

Policy Response

Calculating Housing Need



Savills Research
UK Residential

Standard housing need methodology needs rewriting following release of new household projections

The standard housing need methodology, a cornerstone of the Housing White Paper, needs a re-write following publication of the new household projections on 20th September.

It has brought starkly into the spotlight that relying too much on household projections to assess housing need is inappropriate.

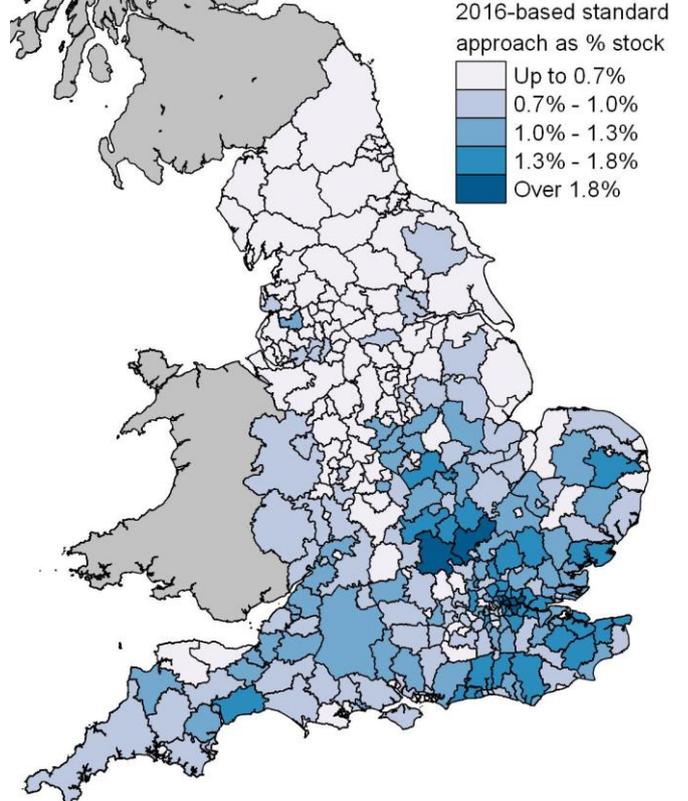
Local Planning Authorities, housebuilders, land promoters and developers are in limbo until the Government concludes its promised consultation on how to change the methodology.

The standard methodology has always had three flaws: the overall number is too low; the need is not sufficiently focused on the most unaffordable regions; and there are some very unaffordable areas with very low housing need due to suppressed household formation.

With the new household projections, the standard methodology generates the housing need shown in Figure 1. This clearly does not respond adequately to the challenge to improve housing affordability (Figure 2).

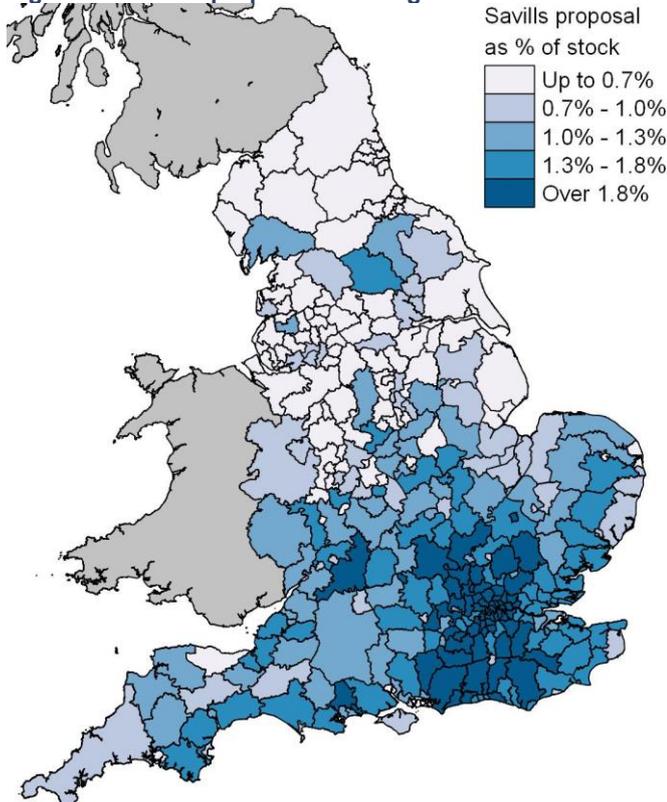
Our recommended approach, first published in October 2017, is more resilient to changes in the household projection methodology. It reduces the impact of suppressed household formation and results in a housing need for England of 290,000 homes per annum, within 3% of the Government's housebuilding target. The distribution of housing need also responds to the challenge to improve housing affordability (Figure 3).

Figure 1 – Housing need based on the standard approach



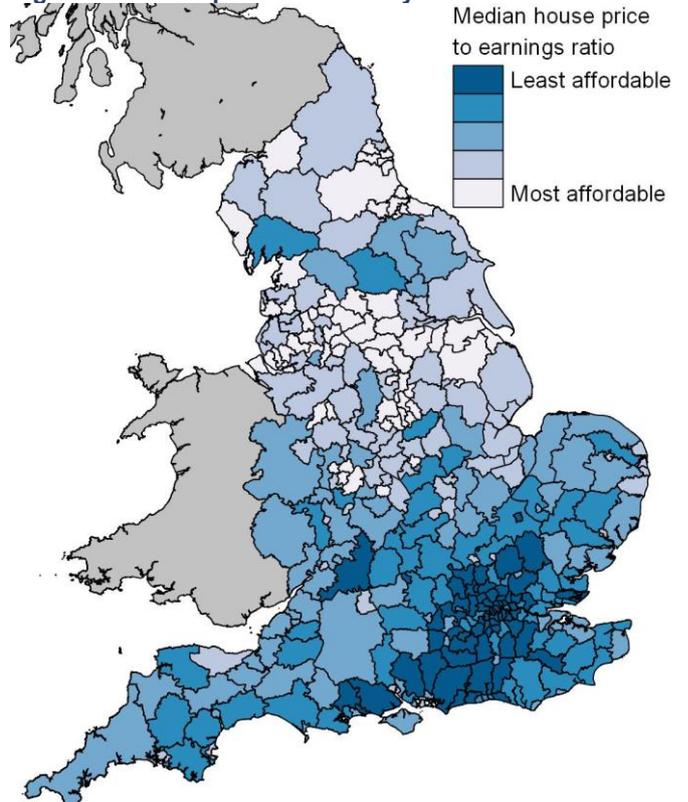
Source: Savills using MHCLG and ONS data

Figure 2 – Savills proposed housing need



Source: Savills using MHCLG and ONS data

Figure 3 – House price affordability



Source: ONS

The new approach to housing need

The Housing White Paper promised a revolution in how local authorities should assess housing need. No longer would they need hundreds of pages of strategic housing market assessments (SHMAs) or days discussing it at Examination. A standard approach to assessing housing need would provide new clarity and consistency.

But as the Housing White Paper metamorphosed into the revised National Planning Policy Framework (NPPF) and updated Planning Practice Guidance, complications arose:

- An over-reliance on household projections as the basis of housing need meant that the new need assessment risked perpetuating suppressed household formation (see https://www.savills.co.uk/research_articles/229130/223654-0);
- The need to plan for different types of housing (housing for older people, housing for people with disabilities, private rented housing, self-build, custom build and student housing) suggests that something like a SHMA may be needed anyway.

The risk of relying on household projections has been brought starkly into the spotlight with the release of the new 2016-based projections by ONS. These are very different from the previous 2014-based projections, on which the standard approach was based. We have reviewed the key differences in a series of blogs:

- National population growth is now expected to be lower. There are fewer births and people aren't living as long, according to the latest ONS assessments. See <http://www.savills.com/blog/article/258812/residential-property/why-population-projections-are-so-important-in-housing-planning.aspx>
- Sub-national distribution of population has changed, with much lower population growth now projected in some of the highest demand housing markets. See <https://www.savills.co.uk/blog/article/260954/residential-property/can-we-rely-on-local-population-projections.aspx>
- Household projections are now based on shorter term trends, since 2001, rather than the longer term trends used in previous projections. The suppressed household formation in unaffordable housing markets over this period is therefore baked into the new projections. See <https://www.savills.co.uk/blog/article/224107/residential-property/what-can-household-size-tell-us-about-housing-need.aspx> and <https://www.savills.co.uk/blog/article/265942/residential-property/using-shorter-term-trends-will-result-in-reduced-housing-need-figures.aspx>

Impact on Housing Need and Planning

The housing need generated by the standard methodology changed overnight last week, following publication of the 2016-based household projections, and in some places the differences are huge. This generates a range of questions for local planning authorities (LPAs):

- Where the projections are significantly lower than before, there will be less pressure to submit Plans ahead of the January deadline for doing so on the old SHMA-based method.
- But in areas where the projections are higher, particularly where the standard method is leading to an increase in the need, there might be renewed pressure to submit before January.

The need for clarity on this is acute. The Ministry for Housing Communities and Local Government (MHCLG) clearly anticipated that some problems were likely to arise when the new Planning Practice Guidance was published alongside the revised NPPF on 24th July. A consultation has been promised to amend the standard approach, making sure that it "continues to be consistent with ensuring that 300,000 homes are built per year by the mid-2020s."

But the projections have immediate effect. LPAs progressing Plans based on the standard method don't know how or when it might change. They now have no clear idea how many homes they should be planning for until the Government has concluded its promised consultation.

There are also implications for landowners, promoters and developers that are seeking to bring sites forward through a local plan. Most significantly, as the projections have immediate effect, they started having implications for applications and appeals determined from Thursday 20th September onwards. This is because they change any calculation of five-year housing land supply where a Local Plan is more than five years old. In places, the land supply will have increased significantly overnight, because of reduced future need. In others it will have decreased.

Where applications and appeals thus stood to be approved, they might well now be refused, and vice versa. In places, this might lead to LPAs and/or applicants withdrawing applications, determining applications, or pausing their processing pending the Government's review of the standard method.

What's gone wrong?

The most obvious problem MHCLG needs to solve is that the standard methodology doesn't add up to 300,000 homes per annum, the Government's housebuilding target to be reached in the mid-2020s. It didn't before the new projections were released either (except without the cap), but the gap has widened, as shown in the table.

Table 1 – Housing need based on the standard approach, before and after new household projections

	Uncapped	Capped
Before 2016-based household projections publication	300,000	270,000
After 2016-based household projections publication	220,000	210,000

Source: Savills using MHCLG data

As important is to ensure the local distribution of housing need makes sense. The standard methodology uses the following formula to derive an adjustment factor, which is then used as a percentage increase to be applied to local household projections.

$$\text{Adjustment factor} = \frac{\text{Local affordability ratio} - 4}{4} \times 0.25$$

Planning Practice Guidance says that the adjustment factor is needed because:

"...household growth on its own is insufficient as an indicator of housing demand because:

- *household formation is constrained to the supply of available properties – new households cannot form if there is nowhere for them to live; and*
- *people may want to live in an area in which they do not reside currently, for example to be near to work, but be unable to find appropriate accommodation that they can afford.*

The affordability adjustment, at the level proposed, is applied in order to start to address the affordability of homes, and is intended to slow down the rate at which local affordability ratios are increasing."

But the changes to the household projection methodology have meant that the suppressed household formation, caused by undersupply of new homes in many areas, now has a far greater impact. One that the affordability adjustment factor cannot hope to solve.

The standard methodology now generates a lower level of housing need across England, but particularly in those areas with the worst affordability statistics, where new housing is clearly most needed. It also suggests that the same level of additions to current housing stock is needed in both the least affordable quintile of local authorities and the next least affordable. There should be a greater level of differentiation.

Table 2 – Comparison of housing need by affordability band, before and after new household projections

Affordability quintile (by number of local authorities)	Housing need using standard approach published alongside MHCLG consultation (capped)		Housing need following publication of new household projections using standard methodology (uncapped)	
	Number of homes	As % existing stock	Number of homes	As % existing stock
Least affordable	85,000	1.7%	60,000	1.2%
	52,000	1.4%	46,000	1.2%
Mid	49,000	1.1%	44,000	1.0%
	33,000	0.8%	27,000	0.7%
Most affordable	48,000	0.7%	35,000	0.5%
England Total	267,000	1.1%	212,000	0.9%

Source: Savills using MHCLG and ONS data, MHCLG Consultation: *Planning for the right homes in the right places*

An extreme example is Cambridge, where the number of households is now projected to fall over the 10-year period from 2018 by the ONS. There is a large affordability adjustment factor in Cambridge; the average home costs 13 times average earnings. But multiplying negative household growth even by a large adjustment factor suggests the local planning authority should (theoretically at least) be preparing to demolish housing in one of the least affordable cities in the country.

Clearly this is nonsense. But it is simply an extreme example of how suppressed household formation can affect the household projections and fatally compromise the standard methodology as a way of calculating housing need.

Déjà vu

This is not new, people have debated the merits of household projections before (https://www.savills.co.uk/research_articles/229130/187096-0). But it has become more obvious due to the change in the household projection methodology.

We suggested an alternative approach when MHCLG first consulted on the standard methodology (https://www.savills.co.uk/research_articles/229130/223654-0). Despite the changes to household projections, it still provides an assessment of housing need that adds up to around 300,000 additional homes.

It also gives a logical distribution of local housing need, answering the challenge to start improving housing affordability. A flaw with the current standard methodology that is exacerbated by the new household projections is the lack of relationship between housing need as additions to existing stock and affordability.

The chart shows that the general aim is still being met: there is a trend of higher need as affordability worsens. But there remain quite a few outliers and anomalies. For example, Hammersmith & Fulham, with a house price to earnings ratio of 21:1, has the same housing need figure as Bolton (affordability ratio 5:1) on a % of stock basis: 0.4%.

Figure 4 – Relationship between housing need and affordability, using the standard methodology



Source: Savills using MHCLG and ONS data

A More Robust Alternative

Our previous work identified three flaws in the standard methodology:

- the overall number is too low;
- the need is not sufficiently focussed on the most unaffordable regions; and
- there are some specific LPAs with very low need for their affordability due to low household projections.

These flaws have become more obvious following publication of the new household projections. The need for our proposed additional step in calculating housing need on a standard basis has been heightened.

It is based on expressing housing need as the growth in existing stock that would be required, with the aim of correcting any outliers with low housing need figures, boosting both the overall numbers and boosting the numbers in the most unaffordable areas.

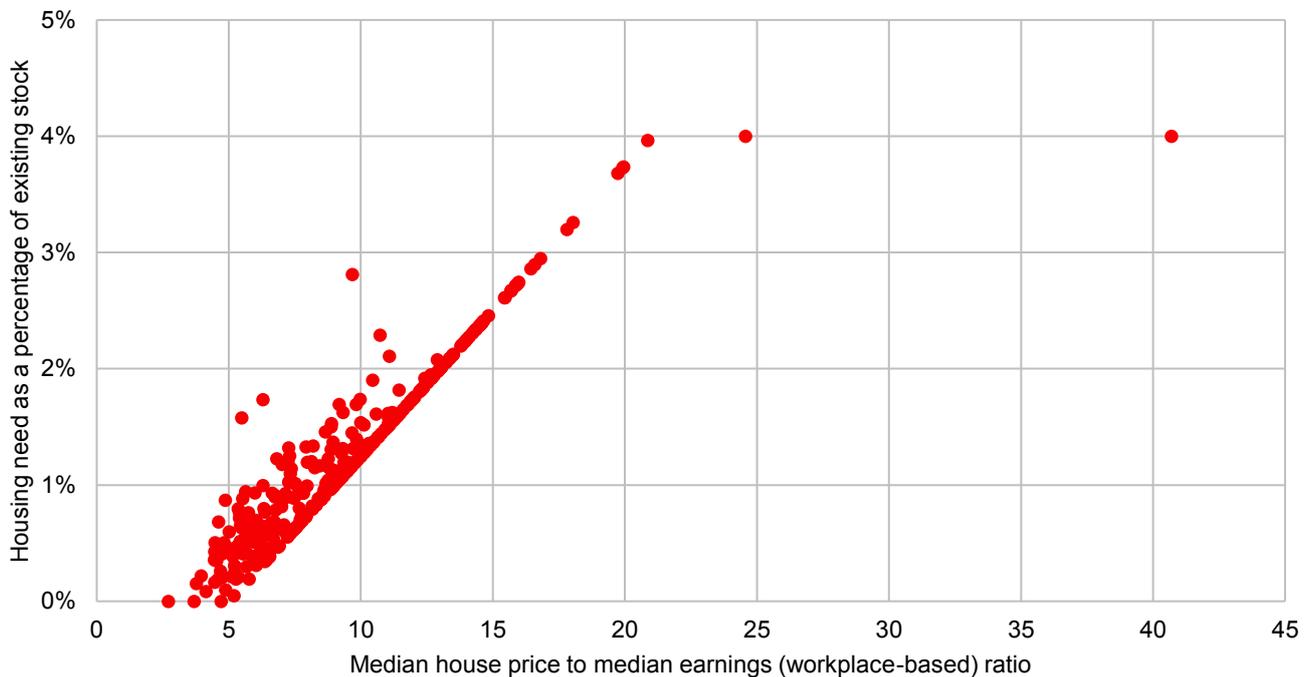
Our method sets a floor based on a stock growth figure that depends on local affordability. We propose that need should be the higher of the MHCLG standard approach figure or a variable stock growth ‘floor’ calculated as follows:

- Median house price to earnings ratio <5 = 0%;
- For every increase in ratio of 1, increase floor by 0.25% (e.g. HP-E ratio of 8 = 0.75% floor);
- Floor stops when it reaches 4% at HP-E of 20 (as everything above 2% is high compared with past delivery, and only three central London boroughs are above this – radical delivery models would be needed to achieve the growth rates required to really improve affordability in these areas).

The results are shown in the chart and tables below, with the anomalies of the MHCLG method removed and the highest housing growth being directed at the most unaffordable areas.

The advantage of our approach is that it is more resilient to changes in the household projection methodology. It also reduces the impact of suppressed household formation. And it gives growth areas, with higher levels of past household growth, correspondingly higher levels of future need.

Figure 5 – Relationship between housing need and affordability, Savills proposed approach



Source: Savills using MHCLG and ONS data

Table 3 – Savills proposal versus current standard approach, by affordability band

Affordability band	Standard method following publication of new household projections	Savills proposal	Increase from Existing to Proposed
Least affordable	1.7%	2.5%	102%
	1.4%	1.6%	25%
Mid	1.1%	1.1%	10%
	0.8%	0.7%	4%
Most affordable	0.7%	0.5%	2%
England Total	1.1%	1.2%	37%

Source: Savills using MHCLG and ONS data

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