

**Executive**

23 July 2008

**IMPACT OF ECONOMIC DOWNTURN ON NEWCASTLE**

**Report by:** Chief Executive  
Executive Director, Environment & Regeneration  
City Treasurer  
Head of Economic and Urban Policy

**Ward Implications:** All

For Decision		
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**1. Summary**

1.1 Newcastle is starting to be affected by the international economic downturn. A number of actions are in hand by Council Officers, with a particular emphasis on assessing the impact on housing markets and our regeneration ambitions. The impact on the City Council's services and finances is also being assessed.

This report is a very much our current assessment of the situation. We propose to report back to Executive in September clarifying our proposed actions. The October/November mid-year review will consider the impact of the slowdown on Council Finances and demand for services.

**2. Recommendation**

2.1 For Information and discussion at this stage, although Members are also asked to consider the proposal at paragraph 7.2 to delay implementation of the agreed increase in Sunday parking charges.

**3. Economic Background**

3.1 After a long period of economic stability and robust growth, the UK economy is hitting a rougher patch. What started as a financial slump in the American mortgage and housing markets has turned into a worldwide squeeze on credit. About a month ago, the Bank of England forecast that annual growth

in the UK would weaken to 1% by the end of the year, its poorest since 1992, before picking up in 2009/10. Since then, a number of other forecasters have been more pessimistic. Some unofficial sources expect the economy to fall into recession.

- 3.2 The latest survey from the Chambers of Commerce suggests that, in common with the rest of the country, companies in the Newcastle area are experiencing weaker sales and are reducing profits forecasts for 2008. Also mirroring trends in the rest of the UK, there are signs that retail spending is slowing, although footfall in Eldon Square is holding up well. Anecdotal evidence from retailers is that they are facing pressure on both costs and spending.
- 3.3 Despite slowing growth, inflation in the UK has picked up to above 4%. This reflects increases in prices of food, fuel, gas and electricity, which are hitting poor people disproportionately hard.
- 3.4 Nevertheless, it is important to avoid exaggeration of the economic gloom, thus weakening confidence and activity further. Inflation remains low relative to previous peaks. The latest labour market data (for June) show no increase in unemployment in Newcastle, while Job Centre Plus continues to report a large number of unfilled vacancies. A number of sectors of our economy continue to report strong profitability, including many in the manufacturing sector. And economic growth in the area in recent years has been slightly above the national average.
- 3.5 The housing market has been particularly adversely affected by the economic slowdown and credit squeeze. It has become much harder for first-time-buyers to obtain a mortgage. The maximum loan-to-value ratio on standard mortgages has fallen from 95%-100% to around 85%-90%, and terms and conditions have tightened even more sharply for buy-to-let borrowers or those with an adverse credit history. Some lenders are placing limits on the number of apartments they will lend on within a particular development.
- 3.6 We have also seen an increase in mortgage margins the gap between base rates of (currently 5%) and mortgage rates (currently often around 7%). Fixed rate borrowers whose deal has expired have seen or will see significant increases in their mortgage payments. For example borrowers coming out of fixed interest deals of between 4% - 5% may be facing re-mortgage rates of close to 7%.
- 3.7 House prices have fallen by about 4-6% in Newcastle since their peak, similar to average falls in the UK (figure 1 in appendix). Most economic forecasters are predicting that there will be further falls across the country. The OECD predicts that prices will fall by 10% in total, although some pessimistic commentators say that prices could in total fall by 35%. Many expect that prices will remain stagnant for some time to come, rather than recovering sharply. The market is unlikely to fully recover losses for some years although. But, to put this in context, only the last 18 months or 2 years of more than a decade of gains have so far been lost.
- 3.8 Caution on behalf of both borrowers and lender's has seen the volume of housing sales in Newcastle fall by half since its 2007 peak.

- 3.9 In line with national developments, the price of retail and office space has fallen in Newcastle. Finance for commercial property development has also become more expensive and cost pressures make new speculative development unviable in the short to medium term. But, once again, it is important not to exaggerate the downside: the market in Newcastle has not been overloaded by large volumes of speculative development. Rental returns are remaining firm. Demand for prime space remains high and retail vacancy rates in Eldon Square remain low in comparison with other retail centres. Good quality schemes with a broad mix of uses and strong tenancy prospects are still attracting funding.
- 3.10 The Council remains committed to minimising the impact of the credit crunch on jobs within the area. The Chief Executive is contributing to the efforts of the Northern Rock rapid response team, which has identified job opportunities for a number of affected staff within local companies. The Government recently announced that a pilot project to deliver new free money advice matters will be based within the North East and, although the location of the service has not yet been agreed, this may provide additional job opportunities as well as financial support for local residents. Despite extensive layoffs by private sector house builders, anecdotal information is that skills shortages persist in some public sector schemes

#### 4. **Impact of downturn on regeneration schemes**

- 4.1 The Government has a target of building 240,000 new homes p.a. giving a total of 3.3m new homes to 2016. As discussed in a recent report,<sup>1</sup> DCLG acknowledges that the downturn in the housing market has made these figures challenging, particularly if current conditions are protracted. Commentators are predicting that the national figure for this year is likely to be as low as 84,000. Government has announced additional housing numbers this week. Newcastle/Gateshead is amongst the growth points identified.
- 4.2 We expect the number of starts and completions in Newcastle to fall significantly this year. We are aware of schemes that are being delayed, while we are being approached to re-visit deals by developers in the city. Nevertheless, regeneration activity in Newcastle remains stronger than in many other cities, reflecting a higher proportion of public-sector led schemes, a lack of over supply and relatively robust demand from end users. Against this, confidence continues to fall and access to funding is becoming more and more difficult.
- 4.3 There is a pressure on the City to reduce land values, weaken Section 106 Planning Agreements, reduce its ambitions for energy-efficient, high quality housing, and change tenure mix. Developers with unsold properties are approaching Registered Social Landlords with proposals for converting these into social homes, but not all are suitable.
- 4.4 In terms of national response, the Housing Corporation has allocated £200m nationally to enable RSLs to purchase unsold new build property, with DCLG's recent announcement pointing to the potential for additional funds

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<sup>1</sup> DCLG (July 2008), "Facing the housing challenge, action today, innovation for tomorrow,"

should there be the right stock available. But, unless the amount is increased by an order of magnitude, it would have a minimal impact on the market if directly spent on houses (£200mn spent nationally could be expected to lead to the purchase of about 100 houses in the region). DCLG recently announced a 'Rent to Buy' scheme, which aims to help prospective first time buyers by enabling them to rent a new build property at less than the market rate for a pre-specified period, together with the option to subsequently buy a share of the property, we are in discussion about these measures, see 6.4.3.

## 5. **Other impacts**

- 5.1 A number of commentators have expressed concern that a slowdown in the housing market might lead to a significant increase in mortgage payment problems leading to repossession orders. This is a consequence of unsustainable lending, higher payments, and wider cost pressures on family and individuals budgets.

There has been an increase in mortgage repossession orders in Newcastle, with court cases rising from 309 to 730 between 2005 and 2007. This has largely reflected difficulties that arose before the economic slowdown and tightening in credit availability. Although some of the increase in court orders may reflect changes in debt collection practices, we have seen an increase in repossessions among former right-to-buy properties. The problems often appear to be associated with excessive debt, including credit card and personal loans. The increase in indebtedness has also led to record levels of personal insolvencies and bankruptcies. And the credit crunch may make things worse – as it will be more difficult to manage existing commitments and debts by borrowing further.

- 5.2 There are signs that short term rent arrears are starting to rise, although Council Tax collection remains robust and overall the trend of rent arrears is still downward.
- 5.3 The increases in fuel and food costs will have had a disproportionately large impact on some of the city's most disadvantaged and older residents, who spend a disproportionately high fraction of their income on these items. At the other end of the scale, there is anecdotal evidence of more school admissions as pupils leave the private sector, although this may reflect improving public sector attainment in the public sector as well as economic pressures.
- 5.4 The impact of fuel and energy price increases alone is estimated to cost the Council around £1.2m extra per year. Income from property related activity, capital receipts, rental income, land searches and planning fees is expected to be lower than expected. This is expected to be partly offset by energy rebates from previous procurement deals and improved interest rates on investment income.

## 6. **Council response: regeneration schemes**

6.1 In looking for solutions, it is important that the Council remains focussed on its key objectives:

- creating a good mix of communities, based on different tenures, across the city;
- high quality housing which is environmentally sustainable and meets Good design and space standards;
- good quality infrastructure including transport, education and leisure facilities associated with new housing;
- maintaining and, where possible, increasing the pace of regeneration;

The Council is committed to working with Government, lenders, developers and other public sector partners to meet these objectives. Of course, it is important to avoid hasty action, particularly where markets are self-correcting after periods of prolonged growth.

6.2 Council officers have had proactive discussions with all partners to seek solutions. Officers have emphasised that the medium and long run requirements for additional housing in Newcastle, especially affordable units, remains strong.

6.3 Council Officers are currently reviewing individual schemes to assess viability and potential amendments which may be needed to sustain development in line with objectives.

6.4 If it is perceived that schemes should be modified, alternative options include:

6.4.1 **Put schemes on hold**

We are reluctant to create uncertainty by allowing schemes to simply be delayed for an indefinite period. This is the “do nothing” option and, while it might be inevitable in some cases, we believe we should engage constructively to see if solutions can be found.

6.4.2 **Agree a different mix of housing tenure**

There are a number of permutations on this. More houses for rent in schemes may make sense, given that uncertainty over the housing market has suppressed demand for owner occupation, at least in the short-term. Although we still have to look at the overall balance of tenure within areas and across the City, given that we seek to introduce a wider mix.

There could be attractions in shifting some existing units from sale to rent in the short term, or even buying back from owners. The Government has announced plans to look at the feasibility of this approach, and the financial implications.

We therefore would not rule out at this stage the selective purchase of houses for social housing, particularly where this might give us “pepper pot” penetration into largely private areas where there is demand for social housing. However, this particular option needs careful assessment of the

Council's powers, the level of financial risk involved and the implications for later Right to Buy.

#### 6.4.3 **Increase flexibility of tenure**

Officers will be talking further to lenders about the potential for shared equity schemes: some such schemes are already in place, but have not proved particularly popular to date. The Council believes that the use of cheaper public funding or guarantees could make these significantly more financially attractive. The Council is also committed to taking advantage of opportunities announced by the Government to make it easier for first time buyers to enter the housing market. Officers are in discussions with the Housing Corporation about the 'renting first and buying later' scheme.

#### 6.4.4 **Helping borrowers obtain mortgages**

As a matter of historical interest, the Council still holds ten mortgages. However, were it once again to become a mortgage lender, there are onerous requirements under the Financial Services Act to comply with. Initial discussions with lenders indicate some appetite for lender-fronted schemes with an element of public sector risk sharing. The permutations are many, and detailed design work is needed, as well as assessment of the risks to public funds of interventions in a falling market.

#### 6.4.5 **The Council taking less value from regeneration developments**

The Council is currently reviewing all schemes on a case-by-case basis. We have already agreed in principle in one case to take a lower initial value for land but with a greater share of future profits. As a general principle, we are seeking (for example in Scotswood) longer term transparency and engagement with developers, so the approach sits well strategically, if the right balance of risk and reward can be negotiated, with the possibility of the Council taking a greater share of any further uplift in value, set against this, the Council will need to give careful consideration to the need to secure best consideration from asset disposals. The Treasurer is assessing the impact of potentially reduced receipts on the Capital Programme. At this stage existing commitments are considered to be secure, but there is unlikely to be any new 'available' resources in the Corporate Resource Pool (CRP) until the capital resource position improves.

#### 6.4.6 **Working to bring forward new sites**

There may be opportunities for the Council to buy land while it is cheaper. We will assess potential purchases with a view to trying to bring sites in earlier to try and maintain momentum in the market. This also applies to existing sites already in our ownership that are ready for market and which we believe to be viable, perhaps with an element of cross-subsidy. The Local Housing Company approach will help us to develop optimal packages. We also have a substantive role to play through our very significant funding for public sector development such as schools, the new library and other facilities.

### 7. **Other Council responses**

- 7.1 The Chief Executive and other senior officers are meeting regularly to assess the wide impact of the economic downturn on the City, its services, and its finances. They are also meeting with lenders, Your Homes Newcastle (who are keen to assist), Bridging Newcastle Gateshead, construction companies and other public sector agencies
- 7.2 There is only a limited amount we can do to influence the wider economy. However we can seek to review any actions which may slow it further. We are due to implement an agreed additional change for Sunday car parking (increasing the fee from £1 to £1.50). Members' views are sought on whether to defer the increase until April 2009. Based on existing levels of demand the cost would be approximately £60.000 in a full year, which could be funded from the additional LABGI grant that the Council received.
- 7.4 Strategic Housing has established a working group in response to the risks posed by debt and the economic downturn, and the possible impact upon homelessness and the associated risks to children and families. We will be working with lenders to design appropriate support for first time buyers, for tightly targeted area schemes, and for those most at risk, of repossession of their houses, provided it can be done at reasonable cost and without creating a liability for non-housing debts. An exit strategy back to the private sector market will be essential unless there are strategic reasons (see 6.1 above) for retaining a home in social ownership.
- 7.5 Poverty and its implications have been identified as the first priority of the Council's Corporate Social Inclusion Strategy action plan 2008 -11. The Council's Social Inclusion Unit is assessing the level and types of support available for people at risk in the city. There are a range of initiatives already in place in relation to people both in and out of work, but their capacity needs to be assessed. For example, there are a number of specialist debt agencies, although anecdotal evidence is that they are currently working at full capacity. The Thoresen review has proposed additional financial expertise and advice be created, with an initial pilot secured in the North East. This is being explored with regional and national agencies.
- 7.6 Officers are ensuring that debt advice, the Credit Union, and Welfare Rights are being geared up to respond to any increase in problems. As discussed in another paper for Executive, the staff working on homelessness prevention are prepared for any increase in potential problems.
- 7.7 A City-wide approach to the identification of those at risk and coordinating responses under the umbrella of the Social Inclusion Strategy will make the best use of the resources available. This work also links closely to the Sustainable Community Strategy priority of combating Child Poverty.
- 7.8 Officers will work with Warm Zone to identify those at greatest risk of fuel poverty with a view to targeting interventions at those in greatest need.
- 7.9 The Council will be contributing towards the national review on the impact of the credit crunch on regeneration instruments, which is being led on behalf of Ministers by Professor Michael Parkinson. An initial discussion has already taken place with Professor Parkinson. Officers remain in close touch with other core cities and central government on this issue

7.10 The City Treasurer is closely monitoring the impact of the Credit Crunch on the Council's revenue budget and capital programme and will reflect the latest information in future reports to Executive on budget monitoring and on the budget proposals for 2009/10

7.11 The timetable for further actions is:

1. Decisions on Sunday car park charges at this stage
2. Ongoing dialogue with central and regional economists, developers, housebuilders, funding bodies (including BNG), lenders, and others.
3. End-July – complete site by site assessments of impact on particular schemes
4. End-August – discuss with RSLs/YHN and Housing Corporation scope for intervention to buy unsold housing for social rent
5. September - further report to Executive with actions in each area
6. October /November – mid year review of impact of slowdown on Council Finances and demand for services

## 8. **Corporate Implications**

### 8.1 **Financial**

The credit crunch and the broader impact of a downturn in economic activity are already having a negative impact on the finances of the City Council.

- In 2007/8 the council tax collection rate was higher than in the previous year, but below target;
- Income from, and the value of, the property portfolio is falling;
- Income from car parking has fallen;
- The rise in oil and energy prices is raising costs;
- These factors are partially offset by an increase in the return that the Council secured on its investments.
- Income from land search and planning fees is likely to be reduced

The increased costs outlined above may be partly offset by additional investment income while interest received on investments is higher than expected.

### 8.2 **Additional Views of the City Treasurer**

This report incorporates the views of the City Treasurer

8.3 **Legal:** none at this stage.

8.4 **Environmental and Sustainability.** None.

8.5 **Key risks include:**

- Not meeting our regeneration targets.

- Intervening when market forces would negate our efforts (even the Government's £200m is generally accepted as being likely to have little impact).
- Given considerable uncertainty over the direction of house prices, getting the price wrong, and paying over the odds, or selling under value. This applies to units, land sales and mortgage support instruments
- Talking up recession and creating wider impacts in the economy
- Taking too long to act, and missing the moment of influence

8.6 **Equalities** None

No **specific implications for Children and Young People.**

8.7 **Ward, Community Impact and Engagement Implications**

All

8.8 **Scrutiny**

The appropriate Scrutiny Committee is: Regeneration

9. **What Happens Next**

9.1 The report is for information, although comments on actions being undertaken by Officers would be much appreciated. The report outlines a number of steps that are being taken by Officers, who will report back to the September Executive.

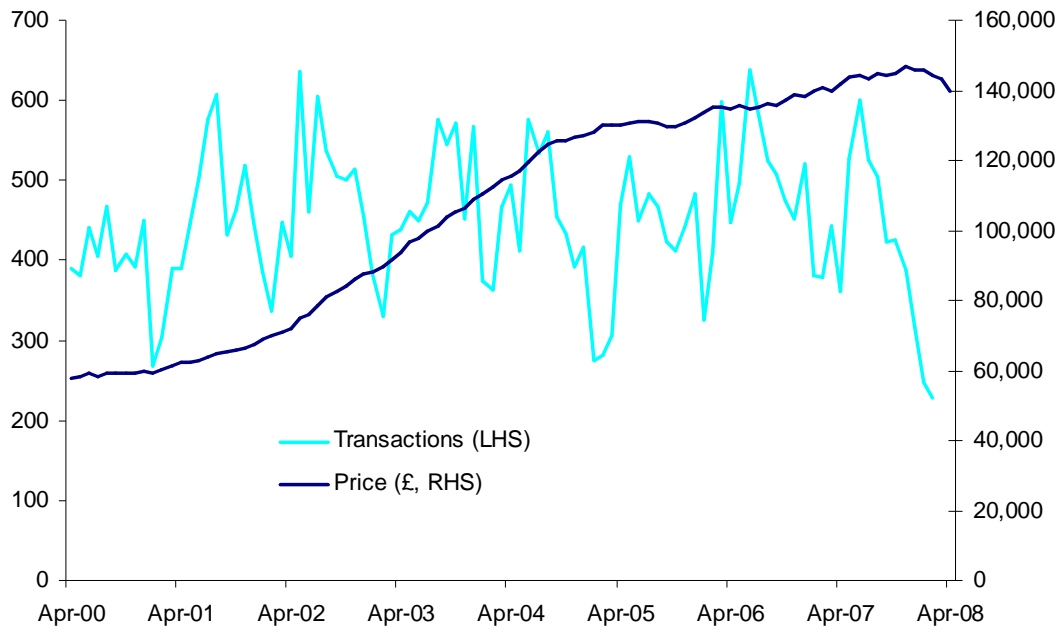
10. **Further Information**

10.1 Contact Officers:-

David Slater, Executive Director of Environment and Regeneration ext 28900  
 Christine Cunningham, Head of Strategic Housing ext 25801  
 Paul Woods, City Treasurer ext 26503  
 Rob Hamilton, Head of Economic and Urban Policy ext 28947

## Appendix

### Chart 1: House prices and sales in Newcastle



Source: Land Registry