BRIEFING NOTE: SECTION 106 AND AFFORDABLE HOMES – HOW TO KEEP DELIVERY GOING IN THE SHORT-TERM

INTRODUCTION

London needs to build at least 66,000 new homes a year[1], but it is falling considerably short of this target. While structural change is required to deliver a step-change in housebuilding in the capital, there are also several immediate issues which, if properly addressed, could help to stimulate development; one such issue is the lack of appetite from Registered Providers to purchase affordable homes through the Section 106 process.

BusinessLDN, working in partnership with DS2, specialists in financial viability and affordable housing, have created this briefing note which sets out what the problem is and proposes some solutions that will help keep development in London moving through the planning system and ultimately into construction.

AFFORDABLE HOUSING AND SECTION 106

Section 106 agreements place obligations on landowners and developers to, amongst other things, deliver affordable housing as part of large developments[2]. Upon completion, these affordable homes are transferred to the ownership and management of Registered Providers (either a housing association or a For-Profit Registered Provider) with the developer typically exiting the project. Local authorities retain the nomination rights for low-cost rented homes.

Affordable homes delivered through the Section 106 process represent a significant proportion of the affordable housing built in London over the last ten years. Though a figure is not available for London, nationally affordable homes funded by Section 106 agreements accounted for 47% of all affordable housing delivered in 2022-23[3]. This reliance on the Section 106 process to deliver affordable housing has been driven by high land prices, competition by the private sector for development sites, low levels of public sector housing starts and low levels of affordable housing grant funding.

REGISTERED PROVIDERS UNDER FINANCIAL PRESSURE

In previous years, the largest Registered Providers have increased the delivery of private and affordable housing by purchasing land and developing sites themselves. However, more recently, Registered Providers have refocused their capital on existing communities rather than on expanding the number of homes under ownership and management.

[1] This is the assessed need in the London Plan, though the capacity-based ten-year target is 52,300 homes.
[2] A large development is defined as the provision of 10 or more homes, or the site has an area of more than 0.5 hectares.
[3] Affordable Housing Supply in England 2022 to 2023, Department for Levelling Up, Housing and Communities.

This refocussed spend is a result of several factors. The same issues that have beset housebuilders - high build cost inflation, regulatory uncertainty and an under-resourced planning system, are also impacting housing associations resulting in reduced spend on new development. Additionally, housing associations are being encouraged to concentrate on repairs and maintenance, upgrading the energy efficiency of homes and addressing fire safety concerns.

Furthermore, over the past 10 years housing associations have had to contend with lower levels of grant to support their construction programmes and changes to agreed rent settlements, both of which have necessitated savings to be found by reducing capital investment into new development.

Most recently, we've seen a rise in For-Proft Registered Providers coming into the market, which has provided a much need injection of capital into the sector – more must be done to unlock such investment[4]. However, their appetite for significant additional investment is currently limited due to the wider economic environment. It is also a part of the market that is evolving and has not reached a scale where it can provide an easy solution to the section 106 logjam that is currently occurring.

IMPLICATIONS – A SLOWDOWN AND REDUCTION IN DEVELOPMENT

As a result of the problems with the Section 106 process, schemes are either taking significantly longer to progress to construction or simply not being built at all.
From discussions undertaken with developers, we understand that whilst two years ago there were normally at least half a dozen Registered Providers willing to bid competitively for affordable housing opportunities in London, in many cases this is now down to one or two and in many cases none. If there are no appropriate offers for the affordable homes, then development can come to a standstill despite the schemes having planning permission and being financially viable.

Due to the current situation it could also be possible to see affordable homes being built but remain unoccupied despite the acute need. Some larger developers have the liquidity to commence projects without a Registered Provider on board, hoping to find one before completion of the scheme. However, there are examples of projects that are approaching completion where no Registered Provider has been found.

The lack of affordable housing provider on these schemes will have cashflow implications for housebuilders affecting their returns on capital and potentially their ability to invest into new housing opportunities. Smaller and medium-sized developers often rely on selling the

[4] See The Case for Private Investment into Affordable Housing, BusinessLDN and CBRE: October 2022.

affordable housing to a Registered Provider to commence development - without a forward sale, securing debt funding will be problematic and schemes will stall.

Even in situations where a buyer is eventually found to purchase the affordable element of the scheme, the previously agreed number of affordable homes may no longer be viable and may have to be reduced – an outcome that no one wants to see.

The drop off in development starts, both now and in the foreseeable future, will only exacerbate the already acute need for affordable housing tenures in the face of ever-increasing housing waiting lists.

Case Study: Barratt London, London Borough of Southwark
Barratt London were developing a project in Southwark which included 90 affordable homes. The majority of the affordable homes were for social rent in a borough with particularly high demand for family housing of this tenure. It was very challenging to secure a Registered Provider to purchase the affordable homes; the contract for the homes were under offer three times and failed to complete twice due to the financial difficulties of the Registered Providers.

A Registered Provider was eventually found but by this point development was substantially underway, with 60% of the development complete. There was a considerable financial cost to marketing the homes and the abortive fees where deals failed to complete. In cases like these, only large developers will be able to commence development without a Registered Provider in place for the affordable homes, but even then, it creates a significant amount of risk.

SHORT-TERM SOLUTIONS

Pragmatic, short-term solutions could help kickstart delivery. In some instances, it makes sense for local authorities to receive the cash equivalent of the affordable homes from the developer – often referred to as a payment in lieu. This money could be used to support a local authority's own affordable housebuilding programme such as an estate regeneration scheme, which may require a cash boost.

In other instances, the approved list of Registered Providers for a local authority could be expanded, or the process by which other Registered Providers can be utilised who aren't on the approved list should be streamlined. This would help increase the number of partners that can work with developers to help deliver and manage affordable housing.

In addition to these solutions, bolder action is likely to be required. One possible course of action could be for London government to establish a vehicle, backed by institutional investment, to purchase Section 106 affordable homes that cannot be sold via the normal process and to manage them to provide long-term housing for working Londoners. Such a proposal is currently being developed by Opportunity London and merits further detailed consideration.

LONG-TERM SOLUTIONS

The quick fixes highlighted above are far from complete solutions and won't work in every situation, but they can play a role in facilitating vital development in difficult market conditions. In the long-term, these pragmatic ideas must be matched by structural reform.

The Government should provide long-term certainty about both a future rent settlement, ensuring its reflective of the costs that housing associations are facing, and its Affordable Housing Programme, ensuring the money is provided flexibly to reflect the cyclical nature of development. This long-term certainty would provide two benefits. Firstly, it would allow Registered Providers to plan with confidence for the future, adjusting their business plans accordingly, and potentially freeing up capital to purchase new homes. Secondly, it could help to attract more private investment into affordable housing, bolstering the limited amount of public funding that is currently provided which, when the economy allows, must ultimately be increased to support a step-change in supply.

SUMMARY

London is in the midst of a housing crisis, with huge demand for housing combined with extremely challenging market conditions which are constraining development. For developments that can negotiate the planning system and financial environment, they are now being confronted with this further challenge of securing a purchaser for the Section 106 affordable homes. This process is an additional barrier to delivery that many developers simply cannot overcome.

Whilst there are long-term solutions, pragmatic action must be taken now to protect housing delivery in London.

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BUSINESSLDN

At BusinessLDN, our mission is to make London the best city in the world in which to do business, working with and for the whole UK.

We work to deliver the bigger picture, campaigning to tackle today’s challenges and to secure the future promise of London. We harness the power of our members, from sectors that span the economy, to shape the future of the capital so Londoners thrive and businesses prosper. We support business to succeed — locally, nationally, globally.

We campaigned for the creation of the office of London Mayor and Transport for London, for the Elizabeth Line, for congestion charging, and we incubated Teach First. We create opportunities for our members, from sharing insights to providing platforms, from making introductions to finding new talent.

DS2

At DS2 we specialise in financial viability and affordable housing, advising on a diverse range of projects including high profile and strategic sites in London and Nationwide.

We concentrate on our market so we can provide clear, independent and commercially-driven advice to our clients.

In addition to the client services listed below, we are thought leaders in the property and housing sector, working regularly with organisations such as the RICS and BusinessLDN to produce published materials on current and emerging issues.