East Hertfordshire District Plan EiP

Response to the Inspector's questions on OAN raised at the Matter 2 Hearing

Benchmarking the Response to Market Signals

1. In order to provide a wider benchmarking of market signals and the associated responses, we have considered the OAN informing all Local Plans prepared by LPAs across the Wider South East (i.e. the former East of England and South East Government Office Regions) which have been adopted in the last 2 years. We have also included evidence on the OAN informing Local Plans that are currently under examination where the Inspector's final report or an interim view has been published.

2. A summary of the household projection-based estimate of housing need, the final OAN and the percentage uplift is provided in the schedule overleaf, together with any further relevant details of the approach taken in each area. Note that these figures relate to the housing need rather than the final housing target included in each Plan (which is sometimes higher and sometimes lower than the identified housing need). The schedule also provides a summary of each of the market signals indicators that are identified by PPG based on information published for 2016, with the exception of overcrowding which has a base date of 2011. Cells highlighted in blue represent market indicators that are better than the equivalent indicator for East Hertfordshire, whereas cells highlighted in orange represent indicators that are worse:

   - Lower quartile house price and lower quartile affordability based on data published by ONS;
   - Average private rent based on data published by VOA;
   - Overcrowding based on Census 2011 data;
   - Rate of housing delivery 2006-2016 based on data published by CLG.

3. Across the Wider South East, uplifts applied to the household projection-based estimates of housing need range from 0% up to 138%. The highest proportionate uplifts are all associated with aligning jobs and workers, with the lowest such uplift being 29%.

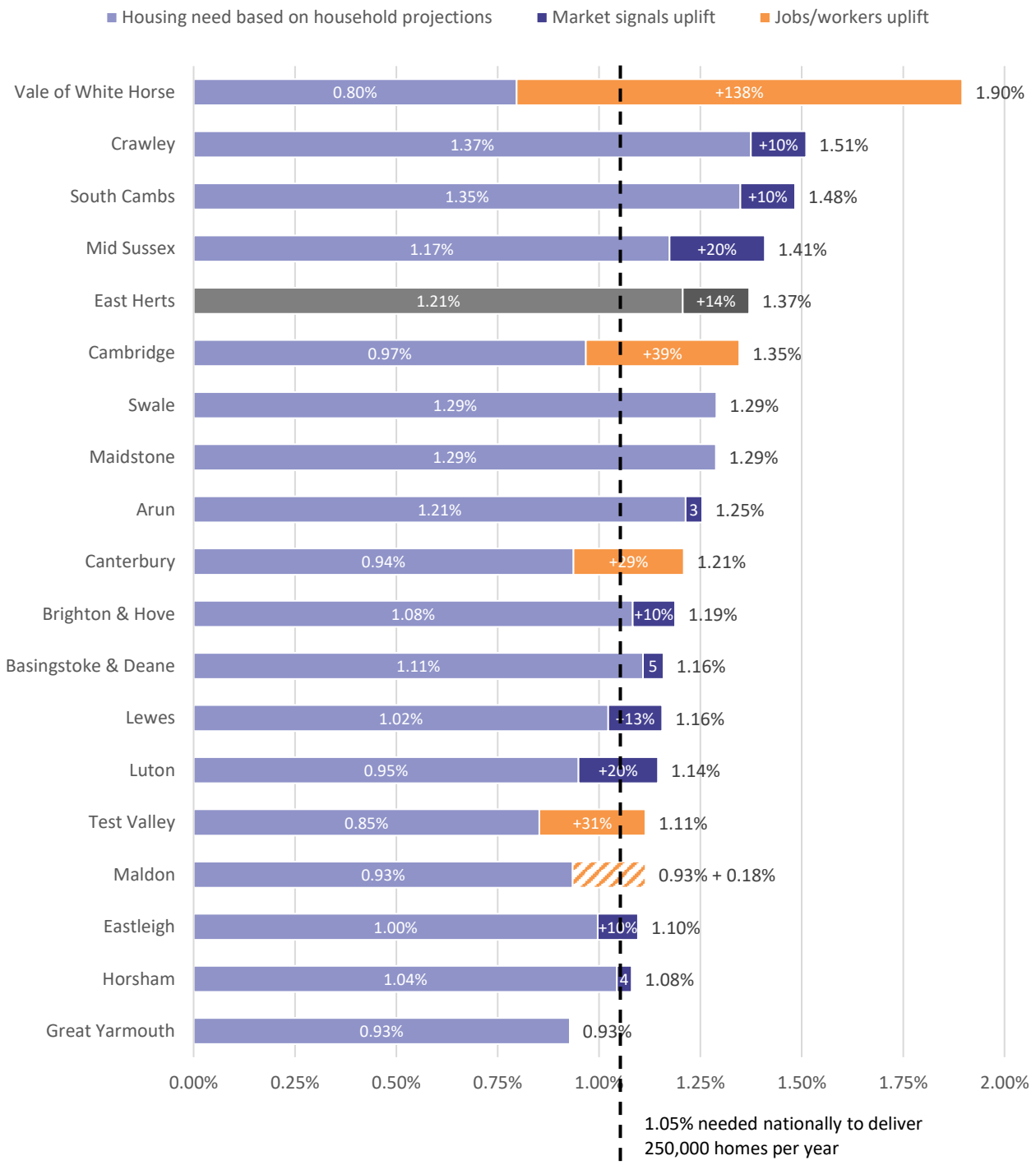
4. When considering uplifts for market signals alone, only two areas have a proportionately higher figure than the 13.6% that ORS has proposed for East Hertfordshire. These are Luton (where ORS proposed an increase of 20% due to acute overcrowding and homelessness pressures) and Mid Sussex (where the LPA had proposed to only uplift in response to suppressed household formation but the Inspector concluded that a further uplift was justified, and his interim views recommended that this should be 20%).

Local Planning Authority	Housing Need			Notes	Market Signals Indicators				
	Household projection-based estimate (dpa)	OAN (dpa)	Overall uplift		Lower quartile house price	Lower quartile afford-ability	Average market rent	Over-crowding	Rate of delivery 2006-16
East Hertfordshire	736	836	14%		275,000	13.10	1,020	6.2%	9.7%
OAN based on household projection without any uplift									
Maldon	260	260 (310)	0% (19%)	Although the OAN did not include any uplift, the housing target was increased from 260 to 310 dpa (an uplift of 19%) to align with the planned target for additional jobs and allow for extra migration in future from London	225,000	11.38	802	3.5%	5.8%
Maidstone	883	883	0%	LPA had proposed a 5% uplift but this was removed by the Inspector given that the household projection-based housing need already represented such a large uplift in housing supply	196,000	9.95	816	6.7%	11.1%
Swale	776	776	0%		167,500	8.38	704	6.1%	10.4%
OAN based on household projection with an adjustment for suppressed household formation									
Lewes	460	520	13%		236,000	11.66	1,005	5.9%	6.6%
Crawley	614	675	10%		220,000	9.52	961	9.8%	8.2%
Basingstoke & Deane	813	850	5%		220,000	9.56	936	5.5%	11.0%
Arun	889	919	3%		200,000	11.69	779	6.7%	7.9%
Horsham	628	650	4%	In both areas, the Inspector concluded that no specific adjustment was needed for market signals, but based the OAN on a household projection that included an adjustment for suppressed household formation	278,000	14.45	1,065	5.3%	10.2%
Great Yarmouth	-	420	-		115,000	5.79	536	6.0%	6.4%
OAN based on a specific uplift to the household projection-based estimate of housing need									
Mid Sussex	730	876	20%	LPA proposed to only uplift in response to suppressed household formation but the Inspector concluded that a further uplift was justified and his interim views recommended an uplift of 20%	260,250	13.17	1,047	5.6%	10.5%
Luton	738	890	20%	Uplift proposed by ORS due to market indicators identifying acute overcrowding and homelessness pressures, despite the area being more affordable	170,000	8.48	788	15.4%	4.8%

Local Planning Authority	Housing Need			Notes	Market Signals Indicators				
	Household projection-based estimate (dpa)	OAN (dpa)	Overall uplift		Lower quartile house price	Lower quartile afford-ability	Average market rent	Over-crowding	Rate of delivery 2006-16
OAN based on a specific uplift to the household projection-based estimate of housing need (continued)									
Brighton & Hove	1,373	1,506	10%		244,000	11.51	1,295	17.1%	4.4%
Eastleigh	549	604	10%	The Plan wasn't found sound, but the Inspector's report concluded that an uplift of 10% would have been appropriate	210,000	10.18	834	5.0%	9.0%
South Cambridgeshire	879	967	10%	This is the uplift proposed based on additional work that was requested by the Inspector, but no further views have been given about whether or not the OAN has now been accepted	262,000	11.03	932	3.9%	13.6%
OAN based on an uplift to align jobs and workers with no further uplift for market signals									
Vale of White Horse	432	1,028	138%	The Inspector discussed whether or not the jobs number was realistic, but concluded that it provided a reasonable basis for aligning workers despite it yielding a number that was substantially higher than the household projection-based estimate of housing need	255,000	10.08	1,019	4.9%	10.9%
Cambridge	503	700	39%	A market signals uplift of 30% was proposed based on additional work that was requested by the Inspector, but as this yielded a number that was lower than the jobs based figure it was the jobs number that was taken as the OAN without any further uplift for market signals. No further views have been given by the Inspector about whether or not the OAN has now been accepted	320,000	13.32	1,118	14.1%	13.7%
Test Valley	450	588	31%	No specific market signals uplift proposed, but consider jobs uplift would provide sufficient response	215,000	10.30	975	4.0%	11.4%
Canterbury	620	800	29%	Market signals uplift of more than 10% proposed and tested at 20%, but Inspector did not consider it appropriate to apply a market signals uplift cumulative to the jobs uplift	210,000	11.10	968	7.6%	9.3%

5. The only effective way to compare the OAN across different authorities is to consider the overall rate of growth in relation to the existing dwelling stock. The following chart identifies the rate of growth necessary to meet the housing need based on household projections together with the uplifts applied for market signals (including suppressed household formation) and aligning jobs and workers.

6. It is clear that the rate of growth identified for East Hertfordshire based on the OAN (1.37% per year) is amongst the highest of all adopted plans across the Wider South East, and is 30% higher than the 1.05% needed nationally to deliver 250,000 dwellings each year.



Impact of the Uplift on Affordability

7. Work undertaken for the National Housing and Planning Advisory Unit (NHPAU) based on the Reading Affordability Model identified the following key elasticities when modelling house prices:[1]

> *The key elasticities in the model are presented below:*
>
> > ***Income Elasticity**: The elasticity of house prices with respect to real incomes is approximately 2.0. In other words, a 1% rise in real incomes would increase house prices by 2%, holding all other influences constant. This elasticity is determined by the income elasticity of demand and the price elasticity of demand. Since the income elasticity of demand is 1 the 1% increase in income increases the demand by 1%. Since the supply is fixed in the short-term, the adjustment comes from changes in price: the price will increase in order to reduce the demand to its initial level and restore market equilibrium. The required price increase depends on the price elasticity of demand, which is -0.5. Hence, to offset the 1% increase of demand the price will eventually increase by 2%.*
> >
> > ***Interest Rate Elasticity**: If interest rates rise by one per cent, house prices will fall. This fall will differ across the regions, e.g. in London the fall in prices in the second year will be approximately 6%, in the Midlands 3% and in the North 1%.*
> >
> > ***Housing Stock Elasticity**: The long-run elasticity of house prices with respect to the housing stock is estimated as -2. That is if housing stock increases by 1%, house prices will fall by about 2%.*
> >
> > ***Elasticity of house price with respect to Household formation**: If the number of households increases by 1%, then house prices will increase by about 2%.*

8. The demographic update (HOP/011) projected an increase of 15,696 households in East Hertfordshire, which represented an increase of 27.6% over the 22-year period 2011-2033. On the basis of every 1% increase in households increasing house prices by 2%, the model would suggest that this level of household growth would lead to house prices increasing by 55.2% above inflation – but that assumes that no additional dwellings were provided.

9. The proposed OAN for East Hertfordshire is 18,396 dwellings, which represents an increase of 31.4% over the 22-year period 2011-2033. On the basis of every 1% increase in dwellings reducing house prices by 2%, the model would suggest that this level of housing delivery would lead to house prices reducing by 62.8% after taking account of inflation – but that assumes that there was no increase in households.

10. Taking the 27.6% increase in households and the 31.4% increase in dwellings together (and assuming no change in incomes or interest rates or any other factors that might influence house prices), the model suggests that there would be an overall reduction of 7.6% in real house prices after inflation. On this basis, the house price affordability ratio would also reduce by 7.6% (given that it is assumed that there is no change in income).

[1] http://webarchive.nationalarchives.gov.uk/20121029114150/http://www.communities.gov.uk/documents/507390/pdf/1345079.pdf

11. The Office for Budget Responsibility (OBR) has recently published results of further modelling which considers this relationship.[2] This report sets out the income elasticity and the housing supply elasticity in the context of other studies:

Table 3.1: UK house price elasticities from the literature

Study	Income elasticity	Supply elasticity	Last data point used
[per household]			
This model	2.7	-1.1	2013 q4
Meen (2013)	2.8	-1.7	2009 q4
[per capita]			
Muellbauer/ Murphy (1997)	2.6	-2.2	1994
Cameron/ Muellbauer/ Murphy (2006)	1.6	-1.6	2003
[unscaled]			
This model, re-estimated without number of households	2.3	-1.2	2013 q4
OECD (2011)	2.9	-2.1	2010 q1
Meen (2009)	2.1	-1.5	2007 q2

Note: See section 7 for full references

The elasticity of house prices to income is consistent with the literature, but the elasticity of prices to supply is low. This may be due to mis-measurement of supply in the model. As explained in paragraph 2.11, we use the owner-occupied housing stock for the variable hshh. However, there has been rapid expansion of the supply of buy-to-let rental property in recent years, which may be an increasingly close substitute for owner-occupation.

12. The housing supply elasticity in other studies has ranged from -1.5 to -2.2, which is consistent with the 2.0% identified by the NHPAU work (which was based on a version of the model produced by Professor Meen). However, the latest OBR model suggests a weaker relationship between house prices and housing supply – though recognises that this may be associated with the supply of buy-to-let properties which their model does not include.

13. However, it is important to recognise that these elasticities relate to regional or national models and would not apply to an individual local authority area in isolation. Therefore, any conclusions would depend on all local authorities adopting a similar approach across a region-wide basis. Furthermore, the relationship between housing supply and house prices is uncertain, and this was recognised in the original Barker report and subsequent studies – so any conclusions must be considered in that context.

14. In summary, the OAN proposed for East Hertfordshire should lead to a reduction in house prices and an improvement in affordability of between 5% and 10% might be expected – but the extent of improvement that is actually realised would be inherently uncertain and will inevitably depend on a wide range of factors. Nevertheless, based on reasonable assumptions, the proposed OAN and the resulting increase to planned housing supply could be expected to improve affordability.

[2] http://budgetresponsibility.org.uk/docs/dlm_uploads/WP06-final-v2.pdf

Aligning Jobs and Workers

15. The Original SHMA projected that the economically active population would increase by 26,439 persons over the 22-year period 2011-2033.[3] The employment growth identified for the HMA was 41,700 extra jobs over the same 22-year period.[4] These figures provided the basis for the alignment of jobs and workers.

16. Taking account of changes to unemployment, inward and outward commuting patterns and the extent of double jobbing, the Original SHMA concluded that there was a shortfall of around 7,800 workers based on the increase in jobs forecast at that time.[5] Therefore, to align future jobs and workers, an uplift of around 5,600 dwellings was needed, equivalent to an uplift of 14.6% on the household projection-based estimate of housing need.[6]

17. In establishing the OAN, a further increase to the housing number was proposed in response to market signals; and this yielded an overall combined uplift of 20%. This comprised the 14.6% uplift needed to align jobs and workers together with a further 5.4% uplift to respond to affordability, suppressed household formation and the other market signal indicators. On this basis, the OAN proposed by the Original SHMA (46,100 dwellings overall, with 16,400 in East Herts) would have yielded an increase of around 34,200 economically active persons resident in the HMA (around 26,400 persons from the baseline projection and a further 7,800 persons as a consequence of the uplift).

18. The demographic update (HOP/011) projected that the economically active population would increase by 47,325 persons, which was 20,886 higher than the original SHMA. This was largely a consequence of higher rates of migration and changes to the projected age structure, but also due to changes in the underlying economic activity rates which affected the whole population. The proposed market signals uplift (6,200 additional dwellings) was likely to further increase this, yielding an overall growth of around 57,200 economically active residents over the 22-year period.[7] The latest employment growth analysis suggests a potential increase in excess of 45,000 jobs; but this is still likely to lead to an increase in out-commuting which would be higher than existing rates.

19. In establishing the updated OAN, there was no longer any justification for an uplift to align future jobs and workers; therefore, whilst the Original SHMA identified a need to uplift by 14.6% to align jobs and workers, the OAN report concluded that there was no need to apply any uplift for jobs and workers. However, market signals indicators continued to justify an increase from the household projection-based estimates of housing need; and whilst the Original SHMA proposed a further 5.4% uplift solely for market signals (in addition to the uplift to align jobs and workers) the OAN report proposed that this uplift should now be 13.6%, more than double the original figure. This is largely due to new evidence published by the GLA on assumed increases in future rates of outward migration from Greater London to the HMA.

[3] HOP/001 figure 39
[4] HOP/001 para 5.36
[5] HOP/001 paras 5.37-40
[6] HOP/001 para 5.44
[7] East Hertfordshire Council Matter 2 hearing statement, response to question 2, para 8