ark
housing consultancy

Bath & North East Somerset Council

The Impact of Affordable Rents on the Viability of Residential Development with Affordable Housing Planning Obligations

June 2011

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Executive Summary

Background

In February of this year, Ark published a report of the findings of an exercise we undertook to test the continuing relevance of the strategic viability assessment previously produced by Three Dragons for Bath & North East Somerset Council to support the latter's emerging affordable housing planning policy.

We tested the assumptions underlying the strategic viability assessment against twelve sites identified in the Council's Strategic Housing Land Availability Assessment (SHLAA).

Since publication of our earlier report the Government has formalised its proposals to reform tenancies in the affordable housing arena.

Affordable Rent tenancies will differ from the existing assured tenancies for social rented housing:

- they will be for a fixed term of two years or more
- they will attract a rent based on up to 80% of the market rent for the dwelling

There is a general perception that affordable rents will exceed social rents by a significant margin.

The Government has already recognised the legitimacy of classifying affordable rents as 'affordable' within the meaning of Planning Policy Statement 3.

This brief report reflects some further research and analysis carried out by Ark to assess the implications for the application of B&NES Council's emerging affordable housing planning policy allowing for the inclusion of affordable rents on the rented element of the obligation.

Affordable Rents and Their Relationship to Purchase Prices for Affordable Housing

When an RP establishes the price which it can afford to pay for a rented dwelling it will base its calculation on a discounted cash flow of the net revenues from that dwelling over many years.

The pricing or investment appraisal approach outlined above is normally described by RPs as establishing the 'supportable deficit' for a rented dwelling. Supportable deficits are capitalised as a price which the RP can afford to pay for a dwelling of a particular type and rent level.

Price differentials between dwelling types and sizes are fairly even and predictable with social rents.

Purchase prices based on supportable deficits for affordable rented homes will vary a great deal more.

Another factor impacting on purchase prices which is of considerable significance is the degree to which RPs have been paying premiums over the true supportable deficits for social rented housing delivered via the planning system.

Whilst some of the factors encouraging RPs to pay premiums will continue to apply to Section 106 deals based on affordable rents, their relevance will be tempered by concerns about new or intensified risks.

We contacted three RPs which have a significant and developing presence in B&NES to obtain indications of the supportable deficit based purchase prices they could sustain for different unit types in different market zones across B&NES, assuming that affordable rents were charged based on 80% of market rents.

Section 4 of the main report includes a table setting out the average purchase prices indicated by the RPs.

All three RPs believe that modelling or appraisal assumptions need to tighten to reflect the increased risks of affordable rents.

The Effect of Affordable Rents on Ark's Validation Study Findings

We have re-visited the viability appraisals for the twelve sites, updating the results by applying prices for rented homes based on the average purchase prices quoted by the three RPs we contacted and assuming affordable rents.

Section 5 of the main report sets out the results of re-appraising the twelve sites.

Key Conclusions

The changes to rent setting for affordable housing proposed in the Localism Bill and developed in more detail for RPs by the HCA's new grant funding framework are going to have a material impact on how RPs determine the price they can pay for rented housing.

There is a general perception that affordable rents will exceed social rents by a significant margin, particularly in an area like B&NES. Our recent research and analysis has demonstrated that this is not always the case and that smaller dwelling types, mainly apartments, in lower value areas are likely to have affordable rents which are less than social rents for the equivalent dwelling types and locations.

As regards the impact which the introduction of affordable rents will have on the delivery of affordable housing via the planning system, it is not appropriate to assume that if an affordable rent is greater than a social rent for a particular dwelling type that this necessarily translates into a corresponding increase in the amount an RP can pay a developer for that dwelling.

Changes in RP's perceptions of risk are meaning that more cautious appraisal assumptions are being adopted and this will have a depressing effect on purchase prices.

In addition to a more cautious approach to assumptions, RPs are less able or willing to add premiums to prices for schemes secured through Section 106 agreements.

Taken overall, our research and analysis demonstrates that there will be increases in rent levels for family houses across most of B&NES with the introduction of affordable rents.

In considering the impact of affordable rents on the delivery of affordable housing via planning obligations it is important to recognise the effects on affordability. The cost of family housing will increase and these increases are very high for larger houses. Rents for four bedroom houses will increase by around 50%.

1. Background

1.1 In February of this year, Ark published a report of the findings of an exercise we undertook to test the continuing relevance of the strategic viability assessment previously produced by Three Dragons for Bath & North East Somerset Council to support the latter's emerging affordable housing planning policy.

1.2 We tested the assumptions underlying the strategic viability assessment against twelve sites identified in the Council's Strategic Housing Land Availability Assessment (SHLAA) with a view to enhancing the credibility of the assessment.

1.3 Since publication of our earlier report the Government has formalised its proposals to reform tenancies in the affordable housing arena, including changing the basis for setting rents on most newly developed affordable housing and on some existing affordable housing when it is re-let. For Registered Providers (RPs), which will continue to be the main vehicle for delivering new affordable homes, the new tenure type will be an Affordable Rent Tenancy.

1.4 Affordable Rent tenancies will differ from the existing assured tenancies for social rented housing in two important ways:

- they will be for a fixed term of two years or more; the default period to be agreed between the RP and the Homes and Communities Agency (HCA),
- they will attract a rent based on up to (and normally at) 80% of the market rent for the dwelling (including service charge) instead of being based on a pre-determined 'target' social rent which is calculated from a formula based on a combination of local house prices and local earnings.

1.5 There is a general perception that affordable rents will exceed social rents by a significant margin. Certainly the Government is assuming that charging affordable rents will increase the revenue available to an RP, reducing the requirement for subsidy in order to achieve a viable affordable home.

1.6 First and foremost the Government is seeking to secure a significant reduction in unit grant rates where the HCA directly subsidises schemes. It aims to achieve this by the introduction of affordable rents for virtually all newly developed homes, the introduction of affordable rents on a proportion of re-lets and the inclusion in an RP's agreed development programme of a number of homes not requiring any HCA grant subsidy (mainly homes secured through planning obligations). RPs submitted offers to the HCA within this new funding framework on 3rd May and are expecting to hear whether their 4 year programmes will be accepted in principle in July. There is likely to be a period of further negotiation between the HCA and RPs before final terms are agreed.

1.7 The whole of an RP's 4 year programme, when agreed, will become the subject of a contract with the HCA. Only those RPs which enter a contract with the HCA will be eligible to charge affordable rents. So, if an RP chooses not to participate in the new funding framework or fails to agree terms with the HCA it will not be able to charge affordable rents or apply affordable rent tenancies to any of its stock. RPs in this position will still be under a regulatory obligation to charge social rents and offer open ended assured tenancies.

1.8 The anticipation of improved rents has stirred a lot of developers or land promoters to explore or to expect improved purchase prices on affordable housing delivered through Section 106 agreements, in particular where schemes were not expected to attract external grant subsidy.

1.9 The Government has already recognised the legitimacy of classifying affordable rents as 'affordable' within the meaning of Planning Policy Statement 3. This document has been amended to include affordable rents within the definitions in Annex B.

1.10 In initial responses to questions of enhanced prices being paid to developers by RPs for rented affordable housing delivered through planning obligations, the HCA emphasised that it was expecting RPs to use any improved capacity to raise capital from revenues brought about by higher rents to reduce the requirement for grant on schemes which needed external subsidy. This fairly tough line has eased and there is recognition that purchase prices paid by RPs for Section 106 rented homes should realistically reflect the terms of the planning agreement. So if the agreement does not stipulate social rented homes then a price based on an affordable rent is reasonable.

1.11 This brief report reflects some further research and analysis carried out by Ark to assess the implications for the application of B&NES Council's emerging affordable housing planning policy allowing for the inclusion of affordable rents on the rented element of the obligation. It explains the factors affecting the price to be paid by an RP for affordable housing delivered via the planning system, it analyses the different impacts by market zone in B&NES and it updates the findings of our earlier validation exercise.

2. Affordable Rents and Their Relationship to Purchase Prices for Affordable Housing

2.1 When an RP establishes the price which it can afford to pay for a rented dwelling it will base its calculation on a discounted cash flow. It will establish an appropriate period over which to assess cash inflows and outflows, usually between 25 and 40 years and sometimes but not always based on an assumed period for repaying borrowing associated with the dwelling or scheme in question.

2.2 The cash inflows or revenues are almost entirely rent whereas the outflows will include the costs of managing and maintaining the stock, the cost of repaying the loan and the potential cost of void periods or any bad debts arising from changes in tenant.

2.3 An RP will apply inflation to its cash flow forecast, despite the fact that it intends to apply a discounting factor to those cash flows. The one aspect of cash movement which is not inflated is the cost of borrowing. The cash flow assumes this to be based on a long term averaged rate of borrowing interest, currently around 6%. The borrowing element represents 60% or more of initial costs in the cash flow but becomes effectively a ‘flat line’ of cost. Because all of the revenues are inflating (usually at the permitted maximum for target social rents of RPI + 0.5% per annum) it is possible to commence a scheme in revenue deficit but after time expect to be in surplus. Achieving an appropriate balance between the early years’ deficits and the future surpluses is the key to establishing viability.

2.4 As mentioned earlier, the cash flow forecasts will be discounted to reflect the eroding effect of time on the value of money. Because of inflation, delayed opportunity and risk, £1 received in the future is worth less than £1 received today. Most RPs tend to discount their cash flows at the borrowing long term interest rate. Although there is no direct connection between the two factors, the borrowing rate is judged to be a reasonable indicator of the cost of money over time.

2.5 The pricing or investment appraisal approach outlined above is normally described by RPs as establishing the ‘supportable deficit’ for a rented dwelling. Supportable deficits are capitalised as a price which the RP can afford to pay for a dwelling of a particular type and rent level.

2.6 Because social rents are based on a published formula and are reasonably consistent across fairly sizeable localities it is a straightforward task to work out what the purchase price for a given dwelling should be. This does require some estimation of the borrowing and management and maintenance cost assumptions an RP would make but these generally do not vary wildly and informed and prudent estimation will give a reliable result.

2.7 Differentials between dwelling types and sizes are fairly even and predictable with social rents and their related purchase prices. Rents step up steadily from 1 bed to 2 bed to 3 bed and so on and also from apartments to houses.

2.8 Purchase prices based on supportable deficits for affordable rented homes will vary a great deal more. Given that rents are to be based on 80% of market rents and that the market rents should reflect the particular locational and specification features of the property in question, there is inherently more potential for variance. Add to that the often substantial fluctuations of market rents by market zones across an area like B&NES and the sometimes steep price hikes from apartments to houses, then patterns of purchase prices will also be less predictable.

2.9 The results of our specific research undertaken for this study, set out later in this report, will demonstrate the more haphazard pattern for purchase prices based on affordable rents when compared with those based on social rents.

2.10 Another factor impacting on purchase prices which is of considerable significance is the degree to which RPs have been paying premiums over the true supportable deficits for social rented housing delivered via the planning system. In Ark's experience these premiums will typically amount to around £10,000 per dwelling for mid-range dwelling types (2 and 3 bedroom houses) in the B&NES area. These premiums have tended to be offered because:

- RPs are normally in competition for Section 106 affordable housing and will have strategic reasons for being keen to secure the business,
- Non-grant funded schemes have helped to bolster other grant funded programmes in the past and so are eagerly sought,
- The exposure to abortive costs and expensive pre-contract scheme development is much lower with Section 106 deals than with traditionally developed affordable housing,
- The underlying collateral value and low revenue risk of social rented housing, even where subject to a Section 106 Agreement, is perceived to be high and worthy of investment above that indicated by the supportable deficit figure.

Whilst some of these factors will continue to apply to Section 106 deals based on affordable rents, their relevance will be tempered by concerns about new or intensified risks.

2.11 Affordable rented housing will by no means be affordable for many low paid households in an area like B&NES. If it becomes therefore largely a tenure option suited to households which are wholly or mainly benefit dependent there are worrying consequences:

- the tenants become locked in a benefit dependency trap, unable to afford to accept employment for fear of having to meet some or all of the high rental cost,

- if benefit eligibility changes, including the proposed caps on Universal Credit being suggested in the Welfare Reform Bill, then even tenants receiving maximum benefit will be unable to afford their rents,

- the advantages of achieving mixed communities including the positive influence of working households in affordable housing will be largely lost and this has proven to create management and social difficulties in some areas.

2.12 Add to the benefit trap problem above, the fact that there will probably be more frequent re-letting of affordable rented housing because of fixed-term tenancies and it is easy to see why RPs are already adopting a different stance to pricing affordable rented housing when compared to social rented housing. The premiums on prices which have been the norm in recent years will reduce significantly and potentially disappear altogether.

3. Consultation with Registered Providers

3.1 We contacted three RPs which have a significant and developing presence in B&NES. All three are known well by the Council and are preferred for access to both grant funded schemes and (to whatever extent the Council can influence this) for access to affordable housing produced by Section 106 agreements.

3.2 Ark's purpose in contacting the three RPs was to obtain indications of the supportable deficit based purchase prices the RP's could sustain for different unit types in different market zones across B&NES, assuming that affordable rents were charged based on 80% of market rents. Additionally, we wanted to discuss with appropriate representatives from the RPs their views on the impact of the new rent setting system and their respective RP's approach to managing new risks.

3.3 Section 4 of this report includes a table setting out the average purchase prices indicated by the RPs. The remainder of this section summarises the views gleaned from the RPs on the application of the new rent setting system:

Principles for assessing purchase prices on Section 106 schemes

- The HCA has stated clearly to RPs that it does not expect any 'hidden subsidy' to be invested in Section 106 deals. There is no clarity on how this can be effectively policed. Also, because a supportable deficit approach to pricing relies on early years subsidy then there can be no such thing as a non-subsidised price.

- The quarterly statement which RPs will sign within the HCA contract terms is expected to include a certification that Section 106 schemes have not been subsidised. However there is scepticism about how carefully scrutinised this will be.

Setting affordable rents

- One of the RPs is likely to cap an affordable rent at the Local Housing Allowance (LHA). The LHA is the maximum rent a private tenant is eligible to claim in Housing Benefit. Tenants of social landlords do not have their HB restricted formally in the same way but the RP in question believes the LHA is a reasonable maximum to contain the benefit trap outlined earlier in this report.

- Figures provided to RPs by Ark showed average market rent levels by market zones. RPs emphasised that prime locations, such as Bath Western Riverside, could have market rents which substantially exceed average levels. RPs are interested in moderating affordable rents in these sorts of locations and hope that Council guidance on affordable housing planning policy will support this.

- There is most potential for large rent increases with the introduction of affordable rents for family houses, particularly in higher value zones. Concerns over affordability problems, especially for working families, are especially acute for these property types.

Perceptions of risk

- All three RPs believe that modelling or appraisal assumptions need to tighten to reflect the increased risks of affordable rents. The provision assumed for voids and bad debts will definitely need to increase and management costs and even long-term borrowing rates are likely also to be increased.

- Because gearing levels will be far higher for RPs with the introduction of low HCA grant levels, lenders are likely to expect increased margins on their loans. One of the RPs questioned is assuming that borrowing and internal subsidies account for over 90% of the cost of the 4 year programme for which it has submitted an offer to the HCA.

- The RPs rightly identify that there is added risk associated with affordable rents because they are 're-based' each time there is a change of tenant and rents could go down as well as up. Social rents are based on a steady inflator of RPI + 0.5%. In theory, if RPI is negative the rent could reduce but in practice there is a lot less fluctuation than with market rents (upon which affordable rents are based).

Modelling assumptions

- There are obvious commercial sensitivities for RPs associated with quoting the specific assumptions adopted for modelling schemes. However, two of the three RPs we contacted were willing to provide figures and we have averaged these to provide an overview of the typical assumptions likely to apply to establishing purchase prices for affordable rented housing on Section 106 schemes in B&NES.

- The typical average key assumptions are that:

    - payments to developers will follow the 'golden brick' VAT efficient approach of an initial payment for land and siteworks/foundations of around 30% of the total consideration followed by stage payments thereafter,

    - affordable rents will assume inclusion of service charges for flats of around £530 pa and for houses of around £200 pa,

    - management allowances will average around £380 pa per dwelling,

    - maintenance allowances will average around £250 pa per dwelling,

- the major repair provision will normally be deferred, anything up to 10 years and be set at around £760 pa per dwelling,
- long-term borrowing will be at an interest rate of an average of 6.25%, that the borrowing will be assumed to be an annuity mortgage, i.e. gradually repaying capital during the loan period and that the loan period will be between 25 and 30 years.
- the discount rate for cash flows will mirror the borrowing interest rate,
- generally schemes will be expected to achieve cumulative break-even by the end of the loan period.

4. Rents and Supportable Deficits Across Bath & North East Somerset

4.1 The table included later in this section shows a detailed breakdown of relevant rent and purchase price data collected or calculated by Ark during the course of this study.

4.2 The first column, in brown, indicates the current Local Housing Allowances for different property types and for different market zones across B&NES. As mentioned in the previous section of the report, LHAs are not a cap on affordable rents or on the eligible level of HB for a tenant of a social landlord. They are though being considered carefully by RPs as an indicative maximum level for affordable rents. The LHAs are expressed as weekly amounts.

4.3 The second column, with figures in purple, shows the average market rents based on data provided by B&NES and then the subsequent two columns in black show the affordable rent based on 80% of the market rent and the social rent for the equivalent property type. These figures are expressed as monthly amounts.

4.4 The columns of figures in red show some Ark analysis indicating affordable rents as a proportion of social rents and LHAs and the income levels required of households in order to afford market, affordable and social rents respectively, based on the Government's definition of affordability which is that no more than 25% of a household's gross income should be paid on direct housing costs.

4.5 The remaining columns are devoted to an analysis of the supportable deficit based purchase prices. The first of these columns shows a series of supportable deficit prices calculated by Ark and using fairly strict and prudent assumptions for modelling and reflective of the assumptions quoted to us by the RPs we contacted. There then follows a column of average supportable deficits for each dwelling, type and market zone derived from figures quoted by the three RPs. We believe that their figures are at levels in excess of those which are genuinely supportable. However, these are the prices those RPs are willing to pay for dwellings with affordable rents delivered through the planning system. The average RP quoted figures are then contrasted with the supportable deficit prices achievable with social renting where more relaxed assumptions have typically been adopted.

4.6 The comparison of supportable deficits for affordable rent and social rent produces some very interesting results. As a general rule the prices for apartments with affordable rents are lower than those for apartments with social rents. The prices for houses tend to be higher except in the lower value zones. In Norton Radstock, prices for all dwellings except 4 bedroom houses are lower with affordable rents than with social rents. In Keynsham, prices for 2 bedroom houses are lower with affordable rents than with social rents. Major increases in prices payable on a supportable deficit basis are only really evident for 4 bedroom houses and increases are generally more evident in high value zones.

4.7 It is worth emphasising that the supportable deficit prices achievable with social renting do reflect the premiums which RPs have tended historically to attach to purchase prices for this tenure type. These premiums will have to reduce in the future as RPs wider financial capacity comes under greater strain.

4.8 In the following section, section 5, we revisit the sites for which we assessed viability in our previous report in February and apply the affordable rent based prices to the scheme appraisals to test the impact. In carrying out those appraisals we have applied affordable rent prices based on an average of the figures quoted by the RPs and not including the lower Ark figures, which depress the averages. We believe this is a reasonable approach given that the RPs have ‘gone on the record’ with their prices and are quoting what they would expect to pay in reality.

B&NES Affordable Rent (ART) Modelling

Affordability Assessment of ART, various criteria

		LHA 30th Percentile (based on March 2011 LHA) £pw	Average Market Rent - data provided by B&NES as at April 2011 £pcm	**ART - 80% of Average Market Rent £pcm**	**Typical Social Rent - New Property £pcm**	80% MR as a proportion of SR %	80% MR as % of LHA	Household Income Required for Market Rent, 25% gross income £pa	Household income for ART at 80% market rent, 25% gross income £pa	Household income for ART at 80% market rent, 30% gross income	Ark - ART 'Strict' Estimate SD £pu	**RP 1, 2 & 3 Average ART Estimated SD £pu**	Social Rent SD average as per earlier RP returns £pu	**Average ART SD as % of SR SD**
Bath North														
Studio		69	515	**412**	**334**	123	138%	24,720	19,776	16,480	36,767	**40,384**	64,000	***63%***
1 bed flat		130.38	655	**524**	**386**	136	93%	31,440	25,152	20,960	54,831	**65,708**	72,000	**91%**
2 bed flat		160.38	740	**592**	**407**	145	85%	35,520	28,416	23,680	73,078	**80,520**	80,000	**101%**
2 bed house		160.38	785	**628**	**472**	133	90%	37,680	30,144	25,120	78,884	**97,721**	89,000	**110%**
3 bed house		183.46	945	**756**	**537**	141	95%	45,360	36,288	30,240	99,528	**116,382**	101,000	**115%**
4 bed house		258.46	1,100	**880**	**606**	145	78%	52,800	42,240	35,200	119,526	**139,882**	113,000	**124%**
Bath South														
Studio		69	490	**392**	**308**	127	131%	23,520	18,816	15,680	33,541	**37,771**	62,000	**61%**
1 bed flat		130.38	565	**452**	**351**	129	80%	27,120	21,696	18,080	43,218	**51,867**	64,000	**81%**
2 bed flat		160.38	700	**560**	**377**	149	80%	33,600	26,880	22,400	60,637	**72,659**	72,000	**101%**
2 bed house		160.38	765	**612**	**425**	144	88%	36,720	29,376	24,480	76,303	**89,138**	78,000	**114%**
3 bed house		183.46	850	**680**	**481**	141	85%	40,800	32,640	27,200	87,270	**102,068**	89,000	**114%**
4 bed house		258.46	985	**788**	**537**	147	70%	47,280	37,824	31,520	104,689	**123,172**	99,000	**124%**
Keynsham	Bristol - BS31 & BS14	Bath												
Studio	63.5	69	n/a	**n/a**	**290**	0	0	n/a	0	0	0	**0**	56,000	**N/A**
1 bed flat	114.23	130.38	510	**408**	**334**	122	72%	24,480	19,584	16,320	36,122	**42,906**	61,000	**70%**
2 bed flat	138.46	160.38	600	**480**	**360**	133	69%	28,800	23,040	19,200	47,734	**56,684**	67,000	**85%**
2 bed house	138.46	160.38	650	**520**	**399**	130	75%	31,200	24,960	20,800	61,466	**70,867**	73,000	**97%**
3 bed house	160.38	183.46	775	**620**	**446**	139	78%	37,200	29,760	24,800	77,594	**90,149**	82,000	**110%**
4 bed house	207.69	258.46	960	**768**	**494**	155	68%	46,080	36,864	30,720	101,463	**119,241**	91,000	**131%**
Norton Radstock														
Studio		69	425	**340**	**290**	117	114%	20,400	16,320	13,600	25,155	**28,078**	56,000	**50%**
1 bed flat		130.38	450	**360**	**334**	122	64%	21,600	17,280	14,400	28,381	**33,470**	61,000	**55%**
2 bed flat		160.38	535	**428**	**360**	133	61%	25,680	20,544	17,120	39,348	**46,587**	67,000	**70%**
2 bed house		160.38	595	**476**	**399**	130	68%	28,560	22,848	19,040	54,369	**62,092**	73,000	**85%**
3 bed house		183.46	710	**568**	**446**	139	71%	34,080	27,264	22,720	69,207	**80,176**	82,000	**98%**
4 bed house		258.46	870	**696**	**494**	155	62%	41,760	33,408	27,840	89,851	**104,925**	91,000	**115%**

Bathavon													
Studio	69	475	**380**	**312**	122	127%	22,800	18,240	15,200	31,606	**35,303**	63,000	**56%**
1 bed flat	130.38	565	**452**	**355**	127	80%	27,120	21,696	18,080	43,219	**51,992**	66,000	**79%**
2 bed flat	160.38	705	**564**	**403**	140	81%	33,840	27,072	22,560	61,282	**73,571**	75,000	**98%**
2 bed house	160.38	755	**604**	**433**	139	87%	36,240	28,992	24,160	75,013	**87,378**	77,000	**113%**
3 bed house	183.46	855	**684**	**494**	138	86%	41,040	32,832	27,360	87,915	**102,978**	92,000	**112%**
4 bed house	258.46	1,040	**832**	**550**	151	74%	49,920	39,936	33,280	111,785	**131,696**	102,000	**129%**
Chew Valley													
Studio	69	500	**400**	**319**	125	134%	24,000	19,200	16,000	34,832	**38,916**	64,000	**61%**
1 bed flat	130.38	550	**440**	**368**	119	78%	26,400	21,120	17,600	41,283	**49,508**	68,000	**73%**
2 bed flat	160.38	640	**512**	**425**	120	74%	30,720	24,576	20,480	52,895	**63,098**	77,000	**82%**
2 bed house	160.38	725	**580**	**452**	128	83%	34,800	27,840	23,200	71,142	**82,848**	82,000	**101%**
3 bed house	183.46	840	**672**	**506**	133	84%	40,320	32,256	26,880	85,980	**100,098**	94,000	**106%**
4 bed house	258.46	1,000	**800**	**556**	144	71%	48,000	38,400	32,000	106,624	**125,531**	103,000	**122%**

5. The Effect of Affordable Rents on Ark's Validation Study Findings

5.1 During the course of Ark's previous exercise to validate the Council's strategic viability assessment we carried out a brief appraisal for residential development on twelve example sites. These were selected from those considered to have development potential in the SHLAA, are spread throughout the B&NES area and provide a good diversity of size and development characteristics.

5.2 We have re-visited the viability appraisals for the twelve sites, updating the results by applying prices for rented homes based on the average purchase prices quoted by the three RPs we contacted and assuming affordable rents.

5.3 The results of the updated appraisals are as follows:

Code MSN 10

An ex-industrial site of 4.4 ha gross with potential for approximately 150 dwellings.

Although this site is in a lower value zone, the predominant dwelling type is a 3 bedroom house and unit prices for rented housing increase by an average of £4,000. The residual value increases to £462K/ha but is still well short of viability at policy affordable housing level of 35%. 11% is achievable.

Code RAD 3

An ex-industrial site of 0.42 ha with potential for approximately 25 dwellings.

The average unit price is a shade lower with affordable rents than was assumed in our original appraisal but not to a material degree. Effectively therefore the result remains a residual land value of £358K/ha and a viable affordable housing level of 10%.

Code RAD 29

A land assembly site of 0.7 ha with potential for approximately 27 dwellings.

As with RAD 3 there is no change to the previous result which showed a residual land value of £462K/ha and a viable affordable housing level of 11%.

Code PEA 1

A greenfield site on the southern edge of a small town consisting of agricultural land with the potential for approximately 95 dwellings.

The average rented unit price improves by about £15,000 which improves the residual land value to £644K/ha and the viable affordable housing level to 22%.

Code EH 3

A village infill site of 0.75 ha with potential for approximately 15 dwellings.

This scheme, which was already viable at policy level affordable housing, is improved to over £2m/ha residual land value.

Code TIM 2

Agricultural land of 2.92 ha with potential for approximately 80 dwellings.

There is no real change to the assumed unit price for rented housing and the scheme remains viable at policy level affordable housing provision.

Code WES 3

A warehouse site of 1 ha with potential for approximately 50 dwellings.

The average rented unit price improves by about £15,000 which improves the residual land value to £1.77m and is therefore now effectively viable at policy level affordable housing.

Code KING 15

A cleared and light industrial site of 0.73 ha with potential for approximately 125 dwellings.

The average rented unit price reduces by around £5,000 and this slightly impairs viability. The residual land value drops to about £1.75m at policy level affordable housing which is a shade under the target of £1.8m.

Code ODN 1

An ex-commercial site of 0.85ha with potential for approximately 43 dwellings.

The average rented unit price increases by around £15,000 and the residual land value increases to £1.9m, making this scheme viable at policy level affordable housing provision.

Code ODN 3

A paddock site of 1.4 ha with potential for approximately 45 dwellings.

As with ODN1 the rented unit price increases by around £15,000. This will increase the residual land value to £1.36m/ha and is still well short of the target £1.8m. 20% affordable housing is now the viable level.

Code K2

A substantial greenfield site in an edge of town setting, in a mid-value locality, with potential for approximately 700 dwellings.

The average rented unit price increases by around £8,000 on this scheme which was already viable at policy level affordable housing provision.

Code K4

A site in the grounds of another property of 0.2 ha with potential for approximately 14 dwellings.

Because the average unit size is smaller for K4 than for K2 there is no material change to rented unit prices and therefore to the overall result, where the scheme was already viable.

6. Key Conclusions

6.1 The changes to rent setting for affordable housing proposed in the Localism Bill and developed in more detail for RPs by the HCA's new grant funding framework are going to have a material impact on how RPs determine the price they can pay for rented housing. This is highly relevant to the application of policy for affordable housing delivered through planning obligations.

6.2 The new affordable rents are set by reference to market rents and the factors influencing those rents differ from the factors influencing social rents and make for a more complex, varied and unpredictable pattern of rents levels.

6.3 Social rent levels tend to be more even than affordable rents in their distribution across an area like Bath and North East Somerset and also differentials between dwelling types and sizes are more consistent.

6.4 There is a general perception that affordable rents will exceed social rents by a significant margin, particularly in an area like B&NES. Our recent research and analysis has demonstrated that this is not always the case and that smaller dwelling types, mainly apartments, in lower value areas are likely to have affordable rents which are less than social rents for the equivalent dwelling types and locations.

6.5 As regards the impact which the introduction of affordable rents will have on the delivery of affordable housing via the planning system, it is not appropriate to assume that if an affordable rent is greater than a social rent for a particular dwelling type that this necessarily translates into a corresponding increase in the amount an RP can pay a developer for that dwelling.

6.6 Given the supportable deficit or discounted cash flow approach adopted by RPs to arrive at appropriate purchase prices, the interplay of a series of appraisal or modelling assumptions governs the amount payable. Changes in RP's perceptions of risk are meaning that more cautious appraisal assumptions are being adopted and this will have a depressing effect on purchase prices.

6.7 In addition to a more cautious approach to assumptions, RPs are less able or willing to add premiums to prices for schemes secured through Section 106 agreements. The new HCA funding regime ostensibly debars RPs from over-subsidising Section 106 schemes but even if this is of questionable real applicability, RPs themselves, because of perceptions of risk and because of growing pressures on their other capital resources, are less able to sustain premiums on prices. Although difficult to estimate, premiums on prices could reduce in the future by as much as £10,000 per unit. On a scheme of 20 affordable housing units this could reduce residual land value or profit for a developer by £200,000 having a material impact on viability.

6.8 Taken overall, our research and analysis demonstrates that there will be increases in rent levels for family houses across most of B&NES with the introduction of affordable rents. These will be most pronounced for 3 and 4 bedroom houses and especially in the higher value market zones.

6.9 Because revenue increases from affordable rents do not translate fully into equivalent increases in purchase prices then many schemes in lower value market zones are unlikely to benefit from improvements in viability. Indeed those with a higher proportion of apartments are likely to experience an impairment to viability. For Norton Radstock and Peasedown, the lowest value market zone in B&NES and the one typically where schemes are not viable at policy level affordable housing provision, affordable rents are unlikely to make a positive contribution to viability.

6.10 For areas where the viability position of schemes is most challenged, these would have been the obvious targets for investment of HCA grant. Given that most market zones in B&NES produce viable schemes at policy affordable housing, this targeting of external subsidy would have been a pragmatic and workable strategy previously. However, the new HCA funding framework expects Section 106 schemes not to benefit from grant funding as a general rule and not to be cross subsidised by RPs utilising their internal capital resources. Therefore, and ironically, the introduction of affordable rents and the new grant funding regime has worsened the outlook for viability and/or delivery of policy level affordable housing provision in the most challenging areas.

6.11 We have re-examined the twelve example sites which were appraised in our previous validation exercise. With the introduction of affordable rents and consequent changes to RP purchase prices for rented housing the following overall results have emerged:

- 4 sites in low value zones continue to be unviable at policy levels of affordable housing although 2 have experienced slight improvements in the amount of affordable housing they can achieve,

- 1 site in a mid value zone experiences improvements in viability which partially closes a viability gap and enables the affordable housing level to increase from 17% to 20%.

- 5 sites continue to be viable at policy levels of affordable housing provision and 4 of these experience improvements in residual land values

- 2 sites become viable at policy levels of affordable housing provision.

6.12 In considering the impact of affordable rents on the delivery of affordable housing via planning obligations it is important to recognise the effects on affordability. The cost of family housing will increase and these increases are very high for larger houses. Rents for four bedroom houses will increase by around 50%. This will make it almost unaffordable for working families with limited or no benefit entitlement to live in larger affordable rented houses.

6.13 One consequence of the affordability problem is that affordable rented houses might become almost ‘residualised’ as housing for households which are wholly benefit dependent. This will create a benefit trap and an unwelcome concentration of worklessness.

6.14 In addition to the undesirability of this benefit trap and concentration of benefit dependency, emerging proposals in the Welfare Reform Bill for the capping of Universal Credit for tenants of social landlords suggest a cap at around £500 per week for a family. If an affordable rent is £177 per week, as it is for a four bedroom house in Keynsham, then this represents 35% of the total benefit income. Can that family with three or probably four children realistically meet its other outgoings (food, clothing, heating, transport, insurances and incidentals) with the remaining £323 per week?