36] Yet there are significant risks to current delivery mechanisms for social and affordable housing, which weigh most heavily on the parts of the country which are the focus of the government's levelling up agenda. The collapse of social and affordable housing delivery through S106 would remove from these communities a vital tool for supporting their recovery from the ravages of the pandemic and would undermine the government's levelling up ambitions.

RISKS TO SOCIAL AND AFFORDABLE HOUSING SUPPLY FROM INCREASED BUILD COSTS



4. RECOMMENDATIONS

The government is right to reform the planning system to achieve better development outcomes and to increase certainty for all development actors on the standards required of new housing in England. We should expect new homes and communities to be well-designed, sustainable, green, and beautiful. However, two crucial points are missing from what we have seen so far of the government's intended planning reforms:

- Affordability must be part of the certainty delivered by any reformed planning system, in the form of clear, firm, and ambitious requirements for social rent housing delivery, which distinguish between different sources of land to maximise supply.
- Improving development outcomes in the ways outlined by the *Planning for the Future* white paper, and the ways needed to meet housing needs, requires a more transparent land market in which landowners are properly incentivised to participate in development.

The following recommendations set out the reforms needed to address these points.

IMPROVE THE INFRASTRUCTURE LEVY

1. Following best practices in the S106 system, councils should be enabled and encouraged to vary Infrastructure Levy rates across their areas to ensure the levy is as sensitive as possible to local market conditions and so maximise land value capture. The levy rates applicable in different charging zones should be clearly indicated through digital maps as part of the local plan.
2. Infrastructure Levy rates should be set using evidence on the level of developer profit required for schemes to go ahead in different housing markets – not using a mandated profit level of between 15% and 20%, as in the current planning system, which has served to inflate profit expectations.
3. To generate early sales receipts from bulk sales to social housing providers, rented tenures of affordable housing should be delivered before low-cost homeownership and market tenures, helping to de-risk development and guaranteeing social housing delivery as part of market-led schemes.

CREATE AFFORDABLE LAND FOR AFFORDABLE HOMES

4. Law and guidance requiring disposals of land in public or charitable ownership to achieve the "best terms reasonably obtainable" should be updated to enable and encourage the sale and use of such land to and by community-led housing

groups, local authorities, and housing associations, for housing schemes that maximise social housing.

5. More ambitious on-site social housing policies should apply to land in public and charitable ownership, following the successful use of this approach for public land in London since 2017.

IMPROVE LAND MARKET INCENTIVES AND TRANSPARENCY

6. The Land Compensation Act 1961 should be amended to remove the entitlement to 'hope value' based on prospective planning permissions in cases of compulsory purchase. Removing the hope value floor from the land market would allow councils, housing associations, and community-led housing groups to acquire land at a price enabling direct delivery to meet housing needs neglected by the market, above all of social housing.
7. Following the government's 2020 consultation *Transparency and competition: a call for evidence on data on land control*, it is critical that greater transparency is required of the contracts used to exercise control over the land market. The government should extend the data held by HM Land Registry to include rights of pre-emption, option agreements, promotion agreements, and estate contracts, and make all this information freely available and accessible. This would improve opportunities for small and medium-sized housebuilders, community-led housing groups, and other new market entrants to acquire land at prices enabling homes to be built at pace.

5. CONCLUSION

The current planning system fails to meet the need for social homes affordable to households on lower incomes as part of market-led schemes. It also fails to provide access to land at the right values for community-led housing groups, councils, housing associations, and others to build homes directly to meet the need. These problems could now be about to become even worse, both because of the threat from rising construction labour and materials costs to current mechanisms for delivering social housing through the planning system, and because of the risk that social and affordable housing policies will be further undermined by misguided planning reforms.

As the government takes time to reflect on the proposals put forward in the 2020 *Planning for the Future* white paper, and the feedback it has received on these proposals from NEF and others, it is vital that politicians, journalists, academics, and other commentators emphasise the need to drive up opportunities to deliver social housing as part of planning reform, both as part of market-led schemes through planning obligations in any reformed system, and through direct delivery by community-led housing groups and others seeking to meet housing needs neglected by the market.

Communities across England cannot meet the enormous backlog of need for social housing by feeding on scraps from the volume developers' table. Instead, it is time for the government to take the action needed to diversify England's housing supply. This will prevent homelessness and sustain housing supply (and therefore jobs in and servicing the construction industry) as the full economic consequences of the pandemic feed through and prevent a collapse in the delivery of social and affordable housing supply in the north and midlands that could otherwise threaten the government's levelling up project.

APPENDIX 1: FULL RESULTS

Local authority	Affordable housing policy	Affordable housing viable with +20% build cost (loss compared to policy)	Affordable housing delivered on S106 schemes 2019-20 (loss compared to policy)
Northumberland	15%	0% (-15%)	15%
Newcastle	25%	0% (-25%)	5% (-20%)
Blackpool	30%	0% (-30%)	0%
Salford	35%	2% (-33%)	35%
Doncaster	23%	0% (-23%)	0% (-23%)
Hull	10%	0% (-10%)	0% (-10%)
Birmingham	35%	0% (-35%)	11% (-24%)
Worcester	40%	40%	40%
Nottingham	20%	0% (-20%)	4% (-16%)
Rushcliffe	30%	0% (-30%)	4% (26%)
Cambridge	40%	40%	40%
East Cambridgeshire	40%	0% (-40%)	0% (-40%)
Kensington and Chelsea	35%	35%	35%
Ashford	30%	0% (-30%)	25% (-5%)
Crawley	40%	0 (-40%)	0 (-40%)
Horsham	35%	35%	35%
Bath & North East Somerset	40%	40%	40%
Cornwall	35%	16% (-19%)	35%

APPENDIX 2: RESEARCH METHOD

SAMPLING

We selected 18 local authorities to analyse to reflect the different viability and land capacity constraints affecting more urban local authorities and more rural local authorities, and affecting local authorities with higher and lower housing demand, in different parts of England. We analysed the potential impact of build cost increases on social housing supply in two local authorities for each region of England - except in London and the South East, where Kensington and Chelsea in London is paired with Ashford in the South East to reflect the impact of London's housing demand on local authorities beyond London's boundary. To ensure our analysis would closely reflect current market conditions at a time of flux and uncertainty for the housing market, we only sampled local authorities with Plan-level viability assessments approved between 2015 and 2021.

DATA AND INPUT SOURCES

We relied principally on inputs from the Local Plan viability assessment of each of the local authorities in our sample. These assess the viability of the policies and measures of the Local Plan. They are undertaken by costing and planning experts and submitted to the Secretary of State as part of the Local Plan examination undertaken by the Planning Inspectorate. The data from these assessments was our principal source of inputs, including:

- Dwelling mix
- Dwelling size
- Open market values
- Development fees (eg marketing fees, professional fees)
- Land fees (eg legal and surveying fees)
- Profit assumptions, for both private sale and affordable units
- Benchmark land values

Assumed build costs for each local authority in our sample were sourced from the Build Cost Information Service (BCIS), part of the Royal Institute of Charted Surveyors and an industry-standard build cost tool. Median build costs were applied, re-based to Q3 2021 by location. As the BCIS cost data excludes external works, we uplifted base build costs by 10% to account for these elements.

We also indexed open market values and benchmark land values to today's values to ensure our analysis reflects current market conditions as closely as possible, using the following sources:

- UK House Price Index, produced by the Land Registry and split by Local Authority
- UK Residential Development Land Index, created by Knight Frank and split by land types

In a minority of cases, some information had not been published within viability assessments. In these cases, we used Altair Ltd's extensive knowledge and experience of application-level and Plan-level viability assessments across the country to identify suitable industry-standard inputs. This was done for a small minority of inputs. Finally, we reviewed Local Plan policies to understand the local authorities' respective affordable housing policies. Where a Local Plan was in draft form, we used the draft affordable housing policy.

APPROACH TO MODELLING VIABILITY IN DIFFERENT LOCAL AUTHORITIES

For each local authority, we created a high-level viability assessment based on a theoretical scheme using information from the Local Plan viability assessment. This was used to illustrate a hypothetical scheme that could be delivered in each area. Viability assessments represent the standard approach used by local authorities and developers to assess how much affordable housing an individual scheme can deliver, and how affordable housing policies across a local authority area should be set.

Viability assessments compare the costs of development schemes (build costs, developer profit, affordable housing and infrastructure costs, etc.) against the income from development schemes (sales receipts and rental income). Once costs have been subtracted from income, the remaining amount, the Residual Land Value (RLV), is subtracted from the Benchmark Land Value (BLV), the estimated cost of the land. If this calculation produces a surplus, the scheme is judged to be viable; if it produces a deficit, the scheme is judged to be unviable.

One scheme was considered per local authority in our sample. We only considered schemes with private sale properties, which make up the majority of new development; we did not consider build-to-rent schemes.

Our initial viability assessment was informed by data from verifiable sources, as listed, and formed our base level: how schemes performed financially in the current planning system. Then, to simulate the increase in build costs implied by the government's stated ambitions for its planning reforms, we inflated build costs by 20% and observed the impact on the viability assessments. We aimed to understand if schemes began to operate with a deficit, or if they could withstand increases to build costs. Then, we calculated how any deficits would impact thelevels of social housing that schemes could achieve relative to local authorities' affordable housing policies in their Local Plans.

For local authorities with a deficit in their viability assessments, we adjusted the level of social housing downwards until the deficit was reduced to £0. We then compared the levels of social housing needed to produce a deficit of £0 to local authorities' Local Plan policies. The difference between these two levels is our estimate of social housing loss for each area.

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