Written Submission from LSE London (London School of Economics) on Matter M17 for consideration in the Examination in Public of the New London Plan, 2019

M17: Housing Requirement

The core issues

This note confines itself to three main topics:

- The methodology used to generate an annual requirement of 66,000 homes
- A more fundamental criticism of such an approach; and
- The implications of such figures for households in the future – including the implications of taking into account the latest government figures.

Has the need for 66,000 additional homes per year been properly calculated?

Technically, the number has generally been calculated in line with guidance. The SHMA comes to a different and lower figure than that calculated by national government using the same basic data in part because it works on a much longer timescale than the London Plan and projections suggest that household formation rates will fall in the 2030s. The national figure of over 72,000 covered the period 2016-2026 – which is more in line with the needs of this exercise.

The methodology in the SHMA is desirable in that, unlike national figures it attempts to take some very limited account of the fact that lower housing output in the past few years has constrained household formation. This generates a housing need figure without backlog, vacancies etc of just over 55,000. However, there is no suggestion that simply taking account of these lower output figures fully reflects the impact that lack of supply has had on the capacity for London's population to form households. More importantly as discussed below it takes no account of the economic and other factors which have led to suppressed household formation rates at least since the financial crisis.

The final figure for the housing requirement estimate of 66,000 includes a reduction in backlog to be spread over 25 years. The backlog is based on existing households who are currently inadequately housed for one reason or another. It takes no account of constraints on household formation. It does however appear to include some households who, when re-housed, will leave a unit acceptable to another type of household so is potentially an overestimate. It would be more appropriate to split the backlog into those that clearly require an additional dwelling and those that while being rehoused leave a vacant, usable dwelling.

Clearing the backlog over a 25 year period is a policy decision – and a much longer time horizon than that included in earlier national estimates of housing requirements. Clearly assuming a different, shorter timescale would lead to a significantly greater requirement.

In addition, an estimate is made of the possible vacancy rate on new supply in line with observed vacancy rates. Again this is one possible estimate but does not reflect the factors that lead to vacancy and how these change.

What is clear is that these figures taken together almost certainly underestimate housing need and therefore housing requirements in London. As such the figure cannot be regarded as a technically based figure but includes a set of assumptions which could more readily be regarded as policy based – or at worst as close to circular in relation to capacity estimates.

More fundamental issues

The main element of the requirements estimate is the household projections for London – which are accepted subject only to a small adjustment for lower house building since 2011. However, projections are exactly what they say they are: projections which assume the future will be like the past. As such they build in the significant decline on household formation over the last decade which has been a function of the financial crisis and its aftermath; increasing regulatory constraints; and undersupply of housing not just in London but elsewhere in the country.   But as or more importantly they also build in the economic environment of the past decade.

Household formation is impacted by a whole range of macro and employment related factors as well as conditions in the housing market including in particular affordability. Nationwide, over the period since 2008 maybe 1.5 million fewer households have formed than were expected to in 2008. The result is that future projections build in this past bad experience and assume that it will continue

This raises two important issues:

o   What do these lower projections imply for housing conditions?

o   What happens if the economy grows more rapidly than assumed in the projections (or indeed if international migration declines)?

*Implications of the tightening market*

Housing conditions, in the sense of being able to form separate households, have been worsening for younger households for over two decades. And has significantly worsened since the turn of the century and is projected to continue to do so at least until the mid-2030s. Figure 1 taken from the DCLG 2014 based projections shows that headship rates have fallen significantly since 1991 for all those aged between 20 and 34 and that no improvement is expected to occur into the future.

Figure 1: headship rates among younger people in London
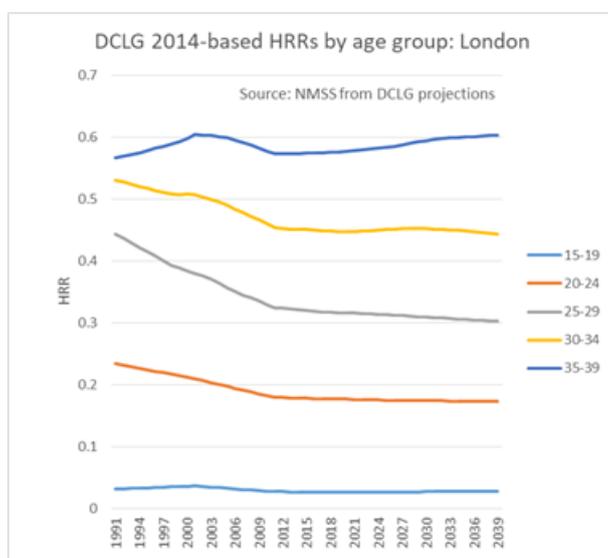
More detailed evidence (reflected in figure 2) shows that single adults are increasingly less likely to form separate households (tending to share in the private rented sector) and that the capacity to live as separate households among young couples has fallen very considerably and is expected to continue to fall throughout the projection period.

Figure 2: Past and projected changes in household mix in London: 25-34s
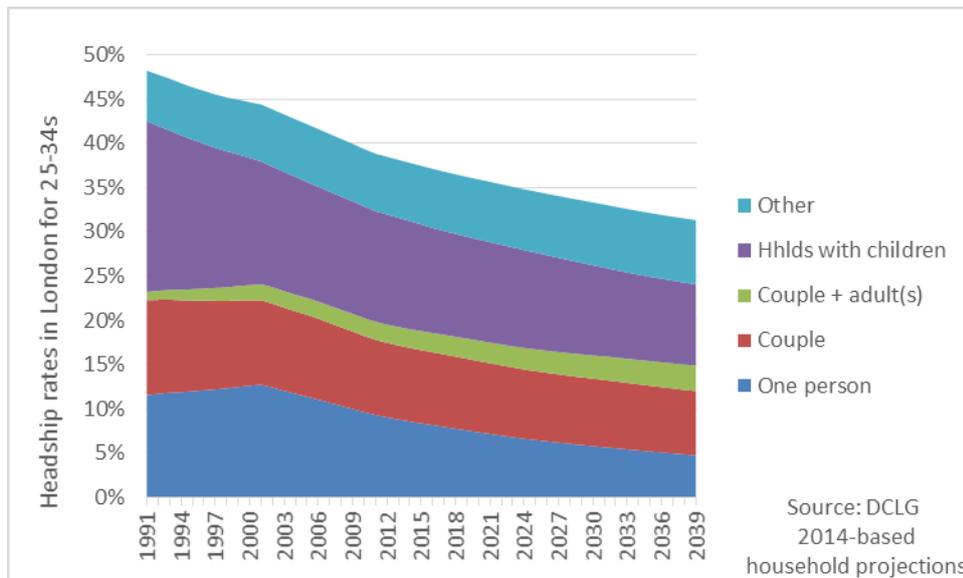
We thus have a situation in which the housing requirement is **planned** to lead to continuing declines in the capacity of younger households to live separately. It is very difficult to believe that this is meeting housing requirements.

What happens if economic growth improves?

If the economy grows more rapidly than it has over the last few years on which the projections are based, many of the households which have not been able to form can be expected to try to find a home of their own. Again is this what we want to reflect in housing requirements – especially as unless supply can adjust very quickly the effect will be that house prices will have to rise further to choke off that demand? The result however would be that, while growth would be good for the London economy it would come at the expense of an even more dysfunctional housing market – and further redistribution towards established households at the expense of new entrants.

Of course there are also other elements that could be expected to change as a result of economic and political circumstances. In particular, outward mobility from London after the financial crisis declined very significantly but has now come back to roughly traditional levels. The projections

reflect this cyclical behaviour. Into the future the extent of movement out of London is likely to depend on growing incomes, the demand for more housing space and the relative affordability of London as compared to the rest of the South East.   The net effect on demand in London is also crucially affected by the attractiveness of the capital especially for younger people.

The biggest unknown is undoubtedly the impact of *Brexit*. If it is a no deal Brexit, affordability can be expected to increase and this could actually lead to more households wanting to form. More likely however is that the impact on wages and employment would offset this effect so the numbers of households forming declines. If there a good Brexit the most likely impact is on house prices as confidence returns and demand increases. This again could make it harder for new households to enter the market.

What we do know for sure is that none of these potential changes are directly included in projections. The logical approach would be to ensure that adjustments to requirements can be made in the light of changing circumstances. It would seem appropriate that this be included as a recommendation.

Implications for the future

The *2016 based household projections* produced by the ONS envisage falling headship rates for London up and including the 75-79 age group. The main reason for this is the is the results of recessionary effects on the 2011 census numbers.   2011 was perhaps almost the worst point for household formation after the crisis in 2008 and thus does not reflect longer term trends. Thus the shift to 2011 as the starting point for forward projections has led to a projected decline which cannot be reversed using the current methodology. That leads immediately to the conclusion that the projections are of little use in estimating housing need.

Figure 3: ONS 2016 based projections including a 2001 floor by (younger) age group

ONS 2016-based HRRs by age group: London with 2001 floor

Source: NMSS from ONS projections
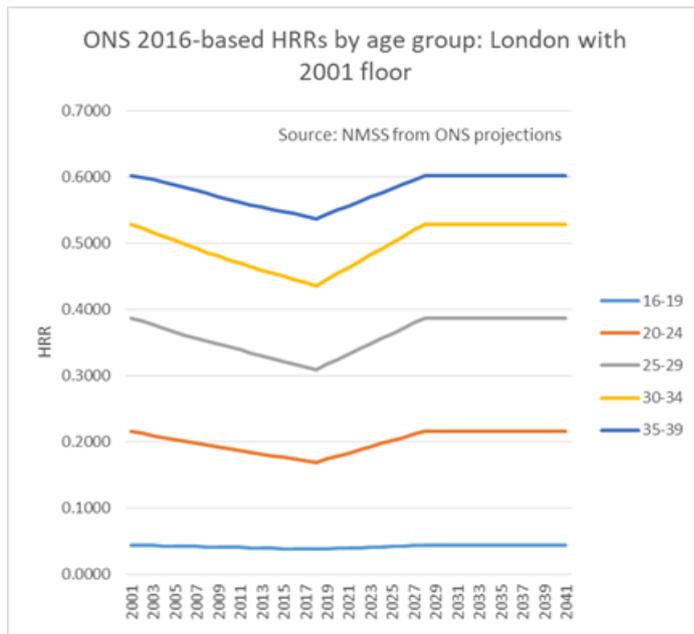
One way of visualising what has been inbuilt into the 2016 projections is to see what happens if we impose a 2001 floor – i.e. that no age group should be worse off in terms of household formation that it was in 2001, a reasonable expectation in a growing economy?

The 2016-based projections envisage that London will grow by an average of 35,000 households a year between 2018 and 2028. Applying the floor increases this to 74,000 if the adjustment is to take pace in the next ten years – as implied in figure 3 above. (Note the floor has been applied to each borough individually.)

The first implication is that as they stand there is no case for taking account of the new 2016 based projections as a means of estimating housing requirements. It would simply re-inforce the 'planning for reduced standards' which is already built into the projections.

Secondly were the principle to be accepted it would also clearly suggest that estimated requirements are significantly underestimated.

Thirdly it reinforces our argument that a projections based approach to estimating need excludes many of the most important determinants of housing need and requirements.

Conclusions

Thus to answer the questions specifically raised:

The approach mainly follows guidance but there are policy decisions within the calculation which mean that the figure could have been lower or higher – and much more likely higher if requirements are to be fully addressed;

There are fundamental flaws in the projections model which takes no account of causal factors. We would therefore argue that at the least there should be strong advice to re–evaluate the requirements figure regularly within the period of the Plan;

The impact of Brexit would come within this regular reappraisal – it is a one-off shock with consequence throughout the period which cannot reasonably be assessed at this time;

The 2016 based household projections are very significantly affected by conditions at the time of the census in 2011 and are inappropriate for the assessment of need and requirements into the future unless we wish to plan for continuing recession.