Living Rents
Calculating the investment needed

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savills

Calculating the investment – Living Rent

Savills estimated the government investment required to support the production of 40,000 Living Rent homes using an industry standard development appraisal model. This was based on assumed costs of developing a 2 bedroom house (regions) or apartment (London) with average Living Rents (2014) The appraisal assumed debt should be repaid over 30 years with an average cost of debt of 6%. It was also assumed that landlords would top up debt with internal subsidy to contribute c.65-70% of the total cost of production. The average capital investment arising was c. £46k per unit (regions) and c.£76k per unit (London).

To arrive at a total capital investment for 40,000 Living Rent homes Savills assumed a distribution of c.58% of these homes being produced in the regions (23,200 homes) and c.42% in London (16,800 homes):

- 23,200 Living Rent homes outside London requires c.£1.067billion investment
- 16,800 Living Rent homes inside London requires c.£1.276billion investment
- Totalling 40,000 Living Rent Homes in England requiring c.£ 2.344billion investment

The subsidy required for the 40,000 intermediate rent and shared ownership homes which are also needed was estimated at an average £20,000 per home ~ £800million per annum.

Assumptions for Living Rent modelling		
Assumption	**Assumption**	**Comments**
Cost of finance	6%	Sensitivity @ 3/4/5%
CPI inflation %	2%	Ass. long term average
Rent Inflation	CPI	Rebased to earnings 5 yrly
Management Inflation	CPI	
Maintenance Inflation	CPI	
Major Repairs Inflation	CPI	
Management Charge per unit/p.a.	£300	Year 1 only
Maintenance Charge per unit/p.a.	£600	Responsive and cyclical
Void and Bad Debts	3%	
Major Repairs Sinking Fund	0.8% of build cost deferred to yr 6	
Rents	**Average Living Rent for 2Bhouse/Apt**	
NPV Discount Rate	6%	Equivalent to cost of funds
Term of loan	30 years	
Benchmarks for Viability		
NPV Net rent	0 or better	
loan repaid by year	30	
Other Items		
Development Administration charge	3.00%	
Other on costs	12%	

***Investment may be in the form of capital grant, free or discounted public land, low cost debt, or come in the form of planning gain subsidy via the Section 106 process.**

Estimated capital grant/subsidy per unit:

Regions				
Unit type	2b4p house			
Min floor area m2	79			
Land	£20,000			
build	£100,000			
on costs 15% of land/build	£18,000			
Interest	£2,207			
Total Cost	**£140,207**			
Living Rent	**£89.41**			
Cost of debt	6%	5%	4%	3%
Funding summary				
Grant	£46,000	£38,500	£30,000	£25,000
Debt/cross subsidy	£94,207	£101,493	£110,613	£114,899
Provider contribution	67%	72%	79%	82%
Government contribution	33%	28%	21%	18%

London				
Unit type	2b4p flat			
Min floor area m2	70			
land	£65,000			
build	£119,000			
on costs 15% of land/build	£27,600			
interest	£2,946			
Total Cost	**£214,546**	**£214,742**	**£214,022**	**£214,261**
Living Rent	**£111.75**			
Cost of debt	6%	5%	4%	3%
Funding summary				
Grant	£76,000	£65,000	£56,000	£50,000
Debt/cross subsidy	£138,546	£149,742	£158,022	£164,161
Provider contribution	65%	70%	74%	77%
Government contribution	35%	30%	26%	23%

Annual programme 80,000 sub market cost homes:

Regions				
Cost of debt	**6%**	**5%**	**4%**	**3%**
Est. capital grant/other subsidy per unit	£46k per unit	£38.5k per unit	£30k per unit	£25k per unit
Est. capital grant/other subsidy for 23,200 LR homes	**£1,067,200,000**	**£893,200,000**	**£696,000,000**	**£580,000,000**
London				
Est. capital grant/other subsidy per unit	£76k per unit	£63k per unit	£56k per unit	£50k per unit
Est. total capital grant/other subsidy for 16,800 LR homes	**£1,276,800,000**	**£1,058,400,000**	**£924,000,000**	**£840,000,000**
England				
Est. total capital grant/other subsidy 40,000 LR Homes England	**£2,344,000,000**	**£1,951,600,000**	**£1,620,000,000**	**£1,420,000,000**
40,000 other intermediate homes -England				
Est. total capital grant/other subsidy 40,000 Intermediate tenure homes England	**£800,000,000**			
80,000 affordable homes - England				
Est.total capital grant/other subsidy 80,000 affordable homes England	**£3,144,000,000**			

Capacity for growth

The actual level of subsidy (grant/free or discounted land etc) required to deliver Living Rent homes will vary by provider depending on its capacity to generate cross subsidy, business plan capacity for growth, access to Section 106 planning gain homes or free/discounted land, the mix of new homes to be provided, and the impact of other business plan pressures.

Access to cheap debt e.g. Affordable Housing Debt Guarantee funding, can reduce the cost of development thereby improving viability and potentially, reducing the level of capital grant/subsidy required or enabling the provider to provide more homes for a given level of government support. Low cost debt is not in itself a complete solution as the issues of gearing and access to loan security for borrowings act as constraints to growth.

Currently most valuations, which are commissioned by lenders for loan security purposes, are done on a large scale block basis. Implementation of the HA SORP (driven by the accounting requirements of FRS102) gives the option to associations to value their stock in smaller groups, but funders have yet to accept valuations based on that principle. The impact of FRS 102 from a valuation perspective and on financial capacity for growth is still a work in progress.

Public land: The investment of land at nil or discounted value would significantly reduce or potentially remove the need for grant. Structuring the investment of this land on a deferred return/deep discounted basis would reduce the short/medium term funding pressure on providers and enable them to increase capacity.

Section 106 Planning Gain Homes: Homes provided through the Section 106 process can make a valuable contribution to supply. The model is under pressure from competing demands for the financial value of planning gain. A strengthened Section 106 in favour of sub market cost housing would contribute to the delivery of 80,000 homes per annum and reduce the capital investment required in the form of grant. A return to the previous practise of allowing 'thin' levels of capital subsidy to supplement section 106 schemes would support the production of homes in high stress areas.

HCA Regulatory Framework: There is a nervousness in the sector regarding the increasing demands being placed on associations to engage in addressing the supply crisis when considered in the context of business plan pressures from welfare reform and the possible extension of Right to Buy for Housing Association homes, and the requirement to protect existing social housing assets from risks associated with diversification. Maintaining the balance between ambition and capacity is key. The housing association and local authority sectors do not have the means to provide the entire subsidy required to produce new sub market cost housing – a partnership with government is key to balance the needs or producing new home and operating within a sensible risk framework which meets the requirements of the Social Housing Regulator for governance and viability.