

BRIEFING NOTE

Planning policy, housing numbers and affordability

January 2019

Lack of affordability is a common theme in almost any discussion about housing in England, and the explanation typically given for affordability problems is that we are failing to build sufficient housing to keep up with demand. In response to these concerns, the Government has therefore put in place policy measures to boost the amount of housebuilding, in areas where affordability is poor.

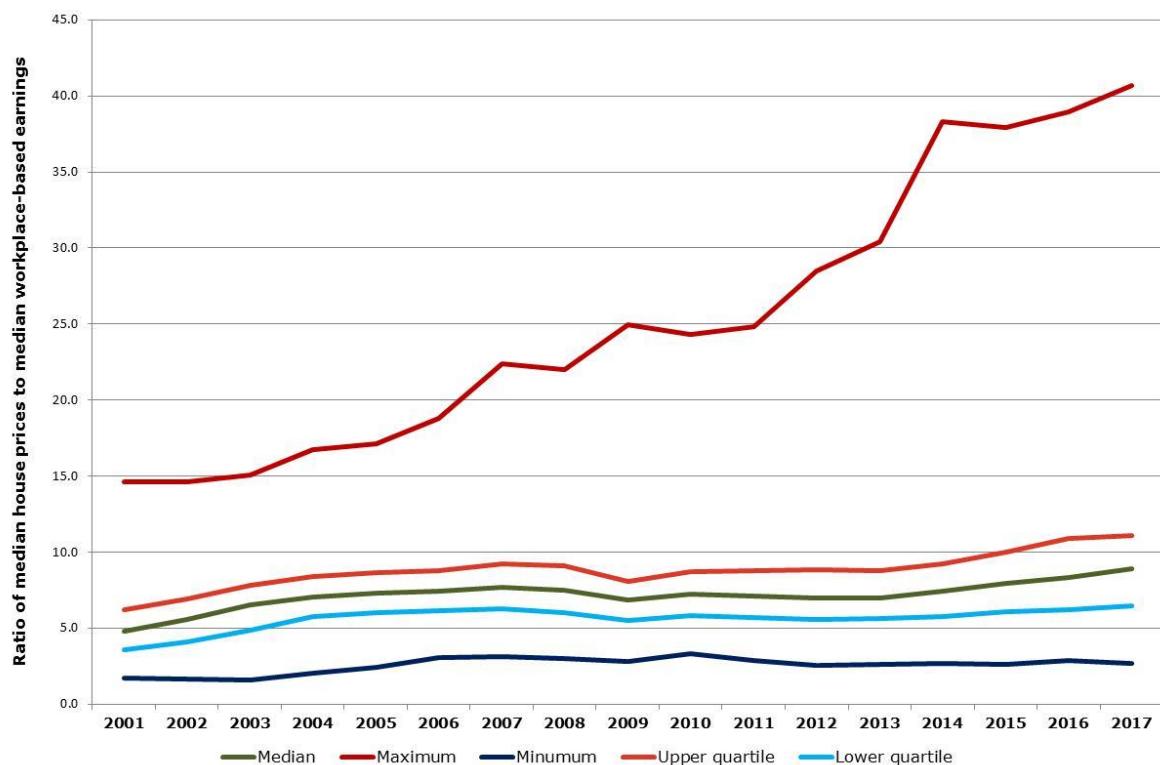
This article looks at the links between housebuilding and affordability in practice, and considers the implications of the new policy regime. In particular, it highlights the fact that historically there has been zero correlation between housebuilding and affordability at Local Authority level. Given this, and the way in which the planning system works, one potential unintended consequence of the change is that over time it could undermine the ability of Local Plans to influence planning decisions.

1. Housing affordability

For anyone wanting to buy a house (rather than rent), their ability to do so will depend on a combination of their savings and the size of the mortgage they can get. In general, mortgage companies try to limit the size of both the loan-to-value and the loan-to-income ratios of any mortgages they provide. This is because capital requirements differ depending on the riskiness of the loans provided, and high loan-to-value and loan-to-income ratios are a signal of a higher risk of default and therefore potentially increase the amount of capital the mortgage provider must hold. Indeed, the Bank of England's Financial Policy Committee closely monitors the number of mortgages with high loan-to-value or loan-to-income ratios. For example, it assesses the number of mortgages where the loan-to-income ratios are more than a factor of 4.5, and the Committee has the ability to further tighten capital requirements, if they consider risks have increased.

For this reason, house price-to-income ratios are a key determinant of the affordability of housing in different areas. Figure 1 shows how the ratio of median house prices to median earnings has changed over time, by looking at the distribution of this ratio across different Local Authority districts between 2001 to 2017. It does so from the point of view of workers based in these districts for work (so-called workplace earnings), as most people would typically prefer to live close to where they work. What Figure 1 shows is that, despite slight improvements in affordability at around the time of the financial crisis, in general the trend has been for affordability to deteriorate. Indeed, even for Local Authority districts in the lower quartile of house price-to-earnings ratios, median house prices have been above 4.5 times median workplace earnings since 2003.

Figure 1 Ratio of median house prices to median gross annual workplace-based earnings by Local Authority District in England, 2001-2017



Source Analytically Driven Ltd

Notes Comparison of 326 Local Authority Districts in England. Boundary changes and the creation of Unified Authorities mean that some LA districts have incomplete records. Workplace-based earnings measure the earnings of workers based in the relevant LA district for work, rather than the earnings of residents. Data are from the Office for National Statistics (ONS).

In fact, in all 313 Local Authority districts in England with data for both 2001 and 2017, the median house price to median workplace earnings ratio increased between 2001 and 2017, indicating that throughout the country affordability was deteriorating. On average, compared to where they stood in 2001, by 2017 median house prices at Local Authority level had increased by an additional 4.3 times the median gross earnings of those working in the district, with the median increase representing an increase of an additional 3.8 times earnings. Even the Local Authority district with the smallest deterioration in affordability, namely Copeland in the North West, the ratio of house prices to earnings increased from 1.7 to 2.7 over the period. For the Local Authority district with the worst affordability, namely Kensington and Chelsea, the median house price to median workplace earnings ratio increased from 14.6 in 2001 to 40.7 in 2017.

2. Planning policy and (lack) of affordability

Economics 101 suggests that the best way to reduce prices is to increase supply relative to demand. Recognising this, when the National Planning Policy Framework (NPPF) was revised in 2018, changes were introduced that increase the local housing needs figures in areas where affordability is poor. Box 1 sets out the different concepts of housing numbers used in planning law and the relationship between them, together with an overview of the adjustments in the NPPF to

take account of affordability. Broadly speaking, in any area where the median house price to median earnings ratio is above four, then the calculated housing need is increased to take into account affordability, with the total increase being capped at about 40%.¹

Box 1 Housing numbers and planning law

While the NPPF provides the overarching framework governing the planning regime, it has no direct role in deciding where and how many houses are built. These decisions are made at a local level through Local Plans (and to a limited extent Neighbourhood Plans). This means that if the planning system is to deliver the right houses in the right places, then the process that Local Authorities use to calculate their housing need, needs to be one that will also deliver the right distribution of housing at national level.

So how do Local Authorities decide on their housing requirement? Following the introduction of the NPPF in 2012, planning law distinguished between three different concepts of housing numbers for a given location.² These were:

- **Household projections:** These are the demographic, trend-based projections indicating likely number and type of households, if underlying trends and demographic assumptions are realised.
- **Full Objective Assessment of Housing Need:** This is the objectively assessed housing need for an area "leaving aside policy considerations". This can differ from the housing projections, if, for example, the projections fail to take into account a factor such as the impact of a major downturn or upturn. Where there are no such factors, it can be the same as the relevant household projections.
- **Housing requirement:** This figure reflects not only the objectively assessed need for housing, but also any policy considerations that might require the housing target to be adjusted. As such the housing requirement represents the "policy on" assessment of housing need. Policy considerations could include, for example, constraints such as the extent of land that is part of an Area of Outstanding Natural Beauty (AONB), or decisions to encourage or discourage particular migration reflected in demographic trends.

These numbers were not only needed to determine how many houses Local Authorities hoped to see built in their area, they also provided a mechanism to allow developers to challenge authorities where they thought they were being unduly restrictive. For example, if an Local Authority could not demonstrate that it had a five-year supply of deliverable housing sites that would meet its housing requirement, then any policies governing the supply of housing in the Local Plan (for example restricting development outside identified areas) needed to be treated as out-of-date in determining planning applications, so that only national policies had full weight. However, although the

¹ The exact size of the increase may be above 40% of the household projections, depending on the status of the Local Plan and the housing requirement identified within it.

² See Mr Justice Hickinbottom's ruling in the High Court case [2014] EWHC 1283 (Admin).

relationship between these numbers was often challenged, the Planning Guidance accompanying the 2012 NPPF did not specify how they should be calculated.

However, revisions to the NPPF introduced in 2018 made changes to the relationship between these numbers and the amount of discretion available to Local Authorities. Specifically:

- Rather than produce their own household projections, Local Authorities are now required to use the national household projections produced by the ONS for their area.
- The assessment of housing need is then required to take into account any lack of affordability. Specifically where the median workplace affordability ratio for their area is above four, then the household projections need to be adjusted upwards, where the adjustment factor is given by:

$$((\text{local affordability ratio} - 4)/4)*0.25$$

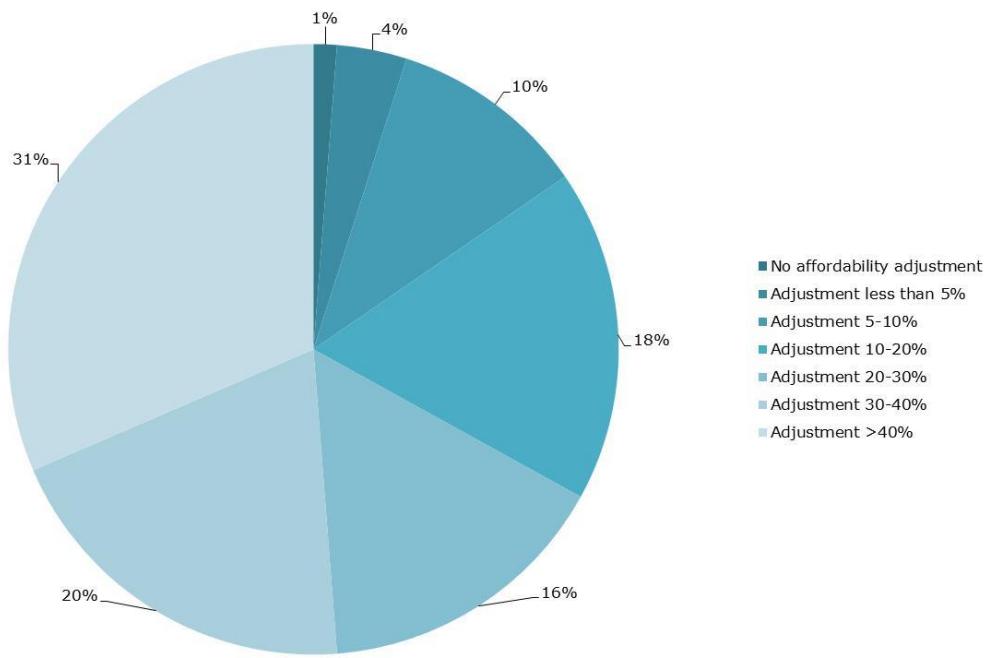
No adjustment is applied where the affordability ratio is 4 or below. The final housing needs assessment is then calculated by comparing this adjusted household projection with a 40% increase in either the identified housing requirement within the Local Plan, or the household projection, with the status of the Local Plan determining which figure is used.

- Where a Local Plan has been adopted in the last five years, then the final minimum housing need is calculated by taking the minimum of the affordability adjusted household projection (as calculated above) and a 40% increase in the housing requirement set out in the adopted Local Plan.
- In contrast, where the Local Plan was adopted more than five years ago, an adjusted housing requirement is calculated using either the household projections or the identified housing requirement in the old Plan, depending on which is higher. The higher of these two figures is increased by 40%, to provide a 40% adjusted housing requirement. The final minimum housing need is then given by the minimum of the affordability adjusted household projection and the 40% adjusted housing requirement.

So given the new framework for assessing housing need set out in the revised NPPF, and the observed affordability ratios in 2017, what sort of increase to household projections should be expected and what does the distribution of these increases look like? As set out in Box 1, the final increase in calculated housing needs over and above the ONS's household projections will depend on the status of the Local Authority's adopted Local Plan. However, in all cases the affordability adjustment to the household projections provides the starting point for the calculation and will therefore be informative about the likely scale of any increases. Figure 2 therefore sets out the results from the first stage of the calculation set out in the revised Planning Guidance, namely the affordability adjusted household projections. The analysis mirrors the findings set out above that detail widespread affordability problems. In particular, only 1% of Local Authorities (4 in total) will

not need to apply an affordability uplift to their household projections, while over half of Local Authorities will need an uplift of at least 30%, with almost one third needing an uplift of over 40%.

Figure 2 The distribution of the affordability uplifts in household projections across Local Authorities



Source Analytically Driven Ltd

Notes Data are from the ONS for median house price to median workplace earnings for 324 Local Authorities in 2017. The formula applied to calculate the affordability uplift to the household projections is set out in the Planning Guidance associated with the 2018 revisions for the NPPF and can be found in Box 1 above.

The ONS's 2016-based household projections (the most recent available), show that the number of households in England is expected to increase by 1.65 million between 2019 and 2029. In total, if the identified affordability uplifts to household projections were to be applied (and the houses associated with them could be funded and built), then the supply of houses in England would increase by 2.24 million between 2019 and 2029, an increase of 35.9% over and above the ONS's projected increase in households. The addition of 590,000 houses over and above the household projections would represent a 2.5% increase compared to the dwelling stock in 2017.³

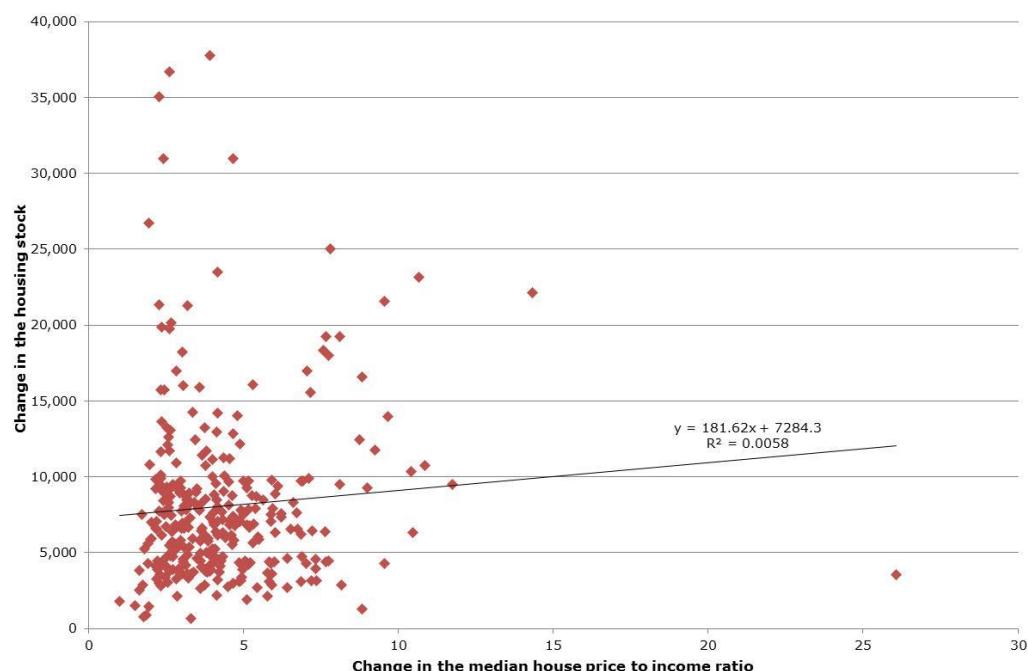
3. The links between affordability and housebuilding at Local Authority level

A key question is clearly whether the scale of the proposed increases in housebuilding will be sufficient to address affordability. While Economics 101 might suggest that raising supply relative to demand must lead to a reduction in prices, one issue that might give pause for thought is the fact that historically there has been zero correlation between the amount of housing built at Local Authority level and relative changes in affordability.

³ 2017 is the most up-to-date data for the dwelling stock by Local Authority.

Even if in aggregate affordability was declining, due to insufficient house building at a national level, it might be expected that any increase in the scale of housebuilding in one district compared to other areas should act to limit any reduction in affordability in that area. In practice this has not been the case, regardless of whether the scale of housebuilding is measured in either absolute terms, or relative to the existing housing stock. This can be seen from Figures 3 and 4, which detail the lack of correlation between housebuilding and affordability at Local Authority level.⁴

Figure 3 Absolute change in the housing stock at Local Authority level between 2001 and 2017 and change in the median house price to median workplace earnings ratio

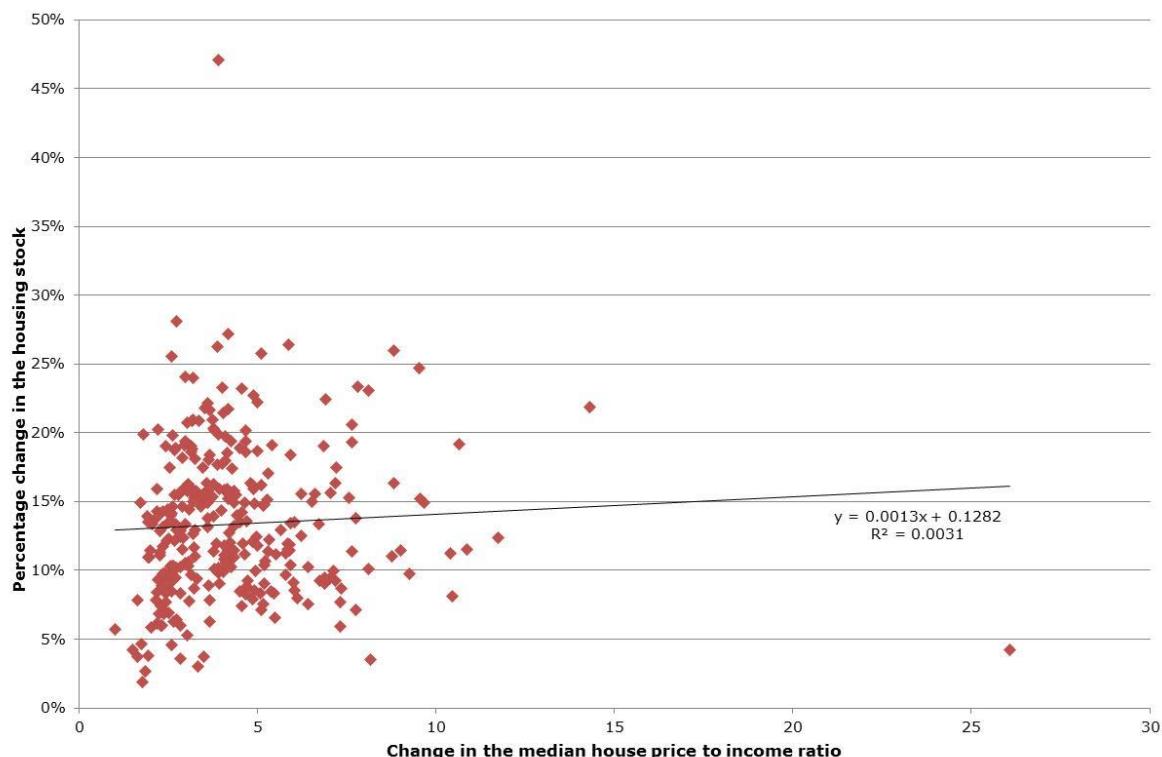


Source Analytically Driven Ltd

Notes Data are from the ONS and are for 313 Local Authorities with complete records for 2001 and 2017. The change in median house prices to median workplace earnings is measured by subtracting the observed ratio in 2001 from the ratio observed in 2017. The change in the housing stock is measured by subtracting the observed dwelling stock in 2001 from the stock observed in 2017. The trend line shows the statistical relationship between the two series, with the slight upward slope indicating that an increase in the amount of housebuilding leads to an increase in the house price to earnings ratio (and therefore a reduction in affordability). However, the R^2 for this relationship is effectively zero, indicating that in practice, from a statistical perspective, increases in housebuilding have had zero impact on affordability.

⁴ Similar findings are observed if the change in affordability is measured in percentage rather than absolute terms, but are omitted here in the interests of space.

Figure 4 Percentage change in the housing stock at Local Authority level between 2001 and 2017 and change in the median house price to median workplace earnings ratio



Source Analytically Driven Ltd

Notes Data are from the ONS and are for 313 Local Authorities with complete records for 2001 and 2017. The change in median house prices to median workplace earnings is measured by subtracting the observed ratio in 2001 from the ratio observed in 2017. The change in the housing stock is measured as the percentage increase in the dwelling stock between 2001 and 2017. The trend line shows the statistical relationship between the two series, with the slight upward slope indicating that an increase in the amount of housebuilding leads to an increase in the house price to earnings ratio (and therefore a reduction in affordability). However, the R^2 for this relationship is effectively zero, indicating that in practice, from a statistical perspective, increases in housebuilding have had zero impact on affordability.

What might explain the apparent lack of correlation between housebuilding and affordability and what are the implications for the Government's new policy?

One potential reason for the observed patterns is that housing markets do not observe strict geographic boundaries. Therefore housebuilding in one area might attract residents from other areas. In doing so, the impact is to increase not only supply, but also demand for housing, potentially neutralising, or even reversing, the expected impact on local house prices. Furthermore, any increase in the supply of houses that is associated with an increase in demand from elsewhere is also associated with an increase in the number of people, and potentially therefore also the number of workers based within a Local Authority area. While evidence from international migration suggests that there is no impact on local wages from high-skilled migrants, the picture for low-skilled migrants is more mixed.⁵ Conceivable, therefore, inward migration, particularly low-skilled inward migration, might act to suppress wages relative to what they might

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Talk by Professor Alan Manning to the Society of Professional Economists, November 22nd 2018.

otherwise have been, regardless of whether the migrants come from abroad or elsewhere in the UK.⁶ Therefore the potential for increases in the housing stock in one area to increase both demand for housing from elsewhere and the supply of workers will make it difficult to disentangle the likely changes to affordability ratios stemming from the increase.

In addition, even within a Local Authority district, there are potentially multiple different housing markets, as the desirability of different properties within the same Local Authority will vary depending on their size, or location relative to key amenities such as jobs, transport infrastructure or good schools. If housebuilding is skewed towards providing larger, more desirable properties (for example, because higher prices help boost developers' profits), then the average price of houses for the district as a whole may increase simply because there are a higher proportion of more desirable properties contained within it. Unless the impact of this change is also to increase the number of high paying jobs within the Local Authority district, the impact of housebuilding may be to reduce median affordability, rather than improve it.

4. The potential for unintended consequences

We have planning policies for a reason – in order to manage the externalities that occur, because there is a mismatch between the incentives for private landowners and those for society as a whole. Estimates from 2017 suggest that one hectare of agricultural land in the South East of England is worth around £22,000, but that the price would rise to around £3.6 million if it had planning permission for housing.⁷ As such landowners can have a strong incentive to push for development. However, land is a finite resource and cannot be moved. Therefore it is important that development is managed in order to minimise potential negative impacts on society as a whole such as: developments in areas with high amenity value because of their natural beauty; the undermining food security by the development of high quality agricultural land; increases in congestion; or potential reductions in road safety.

One of the problems with building more houses is therefore the question of how to plan for where to put them.

Since the introduction of the NPPF in 2012, the planning rules governing development in England have been made up of three components: the NPPF itself; a Local Plan prepared by the relevant Local Planning Authority; and, where the local community decides to produce one, a Neighbourhood Plan covering the relevant area, which is typically the local parish. Within this framework, it is the Local Plan that plays a key role in shaping strategic decisions about where housing should be located and how much housing there should be. Once a Local Plan has passed examination and been adopted, it becomes part of the Development Plan for the local area and is used to determine whether planning permission should be granted on individual applications.⁸

⁶ Given the UK has a minimum wage, this suppression in earnings might manifest itself in a higher share of minimum wage jobs, or in workers not being able to work the hours they want, rather than wage reductions per se.

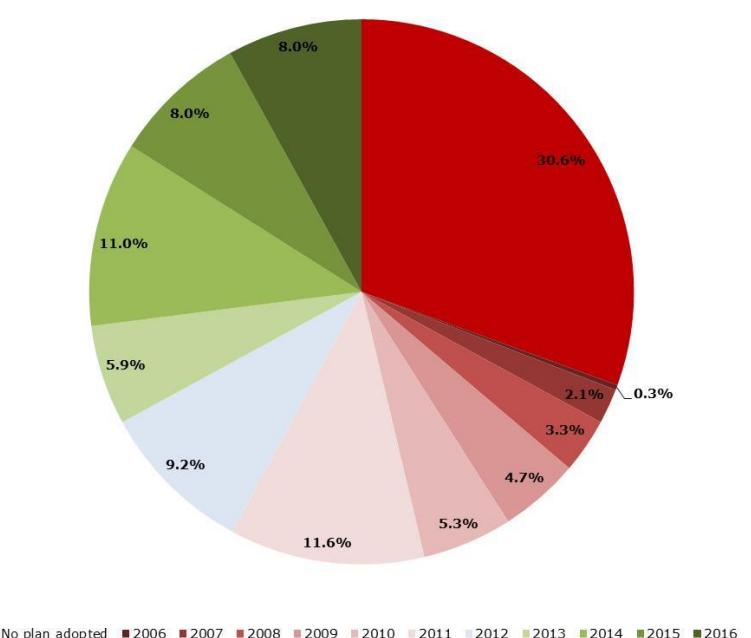
⁷ Giles, C, (2017) "Tory land compensation plan is the first step in housing reform", Financial Times, 15 May 2017, <https://www.ft.com/content/f9d2f67c-395c-11e7-821a-6027b8a20f23>.

⁸ In the case of Neighbourhood Plans, the process of adoption also involves the need to pass a local referendum. As Neighbourhood Plans are not mandatory, not all parishes intend to introduce one.

However, the planning policies set out in Local Plans, such as policies defining which sites have been chosen, can only be given full weight in determining any planning application where the Local Authority can demonstrate that it has a five-year supply of deliverable housing sites that would meet its housing requirement. If it cannot demonstrate this, then developers have far more freedom to propose sites that would otherwise be blocked, and to challenge decisions where Local Authorities fail to approve them. This makes it harder for Local Authorities to manage the externalities associated with development.

The implication of this quirk of planning law is that the combination of the length of time that it takes to introduce a Local Plan and the methodology that the ONS uses to create its household projections may make it ever harder for Local Authorities to keep Local Plans up-to-date. In other words, more and more planning decisions may be made that are contrary the Local Authorities' preferred policies.

Figure 5 Progress on introducing Local Plans – the date of adoption



Source Analytically Driven Ltd

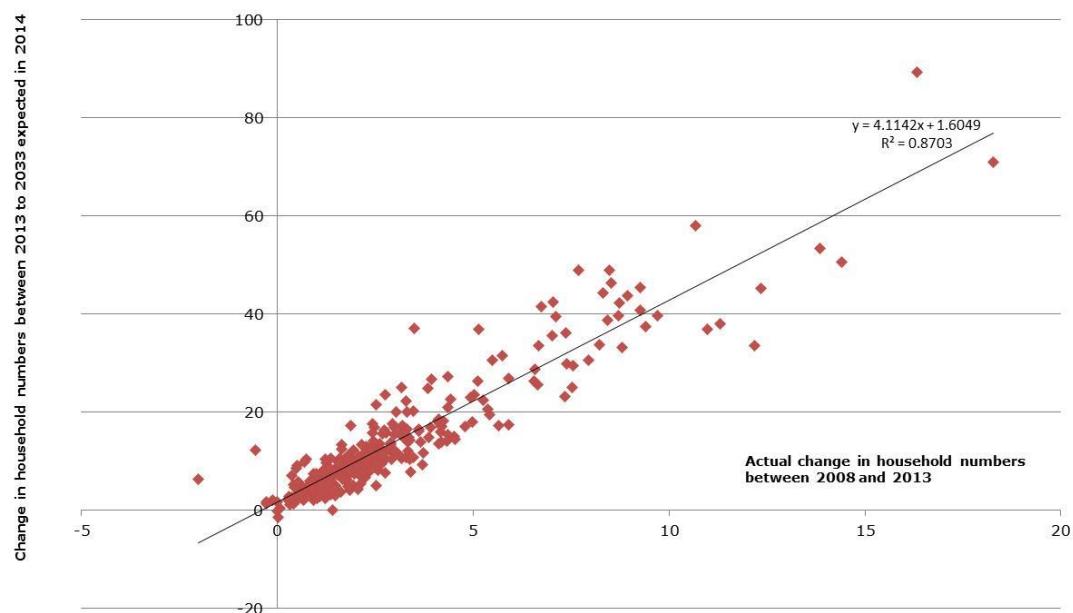
Notes Based on data from the Planning Inspectorate dated 31 December 2016 on the status of Local Plans for 337 councils.

Introducing a Local Plan is not a simple undertaking. It involves several consultations, as well as a formal examination. Data from the Planning Inspectorate show that, even once a Local Plan has reached its pre-examination consultation (the Regulation 19 consultation), on average it still takes a year and seven months for a Local Plan to be adopted. This excludes the time needed to prepare the Local Plan for examination, including earlier consultations on different aspects of the proposed plan. For this reason, historically Local Authorities have only updated their Local Plan on an infrequent basis. As Figure 5 shows, as at 31 December 2016, only 42.1% of Local Authorities had adopted a Local Plan since 2012 (the date when the NPPF was introduced), with 30.6% having no adopted Local Plan.

Infrequent updates to the Local Plan may have worked historically. However, if Local Authorities want to avoid the policies within their Local Plan being ruled as out-of-date on technical grounds, they will need to bring forward sites more quickly, particularly in light of the affordability adjustment to the calculation of housing need set out in the 2018 revision of the NPPF.

This has two potential consequences. Firstly, if developers are reluctant to bring forward the sites identified in Local Plans more quickly, developers of less desirable, but potentially more profitable, sites may bring their sites forward, contrary to the adopted Local Plan. Secondly, the impact of the methodology that the ONS uses for household projections may mean that more development leads to further increases in the need for development, so that Local Authorities end up chasing ever increasing targets. This is because the ONS subnational household projections do not attempt to forecast household numbers, or consider questions such as the desirable geographic distribution of housing. Instead ONS projections simply use the rate of change at subnational level over the previous five years, in order determine the distribution of future projected changes, see Figure 6.

Figure 6 Relationship between household growth outcomes and projected household growth (thousands)



Source Analytically Driven Ltd

Notes Based on the ONS's 2014-based household projections.

A key question is therefore how important are the potential externalities associated with more planning permissions being granted that are contrary to adopted Local Plans?

5. Conclusions

In response to concerns about the affordability of housing, in 2018 the Government introduced changes to force Local Authorities in areas where affordability is poor to increase housing targets. The impact of this change is likely to be a significant increase in the number of houses that get built, relative to what might otherwise have been the case. Indeed, only around 4% of Local Authorities in England are likely to see no impact from the changes, while around half are likely to face a relative increase in the houses they need to plan for of at least 30%.

However, the likely impact of these changes on affordability is less clear. In particular, historically there has been zero correlation between changes in the housing stock and changes in affordability at Local Authority level. This reflects: the overlapping nature of housing markets, with supply in one area attracting demand from elsewhere; inward migration in response to an increase in the housing supply, also increasing the supply of workers, and therefore potentially impacting wages; and finally potential skews in housebuilding towards more desirable homes increasing both the average and median house prices as a result of a batting average effect.

Regardless of the impact of affordability at a national level, the changes may potentially make it harder for Local Authorities to demonstrate that they have a five-year housing land supply. This means one potential unintended consequence of the new regime is that it will undermine the ability of Local Plans to influence planning decisions.

Report by Dr Rebecca Driver, Director, Analytically Driven Ltd



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