

Consultation response

# Shelter response to the Lyons Review of housing supply

March 2014

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# Summary

Shelter welcomes the opportunity to respond to Sir Michael Lyons' review of house building in England. In this response we set out the core principles that any new government in 2015 must follow to get England building the minimum 250,000 homes per year we need to meet need. Shelter will be setting out more detailed policy proposals for the house building system in a forthcoming report with KPMG, due to be published in May. We strongly recommend that Sir Michael Lyons considers our full set of recommendations from that report.

## To get us building enough homes, a 2015 government must:

- Take a more robust approach to the land supply system so that more land is made available in the right places at reasonable prices. A more robust approach to public intervention in the land market is required as despite hugely rising housing demand, land supply for homes has fallen dramatically over the last twenty years. This is not just a planning question, but also one of the land markets behind the planning system.
- Boost public and private investment in an appropriate mix of affordable housing tenures. There is a strong case for direct capital investment given the multiplier effects of house building and high levels of need, but we also recognise that in a tight public spending environment this should be supplemented by policy measures that can deliver investment without increasing the deficit, including leveraging in much more private investment which will be possible with robust land market interventions.
- Bring on new capacity from a wider range of developers. More than doubling the rate of house building to reach the 250,000 new homes per year England needs will be a challenge for the construction industry which will need to expand its range of firms. The industry also needs a broader base if it is to be more resilient to future house price shocks such as we saw in 2007/08. Simply ramping up land supply and investment alone will not be sufficient to create a stable, resilient, high output house building industry. We need to see many more local builders and self-builders entering the market, with support for SME builders in particular.
- Be strategic about where homes will go and who will lead. The barriers to housing supply are not uniform across England and a pragmatic policy programme will recognise and reflect these differences. In many cases, this will mean devolving more power to economically buoyant cities and towns and looking closely at how rural authorities can be incentivised to take extra development when urban authorities are unable to grow further within their boundaries. This is a programme of work that Shelter is currently developing and we recommend that the Lyons Review takes into account our evidence as it emerges.<sup>1</sup>

For Shelter, the most important conclusion that can come out of Sir Michael Lyons' timely review of the housing supply system would be that we can **no longer be timid** in our response to the housing shortage.

In England, we have seen successive governments – Labour, Conservative and Coalition – fail to build enough homes for the best part of 40 years. All parties have been long on initiatives to stoke up demand in the mortgage market, but short on the tough choices that would make house prices or rents more affordable for families on normal incomes. We need ambitious reforms to deliver a new paradigm of house building in England. One which provides high quality homes in sufficient numbers which are affordable to rent or buy now and in the future for those on normal incomes. Nothing less will do.

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<sup>1</sup> Shelter and IPPR are developing a report on Land markets and Localism which is looking in detail at housing supply with several city-regions, including Bristol, York, Oxford/Bicester and Cambridge.

# Analysis and Recommendations

## Housing Supply

### (1) A more robust approach to the land supply system

Sir Michael Lyons' review is right to recognise that the land supply system is critical to increasing house building. The land supply system includes both the land market and the planning system. Some commentators assume that "fixing" or "liberalising" the planning system alone is a silver bullet for the housing shortage, but we are unconvinced that such an approach would work. Nor would it be politically possible on the scale required to make a real difference. A more nuanced approach is required.

In particular, we must look at the land markets which sit behind the planning system and are responsible for bringing land to the planning system for consideration. Development land provides us with a highly unusual – even unique – set of local markets, with finite supply, long lag times, concentrated ownership and an important and conflicting range of uses. Importantly, these local land markets cannot be understood in isolation, but only in the context of their linkages with the second hand sales market for homes, which strongly influence the price of land for home building.<sup>2</sup>

To be clear, we do not think that 'land banking' of permissioned sites by major house builders is the primary problem, as construction time lags mean developers need a reasonable forward supply of land. Developers' strategic land banks of optioned sites may present barriers to effective market operation – but as there is no public record of options agreements it is difficult to assess the severity of this problem.

A more serious problem is that too much developable land is held out of production in the hands of owners who do not intend to develop it, but seek to make speculative profits from land trading. Speculators who acquire land and promote it through the planning system can then demand extremely high prices from developers desperate for shovel ready sites – extracting value that could otherwise support developer margins, build quality and affordability.

This phenomenon is symptomatic of the structural problems in the way the land market operates that work against the provision of enough homes at reasonable prices. Every house price boom produces the most modest increase in building, but a bidding frenzy in the land market. This is because developers value land by assessing the future sales prices of homes on it, often years in advance.

Long lag times make the land market highly pro-cyclical, rushing up in housing market booms and crashing during busts.<sup>3</sup> Soaring land prices create opportunities for turning a fast profit trading land and a speculative asset bubble can set in. As house prices rise, land prices rocket, without many more homes being built. In England, farmland prices in 2013 rose at almost twice the rate of house prices, suggesting that we may be starting on this cycle once again.<sup>4</sup> High land prices make development risky and costly, which over time has led to a more concentrated and risk averse house building industry which is highly vulnerable to house price movements. As a result, land supply is not responsive to demand for homes. Between 1990 and 2010 house prices rose more than 300% but the annual supply of new land for homes fell by 63%.<sup>5</sup>

Land is the most important resource for getting new homes built, so without a more responsive land supply system, we are unlikely to build enough homes. Without more land at better prices, we won't

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<sup>2</sup> Developers determine how much to pay for land through a residual land value model based on estimated future sales prices and expected construction costs. This model operates in a way that prioritises squeezing quality of materials, unit sizes and construction costs, in order to maximize of the land price paid to the land owner. See Shelter, Solutions for the Housing Shortage, 2013

<sup>3</sup> See detailed discussion in Shelter, Solutions for the Housing Shortage, 2013

<sup>4</sup> FT, [Farmland prices rise sharply as investor demand grows](#), February 2014

<sup>5</sup> ONS, House Price Inflation Annual Data Table 22, 2013. Data is for the UK. DCLG, Live Table 226 (Land use change to residential). Data excludes 'residential changing to new residential'.

build attractive homes that ordinary families can afford. The market itself cannot deliver more land without public intervention.

**Recommendation: The Lyons Review should call for robust public interventions in the land supply system to ensure an improved supply of development land at reasonable prices across the housing market cycle.**

### **Take a tough but proportionate approach to stalled sites with planning permission**

The number of stalled sites with planning permission is relatively low<sup>6</sup>, but these sites can be highly visible and critical to urban regeneration efforts, making delays particularly frustrating for local authorities and local people who want to see brownfield sites developed first. To unblock these sites we recommend exploring possible tax and infrastructure measures to change the balance of developer incentives in the first instance, before any "use it or lose it" policy.

### **Open up the land market to scrutiny**

Currently far too much data on the land market is not collected, or is difficult or impossible to access, for all market participants. In particular we should see the release of much more data on land prices, land ownership and option agreements held on land without planning permission. More data should also be released on new build floor space and the purchasers of new build homes (i.e. nationality) as policy making currently relies on partial data.

### **Capture land value uplift**

To provide a counter-cyclical balance to the dysfunctional land market, greater use should be made of development corporations with land acquisition and planning powers, as were used with the New Towns and more recently at the Olympic Park and the London Docklands. More pro-active forms of land assembly by local government are successfully used in most equivalent European countries<sup>7</sup> to ensure that large sites with multiple owners (both public and private) are developed in a timely and strategic fashion. Another option is to look at positive planning measures like 'zoning' which designate areas for development and could be used alongside a bidding mechanism to drive up the quality and speed of development.<sup>8</sup>

### **Give greater flexibility to the planning system and speed up some processes, but don't re-open fundamental reform**

Any further systemic shake up of planning would create uncertainty and slow development in the short to medium term, as happened after the introduction of the National Planning Policy Framework in 2012.<sup>9</sup> Equally, any major reform will be extremely costly politically and could de-rail a wider housing programme. Shelter agrees that the planning system could be quicker and easier to navigate, something we heard from developers in the West Midlands.<sup>10</sup> However, the Coalition has already made a lot of progress in simplifying the planning system via the NPPF – this system needs to bed in, and be given greater force in some areas, rather than torn up. We also think that there could be more flexibility for local planning authorities in making green belt swaps on marginal agricultural land – but that any such approach should not look to swap more than 1% of green belt land in England.<sup>11</sup>

### **Take an ambitious and innovative approach to Garden Cities**

Garden Cities will not be a silver bullet for housing supply within the 2015 parliament, given the time it takes to plan, consult on and build whole new settlements. However they could be vital as flagship

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<sup>6</sup> The planning minister estimated around 60,000 plots in England in 2013.

<sup>7</sup> JRF, International Review of Land Supply and Planning Systems, 2013

<sup>8</sup> Shelter will be setting out a proposal along these lines in our forthcoming report with KPMG.

<sup>9</sup> The introduction of the NPPF led to a drop in planned homes one year after. Hepher, National Planning Policy Framework (NPPF): one year on, Savills 2013

<sup>10</sup> KPMG and Shelter, Ibid

<sup>11</sup> Shelter, Solutions for the Housing Shortage, Ibid

developments in setting a new standard of housing supply, and a legacy for the 2015 government. We recommend that a new generation of Garden Cities be planned on a national level, utilising the existing Development Corporation model and/or innovative approaches to land assembly and investment, as we have outlined in our Wolfson Prize entry.

## **(2) Invest in an appropriate range of affordable housing tenures**

Sir Michael Lyons' review is also absolutely right to focus on investment, particularly long term investment in affordable housing tenures.

Successive governments have switched spending from building new affordable homes to subsidising spiralling housing costs. In 2012/13, central government spent just over £1 billion on new affordable home building compared to a forecast £23 billion on housing benefit.<sup>12</sup> Declining grant funding from central government has meant that affordable housing providers are under more pressure to borrow against their existing assets and future rents in order to build. However many are now running into the limits of their ability to borrow.<sup>13</sup> If we want to stop the benefit bill rising inexorably we have to preserve our existing low rent homes and build new ones - which will require additional capital investment.

In addition to cuts to central grant funding, investment in new affordable homes has been constrained by restraints on the borrowing capacity of local authorities set by national government. This has been partly mitigated by recent reform to local authorities' Housing Revenue Accounts and a £300m raising of the cap in the Autumn Statement 2013, but the caps and accounting rules faced by councils in England are still much stricter than in comparable European nations.<sup>14</sup>

In terms of tenure, we need a public investment strategy that meets local need for both social rented and intermediate homes. In addition to thousands more social rented homes, Shelter believes that a better shared ownership market, with greater protection for shared owners and more ability to move within the market, could be of benefit to many of those priced out of full ownership and unable to access social housing.<sup>15</sup>

We need a bold investment package from whoever forms the 2015 government if we are going to be able to retain existing low rent affordable housing and build enough new genuinely affordable housing to meet need.

**Recommendation: The Lyons Review should recommend a significant boost to investment in new homes for low rent and shared ownership.**

### **Prioritise capital investment for the 2015-2020 period**

Currently, just under £3bn is allocated for affordable housing tenures for 2015-2018 and the HCA prospectus does not include funding for a low rent product( i.e. at rents of 40-50% of market levels).<sup>16</sup> The Lyons Review should recommend a substantial uplift in the investment budget for the period, with a new prospectus to allow the funding of social rent as well as shared ownership homes.

### **Create new models to capture private investment**

Models such as development corporations, new home zones or new garden cities could be very effective at attracting private long term investment, but will require a significant land market intervention (i.e. the ability to acquire land at not much more than existing use value). Other models for the Lyons

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<sup>12</sup> HCA, Affordable Housing Programme and DWP benefit expenditure and caseload 2012 (Table 1a)

<sup>13</sup> KPMG and Shelter heard in 2013 that many housing associations in the West Midlands were concerned about their capacity to borrow further without grant funding and were therefore planning conservatively. KPMG and Shelter, Homes for the Next Generation: Lessons from the West Midlands, 2013

<sup>14</sup> Perry, Treating Council Housing Fairly, National Federation of ALMOs, 2013

<sup>15</sup> Shelter, Homes for Forgotten Families, 2013

<sup>16</sup> The Mayor of London's Draft Housing Strategy does include 30% of allocated investment over the period to be spent on a "capped" rent product.

Review to consider include a new Housing Investment Bank, a model that Shelter is currently developing, local joint ventures, and guarantees to help small builders gain access to development finance.

### **Let local authorities increase their role**

Gradually raising the cap on local authority borrowing in the Housing Revenue Account (HRA) towards local authority prudential borrowing levels is proportionate and pragmatic. This would build on the recent reforms under the Coalition to give more financial autonomy to local authorities on housing. There is a strong case to go further and reform accounting rules to be in line with European norms so that local authority borrowing for housing does not count against total public debt.<sup>17</sup>

### **(3) Bring on new capacity from a wider range of developers**

In England, the home building sector is highly concentrated with a few major developers dominating most of the market.<sup>18</sup> Over the years, many smaller builders have been forced out of the market or merged into the larger players. Forthcoming analysis by Europe Economics for Shelter suggests that a more diverse house building sector could significantly increase its resilience and output.<sup>19</sup>

Far fewer people commission a local builder to build their home in England than in other comparable counties. 'Self-build' homes, which are usually commissioned to a local builder, are typically built to high quality standards and are usually designed to be lived in, not to be financial assets. A higher proportion of self-builders in the market would make overall house building more resilient and diverse, as self-builders are typically less affected by wider housing market trends such as falling prices because they are not building for short term margins, but for long term owner occupation.

The 'volume' house builder model is the main source of new homes in England, but may not offer consumers the best value. New homes in England are some of the smallest and most expensive in the world, and the industry has proved slow to adopt new technologies compared to other countries or other sectors.<sup>20</sup> The interaction between volume house builders and the development land market through residual land prices means that build size and quality of new homes are systematically reduced at the expense of land value.<sup>21</sup>

No one in the current housing market is acting irrationally or in an anti-competitive manner.<sup>22</sup> However the net effect of a dysfunctional land supply system and the development sector that has grown around it is a low output, volatile and vulnerable house building system. If we look at private house builder output since the Second World War, it is clear that there has been a ratcheting down from each peak of output, despite soaring prices over the period. Without a broader base for development alongside land market interventions already discussed, this pattern of spasmodic decline seems set to continue.

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<sup>17</sup> Perry, Treating Council Housing Fairly, National Federation of ALMOs, 2013

<sup>18</sup> IPPR, We Must Fix It, 2011

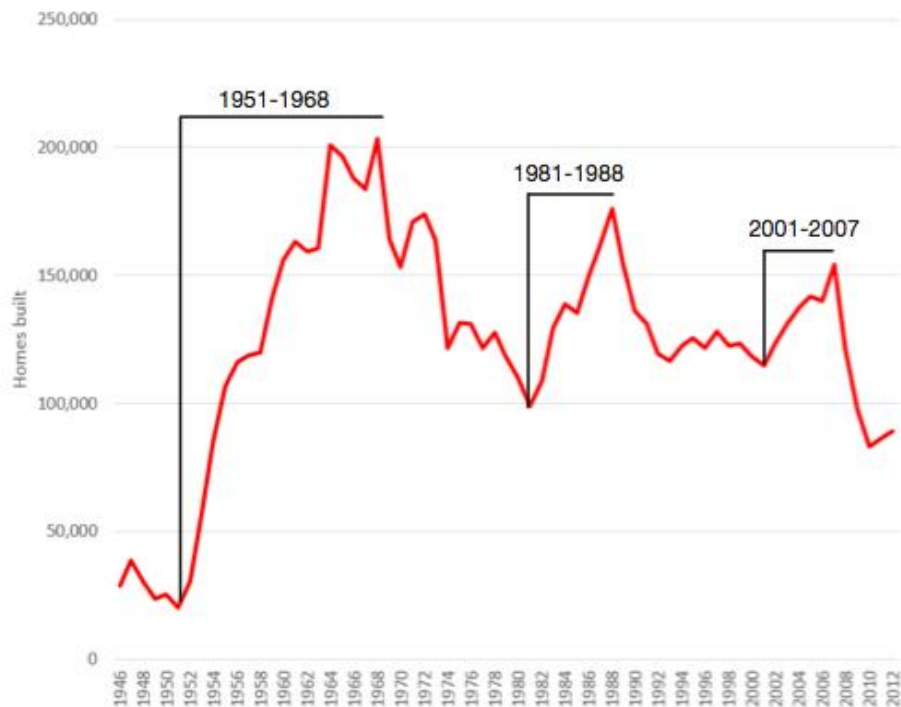
<sup>19</sup> Europe Economics, How to increase competition, diversity and resilience in the house builder market, forthcoming 2014

<sup>20</sup> Shelter, Little Boxes, Fewer Homes, 2013

<sup>21</sup> Shelter, Solutions for the Housing Shortage, Ibid; Parvin and Saxby, A Right to Build, 2011

<sup>22</sup> OFT, Home building in the UK: a market study, 2008. The Callcutt Review of house building delivery, 2007

## Private house builder output (1946 – 2012)



**Recommendation: The Lyons Review should recommend policies to broaden the base of the house building sector to make it more resilient and diverse.**

### Support small builders to enter the market

Development finance is often cited as a key constraint on small builders entering the market. The Lyons Review should recommend exploring measures to support development finance for SME builders, for example by diverting some of the mortgage loan guarantees available under 'Help to Buy' support loans to local building firms.<sup>23</sup>

### Support self-builders

Land market interventions should lock-in a principle of providing serviced plots for self-builders. Shelter suggests that 20% of plots on sites released by land market interventions such as garden cities be provided for self-build. Any approach to releasing land for self-build will also need to be supplemented by policies to make the use of self-build easier for consumers, in such a way that it can still support small, local builders.

### Make a stable housing market a priority

Increasing the supply of homes is a good way to bring confidence to the market and help stabilise prices. Importantly, however, this relationship works the other way too. There is growing evidence that the instability of the housing market has played a large part in the trend towards consolidation of the housing sector.<sup>24</sup> Due to the time lags between land purchase and home sales inherent in house

<sup>23</sup> This option is being worked up for Shelter by Capital Economics in a forthcoming report.

<sup>24</sup> See IPPR, Ibid, FTI for Shelter, Understanding Supply Constraints in the Housing Market, 2012 and forthcoming Europe Economics report for Shelter



building, volatility in house prices increases developers' risk – particularly for smaller developers with fewer reserves, many of whom went bust or were taken over following the 2007/08 house price falls. Stabilising the housing market should be a central macro-prudential and macro-economic goal, just as controlling inflation was during the 1980s and 1990s.

#### **(4) Create a framework for clear strategic leadership at the local level**

There are few incentives on local leaders to get more homes built.<sup>25</sup> While in recent years we have seen the creation of Local Enterprise Partnerships (LEPs) and City Deals to support economic growth for the “core cities”, we have not seen similar cross-boundary, long term strategies for housing growth.

Those local leaders who do want to get homes built have few budgets and powers at their disposal, with the exception of the Mayor of London. In some cases, local authority boundaries combined with tight green belts make it increasingly hard for cities that are growing economically – such as Cambridge, Oxford, York and Bristol – to grow their housing stock. In some areas, there is a clear tension between urban authorities who need more homes and surrounding rural authorities under political pressure to constrain development.

The concerns of those who oppose new housing development often centre on the pressure the new homes will place on local infrastructure and services. Without a joined up approach to homes and infrastructure, local people will continue to worry that a major new housing programme will simply make life harder for them.

Shelter is carrying out detailed policy research with the Institute for Public Policy Research looking specifically at issues around land use and localism. That report will make detailed recommendations as to how land market interventions can work locally.

**Recommendation: Prior to the results of our further work in developing this area, Shelter would recommend an approach that incentivises local authorities to grow their housing stock, and empowers growing cities to take a greater leadership role in co-ordinating growth.**

#### **Plan homes and infrastructure more closely together**

The Lyons Review should recommend that City Deals and other incentive packages for cities and towns are used more effectively to combine homes and infrastructure. For example, there could be a case for devolving some of the expanded HCA budget to cities and towns which are willing to take a leading role in expanding their housing stock. Such an expanded form of City Deal could come with a quid pro quo of support for rural periphery authorities which sign up (including on service delivery), with those who refuse left behind for that round.

#### **Provide the models and the resources to enable local strategic leadership**

Few local authorities currently have the capacity, the expertise or the culture to lead a renaissance in strategic development. New joint venture models that combine public and private resources could help address this, as could providing floating delivery support for local authorities via the HCA – along the lines of the ATLAS team that provides short term support on major planning applications.

#### **Assess housing need across functional housing areas**

One clear problem under the current localist system is the lack of strategic assessment of housing needs that is essential for effective local plan making. Strategic Housing Market Assessments could happen in a co-ordinated way by statute, rather than in the ad hoc way under the NPPF. One option is to look at whether Local Enterprise Partnerships should have a statutory role in co-ordinating SHMAs.

#### **Integrate major infrastructure with homes**

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<sup>25</sup> The National Audit Office found that the New Homes Bonus was poorly targeted and potentially ineffective, NAO, 2012



Britain is currently building or planning several major pieces of new transport infrastructure. Clearly, this provides significant opportunities to build new homes in strategically valuable areas. Yet, unlike other European countries, England has no national spatial plan for housing. The Lyons Review should recommend that new major infrastructure is planned with homes fully integrated. Currently, the £300bn National Infrastructure Plan does not include homes.

### **Design high quality homes fit for families**

We don't just need more homes to be built, we need better homes to be built. Minimum space standards, high environmental and design quality, good transport links and green space should all form part of the recommendations from the Lyons Review. Quality should not be thought of as something to be traded off against numbers or affordability, but considered as an essential requirement of development so that the costs are factored into land prices.

## **Housing Need**

### **How many homes do we need to build each year?**

Independent assessments of housing need have put household formation in England between 230,000 and 280,000 per year.<sup>26</sup> There is also the backlog of hidden households who are struggling to form due to high housing costs. Some recent estimates have put the number of 'concealed' households in this group at over two million.<sup>27</sup>

Shelter believes that 250,000 homes per year is a realistic target for the end of the 2020 parliament, so long as whoever forms the 2015 government embarks on an ambitious programme of reform and investment. Without meeting base-line housing need, the deficit of housing supply to housing need will only grow, and housing pressures increase.

**Recommendation: There is a case for Sir Michael Lyons to look again at the target of 200,000 homes per year in England and make a recommendation to the Labour Party that this may not be sufficient to meet emerging housing need or to reduce existing housing pressure.**

### **Where are new homes needed?**

There is no a 'one size fits all' solution to the problems of house building in England. The need for new homes varies greatly across the country.

In the South East and London<sup>28</sup>, where millions are faced with unaffordable house prices and sky-high rents, there is a need for strong interventions to reduce the cost of development land, and whole new garden cities will be needed.

There is however great housing need outside of the capital too: economically buoyant cities such as Bristol, York and Oxford are constrained and unable to grow despite creating thousands more jobs. We need an approach to these places which reflects their desire to grow their economies as well as their housing supply. Major city-regions such as Birmingham and Manchester could be helped by unlocking

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<sup>26</sup> The government's latest projections are that household growth from 2011 to 2021 will be 221,000 households per year in England. Independent projections by the Centre for Housing and Planning Research, the TCPA and the National Housing and Planning Advice Unit estimate household growth is closer to 280,000 per year. Recent research by the RTPI suggested that the ONS figure could be an underestimate by up to 30% due to the impact of the recession and migration on household formation rates. RTPI, Planning for Housing in England: understanding recent changes in household formation rates, 2014

<sup>27</sup> DCLG, Estimating Housing Need 2010. In 2003 Kate Barker estimated that there were 450,000 households without self contained dwellings. Barker, Review of Housing Supply, 2003

<sup>28</sup> One recent analysis suggested that the South East mega-region based around the London economy includes 18 million people and more than 50 urban centres outside London. Hall and Falk, Good Cities, Better Lives, Routledge 2013

stalled brownfield sites and urban extensions, while in some northern towns the most pressing need is for bringing empty homes back into use by incentivising their re-use.

To reflect these differences, the right strategy is to devolve a wider range of powers and budgets to cities and towns so that they can take their own decisions on how to meet their objectively assessed housing need. On top of this, central government will need to make building homes for the next generation a cornerstone of its programme of government and set out a clear national plan for delivering this, including proposing sites for new towns.

It is also important that the right type and tenure of homes are delivered to meet local need, rather than simply supporting the most viable development. For example, in some areas there is a shortage of family homes that are affordable to people on average incomes. In other places, we need to deliver homes suitable for an increasingly aging population.

**Recommendation: Given the very different nature of housing markets across England, a core principle of the Lyons recommendations should be devolution and local strategic leadership. A different set of policies will be needed in the low demand market of Liverpool to the high demand market of London. The best people to make decisions on how to do so are locally elected leaders, but they will need greater budgets and powers to do so.**

## Conclusion

For Shelter, the most important conclusion that can come out of Sir Michael Lyons' timely review of the housing supply system would be that **we can no longer be timid** in our response to the housing shortage. In England, we have seen successive governments – Labour, Conservative and Coalition – fail to build enough homes for the best part of 40 years. All parties have been long on initiatives to stoke up demand in the mortgage market, but short on the tough choices that would make house prices or rents more affordable for families on normal incomes. We need ambitious reforms to deliver a new paradigm of house building in England. One which provides high quality homes in sufficient numbers which are affordable to rent or buy now and in the future for those on normal incomes. Nothing less will do.

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