

Solutions for the housing shortage

How to build the 250,000 homes we need each year

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Shelter

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Executive Summary

Introduction

Few now doubt that England faces an urgent housing shortage. Since the Barker Review in 2004 policy makers, academics and politicians of all stripes have recognised the need to significantly increase the supply of new homes in order to meet current and future housing need, and limit further dramatic increases in housing costs.

But almost ten years on from Barker our house building performance remains dire – and has been made considerably worse by the impact of recession and the fallout from the credit crunch. Indeed, since 2004 we have failed to build over a million of the 3m new homes identified as necessary by the Barker Report.¹

England is now delivering fewer homes than in any peacetime year since the First World War, even before accounting for a much larger population and smaller households. As a result, the country faces a large and accumulating shortfall between the homes we need and the houses we are building – of approximately 100,000 to 150,000 homes a year. If we remain building at current levels, we build a million fewer homes than we need every seven years.²

Failure on this level requires a radical response. This paper sets out the options for closing this housing shortage and improving our housing supply system.

All of these options involve hard choices, significant changes and real costs. None are easy to deliver. Yet the worst option of all would be to do nothing. Inaction would be as much a choice as the more positive and creative options outlined in this paper. It would bring with it real consequences.

The current system of housing delivery is manifestly failing to deliver the homes that England needs. To continue on this path would mean accepting a continued fall in homeownership³. It would mean accepting continued year on year above inflation rises in rental costs – squeezing the incomes and living standards of an ever growing section of society. It would mean dramatically raising the housing benefit bill, leading to further pressure on the public finances.

Doing nothing would mean access to homeownership would become the preserve of the very few, and accessible only by taking on large levels of mortgage debt – increasing both household and national vulnerability to economic shocks. Larger numbers of people from lower and middle income social groups would be forced to rent, with more requiring ongoing government support via housing benefit, and increasing the burden on the state when these groups retire. Particularly high-pressured housing markets, such as London, would become ever more stratified by wealth inequalities.

These outcomes would constitute a dramatic change to our society, with greater negative social, environmental and political consequences than any of the proposals in this paper aimed at increasing the level of house building.

But continuing along the current path is essentially a negative choice – and the consequences of it are dispersed and long term. Changing direction entails positive action, challenging vested interests and established orthodoxies - with all the potential for political battles that that entails.

If it is to avoid further failure, the government must now widen its reform agenda beyond narrowly targeted interventions and short term gimmicks. There is no easy quick fix to the problem of housing supply. Solving it requires combining immediate short term measures to boost investment with long term structural reforms to permanently raise levels of house building.

1. The Barker Report recommended building 245,000 private sector homes per year to keep house price inflation at the European average of 1.1% per annum. Between 2004 and 2012 there has been a cumulative shortfall in England of 1,154,750 homes.
2. Based on the Barker calculation of annual needed private house building (245,000) and current levels of private house building in England (89,010)
3. Homeownership peaked in 2003 and has been declining since then

Overview

This paper examines the measures that could be taken to increase supply in the short to medium term – through immediately available policy levers and through more substantial reforms.

It argues that neither the current housing market and supply chain, nor the current range of announced policy interventions, are capable of stimulating economic growth or delivering homes on the scale needed to meet current demand – let alone the backlog built up by decades of under supply. It looks at the range of alternative actions available and the balance of choices policy makers face.

Building more homes must be partly about greater levels of investment. If we want to increase our level of house building we have to spend more money. This requires tough choices on public spending. But the case for improving England's housing performance goes beyond money – indeed many possible and useful interventions will have little overall cost to the Exchequer.

To successfully and consistently raise the number of new homes we build, we must also increase the dynamism, competition and pluralism of those who deliver new homes. Our current actors cannot, by themselves, make up the housing shortage. Securing a step change in supply rates will require more radical interventions, notably through reform of the land, debt and development markets. The obstacles to these reforms have less to do with fiscal constraint than with a collective failure of imagination and policy.

There is no silver bullet: we need a balanced approach

Figure 1 below shows that we are not expecting to build enough homes for the foreseeable future. The most recent announcement of additional government investment for housing contained in the 2013 Comprehensive Spending Review and longer-term capital investment plans, still falls far short of meeting England's housing shortage. Doing nothing means therefore that the housing shortage will continue to grow. Figure 2 shows one balanced mix of policies to face up to the housing shortage.

Figure 1: Even on an optimistic scenario, current plans won't deliver enough homes

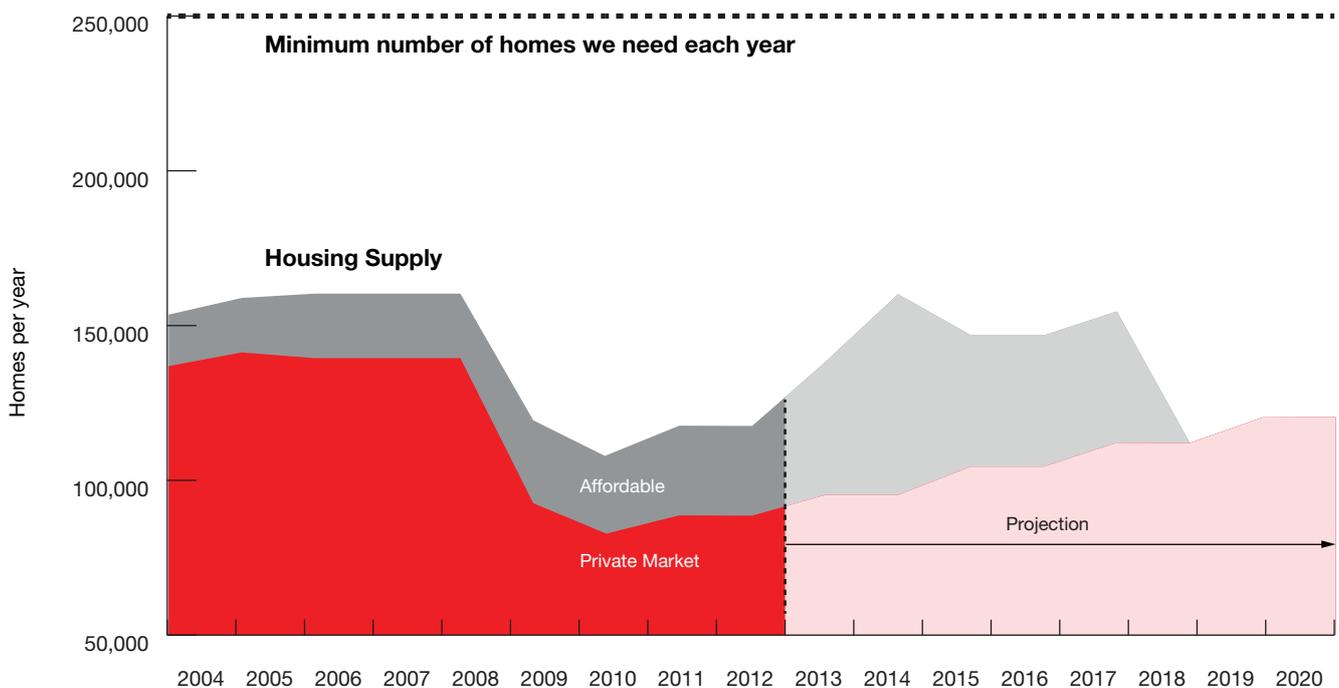


Figure 2: How could we build enough homes?

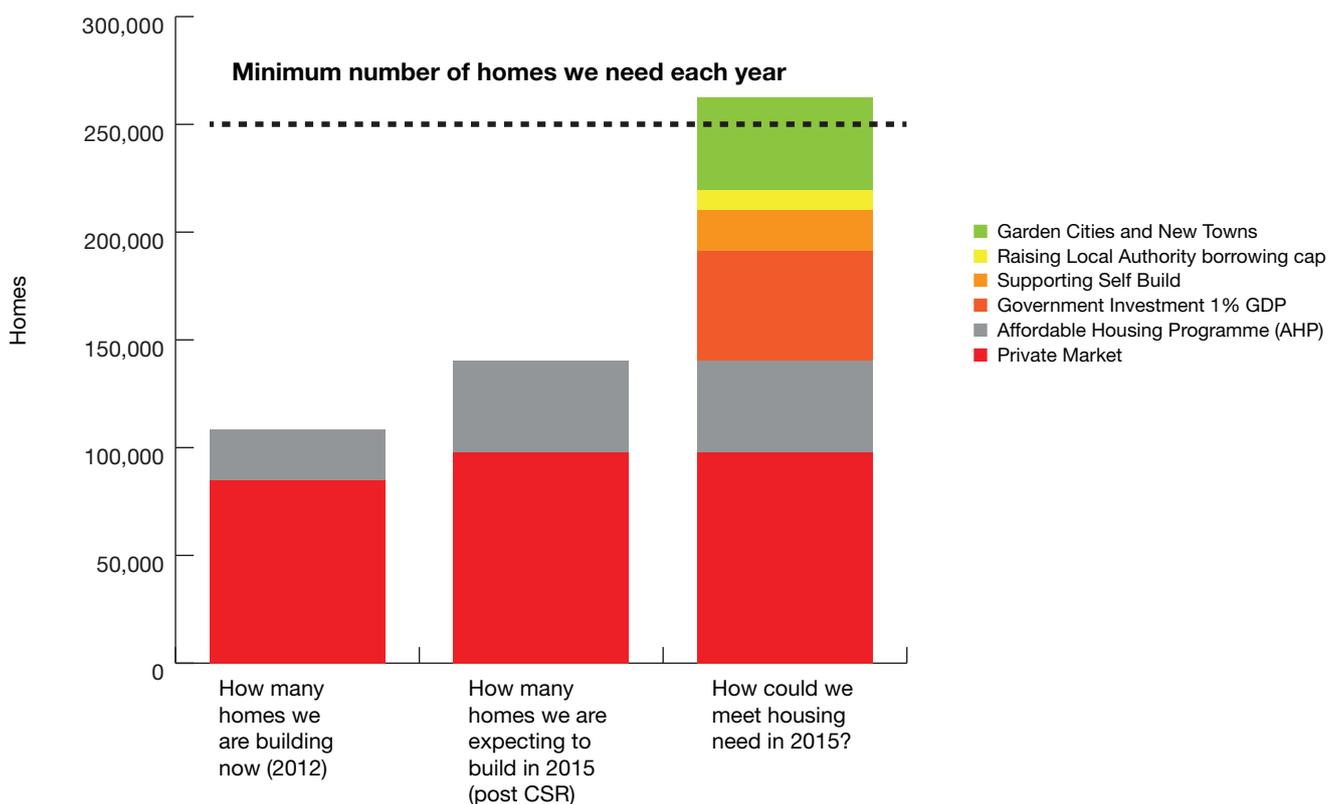


Table 1: Full range of long and short term options for policy makers

Table 1 below shows the full range of long and short term options along with an approximate number of homes that could be delivered per year by introducing the policy. The following pages provide short descriptions of each policy option.

Option	Extra homes built each year	Notes	Full information
Doing nothing	0 (current level)	Continued falling homeownership, rising rents and rising social security bill	p. 37
Short Term Measures			
Increasing Capital Spending			
Direct investment by central government	51,072	£12bn investment (1% GDP) every four years Called for by Vince Cable, CBI and others Financed from re-allocated spending or borrowing	p. 24
Increased Local Authority Borrowing			
Moderate reform: prudential accounting	12,000	A moderate package of fiscal reform that is within realistic local authority capacity Currently has cross party support at local authority level	p. 31
Radical reform: European accounting	17,000	Would require substantial accounting reforms and clear articulation to markets of changes Local authority capacity would take some time to deliver high levels of housing	p. 31
Quick Changes			
Supporting rural affordable housing: Exception Sites	1,500	Creates lower cost affordable housing in key area of housing need Limited supply impact	p. 34
Commercial property conversions into residential	10,000	Commercial property owners have strong financial incentive to deliver, as residential more profitable Would involve potential conflict over use designation with local authority planning authorities	p. 35
Green belt flexibility	33,000	Would lead to no net loss of the green belt and enhance its overall landscape and environmental value Targets housing in key areas of need with land outside of existing housebuilder control. Limited %age of land use has high impact	p. 33

Longer Term Measures

Structural Changes

Garden Cities and New Towns	43,000	<p>Proven method of delivering large scale, well planned new housing settlements. Concentrates opposition to new housing in limited number of locations. Land value uplift present opportunities to share benefits with impacted communities and local authorities</p> <p>Financing may involve new government lending or guarantees</p> <p>In areas where most needed, notably the South East, will have to find new ways to win support of communities and local authorities</p>	p. 48
Supporting self build through the planning system	19,000	<p>Creates new delivery method needed to complement current market builders and housing associations</p> <p>Self build will reduce, but not eliminate, anti development sentiment. Will require support from UK mortgage lenders</p>	p. 40
Community Land Auctions	Use with others to increase supply	<p>Land release mechanism, so would need to be used with other policies above to get homes built</p> <p>Market based method of land release that will reduce the price of residential land</p> <p>Potential for significant land value uplift to be captured by government directly (with ability to then fiscally reward communities) that is currently lost to land traders</p> <p>Requires willing pro-development local authorities to organise. May produce land that is not strategically optimal</p>	p. 39
Compulsory Purchase	Use with others to increase supply	<p>Land release mechanism, so would need to be used with other policies above to get homes built</p> <p>Highly effective method of delivering cheap land for housebuilding with recent success at the Olympics in delivering fast and effective development projects</p>	p. 41

Investment Options

Investment is critically important, particularly if we are looking for ways that both quickly increase new house building whilst stimulating economic growth.

Increased investment in housing could come in a variety of guises; from direct central government spending, from new settlements for council borrowing and investment, from use of new government guarantees, or from a robust new approach to securing and delivering cheaper land.

Housing is a prime candidate for delivering effective counter cyclical intervention with a wide range of economic and social benefits. As previous research by Shelter and respected academics shows, increasing the supply of new homes can produce major economic benefits, helping to drive an economic recovery:

- every £1 spent on construction generates an additional £2.09 of economic output, higher than the return to most other sectors, including advanced manufacturing and banking and finance;⁴
- for every £1 spent in building, 92p stays in the UK;
- for every £1 spent by the public sector, 56p returns to the Exchequer, of which 36p is direct savings in tax and benefits.⁵

As a form of infrastructure investment, investment in housing creates new assets that underpin economic activity and generate long term economic and social returns to the UK.

Such investment would present no danger of inflation, given the spare capacity within the current house building sector, even with a doubling of current output.⁶ The fiscal impact of investment in infrastructure is also thought to be higher than those from any further changes to tax and current spending.⁷

House building, unlike other major infrastructure projects, has relatively short lead-in times between investment and economic activity. The benefits of focusing on housing are now recognized across the business and finance community and amongst a broad range of economic commentators.⁸ If we want to stimulate economic growth quickly, housing is the sector that can deliver quick returns.

Investment would also create long-term benefits for the economy and the exchequer. Lowering housing costs would reduce the large and growing housing benefit bill. Lower housing costs would also reduce their damaging drag on economic performance. High housing costs increase personal debt levels and increase vulnerability to external credit shocks. High housing costs reduce labour mobility, add an additional cost to businesses in the form of higher wages, and drain disposable income out of the wider economy.

Spending more on house building

A return to higher spending on house building could happen immediately. Its impact would also be effective and quick.

Government has recently announced its housing investment plans for the three years from 2015/16 to 2017/18 with £2.8 billion pledged to extend the Affordable Housing Programme. This means a reduction on current affordable housing spending, from £1.15 billion per year to £957,000 per year.

We set out two alternative spending proposals

The first option is to increase spending from central government. The lead proposal, as promoted by the Secretary of State for Business, is for £12 billion of new spending – still a relatively modest 1% of GDP. This would deliver 204,000 new homes and lead to substantial long term government savings from reduced housing benefit costs.

The second option is to increase spending by local authorities, via increased borrowing based upon existing housing assets. The lead proposal of raising the current local authority borrowing caps so that investment could increase along prudential lines, would release an extra £7 billion on investment over five years and create an extra 60,000 new homes.

Both options would of course run counter to the government's current plans, as the increased investment would have to come from reprioritising other departmental budgets, tax increases, or increased borrowing.

The first option would require tough spending choices, with deeper cuts to other departmental budgets in the face of a tighter than expected Comprehensive

4. FTI Consulting Investment in Housing and Its Contribution to Economic Growth, October 2011

5. Construction in the UK Economy: The Benefits of Investment, LEK Consulting for UK Contractors Group, November 2011

6. FTI Consulting Investment in Housing and Its Contribution to Economic Growth, October 2011

7. See Office of Budget Responsibility Forecasts, June 2010, Table C8 and Note by the Staff of the International Monetary Fund for G20 conference, 2009, Table 4

8. See for example the recent budget submissions from the CBI and the British Chambers of Commerce

Spending Review. This presents political difficulties, although the case for prioritising investment spending in housing over other forms of current spending has been well made by the CBI and British Chamber of Commerce.⁹ Raising taxes could also be a hard political sell, and could risk choking off demand further.

Additional borrowing for housing investment remains the least difficult option. This would not necessarily have negative impacts on wider market confidence, if it was structured and rationalised within a limited increase in current expenditure and pro growth framework. Growth, as well as fiscal discipline, is necessary to continue to maintain the UK's debt repayment obligations and the rationale for a pro growth stimulus from house building is strong. There is also increasing market appetite for a shift towards investment spending by government, and house building represents one of the fastest and most effective forms of infrastructure spending to create growth.

Short Term Reform Options

As well as increasing investment, there are some relatively quick reforms that could be made now to boost housing supply in the short to medium term. There are at least three areas where boldness would deliver results:

Green belt flexibility:

There is scope to expand green belt swaps - exchanging low grade agricultural land with little landscape or environmental value for equal sized green belt designations of higher quality land. This would allow the release of modest amounts of low value land for house building in areas close to where housing pressures are highest.

Supporting rural affordable housing:

Expanding the use of exception sites - affordable housing sites located within or on the edge of existing small rural settlements - to increase affordable housing delivery would build upon a successful housing policy that has potential to deliver more affordable and market homes at low levels of cost to government. Land secured through exception sites is outside the normal planning regime, and so can be released at well below mainstream residential market value.

Commercial property conversions:

In some places there is scope to make it easier to convert retail and office buildings into homes, whilst capturing part of the uplift in value for affordable housing (unlike current government plans). This would provide powerful incentives for the switching of existing empty offices and shops into much needed homes, while generating additional money for affordable housing.

All three of these short term reforms would help quickly increase either the supply of cheaper land into the housing market or reallocate part of our building stock away from sectors with high vacancy rates and low levels of demand and into homes.

Longer Term Reforms

Short term measures and boosts to investment are needed to raise our terrible housing performance. But by themselves they will not be sufficient to permanently improve our house building performance to the levels we need. At worst there is a risk that increasing investment without systemic reform could inflate prices and preserve the dysfunctional status quo.

Policy makers therefore have to confront systemic problems that pre-date both the credit crunch and current pressures on government spending.

Widening and diversifying who delivers housing

A new approach to who delivers our houses is urgently needed - increasing the diversity of the development sector and creating complementary and supplementary business models.

England's failure to deliver more supply is partly a story of a steady fall in the diversity of the house building system - both in the spread between private and public sectors and in the diversity of private house building firms.

Greater delivery diversity was central to the success of our inter war and post war housing supply record, but since the 1990s the expectation for the delivery of new housing has rested primarily on a shrinking number of increasingly large private house builders, who largely operate on the same business model and respond to the same cyclical pressures. The fallout from the recession means that we now have the most concentrated house building sector ever - with nearly

9. See for example the recent budget submissions from the CBI and the British Chambers of Commerce

70% of all private sector output now being produced by just the largest house builders. This reduces competition, and reduces the responsiveness of the industry to housing demand. The result is a downward ratchet of house building with every boom and bust of the property market.

Private house builders will remain a vital part of England's housing delivery mix. But meeting the housing supply gap would require the current crop of house builders to raise their output far beyond what is practically or realistically viable. And there are good reasons to think that their ability to deliver substantial output growth is limited.

Government policy instead needs to also encourage the emergence of new house builders – in the form of small or medium sized firms that have largely exited the market, or entirely new actors, private or public.

Housing Associations can deliver part of this growth, but, again, remain constrained by both the amount of money that central government can spend on affordable house building and limits to their total level of borrowing.

The 'sleeping giants' of delivery are local authorities – who have shown recent signs of waking. Yet they remain tied by a framework of fiscal rules that is overly restrictive and goes against the spirit of localism.

But we also need to think of entirely new actors – small builders, self builders and new delivery agents – with different incentives and that operate on different business models and on different business cycles. Greater diversity in the development industry would increase competition and improve the sector's resilience to economic shocks.

Land market reforms

The land market is the heart of the development industry. Improving its ability to provide land for development at reasonable volumes and reasonable prices is the greatest challenge facing housing supply policy today. Public policy levers in this area have largely fallen into disuse, leaving land supply at the mercy of an opaque market and an unresponsive planning system.

A recent major international review of land supply and planning systems conducted by the Cambridge Centre for Housing and Planning Research found that countries that have demonstrated success in housing delivery are much more pro-active in the land

and development market than England.¹⁰ We need to learn from these successes. This would require two interlinked sets of reforms:

- A new approach to acquiring and releasing land. This is important to drive down the price of land, make it less volatile and overcome one of the major barriers to entry into house building.
- A new set of Development Vehicles, that are able to deliver housing on scale (such as Garden Cities and New Towns) and allow new smaller actors the opportunities to build.

There are four primary options for reforming our land market so that it spurred, rather than constrained, increased housing supply.

- Strategic release of public land, structured in order to maximize new housing supply rather than secure short term cash receipts. This would require leadership from central government to encourage public land owners, such as the MOD, to release land given the economic disincentives of selling land below market rate.
- Market-based Community Land Auctions, to expand the amount of market land available for development in a way that drives down prices and reduces the power that landowners currently exert in the planning system.
- Where local authorities fail to meet their housing delivery targets, compulsory allocation of non-allocated land for development by self builders, small builders and affordable housing providers.
- More muscular approaches to land acquisition, assembly and release through more widespread use of Compulsory Purchase Orders – as used successfully by the Olympic Delivery Authority to deliver strategically important housing development.

These measures are not mutually exclusive, and could usefully be supplemented by new targeted tax measures to discourage speculative hoarding by landowners.

New strategic development vehicles

Land reforms could be combined with a far-sighted approach to new development methods by setting up new development vehicles to help plan, finance and deliver new housing development. There are options to do this 'off-balance sheet' or with private backing. The two most likely successful forms being:

10. Monk et al 2013,

- New Town or Garden City Corporations, with substantial powers to acquire land at close to use value, long term financing via government loans or private market bonds and the ability to make successful, green and desirable places to live.
- Local authorities themselves, either directly or via special purpose vehicles, to develop either their own land holdings or land released in parallel to the existing planning system.

The powers to deliver both of these options already exist: all that is needed is the political will to implement them.

Longer term financial reforms

Finally, it seems highly likely we need more substantial fiscal reforms to improve the ability of housing development to attract long term investment. Two main routes are available:

- Guaranteeing investment and borrowing from new private sector actors;
- Restructuring the borrowing capacity of local authorities.

Help to Buy is the wrong policy – it underwrites increasing demand, rather than supply, and risks pushing house prices even higher. This has been noted by the OECD, IMF and OBR among others. But it does open up the possibility of using the government's balance sheet to extend investment in housing supply, rather than merely re-inflating demand. If government is prepared to extend the liabilities of the state in this way, it would far better to do so by supporting new house building than by subsidising mortgage debt.

Government supply guarantees are already happening in the case of housing associations and in the drive to encourage greater investment in private rented sector investment. But the success of the former may be limited by insufficient further capital grant into affordable housing and already stretched borrowing capacity. The success of the latter may be limited by the lack of access to cheap land that limits opportunities for investors to invest and secure attractive rental yields.

In offering investors a product that is lower risk (compared to other market investments) and higher yield (compared to gilts), investment guarantees for new supply should be an attractive pull into the sector. Over the long term, large scale private sector housing investment, particularly of rented housing, offers to create good long term income streams that have proven themselves excellent hedges against inflation (Cooke and Hull 2012).

Any major scale private sector development will also face significant upfront costs in the shape of land and infrastructure investments. The private sector may be able to overcome this by the issuing of bonds or using upfront capital, but getting this relatively new market to scale may require some form of government guarantee.

In some cases this may also merit direct government loans – for example in helping to capitalise new development vehicles, such as Garden City Corporations. Government should learn lessons from the New Towns and Garden Cities experience, where many examples showed high returns to public investment alongside an impressive long term supply response.

Finally, a serious re-examination of how we account for local authority housing investment is needed.

Reclassifying local authority housing debt as investment by public corporations in line with international accounting rules could have a transformative effect on investment and the output of new housing. Under the standard General Government Gross Debt accounting rules, borrowing against revenues is allowed in much of Europe – including France and Germany.¹¹

This would mean local authorities' housing balance sheets were treated much more like those of housing associations, with positive implications both for local authorities' ability to invest and the categorisation of this investment borrowing outside of government's formal debt levels.

If this were to happen one study estimates that local authorities could borrow up to £20bn in the next five years, based on their current projected income and up to £27bn if they charged higher Affordable Rents on newly built stock.¹² This extra borrowing (with no additional central government grant) would enable 170-230,000 extra homes to be built in total, if all the potential investment were devoted to new build.¹³

Additional private or public borrowing measures would require a clear articulation to markets of their rationale, with the clear, limited and manageable risks set against the pro growth benefits. This is a reasonable task and within a context of market opinion that is now more favourable to greater investment spending (see below and Tullett Prebon 2012).

11. Wilcox et al UK Housing Review 2013 Commentary

12. Let's Get Building, A report by the NFA jointly with ARCH, CIH, LGA and in association with CWAG, John Perry, November 2012

13. There are however questions about both the current capacity and willingness of local authorities to take on this level of new borrowing in the short term (Perry 2012)

Conclusion

The reforms presented here represent a radical set of options to help build the homes we need. The alternative to radicalism is not a comfortable middle way. It will mean England falling far short of producing the housing it needs, with serious detrimental consequences for the economic, fiscal, and social life of our nation.

Every year, year on year, failure to tackle the supply system ratchets up the pressure of England's housing crisis. More households will suffer from overcrowding; more families will struggle with rising rents and large mortgages, and fewer young adults able to leave their parental home before the age of 30. Ultimately, having a decent home to call one's own will become the preserve of fewer and fewer people.

1. The problem

We haven't built enough homes

England has seen a trend of deteriorating housing affordability and unmet housing need that is contributing to a growing housing crisis. Underpinning this is the failure to build enough new homes.

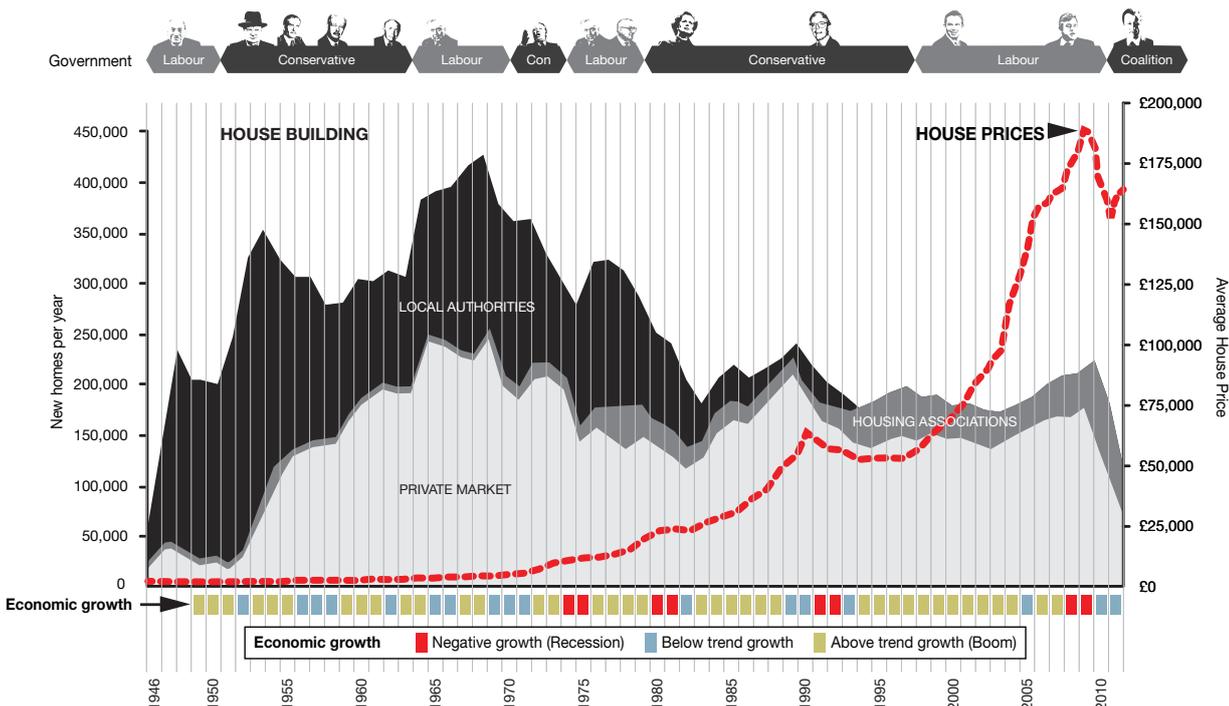
The number of households in England is projected to grow by 221,000 a year from 2011 to 2021 by the government.¹⁴ The Barker Review (Barker 2004) recommended that we needed to build 245,000 private sector homes per annum if we were to contain house price inflation within reasonable levels.¹⁵ The Cambridge Centre for Housing and Planning Research calculate we will need to build 270,000 new homes a year for the next twenty years to meet housing demand.¹⁶ The TCPA estimate we will need to produce 275,000-280,000 new homes each year¹⁷. Whilst the National Housing and Planning Advice Unit (NHPAU) projected nearly 280,000 per year in England would be necessary to restrain the

projected long-term rise in house prices.¹⁸ In this report, baseline need is estimated to be 250,000 new homes per year, which is towards the middle of this range of projections.

We are currently not close to meeting any of these projections of housing need. In 2011 total new housing completions by private house builders, housing associations and local authorities stood at just over 114,000. Total completions by private house builders stood at 86,000 (CLG LiveTable 244).

This is not just a recessionary phenomenon: housing supply has failed to respond adequately to high levels of demand for decades. England has a long record of failing to produce enough new houses to meet market demand. Since 1981, total new private housing supply has only once produced over 200,000 homes per year and averaged just over 150,000.¹⁹

Figure 3: House Building, House Prices and Growth in England



14. Department of Communities and Local Government, Household Interim Projections 2013
15. This number of new private market houses were seen as needed if we were to bring down real house price inflation to the European average of 1.1% per annum (Barker 2004).
16. IPPR also estimate that demand will outstrip supply by 750,000 homes by 2025 if current supply and demand trajectories continue (IPPR, The Good, the Bad and the Ugly Katie Schmuecker 2011)
17. Mind the Gap: Housing Supply in a Cold Climate, A Discussion Paper by David Pretty CBE and Paul Hackett for the Smith Institute, the Town and Country Planning Association, and PricewaterhouseCoopers 2009
18. NHPAU (2008) Meeting the housing requirements of an aspiring and growing nation: taking the medium and long-term view, London: NHPAU
19. CLG Live Table 244 England Completions

Most recently, a decade of strong house price inflation and mortgage lending have failed to translate into an equal rise in house building. Between 1999 and 2007, new private housing completions in England rose from 123,180 to 154,210 per annum, an increase of 25 per cent.²⁰ This is compared to an increase of 173 per cent in UK house prices and 182 per cent in total mortgage credit.²¹

England therefore has a housing shortage of between 100,000 to 150,000 homes a year. We need to build this many extra homes just to keep pace with growth, even before we start to address the decades of undersupply that will be needed to bring down the UK's very high housing costs.

The urgent question facing government is, in the very short term, how do we best increase the level of house building now?

But this must be accompanied by the medium term question of how we reshape our housing delivery so that it is able to overcome its thirty-year record of failure to deliver the housing numbers England needs.

Problem One: The Broken Housing Delivery Sector

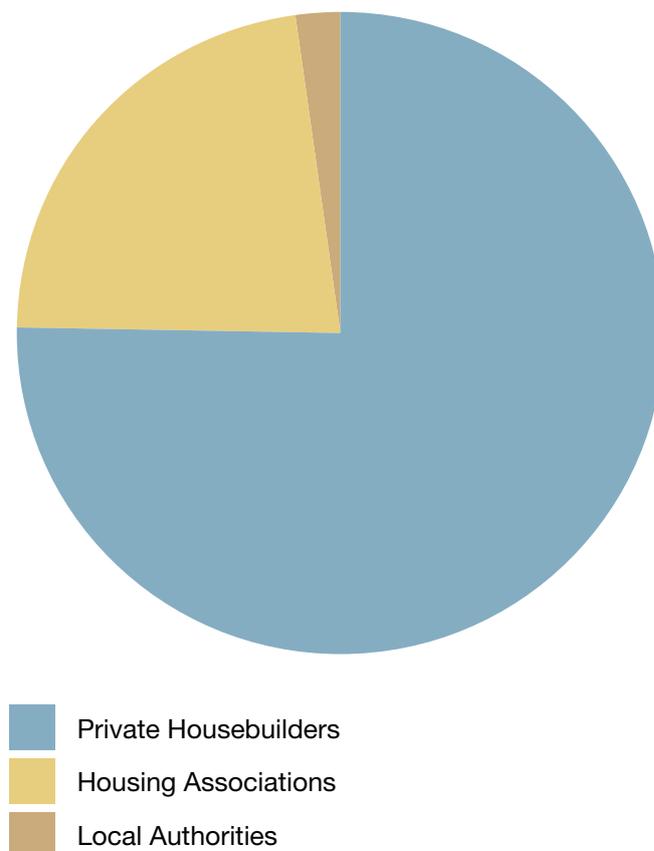
The English housing market is a deeply dysfunctional one; it has highly volatile land and development markets; a history of cyclical boom and bust in prices and credit availability; high levels of unmet demand and a very irresponsive supply side. One respected economist recently observed that currently “the supply elasticity of new housing is approaching zero”.²² In other words, when prices go up this doesn't mean that we build more homes.

Declining diversity

England's failure to deliver more supply is partly a story of a steady fall in the diversity of English housing delivery.

As Figure 3 on the previous page shows, post war house building on a large scale has only come about through a mix of types of organisations which build homes – in the case of 1950 to 1980 period this was achieved through a balance between building by private house builders and by local authorities.

Figure 4: The current house building delivery mix: housing completions by delivery type 2011



Since then the expectation for the delivery of new housing has rested primarily on private house builders.

In 2011 England's delivery balance of housing completions was 75% by private house builders, 23% by housing associations and 2% by local authorities [see Figure 4 above].

Declining diversity within England's private house builders

Yet growing reliance on private house builders to build new homes has coincided with a steady loss of diversity in the sector.

There has been a fifty year trend of consolidation in the industry and the loss of smaller and medium sized builders – a lack of diversity that recent Shelter research sees as hampering the ability of the sector to expand production.²³

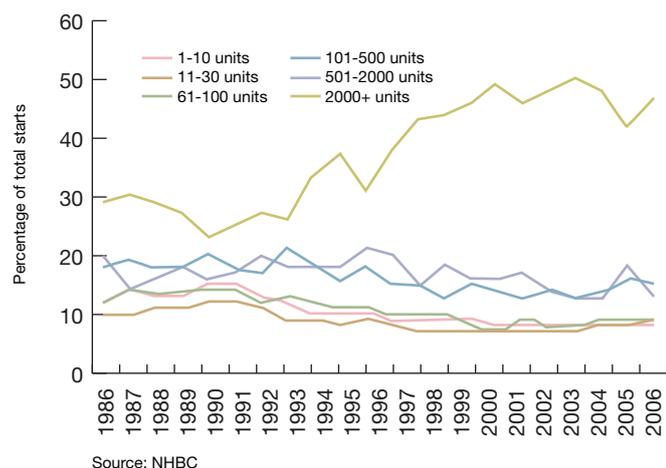
20. Department of Communities and Local Government: Private house building completions, England, LiveTable 244

21. House price data from Q1 1999 to Q4 2007 (Nationwide), mortgage-lending data, annual mortgage lending for 1999 and 2007 (Bank of England)

22. Comments by Professor Paul Cheshire, London School of Economics Spatial Economics Research Centre 27th March 2013

23. FTI Consulting (2012) Understanding Supply Constraints in the Housing Market London: FTI Consulting

Figure 5: Percentage of UK total starts by size of house builder, 1986-2006



At the same time the self build sector in the UK barely exists – the Callcutt Report estimated that self-build made up approximately 15,000 to 18,000 units a year, or 10 per cent of total current UK production in the mid-2000s. This is lower than in other European countries, and ‘far below’ that in France (where it accounts for between 40 and 50 per cent of building output), Belgium (over a half), Sweden (where it is a third), Germany and Japan (OFT 2008, Dol and Haffner 2010). Worryingly, UK self-build output also appears to have been gradually declining in the past two decades (Ball 2010).

Since the credit crunch the number of smaller and medium sized builders has contracted at a much faster rate than the larger house builders.²⁴

- The number of small house builders producing between one and thirty units a year shrank 47% from 5,156 individual firms to 2,723 firms.
- The number of medium sized house builders producing between 31 and 500 units a year shrank 60% from 452 to 181.
- The number of larger house builders, building over 500 units a year, remained more stable, shrinking 16% from 37 firms to 31 firms.

There has therefore been a sharp further consolidation of the house building sector during the most recent recession.

Larger firms producing over 500 houses a year increased their market share from 56% to 68% between 2008 and 2012 (see Figure 6).²⁵ This lack of diversity applies to even the most dynamic of England’s housing markets – the most obvious example being

24. Figures for 2007 to 2012

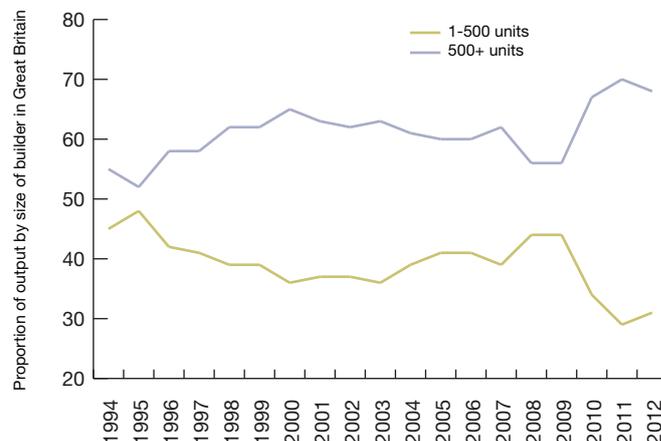
25. NHBC Data

26. GLA 2012

London, when, in the 12 months to June 2012, 70% of all private market starts were started by just 23 developers.²⁶

Housebuilding in the UK is now the most concentrated and least diversified it has ever been.

Figure 6: Percentage of UK housing output by size of housing building firm 1994 - 2012



The challenge of raising private housing output means either the largest remaining house builders raise their output significantly or government policy encourages the emergence of new house builders – be they small or medium firms that have exited the market or new actors.

Why just relying on private house builders won't deliver

Private house builders will remain a vital part of England’s housing delivery mix. But there are good reasons to think that their ability to deliver substantial output growth is limited.

Private housebuilders have long faced a series of constraints on expanding supply, both state imposed (through the constraint on land supply created by the planning system) and from market dynamics (with volatile land, housing, credit and mortgage markets). This raises the level of risk faced by market house builders and makes them highly cautious in expanding supply (Calcutt 2007, KPMG 2008).

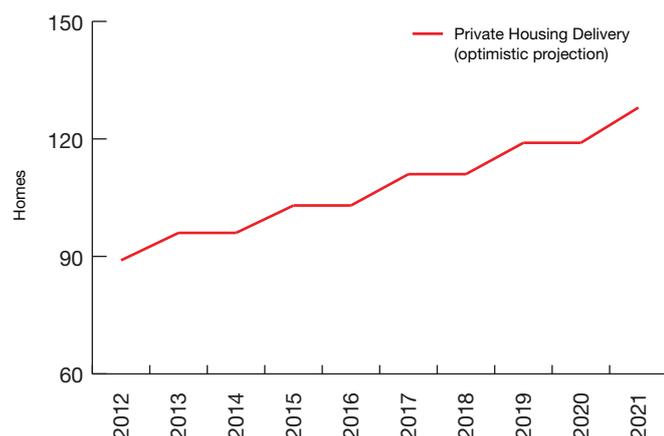
This risk and resulting business caution puts strong brakes on house builders’ ability and willingness to expand production.

The average annual output level of private house builders since 1950 – a sixty three year period - has been 129,507 homes. This is around 100,000 below the number of households currently forming each year.

Over the 50 years from 1957 to 2007, private sector housing delivery experienced only 24 years of expansion. For more than fifty percent of this time period, private sector housing output either stagnated or contracted – despite a near continuous growth in nominal house prices, normal levels of market transactions and growing owner occupation levels. In those years of expansion, private sector housing output grew by an average of 7.5%.²⁷

Taking the 2012 house building data, if we reproduce the above level of growth and calculate a 7.5% growth rate in output every other year (with the second year being one of zero growth) over the following decade private sector housing completions would grow to 118,870 housing completions annually by 2020.

Figure 7: Projected growth of private completions under optimistic scenario



What has the historical record of recovery been?

Unfortunately, the historical record of recovery from previous recessionary shocks makes this scenario appear optimistic.

In previous major recessions, in 1972 and 1988, the house building sector underwent a decade of output at low post recessionary levels.

The post 2008 recessionary period has already seen a much larger fall in house building than the two previous

recessions (at 46% from peak to trough compared to 43% in the late 1970s recession and 35% in the 1988 recession). The current contraction has also been faster and more sustained – three out of five years have seen output at below 40% of peak, compared to only one out of ten years in the 1988 recession and none at all in the 1970s (see Figure 8).

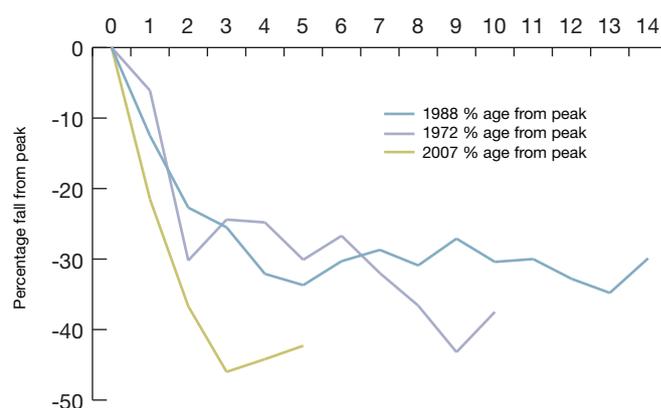
These cycles have also been getting progressively worse, with no year in the past 30 years ever regaining the previous output high of 1988.

If we were to assume that this recovery matches the 1988 recovery, then private housebuilding levels should reach just over 100,000 completions by 2020.

This could itself be seen however as optimistic, in the 1988 recovery at this point in the cycle was -34% of peak output, compared to the -42% of 2012.

If we instead mirrored the 1988 pattern of recovery from the position of five years from the market peak, this would mean private sector completions would actually contract to 87,648 by 2020.

Figure 8: Poor record of recovery from peak



Current business strategies of the major market house builders

Will larger house builders raise their output to the extent needed? The experience of these companies during the credit crunch and their current business strategies both suggest not.

During the immediate aftermath of the credit crunch the majority of the major house builders underwent severe financial stress – forced into renegotiating bank covenants, taking significant write downs to their land

27. Savills Residential Research, 8 March 2013

banks and registering major losses (IPPR 2012, Ball 2010).

Leniency from creditors, low interest rates and significant intervention and direct support from government have helped the sector deal with the direct shock of the recession. But five years on, the strategy of most market house builders remains deeply cautious.

Although the most recent reporting season saw the largest house builders posting reasonably healthy profits, their business strategies remain focused not on increasing the number of homes built, but on repairing profit margins and land portfolios.

In the last reporting season, of the major house builders only Bellway PLC stated that growing volume output was a major strategic priority. Instead priority is given to improving profit margins, land banks and reducing indebtedness.

In their own words: strategic priorities for the major house builders

- Barrett's state that "Our strategy remains to rebuild profitability and reduce overall indebtedness." (Barrett 2012),
- The three 'key strategic priorities' listed by Redrow in their 2012 annual report are to increase margins, raise the average selling price of their houses and to maintain the quality of their land bank (Redrow 2012).
- Persimmon list their main strategic priorities as improving margins, selective new site acquisitions and strong cash generation. "Our strategy is to continue to optimise the scale of our landbank to a size that supports the level of trading achievable within the current market." [our emphasis] (Persimmon 2012)
- "We continue to prioritise both short and long term margin performance ahead of volume growth. Increasing the contribution per plot is a key driver to achieving this priority." (Taylor Wimpey 2012)

Housebuilders' business strategies are now explicitly avoiding increasing the number of homes built. For example, key trends have been –

- Land buying has been occurring during the trough of land prices between 2009 through to 2011
- The focus of output has been to sites with the highest profit margins, with a strong component of 'mixing' of output to achieve this.
- Geographically output has shifted towards the more buoyant markets of the South East and London
- Most market builders have moved towards the higher end of the market and larger family homes

There also now appears to be signs that the market will enter a period of merger and acquisition (M&A) activity, with larger house builders expressing interest in medium and smaller sized builders with strategically important land holdings.²⁸ The Persimmon chief executive, Mike Farley, was recently reported to have said that house builders are poised "to snap up smaller competitors as their finances improve and they chase high-quality land".²⁹

The takeover of the medium sized south east based builder Hillreed, which specialised in up market homes, by Persimmon in October 2012 for £35.7 million is an example of a trend that looks set to continue.³⁰ This suggests house builders may pursue a strategy of growing market share through M&A rather than through expanding output.³¹

In the wake of recovery from recession this means many firms are operating in a sphere that is close to their desired output capacity. This applies even in the England's most buoyant market, London, where a recent GLA study found that:

"With a few exceptions, these [major building] firms also say they are operating at capacity. They have already expanded following a retrenchment in 2008 and would be cautious about expanding further." (GLA 2012)

Conclusion: the broken housing delivery sector cannot deliver the homes we need

The current behaviour of English housebuilders is understandable – it is not the purpose of private housebuilders to provide the socially optimal level of new homes. Greatly expanding private output would require taking on a level of risk that is not attractive to either their lenders or shareholders.

28. Conversation with house building analyst, 25th March 2013

29. Financial Times 14th November 2011

30. <http://www.theconstructionindex.co.uk/news/view/persimmon-takes-over-hillreed-homes>

31. Worryingly for those concerned with raising levels of UK house building, consolidation via mergers is also strongly associated with decreasing levels of housing output among the affected firms. Analysis of the five merger and acquisition deals with values over £500 million by KPMG after 2000 found that 'all appear to have resulted in the combined entity producing fewer units in the subsequent year, compared to their combined output in the previous year'. This can be put down to a combination of risk management, post-merger rationalisation and a scaling back of output to meet market demand.

But for policy makers this means that, in the short to medium term, it is very unlikely that current market house builders can deliver the additional much needed growth in housing output to fill England's housing shortage.

The short term range of annual housing completions delivered by private house builders in England is likely to be between 90,000 and 110,000 over the next five years. This is still over 100,000 homes below the lowest estimates of projected housing need and 150,000 below the commonly agreed level of need.

In the medium term, over the next ten years, we believe a realistic range of output to be between 100,000 to 125,000 homes completed per year by 2021. These estimates are uncertain, but they fall far short of England's necessary housing supply needs. Assuming the higher of the two figures, this would be around 125,000 homes short of the lowest estimates of projected housing need.

Private house builders will remain a vital part of the mix, but within a band of output that remains constrained. They cannot be expected to achieve all the housing growth we need.

Problem Two: The Broken Land Market

A planning system that doesn't release enough new land

England's record of releasing land for housing development has been poor. As Figure 9 shows, land released for housing development has been declining since 1989.

Not releasing enough land to meet demand has made land more expensive. This increases the cost of building new homes. Research by Savills found that between 1992 and 2002 the proportion of the cost of a new home made up from land rose from 15 to 34 per cent (Savills 2003).

Figure 9: Land changing to residential use



Source: CLG Table P222

Please note.

No data for 1999 so it was calculated as an average of 1998 and 2000.

Lower land costs can make delivering homes more affordable. For example, during the recession falling land prices meant that the average cost of land per socially rented house between 2008/09 and 2010/ decreased by £27,000 in London and £14,500 in the south-east (NHF 2012). Expensive land, and the prospect of rising land prices, undermines tax payer value for money and the ability to deliver more homes.

It has also made land prices more volatile.

Land market volatility

Land prices have been more volatile than house prices. Residential land prices between 2000 and 2007 rose by 170 per cent, compared to a 124 per cent increase in house prices.³² Over a longer time period, land prices rose 1,595 per cent between 1983 and the end of 2007, compared to a 553 per cent increase for house prices.³³

32. Land values date from spring 2000 to July 2007 for England and Wales (VOA), house prices measured from Q2 2000 to Q2 2007 for the UK average (Nationwide).

33. Land values date from autumn 1983 to Jan 2008 for England and Wales (VOA), house prices measured from Q3 1983 to Q4 2007 for the UK average (Nationwide).

How Land Prices and House Building Interact

The volatility in land prices can be partly explained by the way England plans for and builds new houses. Land prices are partly set by the balance of the supply of land with residential planning permission and demand for houses. When not enough land is available for needed residential development, land prices rise.

Within this balance of supply and demand, land prices are also determined by 'Residual Land Value'. Put simply, Residual Land Value is the remaining price a developer is prepared to pay after build costs and profit margins have been accounted for.³⁴

A house is generally not built and sold until several months, or even years, after the land has been bought. Because of this land buyers tend to bid for land based on estimates of future house price growth. This means land prices rise much faster in periods of house price growth,³⁵ and fall much faster when house prices fall.

Land risk and control

The volatile and high priced land market raises the risk levels for the English building sector, exposing them to greater levels of financial risk, debt and vulnerability to economic shocks.

This has made house builders very cautious about future development – this risk aversion means builders tend to build less than the optimum levels possible.

As an overarching risk management tool, most homebuilders aim to avoid having too much production in any one year concentrated on any one site (KPMG 2008).

Most house builders therefore appear to prefer to concentrate on smaller levels of controlled output at larger margins (capitalising on maximum land value uplift), rather than increase production, even if this may mean short-term absolute profits are lost. (IPPR 2012)

Another result of a restrictive planning system and the volatility of land prices is that house builders have become 'inherently land focused' in their business models (Adams et al 2008). Barker noted, 'the most important objective for a house builder is to obtain land where people want to live' (Barker 2004).

Larger English house builders have become primarily focused on land trading and adding value through the planning system. The Callcutt Review put it succinctly: '[I]dentifying, acquiring, preparing, developing and selling land is the key activity of all [English] house building companies'.

Land banking

Land banks are a central part of English house builders' business models. Land banks are an attempt by house builders to secure future land supply for development, whilst trying to capture the maximum value uplift in land values and reducing their own exposure to risk. These are rational responses to the uncertainties and scarcity of land markets in the current planning system.

English house builders' land banks are made of the following two components:

- The first is 'current', with planning permission, or short-term land banks, through which short-to medium-term development needs are met. This is the most commonly used definition when discussing land banks. These short-term land banks will include land that has been, or is close to being, granted planning permission.
- The second is 'strategic' land banks, through which builders control and access larger amounts of land that may become developable through the planning system in the medium to long term. Strategic land banks do not contain land that has been granted full planning consent. Strategic land banks are usually bought on 'option' rather than bought outright.

The Barker report found the average 'current' land bank was equivalent to three to seven years production. The OFT found that within current land banks the average amount of land with planning permission was equivalent to 3.2 years of production. The OFT also found that the 'vast majority' (82 per cent) of land held by builders was strategic land, and these strategic land banks were an average of 14.3 years long (OFT 2008).

34. The Residual Land Value model is a simplified and schematic version of more complex and diverse development viability models used across the sector

35. KPMG find that land prices reflect expected changes to house price inflation, rather than actual house price inflation, calculating that an extra three per cent in forecast house price inflation adds an extra 10 per cent to land values (KPMG (2008) Homebuilding market study: Study investigating financing for homebuilders, London).

Option Agreements

'Options' are private legal agreements between landowners and developers.

Strategic land is generally bought on 'option'. The developer does not buy the land outright, but agrees to handle the planning process on behalf of the landowner.

The OFT estimates that over 60 per cent of land banks were found to be under 'option'-type agreements. But detailed analysis of options is difficult – the legal content of options varies considerably and they are nearly always untransparent.

Nearly all option agreements however are centred on the exclusivity of sale between landowner and developer – only the developer in the option agreement has the right to buy and develop the land. Once the landowner has signed an option agreement, their ability to sell elsewhere is dramatically curtailed.³⁶

Given the scale and coverage of current option agreements, this has very important implications for the operation of the land market and the ability of other actors to break into it. As LSE professor Paul Cheshire puts it the planning system and options 'gives monopoly power to developers who own particular patches of land where large proportions of development [are] being made available'.³⁷

Access issues

New entrants face a series of serious obstacles to acquiring cheap, developable land. For example land banks ensure that any land released by the planning system is highly likely to have been retained by existing house builders.

The result is that very few new entrants succeed in breaking into the market. The record of foreign entry into the English market (so common in most other economic sectors) is thus very poor.³⁸ (OFT 2008).

For smaller English builders, these land-related barriers mean that developable sites are scarce and, by the time they get to market, very expensive.

"There are only two ways to get development land: pay more than anyone else thinks it is worth or work hard for many years alongside a land owner. Helping them to get a planning permission. Neither is really an option for the new entrant unless very well capitalised." (GLA 2012)

The way the English planning system and land market works thus poses very large obstacles to diversifying England's house building industry and allowing new firms to enter the market and compete.

These methods of land control also mean that just focussing on some further liberalisation of the existing planning system is unlikely to release enough new land to loosen the de-facto monopoly power of existing developers and landowners (see below).

Problem Three: the Wrong Responses

House building sits prominently in the package of government reforms designed to stimulate economic growth. The prime minister commented that the aim of the government is to 'Get Britain building again ... to help drive local economies and create jobs'.³⁹ The government's flagship Housing Strategy states: '[T]he Government is clear that we need to get the housing market – and in particular new house building – moving again. This is central for our plans for economic growth' (HM Government 2011).

Government intervention so far has focused on attempting to stimulate new house building through three primary policy focuses:

36. There are some caveats to this, usually involving a lapse of a significant time period (often over ten years) or if the developer can be proven to not be promoting the land through the planning system.
37. Paul Cheshire, Emeritus Professor of Economic Geography, London School of Economics and Political Science, speaking at the House of Commons CLG Select Committee, 10 October 2011
38. Its rare success is reliant upon companies entering by buying strategic land banks via company acquisitions. One major Dutch developer interested in entering the UK market said that 'direct land purchase and development posed too many risks due to knowledge and information barriers' (quoted in Ball 2010). While the OFT found that barriers to foreign firms were 'significant' (OFT 2008), particularly access to land.
39. Comments by the prime minister on the launch of the new Housing Strategy, Number 10 website, 21 November 2011

- Intervention and support for existing house builders
- Support to short term demand, particularly mortgage demand
- Long term supply reforms via changes to national planning policy

This sits alongside a five year programme for subsidised housing delivery, the Affordable Housing Programme, costing £1.8 billion between 2010/11 and 2014/15.⁴⁰

Some of these interventions are necessary, some have significant problems. But all rest on the primary expectation that private house builders, with supporting

interventions and policy changes, will be able to deliver the lion's share of needed future output growth.

Yet, as we have seen, private house builders are understandably cautious. They will deliver some homes, but not enough.

Intervention and support for existing house builders

Up to now government has focused much of its attention, and money, on schemes that will help the house building sector cope with recessionary fall out.

Table 2: The Post Crunch Balance of Housing Interventions

2008 - 2010		
Private Housebuilding Interventions	Date	Size of Intervention
Home Buy Direct	September 2008	£400m
NAHP Top 20 House Builders	2008 - 2011	£345m
Kick Start 1	April 2009	£425m
Kick Start 2	December 2009	£550m
Public Land Initiative	2010	£53m plus access to public land
		Total: £1.78bn
2010 - 2013		
Private Housebuilding Interventions	Date	Size of Intervention
FirstBuy Direct	March 2011	£400m
Build Now, Pay Later	November 2011	Access to public land and subsidized finance
Get Britain Building	November 2011	£550m
FirstBuy extension	September 2012	£280m
		Total: £1.23bn
Mortgage Guarantees	Date	Size
NewBuy MIG	November 2011	£1bn guarantee
NewBuy MIG extension	January 2013	Extension of guarantees
Help to Buy equity loan scheme	March 2013	£3.5bn
Help to Buy Mortgage Guarantee	March 2013	£12bn
		Total: £16.5bn guarantees
Access to other support		
Build to Rent 1	November 2011	£200m
Growing Places Fund	November 2011	£500m
Build to Rent 2	March 2013	£800m
Removing S106 agreements	November 2011	Estimated to be between £20,000 to £60,000 per plot or £5 - £15bn in support of land bank value
		Total: £6 - £16.5bn

40. In addition to the current AHP funding, the HCA is also spending a further £2.28 billion over the 2011-15 period completing schemes begun in earlier years using money from the National Affordable Housing Programme, which is due to deliver 72,000 homes.

Between 2008 and 2013 government has announced 16 separate schemes that have targeted the house building industry (see Table 2 above). Government support has totalled:

- Over £4.5 billion in direct government spending
- £4.5 billion in government guarantees to mortgage lending directly linked to new market house building.
- An extra £12 billion in government guarantees to support mortgage lending across the housing market
- Housebuilders have received additional financial benefits from access to public land at subsidised finance and a reduction in regulatory obligations – including the opportunity to renegotiate all Section 106 agreements in place before April 2010. One housing analyst suggests the removal of these regulatory burdens could be worth between £5 to £15 billion in additional value added to major house builders landholdings.⁴¹

Despite these large sums of money spent on private house builder subsidies, the past four years have been the worst four years of private house building completions since 1955.

Mortgage guarantees

The Help to Buy: Mortgage Guarantee scheme could greatly increase demand in the wider housing market, with the potential to underwrite £130 billion in new mortgage lending through £12 billion in direct guarantees.⁴²

The decision for government to underwrite loan guarantees is a bold one, which some economists see as the equivalent of direct government borrowing.⁴³

There are four reasons why the demand side guarantees of Help to Buy is unlikely to be effective in significantly raising levels of house building.

First, mortgage credit levels increased by 182 per cent between 1999 and 2007⁴⁴ with little impact on housing supply. Restarting the flow of mortgage credit would, on this evidence, be an inefficient way of achieving more house building.

Second, lag times in development mean that it would take several years for supply to respond to inflated demand, if at all. This is likely to mean that in the short term, stimulating greater mortgage finance will lead to a period of sharply rising house prices before we see a supply response, and historical experience suggests this supply response will be very weak (Carver 2011). As the OBR's Steve Nicholl commented at a Treasury Select Committee hearing:

“The key is: is it [Help to Buy] just going to drive up house prices? By and large, in the short run the answer to that is yes. But in the medium term will the increased house prices stimulate more house building, and our general answer to that would probably be: a bit. But the historical evidence suggests not very much.”

Third, this supply response relies upon output decisions by existing, cautious, builders and confidence that the mortgage stimulus would be sustainable, continued and low risk. Given that the Help to Buy: Mortgage Guarantee scheme is time limited this may not be the case.

Finally, previous increased credit also had a powerful effect on increasing land prices (GLA 2013)⁴⁵ which would mean that mortgage stimulus is likely to further cut against the ability of the sector to deliver cheaper housing.

The risk of such a scheme is that because new supply in the English market is so inelastic to demand, any increase in demand will be translated straight into higher market prices. This will ultimately make housing less affordable and lock more aspiring first-time buyers out of home ownership.

This raises the question as to whether underwriting borrowing for more supply would be a better choice than underwriting greater mortgage demand.

It also raises the larger question of whether £12 billion in either direct new government investment (see Chapter 2) or direct government loans would be a more effective policy choice to raise house building levels.

41. <http://www.insidehousing.co.uk/community/blog/gaining-the-plot/6512859.blog>

42. HM Treasury Budget 2013 supporting documents

43. The former US Treasury Secretary Larry Summers points out in relation to the Help to Buy: “a loan guarantee was more or less the same thing as a loan, both expose taxpayers to the risk of loss, and so borrowing money and guaranteeing the loans of others are really very similar” Interview on Newsnight 25 March 2013

44. Bank of England: Mortgage lending data, annual mortgage lending

45. Major developers interviewed in London expressed concern that guarantees to loans would simply feed into higher land prices (GLA 2013)

Reform of the planning system

As we have seen, the English planning system has not been releasing enough land to meet housing demand. Restrictions in land supply, particularly in places where people want to live, have raised levels of costs and risks for the building sector and pushed the price of new housing up for the consumer.

Releasing more land using the planning system should help reverse this long term trend. The government has been doing this through the introduction of the National Planning Policy Framework (NPPF).

Planning reform is also a fiscally inexpensive way to help house building.

Reforming the planning system therefore is important in releasing cheaper land into the development pipeline. But although necessary, it is not sufficient to raise house building to the levels needed.

The draft National Planning Policy Framework (NPPF) requires local authorities to provide sufficient land through the planning system for future perceived development need as part of their local plans. In the absence of up-to-date and adequate local plans there will be a 'Presumption in Favour of Sustainable Development' to grant planning permission for schemes put forward to local planning authorities by developers.

This is likely to face the following problems:

- Local authorities fail to give planning permission, as local political pressures act against plans for new housing.⁴⁶ Local authorities are therefore likely to release limited amounts of new land for house building, and only in order to satisfy pressure from central government and the planning inspectorate. This will be land that was likely to be designated as planning land over a short to medium time frame.
- Allocated land that is released will be primarily in the hands of existing house builders via option agreements, making it hard for new entrants to break into the development market.

- New land will primarily help builders raise margins, as they bring forward new high margin land for development, and therefore improve their financial position and the returns on the sites they build.⁴⁷ This is likely to be part of mix adjustment away from less viable sites, so the net impact on housing supply may therefore be limited.

Current state of the land market

Recent land market trends have been:

- 2004-2007: High house price growth and excessive purchase of land at high prices
- 2008-2009: Sharply falling house prices and lack of house sales lead to existing land holdings becoming unviable and a sharp fall in land prices
- 2008 – 2012: Housebuilders attempt to manage existing land holdings to build out those that can be profitable or dispose of land that is not.
- 2010-2012: Low land prices and a more stable market led to house builders who are able to secure finance, restarting land acquisition.
- 2011-2013: Regionally specific recovery in house prices leads to the re-emergence of competition in the land market and rising land prices.

Rising land prices help alleviate previous problems of land bank viability faced by market house builders. But they also threaten to make future land supply bought through the planning system unviable.

This is already starting to happen in the recovering markets of London and the South East. The best prime locations in and around London are said to be now achieving peak prices and competitive bidding.⁴⁸

So as time progresses, house builders will become reliant on a continued upward rise in house prices to make these land holdings profitable. The uncertain, and regionally highly varied, projection for house prices means that this will reinforce major builders' high level of caution in their housing output growth.

46. Councils are currently planning to build 272,720 fewer new homes since the abolition of regional planning (Morton 2012)

47. Improving land margins through strategic site acquisition and bringing forward newly bought land are currently a common feature across the building sector (see for example the annual reports of Bellway and Persimmon). For example in 2011/12, 35% of Barratt's completions were on newer, higher margin land and they expect this to increase to just over 50% of completions in 2012/13 (Barratt 2012).

48. Treasury Select Committee Evidence Session, 26th March 2013

2. Short term: investing to tackle the housing shortage

The most obvious way to stimulate more house building is for government to directly fund expansion in supply. The post war record demonstrates that high levels of total housing output have been accompanied by direct spending from government, through both local authority expenditure and subsidy to housing associations. The depth of the slump in housing supply, and the entrenched nature of the problems the sector faces, mean that it is impossible to significantly boost house building in the short term without significant public investment.⁴⁹

This chapter examines what impact additional spending would have in terms of new housing, and outlines the options for how such investment could be delivered.

The case for public investment

The economic case

A major government stimulus for house building is supported by a wide range of organisations – including all major business lobbies, such as the Confederation of British Industry and the British Chamber of Commerce. The housing shortage is already a major constraint on businesses' ability to expand. As part of a package of infrastructure investment, house building would create assets that can help underpin economic activity and generate long term economic and social returns to the UK.

Increasing the supply of new homes can produce immediate economic benefits:

- every £1 spent on construction generates an additional £2.09 of economic output, higher than the return to most other sectors, including advanced manufacturing and banking and finance.⁵⁰

- for every £1 spent in building, 92p stays in the UK
- for every £1 spent by the public sector, 56p returns to the Exchequer, of which 36p is direct savings in tax and benefits⁵¹

Increasing public investment now would therefore provide a counter cyclical stimulus for wider economic activity. For this reason, public investment in house building has been proposed by respected economists and commentators: Martin Wolf, the chief economics commentator at the Financial Times, recommends an infrastructure spending programme of between 3 to 4% of UK GDP (approximately £40 to £50 billion), while the Secretary of State for Business has argued for spending 1% of UK GDP on new house building alone (approximately £11 to £12 billion).

The delivery case

Central government spending is the most responsive lever that politicians can pull to deliver new housing quickly.

Successive governments have a strong record of spending directly on building new homes and the delivery infrastructure is already in place. Central government can channel money through existing channels (using the Homes and Communities Agency) and have delivery agents who, if given appropriate subsidy, could build homes in the very short term – this year and next.

Indeed, these channels are currently under utilised following 2010 Spending Review cut in capital investment in housing from £8.4bn for the period 2008-11 to £4.5bn for 2011-15. This represented a 63% cut in real terms – the biggest single cut to any capital budget across government.⁵² Reversing this cut would have quick and effective impacts.

49. There was a large market-led housing boom in 1930s without direct stimulus from government - although the RTPI note that this was preceded and accompanied by a significant rise in public investment (RTPI 2012). However this boom occurred in a very different planning environment, which is politically extremely unlikely to be repeated. Therefore this report considers options for boosting housing supply with the assumption that there will not be a complete abolition of the post-war planning system.

50. FTI Consulting Investment in Housing and Its Contribution to Economic Growth, October 2011

51. UK Contractors Group 2011

52. HM Treasury 2010 / NHF 2013

Paying for it

The first option would be to increase direct spending by central government, funded from taxation, borrowing or the reinvestment of savings from other government departments. The lead proposal for central government investment, at £12 billion in new spending, remains modest at 1% of GDP.

The second option would be to increase spending by local authorities, via increased borrowing based upon existing housing assets.

Reprioritising expenditure would require tough spending choices, but the case for prioritising investment spending in housing over other forms of current spending has been well made.⁵³

Increasing national government borrowing to spend more on house building would undeniably run counter to the narrative of deficit reduction. But it would not necessarily have negative impacts on wider market confidence, if it was structured and rationalised within a limited increase in current expenditure and a pro growth framework.

Growth, as well as fiscal discipline, is necessary to continue to maintain the UK's debt repayment obligations and the rationale for a pro growth stimulus from house building is strong. There is an increasing market appetite for a shift towards investment spending in UK government plans, and house building represents one of the fastest and most effective forms of infrastructure spending to create growth.

'I do think there is need for fiscal stimulus and a scope for it, but I do think that government has to behave quite cautiously as there isn't a mechanistic connection between how much the market borrows and how the markets react... However, if the UK economy doesn't recover, although in the short term that may be good for bonds, in the long term it isn't good for bonds. What happens is that debt ratios continue to rise, policy becomes unpopular and the chances begin to grow that eventually there is some sort of disaster... A well constructed and targeted package: I think the markets could accept that quite readily.'

Roger Bootle,
Managing Director of Capital Economics⁵⁴

Investment: Balance of Choices

Central government housing spending choices are strongly conditioned by choices made about the types of affordable housing provided – and their varying reliance on government grant, private and housing association borrowing, sales, rents, and Housing Benefit expenditure.

These choices balance short and long term costs to the Exchequer, the quality and cost of the homes, and the rental and sales income generated for the provider. Spending choices also need to balance costs across government departments. A programme that relies on higher rents for tenants will mean higher housing benefit costs for the Department of Work and Pensions – even if the headline subsidy cost for the Department of Communities and Local Government is lower.

Finally, government investment in housing supply, particularly the current Affordable Homes Programme, has come to rely heavily on the borrowing capacity and financial health of housing associations.

Housing Benefit Expenditure

Increasing house building has the positive side effect of reducing the pressure on the government's housing benefit bill.

At present government spends 95% of housing expenditure on subsidising rents and just 5% on building more homes (Cooke and Hull 2012).

Increasing house building will decrease upwards pressure on market rents via more market supply. Whilst increasing social house building will allow more housing benefit recipients to be housed outside of the more expensive private rented sector.

But choices on how we finance building more homes matter in deciding how much we save on housing benefit. If we finance new homes through charging higher rents to tenants, as is currently happening, this increases the longer terms costs to the government via a higher housing benefit bill.

53. See Confederation of British Industry, Budget Submission March 2013 and British Chamber of Commerce, Budget Submission March 2013

54. Quoted in Perry (2012)

Current planned expenditure

The current government house building spending is predominantly channelled through the Homes and Communities Agency (HCA) and direct spending on new homes goes through the HCA's Affordable Homes Programme (AHP).

The AHP budget is set at £1.8 billion⁵⁵ for the four years 2011 – 15, and is expected to deliver 80,000 homes through a mixture of Affordable Rent and Shared Ownership completions. This is achieved only in partnership with housing associations spending another £10 billion through increased borrowing and greater use of their other resources. The AHP will also lead to an increased housing benefit bill of £553 million.⁵⁶

This programme replaced the previous National Affordable Housing Programme (NAHP), which covered the three years 2008-11. In addition to the current AHP funding, the HCA is also spending a further £2.28 billion over the 2011-15 period completing schemes begun in earlier years using money from the NAHP, which is due to deliver 72,000 homes.

Government also recently announced an extension of the Affordable Housing Programme over the three years 2015/16 to 2017/18. This would be achieved through a budget of £2.8 billion. This would be a reduction in current levels of affordable housing spending, from £1.15 billion per year to £957,000 per year

The actual and expected numbers from these investment programmes as guides can be used to outline potential options for increased public investment, and estimate their impact. Precisely calculating the future results of government spending on affordable housing is difficult because housing programmes rest upon a bidding process in which delivery bodies (primarily housing associations) bid for particular grant levels on particular sites – something very dependent on current and specific market conditions. Land and construction costs also vary considerably from scheme to scheme.

Furthermore, as the previous chapter has set out, increased spending without greater land release would be likely to push up development land prices, which would add to development costs and have other potential negative knock-on effects on the market.

What are the difficulties in extending the current Affordable Homes Programme (AHP)?

The option that has been taken by government for 2015/16 to 2017/18 is to increase spending on the existing Affordable Homes Programme. This however creates additional risks for housing associations and will lead to increased spending on housing benefits.

AHP spending after 2015 is constrained by the borrowing capacity of housing associations to deliver more housing – which CLG estimates is £11.6 billion. Assuming that the housing association sector increases its borrowing to its maximum capacity and at current borrowing rates, further AHP capital investment could be able to absorb, at the most optimistic projections, another £1.8 billion in government spending. This will incur additional housing benefit costs, while also increasing risk for housing associations (for further information see Appendix 1).

The additional billion of spending outlined for 2015/16 to 2017/18 must come from other sources of borrowing or income – either higher rents to tenants, even greater leverage or a much greater use of existing resources by housing associations. These all present significant problems of long-term sustainability.

55. Pre CSR 2013

56. Cost calculated over a 30 year period using the central scenario of government estimates (CLG 2011)

Past and Present Government Housing Spending Programmes

The current Affordable Homes Programme means housing associations can charge up to 80% of local market rents, but have to fund more of the development costs themselves. Associations have therefore had to take on a greater level of borrowing and increased leverage from their capital and investment base.

The result has been that government currently provides a third of the grant per home than under the previous National Affordable Housing Programme.⁵⁷

Average Grant for Every New Affordable Home:

- Affordable Homes Programme (AHP) 2010/11 to 2014/15: £22,500
- National Affordable Housing Programme (NAHP) : £60,000

The National Audit Office estimates that the AHP will involve housing providers spending approximately £12 billion on new homes, funded by a combination of government grant (£1.8 billion), borrowing by providers supported by rents on the new properties (estimated at approximately £6 billion), and funding from other sources (about £4 billion)⁵⁸

Rents totalling around £500 million a year on new homes will be paid by tenants, approximately two-

thirds of whom are supported by housing benefit. This means the AHP requires a net increase in expenditure by social housing tenants themselves, and the taxpayer. DCLG calculates that over 30 years higher rents would result in increased housing benefit costs with a net present value of £1.4 billion, or approximately £17,500 per home.⁵⁹

The Affordable Homes Programme has lower initial capital spend implications for central government, but comes at the cost of higher medium and long term expenditure from the DWP budget and higher levels of risk and financial gearing taken on from providers.

The NAO's analysis of the DCLG impact assessment found that, over the 30-year period analysed, continuing to fund housing on the previous model of the NAHP "offered the highest ratio of benefits to costs and hence the best value for money".⁶⁰ This was predominately because of housing benefit savings due to tenants moving out of more expensive private rental sector, offsetting much of the initial capital cost.

Therefore, although the Affordable Homes Programme had much higher levels of housing output per £ of grant spending, the net cost was higher and the long term level of housing delivery was lower. The NAO estimated that the NAHP would have delivered an extra 8,200 homes at the same total cost over a 30 year period.

57. HoC 2012

58. This is a large assumption, given the structure of current Housing Association borrowing which we examine below.

59. It is important to note that the delivery of the current funding model was on through a bidding round for allocations of funding per housing scheme. The cost of £20,000 is therefore an average cost, and represents the balance of what Housing Associations felt they could deliver against a balance of grant funding versus their own borrowing or leverage over a four year period.

60. NAO 2012

Return to previous capital investment plans

Housing associations will require higher grant funding per unit than under the current Affordable Housing Programme, if additional public investment is to exceed £1.8 billion. A return to the NAHP funding model, under which grant per unit was higher and rent levels lower, could therefore provide a model for increased investment.

Under the National Affordable Housing Programme the HCA spent £8.4 billion over three years to deliver 155,000 new homes. These were made up of 35-40% low-cost home ownership units and 60-65% social rented homes.⁶¹ Over a 30 year period this project will lead to savings for the government from the housing benefit bill of approximately £3.3 billion (DCLG 2011).

Options for Central Government Investment

Given these considerations, two different models of spending any extra investment are outlined below, using different mixes of the type of homes delivered.

- The first option is through delivering a mix of homes with a greater weight given to 'affordable rent' and shared ownership products. These tenures require less capital subsidy and would enable housing associations to stretch the number of homes produced. But they are less suited to low income households and would lead to the government spending more money on housing benefit.
- The second option is to replicate the balance of housing produced by the NAHP, with a greater weight given to social rented housing. Social rented housing has a lower level of rent and is therefore more suitable to low income households and would lead to the government spending less money on housing benefit. They would however lead to less homes being built.

Spending 1% of GDP (£12 billion)

Spending 1% of GDP on new housing would increase housing expenditure by £12 billion. This level of expenditure is politically realistic and would go some way to closing the housing shortage over a four year period – but would need to be accompanied by other options to fully close the gap.

Programme 1: Market Weighted

- £12 billion through tenure mix of 50% affordable rent, 25% social rent and 25% low cost home ownership.
- Increasing spending through a tenure mix that gave less emphasis to social rent would secure 330,000 homes, or 82,500 per year of the programme.⁶²

Programme 2: Social Rent Weighted

- £12 billion solely through the NAHP programme model, with a tenure mix of 65% social rented housing and 35% low cost home ownership.
- Increasing spending through the NAHP model up to £12 billion would secure 204,000 extra homes, or just over 51,000 per year of the programme.

61. NAO 2012

62. NAO 2012

Range of central government direct investment choices

Using the two different programmes of spending extra investment on the previous page it is possible to extrapolate how many units would be delivered from differing levels of investment and how far each option would go to close the annual housing shortage.

Table 3: Direct Spending Options and the Housing Shortfall

	2015 - 2016	2016 - 2017	2017 - 2018	2018 - 2019
Current Supply Projections				
Affordable Housing Programme II ⁶³	42,533	42,533	42,533	N/A
Market Housing ⁶⁴	102,862	102,862	110,577	110,577
Local Authorities ⁶⁵	2,500	2,750	3,000	3,000
Total	147,884	148,145	153,110	113,577
Housing Need ⁶⁶	250,000	250,000	250,000	250,000
Housing Shortfall ⁶⁷	-102,116	-101,855	-96,890	-136,423
Fiscal Options – Annual Affordable Housing Outputs				
£8 billion				
Programme 1: Market Weighted	55,000	55,000	55,000	55,000
Programme 2: Social Weighted	34,048	34,048	34,048	34,048
£12 billion / 1% GDP				
Programme 1: Market Weighted	82,500	82,500	82,500	82,500
Programme 2: Social Weighted	51,072	51,072	51,072	51,072
£24 billion / 2% GDP				
Programme 1: Market Weighted	165,000	165,000	165,000	165,000
Programme 2: Social Weighted	102,144	102,144	102,144	102,144

63. The exact output of the recently announced additional spending of £2.8 billion for 2015/16 to 2017/18 is not yet clear. Housing output and average grant per unit will not be finalised until the bidding process held by the Homes and Communities Agency has been completed. The figures here therefore use the average grant rate of the previous Affordable Housing Rate as a reasonable estimate of likely numbers of affordable homes produced. Given the tighter borrowing capacity of housing associations this number is more likely to be an overestimate of output than an underestimate
64. This market housing output projection is based on the most optimistic assumption in our paper – that the private housebuilding will undergo steady and continuous increases of 7.5% every two years, with no years of falling output. Base line 2012.
65. After a fall in Local Authority output in 2012, we assume a steady growth in Local Authority housebuilding as the Housing Revenue Account (HRA) changes take effect. This then reaches the 3,000 annual level which is projected in the ‘Let’s Get Building’ report (Perry 2012)
66. We take an annual figure of 250,000 new homes needed per year. This is slightly above the Barker report recommendation of 245,000 private housing completions a year, but below projections made by the NHPAU and the Cambridge Centre for Housing and Planning Research
67. As table 3 demonstrates, fully addressing England’s housing shortage through additional central government affordable housing provision would require the investment of close to 2% of GDP every four years if using a more market weighted scheme, and over 2% of GDP if the priority was a greater proportion of social rented housing. If policy makers are not prepared to commit to this level of new spending, they must come up with plausible alternative reforms for raising housing supply. If they commit to some increase of spending, they must state what additional measures are needed to close the remaining gap

Housing Associations Borrowing Capacity

How much more borrowing could housing associations undertake to deliver more affordable housing?

Housing association's capacity to borrow is based in large part on the value of their housing stock. When the value of these assets rise, it creates 'headroom' for more borrowing.

Associations have been able to borrow more under the AHP funding regime because their asset values have risen considerably in line with wider house price inflation over the past ten years. This increase in headroom was a 'one off' event, suggesting that borrowing cannot expand indefinitely. Nonetheless, the 2010 Affordable Housing Programme bidding round suggested some significant remaining capacity amongst housing associations. The programme was oversubscribed and ended up securing 80,000 homes compared to its initial target of 56,000, and at a lower than expected average grant rate.⁶⁸

In 2012, Sir Bob Kerslake - then Permanent Secretary of the Department for Communities and Local Government - estimated that housing associations still had £11.6 billion in undrawn facilities available.⁶⁹

"We know that there is still some headroom there. We have not completely exhausted the headroom available for new housing supply. I think a key question will be what that looks like in the next spending review. But we are some time ahead of that."

Sir Bob Kerslake⁷⁰

However, the borrowing capacity of housing associations is not evenly spread amongst the sector. Some have undrawn borrowing facilities, but others do not. Those with greater ability to borrow are, generally, likely to be more risk averse and without a recent history or appetite for development. In contrast, many of the housing associations which have been significant developers now have constrained balance sheets.⁷²

If the current ratios of capital grant to housing association borrowing were maintained this would imply that housing associations have the borrowing capacity to deliver at least a repeat of the Affordable Housing Programme (where combined housing association borrowing and other non government sources of funding came to £10 billion).

This suggests that housing associations have the capacity to absorb another £1.8 billion in government spending through the AHP. This is significantly less than the £2.8 billion of spending recently announced,

68. NAO 2012

69. Comments in House of Commons Committee of Public Accounts (2012) Financial viability of the social housing sector: introducing the Affordable Homes Programme: Thirteenth Report of Session 2012–13 London: House of Commons

70. House of Commons note 2012

Options for local government investment

Local authorities traditionally played a major role in housing delivery in England, in both the pre and post war period [see figure 2 above], and averaging over 130,000 new homes per annum in the 1950s and 1960s.⁷¹ But direct building by local authorities has not happened at scale for decades.

The local authority sector is the ‘sleeping giant’ of housing delivery. Increasing its role would allow an additional supply of housing which would add to market and housing association delivery – an obvious supplement to help bridge the gap between current supply and housing need.

Local authorities are now in a strong position to act as a counter cyclical delivery agents, as - unlike private developers and housing associations – they have low housing debt profiles and strong income streams. Local authorities also have access to land and greater control over planning decisions, enabling more innovative delivery approaches than centralised structures tend to support.

On the face of it, councils have great potential to re-emerge as contributors to new housing supply. In practice the extent to which they can achieve this will be dependent on changes to local authority borrowing powers, and the types of delivery model chosen.

Current position of local authority house building

Since 2008 local authorities have increased their building rates from 630 completions to over three thousand in 2011, in response to new grant funding availability from central government.⁷²

In April 2012, the £28bn Housing Revenue Account – through which the 171 authorities that own council housing manage their housing assets – was also reformed to allow councils to borrow against future rental streams. As a result, on average housing authorities will have 14% more to spend on existing and new stock. Under UK accounting practices, unlike elsewhere in Europe, this borrowing is added

to the Public Sector Net Debt. To limit the scope for increasing national debt, Government imposed tight individual caps on the amounts that can be borrowed by local authorities.

In this context there are three options for expanding local authority borrowing for investment in housing.

Option 1: Rearranging borrowing within current caps

At present, England’s stock-holding local authorities have total headroom within the current caps for £2.8bn of additional borrowing – enough to produce a significant number of new homes.⁷³ Current local authority plans include building 4,000 new homes per year spread over five years, or about 20,000 additional houses.⁷⁴ This will be a welcome but limited contribution to total housing delivery.

At present, HRA borrowing capacity varies greatly between individual councils – and there is no automatic alignment between those that can borrow to build, those that have the land to build on, and those that actually want to build.⁷⁵

London Councils have argued that there is therefore scope to pool and redistribute borrowing capacity between authorities, while maintaining the same overall national limit.⁷⁶ This could be achieved by setting up a system analogous to carbon trading, which would allow the trading of borrowing headroom to those councils who are willing and able to build from those that are not.

Alternatively, the caps could be increased for authorities that met financial criteria, and lowered for others with less capacity or need, ensuring that the total amount of borrowing remained the same. These approaches could be taken without requiring any changes to the current national debt arrangements.

Option 2: Indexing borrowing caps

The borrowing caps are currently fixed in nominal, cash terms, meaning that the amount of borrowing possible

71. Mind the Gap: Housing Supply in a Cold Climate, A Discussion Paper by David Pretty CBE and Paul Hackett for the Smith Institute, the Town and Country Planning Association, and PricewaterhouseCoopers 2009

72. CLG Live Table 211

73. Wilcox et al 2013

74. Perry J 2012

75. Wilcox et al 2013

76. London Councils 2013

will lose value over time, unless the caps are increased in line with inflation.

A second method of gently increasing the building capacity of local authorities within the existing policy framework of capped borrowing would be to index-link the caps so that they maintain their value over time. If the cap was linked to RPI at, say 2.5%, one local authority estimated that it would be able to borrow an additional £40m over five years.⁷⁷

Option 3: Raising the current local authority borrowing cap

Many local authorities view the assessment by which government came to the current borrowing cap to be artificial and not based on a realistic assessment of local authorities housing assets.⁷⁸

A way to substantially increase local authorities contribution to new housing supply would be to reform restrictions on the borrowing cap. This approach has widespread cross-party support at the local government level, and is gaining support at the national level.

The most straight forward way to achieve this would be to allow borrowing within limits that comply with the well-established prudential rules that already apply to local authorities. London Councils have estimated that this move would double their member boroughs' borrowing capacity from £1.6 to £3.2 billion and would lead to an estimated 54,000 extra new homes in London over a five to seven year period.⁷⁹ ALMOs estimate that lifting the borrowing caps would give the local authority sector a further £4.2bn to invest in house building.

A recent major report commissioned by the National Association of ALMOs found that an extra £7bn investment over five years would be comfortably within current prudential borrowing rules. Local authorities could sustain this amount of borrowing, given their current low debt levels per existing property and a buoyant income stream from rents.⁸⁰

Additional local authority borrowing of this sort would add to total public sector debt levels under current fiscal rules.

Debt implications

To the extent that local authorities borrow within the caps set by government, this would be within current Treasury and OBR forecasts of public sector net debt (PSND). Council borrowing to fund an enhanced new build programme that exceeded the current caps would have implications for PSND. The government could respond to this in two ways:

- Accept that Public Sector Net Debt will increase, as a part of a fiscal and housing market stimulus.
- Review its fiscal rules and bring them into line with international conventions, which would no longer require council housing investment to be counted against the main measures of government borrowing and debt – which would not add to the government's politically sensitive measure of the deficit.

Scale of impact

- Existing local authority plans, under current borrowing limits, would add an estimated extra 20,000 units spread over five years, or about 4,000 per year.
- Exploiting the full capacity within existing borrowing caps would add an additional £2.8 billion to local authority house building budgets.
- Raising the borrowing cap to allow additional local authority investment is calculated to realistically allow borrowing of £7bn over five years, building up to 12,000 extra homes per year creating a total of 60,000 additional new homes.

77. Private conversation between author and local authority representative

78. Discussion between author and local authority representative

79. London Councils 2013

80. Perry J 2012

3. Short term: fiscally neutral options

There are other options to boost housing supply quickly which should be looked at by government. These would be useful additional changes, but would be insufficient to raise house building levels to the extent needed.

These either increase the supply of land into the market or bring new actors directly into residential development.

Green belt flexibility

The green belt in England has been in place since the 1950s. It has successfully constrained the growth of all of our major cities, but the policy has come with many costs for new housing supply and housing affordability.

Contrary to public opinion, the green belt has no intrinsic aesthetic, amenity or public access value. The green belt in England is very substantial in size (at 13% of England's land area)⁸¹. It is much larger than all urban areas combined (7% including parks and gardens)⁸². The green belt often isn't particularly 'green', including high intensity agricultural or low value scrub land in the same category as land with a high environmental or landscape value.

Green belt designation also means that development is impossible in many sensible, accessible sites in high demand, high employment areas that could be developed with minimal damage to the countryside or the environment. All too often it displaces housing growth over green belt boundaries, leading to a much greater negative environmental impact from increased commuting and transport. For example, in Cambridge over 40,000 daily work journeys are made over the green belt into the city.⁸³

Other countries manage to combine urban containment with flexibility to allow for future growth, with

boundaries revisited at regular intervals. In England however, the opposite has been the case, with growing housing demand in the post war period combining with tighter controls and much larger amounts of land designated as 'green belt'. Between 1979 and 2011, the amount of green belt more than doubled from 721,500 hectares to 1,639,540 hectares.⁸⁴

Yet the green belt has become a no-go area in political debate, even though many high profile conservationists recognize its problems and the case for reform.⁸⁵

The government are currently encouraging local authorities to use their existing powers to reallocate brownfield land within green belts for housing development (so called "green belt swaps") but in return other more attractive land for leisure and other purposes would be added to the green belt.⁸⁶

Green belt swaps could be extended to include not just brownfield land within green belts but also low value agricultural or marginal land.

There are recent successful examples of this happening in the England – most notably Cambridge, where the green belt was expanded to the south and the north of the city in the 1980s to accommodate the city's growth as a science, knowledge and technology centre (Monk et al 2013).

Expansion could also happen in a more planned way, in which new settlements and town extensions included large areas of high quality accessible parkland between new developments.⁸⁷ Allowing development on just one per cent of reclassified green belt would allow for the creation of almost half a million new homes with gardens.⁸⁸

81. Green Belt - Commons Library Standard Note, UK Parliament 14 January 2013

82. UK Natural Ecosystem Assessment, Defra 2011

83. <http://www.cambridgefutures.org/futures1/campast.htm>

84. The 1979 figure is for the whole of the UK, the 2011 figure is for just England – hence this is an underestimate of the size of growth (Source: UK Parliamentary Briefing on the Green Belt)

85. See Sir Simon Jenkins recent comments to move towards a grading of countryside based on environmental and landscape value.

86. House of Commons Library Note, December 2012

87. How to achieve successful extensions to towns and villages has been written about in substantial detail in Lord Matthew Taylor's 2008 report to the Prime Minister, 'Living, Working Countryside' <http://archive.defra.gov.uk/rural/living/housing/taylor.htm>

Doing this in a pro-active way would also allow access to land that is outside of the control of the major developers and potentially below current residential land prices – if land purchase is handled in a new way (see below).

Green belt swaps without a new approach to land supply would create the problem of reallocated land creating a mini industry in speculative land trading in green belt areas – where the “hope value” of land in the green belt increases exponentially, making cheap land release much harder, as landowners hold out for high prices on what is potentially very high value land.

Green belt swaps therefore need to be combined with a new mechanism for securing low cost land and eliminating hope value. But a quick win would be to use the Exception Site model (to only sell green belt land if it is secured at a low price and for use for affordable housing) or via a New Towns model (where land is secured at a lower price by a public or private development corporation).

Extending rural Exception Sites

Expanding Exception Sites in England’s Small Towns

Exception Sites are affordable housing sites located within or on the edge of existing small rural settlements. They are part of the planning policy framework, but are not allocated and not normally used for housing. However they are given planning permission because they provide affordable housing that meets local needs in perpetuity.

They are common policy in rural local authorities, but currently deliver small numbers of housing – with only 1,535 new exception site homes being built in 2011.⁸⁹ This is however almost half of the housing delivered in settlements of less than 3,000 population using government grant.

As they lie outside the geographical areas where land is allocated through the planning system, and would not otherwise be granted planning permission, Exception Sites offer landowners the chance to sell agricultural and other non-residential land (for example a paddock) at a higher price than it would otherwise fetch.

This is often reinforced by explicit local authority policy of limiting the land price paid under their Exception Site policies.

Exception Site land also tends to be outside of existing house builders and their strategic land banks – either under direct control or under option.

Exception Sites therefore create a supply of low priced land, tied to affordability criteria and outside of the control of larger house builders – all of which can help increase the supply and reduce the price of housing.

Traditionally Exception Sites have been solely for the use of affordable housing – funded with grant. These affordable units have been for local need and underwritten with local residency criteria either for rented property or, in the case of shared ownership, with sales conditions.

Exception Site viability has traditionally been based upon the lower land prices paid and higher grant levels received. However lower grant levels under the Affordable Housing Programme and, in some rural areas, lower market rent levels, has made Exception Sites consisting solely of affordable housing unviable in current market conditions.

Because of this there have been recent changes in policy to allow larger sites that involve a cross subsidy of affordable units from market housing.

Exception Site Definition

At present Exception Sites are defined within the glossary of the NPPF as:

“Rural exception sites: small sites used for affordable housing in perpetuity where sites would not normally be used for housing. Rural exception sites seek to address the needs of the local community by accommodating households who are either current residents or have an existing family or employment connection. Small numbers of market homes may be allowed at the local authority’s discretion, for example where essential to enable the delivery of affordable units without grant funding.”

Paragraph 54 of the NPPF states: “Local planning authorities should in particular consider whether allowing some market housing would facilitate the provision of significant additional affordable housing to meet local needs.”

88. As of 31 March 2011, the green belt in England is estimated to cover a land area of 1,639,540 hectares and thus one per cent would constitute 16,395.4 hectares. Building on this land at a low density of 30 homes per hectare (approximately village level density) would create 491,862 homes. If built over a 15 year period this would produce approximately 33,000 new homes annually

89. According to local authority Housing Statistics (LAHS) data returns 2011

At present some rural local authorities have used the ability to cross subsidise to increase both market and affordable output even in conditions of lower overall grant.

Cornwall, for example, has delivered 524 Exception Site units using cross subsidy since 2009. Their sites have come through a mix of community gifts, landowners or from private developers approaching them directly. They have been facilitated by a strong local authority level policy and a good enabling team which is excellent at viability analysis and land market issues.

Flexibility in implementation also means that successful local authorities, and access to the cheaper land that Exception Site provisions provides, are able to provide a balanced set of tenure including, in some higher value markets, provision for lower priced market homes and affordable rented housing at less than 80% of market rents.

In areas where there is high market demand (a substantial part of rural England, notably in the South East and South West), this offers a chance to deliver new housing, with a strong affordable and community element, with minimal grant levels, whilst also giving access to development to smaller players and new entrants. However this must be tempered with the fact cross subsidy does not work in low demand housing markets.⁹⁰

There is also anecdotal evidence that providing cross subsidy can reduce opposition from local communities as they perceive the resulting mixed schemes as being socially less threatening and more inclusive.

It is important to note that successful Exception Sites policy have tended to have supportive local authorities, well resourced local authority housing teams and a robust set of policies for engaging with landowners and developers.

Exception Sites also present a model that could be used to bring in much more low cost land into use for housing supply. The Exception Site model however only works if Exception Sites are the only alternative for landowners to agricultural use. As soon as the possibility of land being allocated through the mainstream planning system occurs, landowners will hold out for the much higher prices this brings (what is called “hope value”).

Exception Sites could be scaled up significantly, but it would have to be in areas where traditional land allocation is not going to happen and hope value does not exist – this makes Exception Sites a useful possible model for green belt swaps or for other non allocated rural land where New Towns could be built (see above and below).

Helpful changes from government could include:

- The Planning Inspectorate and Ministers issuing further guidance to rural local authorities on the need for greater levels of market cross subsidy in exception sites
- Inheritance Tax deferment from landowners who gift land for exception sites as part of their estate planning to bring forward greater levels of land into Exception Site schemes
- Government continuing to provide grant funding at levels that reflect the viability of providing rural affordable housing, with variable rates reflecting different housing market conditions across the country.

Commercial property conversions

Government has already announced plans to make it easier to obtain permission for a change of use from some commercial and industrial property to residential property.⁹¹

This gave new permitted development rights to allow change of use from offices B1(a) to homes (C3) to provide new homes in existing buildings.

This provides some limited flexibility within the current building stock to shift from under used office space into housing. However this change is limited – confining itself just to one use class and for a time limited period.

Current changes will also give current owners of commercial property large one-off cash windfalls, as residential is typically more expensive than commercial land. A more coherent approach would be to maintain the incentives for converting commercial to residential property, but also capture some of the resulting windfall to spend on more affordable housing.

90. In the 30% of highest-value rural areas nationally, an affordable housing contribution of 80% can be gained through cross-subsidy on rural exception sites, assuming a residual land value of £10k – 12K a plot; but in the 30% of lowest-value rural areas the affordable housing contribution fell to 30% and this was only possible where the residual land value was £5k a plot. The latter price is often less than agricultural value and therefore landowners are unlikely to want to sell at the site.

91. Written Ministerial Statement by Communities Secretary Eric Pickles on promoting regeneration 9th May 2013 <https://www.gov.uk/government/speeches/planning-promoting-regeneration>

Benefits

There is a long-term deep structural change in the use of the built environment away from office and commercial property – driven by changing work, consumer and business patterns. The changes in use class are potentially large - vacancy rates in the commercial, employment and retail property sector have been between 15-18%, much higher than vacancy rates in residential property, and CLG figures put the number of empty non residential buildings at 266,000 units.⁹²

Commercial property owners have strong current incentives to shift commercial property (with lower values, yields and high voids) into residential (with higher values, yields and lower voids).

Change of use therefore offers a way to very quickly expand our residential housing supply. Change of use has a much shorter delivery time line than new construction, and fewer of the development risks inherent in new housing development. It would be less likely to mobilise 'NIMBY' opposition because of its reuse of brown field sites.

Expanding current change of use policy

Change of use could be expanded into a greater range of building classes, notably allowing change from retail (Class A1) and financial services outlets (such as banks and estate agents – Class A2) to residential property.

Although there are benefits from change being permitted for a time limited period (in incentivising property owners to move quickly), there is also scope to make this a more permanent feature of our planning regime, given the longer term forces reshaping our retail and office markets – be it internet shopping or home working.

Harnessing an 'affordable housing windfall' from the likely shift into residential property would therefore be harnessing a powerful market trend.

This could either happen through allowing change to occur without planning permission, as is the case with the most recent government announcement, or by encouraging planning authorities to make change

of use easier through having to have strong reasons for turning down an application for change, such as making it much harder for local authorities to turn down applications if local commercial property vacancy rates are above a set percentage threshold.

The latter has the advantage of allowing change of use to occur alongside a levy from local authorities in the shape of either a Section 106 provision, or other value uplift tax, to capture part of the lift in value in switching property into the more valuable residential category.

At present change of use is likely to gift significant value uplift to a small group of commercial property owners.

Both would need to maintain the incentives for commercial property owners, but would lead to an affordable housing revenue windfall and help pay for associated increases in local services and infrastructure.

92. National non-domestic rates collected by local authorities in England 2009-10, DCLG, 2010, available: <http://www.communities.gov.uk/publications/corporate/statistics/nondomesticrates200910>

93. Author conversation with Tim Leunig

4. Long term: facing up to tough choices on house building

England faces a large housing shortage between the houses we need and the houses we build. This shortfall has been sustained and significant for a long period of time. In order to prevent ratcheting house prices and rents we need to find ways to bridge this gap.

As we note above, addressing this housing shortage through additional central government spending alone will require the investment of around 2% of GDP every four years.

If policy makers are not prepared to commit to this level of new spending, they must come up with plausible alternative reforms for raising housing supply. If they commit to some increase of spending, they must state what additional measures are needed to close the remaining gap.

This will likely require both more competition among the house building industry, but also new methods of delivering homes – critically new methods of releasing land.

There are no easy options, only tough choices. Doing nothing must be included as one such choice so that we can consider the consequences.

a. What happens if we do nothing?

If we remain at current levels of private sector building (89,010) and compare them to Shelter's estimate of the annual housebuilding needed to meet housing need (250,000), this would mean we would be creating a shortfall of a million homes every six and a half years.⁹⁴

To allow this would mean accepting a continued fall in homeownership, which would become precipitous among younger age groups.

It would mean accepting continued year on year above inflation rises in rental costs – squeezing incomes and living standards and dramatically raising the cost of the housing benefit bill, leading to further pressure on the deficit and for tax payers.

Access to homeownership would become the preserve of the very few or accessible only by taking on large

levels of household debt – increasing both family and national vulnerability to economic shocks. Lower and middle income social groups would now rent, increasing the burden on the state when these groups retired. Particularly high-pressured housing markets, such as London, would become ever more spatially stratified by wealth and inequalities.

This would be a more dramatic change than any of the proposals in this paper to increase our level of housing supply.

All positive possible changes to stop this from happening must be considered against the worst outcome of doing nothing at all.

b. Reform the private land market

As we have seen, our current land market puts major obstacles in the way of expanding our future housing supply

- Not enough land is released
- Land is therefore very expensive
- Land prices are highly volatile,
- This creates risk for the development sector
- Land has also become the major barrier for the entrance of new house builders to the market

All of these trends raise the cost of new housing, increase the risks of development and decrease our ability to deliver new supply.

Our current method of land release, via the mainstream planning system, exacerbates all these problems.

The current planning system restricts supply, creates uncertainty about this future supply and leads to existing developers spending significant time, money and effort focusing on securing future land supply rather than building houses.

The current planning system also creates a 'winner takes all' system of distributing the value that comes from changing land's status into residential land. The large sums of money created by permitting

94. Based on the Barker calculation of annual needed private house building (245,000) and current levels of private house building in England (89,010). The Barker Report recommended building 245,000 private sector homes per year to keep house price inflation at the European average of 1.1% per annum.

new housing on previously undeveloped land are all captured by the landowner and the developer, some of which is then recouped by government in the form of taxes on infrastructure (CIL) or social housing (Section 106 Agreements).

A recent major international review of land supply and planning systems conducted by the Cambridge Centre for Housing and Planning Research suggested that successful countries are much more pro-active in the land market than England. (Monk et al 2013)

If we are serious about raising the level of housing supply and creating a more diverse and higher performing housing development sector, we need to consider closely reforms to the land market.

Four options for reform are outlined below:

- State release of publically owned land
- A new market based auction system of land release (Community Land Auctions)
- A state based intervention in the land market to release additional supply that is part of the current planning system (self build or expanding Exception Sites)
- A state based intervention separate from the current planning system (via Compulsory Purchase)

Option 1: releasing public land

Releasing public land at low cost or at subsidised finance can be one way to help improve the short and longer term output of housing.

The government has committed to release public land with enough capacity to build up to 100,000 new homes by 2015.⁹⁵ It has also committed to sell public land worth £5 billion between 2015 and 2020. Government has also put in place new structures to make public land release easier – including a ‘right to contest’ for communities and businesses who are interested in acquiring surplus local authority land and a strategic land review to identify and release further public land to support economic growth.

According to the National Land Use Database, in 2009 there was 5,756 hectares of brownfield land suitable for housing and owned by the public sector that could accommodate 291,000 homes.⁹⁶ It is important to note however, that successive governments have promised public land release for house building, and that headline

figures have tended to disguise land that is difficult or unsuitable to build on.

In making land available where used outside of the system of land banking and planning uncertainty, public land can also help facilitate new entrants into house building who can help supplement the output of existing private house builders.

Government currently sees public land as a way to inject lower input costs into the building sector and overcoming development finance hurdles, both by selling land at lower, or nil cost, or by restructuring the repayment terms, so that it is paid for after the final development is sold, thus relieving upfront financing costs for builders.

This occurred under the Labour government, for example the Public Land Initiative in 2010, and an alternative scheme was announced under the Coalition government as the Build Now, Pay Later scheme in March 2011.

The Build Now, Pay Later scheme is less radical in its approach to helping encourage new market entrants – primarily focusing itself on providing subsidised finance to allow developers to defer payment for land to a later stage in the development process.

It thus focuses on trying to get current builders to raise their production levels, rather than allow new builders into the market which, given the constraints on current output, limits the likely success of the scheme in significantly shifting England’s overall supply performance.

The Public Land Initiative was more successful in encouraging new entrants. In early 2010, the HCA as part of the Public Land Initiative established an innovative pilot model through using a Delivery Partner Panel (DPP) that released public land for new housing. The 2010 bidding round used a joint venture model to capture a percentage of land value gains for the public sector while setting out strict criteria for lower profit margins and fast build-out rates to spur investment activity. The HCA allowed ‘building under license’, while containing control of how development happened and who profited from it.

The successful bidders were notably from domestic and foreign construction firms (such as Lend Lease, Bouygues, Waites and Skanska), rather than traditional vertically integrated house builders, prepared to take lower margins in return for lower land risk. This shows

95. <https://www.gov.uk/government/news/government-on-target-to-smash-public-land-ambition>

96. <http://www.insidehousing.co.uk/development/government-urged-to-speed-up-public-land-scheme/6523653.article>

that new and more competitive entrants can flourish if given access to land.

In releasing further public land owned by central government departments, the government needs to be much clearer in using its land to open up market opportunities for small builders, self builders and new market entrants. In the short term it could do this by releasing small sites to developers through an innovative, open competition. This would help widen our delivery capacity and deliver more homes.

Option 2 Community Land Auctions

Another form of new land release could occur via a new market mechanism called Community Land Auctions.

The Community Land Auctions idea has been promoted by Tim Leunig from the London School of Economics (Leunig 2007) and has gained support by several respected figures, such as Kate Barker, and from senior figures within government, including the Chancellor.⁹⁷

The Community Land Auctions idea proposes the operation of an inverse auction for the granting of residential planning permission among private landowners. The auction would be held by local authorities and would help drive down market land prices.⁹⁸

Land Auctions would allow an open market system for selling land that enabled residential land sales from land owners who would not otherwise be likely to gain planning permission. This opportunity, combined with an auctions system, in theory, should increase the supply of land available and its price.

In achieving land sales through the direct participation of the landowner and the local authority, land auctions would enable the local authority to capture the land value uplift that was previously shared between landowner and developer. In doing this using an open market mechanism, it would also reduce legal challenges that more coercive land acquisition strategies could face (for example Compulsory Purchase).

Government promised a trial of the land auctions idea in the 2011 Budget, but the 2011 Housing Strategy only contained the offer of a trial using public land under the control of government departments.

The coalition government is now taking forward land auction pilots on public sector land with the aim of having two sites ready for market by the end of the year. The land will then be auctioned to the highest bidder. Although this is an interesting mechanism for disposing of publically owned land, using public land defeats the original purpose of what is a mechanism designed to drive private land market prices down.

97. For full details of the land auctions idea see Tim Leunig (2007) *In My Backyard: Unlocking the Planning System*, London: Centre Forum.

98. Leunig 2007

Option 3: Supporting Self Build

The planning system currently allocates a five year supply of future land for development.

This system has many downsides. Not least in ensuring the future supply of nearly all development land is controlled by a small group of developers.

Merely pushing a limited amount of new land through the existing planning system does little to lower its price, the negotiating power of landowners or reduce concentration of its control by current developers.

Trying to shift allocated land from one set of developers to another would also be difficult, given the widespread existence of 'option' agreements that monopolise land control in the hand of one developer. Meanwhile, the 'hope value' of allocated land makes it harder to persuade landowners to sell at anything other than the maximum possible residential value price.

There are possible methods by which the current planning system could be supplemented to break

open the land market to new entrants, via new methods of land release.

The most prominent proposal for this has been put forward by Policy Exchange around forcing local authorities to release sites for Self Build.⁹⁹ Given the current very low level of self building in England, compared to most other developed countries (see above), creating a space in which self build could flourish should add an extra stream of housing numbers to supplement England's overall housing output.

Policy Exchange's proposal would require local authorities who fail to meet their housing targets to release the shortfall to Self Build homes in the following year. Whilst land would be obtained from holding a Community Land Auction (see above) from unallocated land coming forward from willing landowners, of which a lower priced suitable site would be selected. This would overcome the problem of 'hope value' (as the auction is the only realistic chance for these landowners to sell land at above agricultural value) and produce land that was, again, outside of existing developers' control.

A similar proposal could use the Exception Site model to offer an alternative funding model that was grounded in the provision of affordable housing, with some local perpetuity element.

Housing Growth in Smaller Towns

A new approach to land allocation could work well with new ways of thinking about the spatial geography of our future housing.

Green belt swaps offer a way of combining new methods of land release (say via an expanded Exception Site model) of currently unallocated land with no other chance of winning development rights.

There is also merit in looking again at new approaches to expand England's smaller geographical settlements, which either have very little development, or unsympathetic and poorly planned extensions.

The planning regime and successive governments has favoured new house building in larger urban cities and

towns. This has been caused partly by the politics of the planning regime, but also the feeling within government that large output could best be achieved by focusing house building in large settlements.

Yet the number and size of small towns suggest there are significant cumulative gains that could be made by making house building easier in smaller settlements.

In 2009 the population living in English small towns was 11.4 million or 22% of England's population.¹⁰⁰ This was two-thirds of the size of the population living in England's largest urban areas, and the second largest type of settlement in England. In 2001 small towns had 5.2 million separate residencies.¹⁰¹

Small incremental growth could therefore deliver large total numbers of new homes. Allowing small towns to expand by 5% would lead to an increase of approximately 258,000 new homes. Allowing small towns to expand by 10% would lead to an increase of over 500,000 new homes. Allowing small towns to expand by 20% would increase England's housing stock by over 1 million.

99. Morton A 2013

100. Using the Birkbeck Rural Research Centre definition of small towns: 'Under this categorisation all rural places with between 1,500 and 40,000 residents, free standing and in open countryside are classed as Small Towns. Using this classification there are over 1,600 such places in all parts of England.' http://webarchive.nationalarchives.gov.uk/20110215111010/http://www.ruralcommunities.gov.uk/files/sotcupdate_market_towns.pdf

101. Birkbeck Rural Evidence Research Centre data, based on residential address points and 2006 ONS estimates

Because small towns, by definition, tend to be surrounded by non-urban land, allowing their expansion would also allow development where land was relatively plentiful. This could increase the supply of homes in high demand housing markets with high levels of housing need. Combining this with a new approach to land release focusing on local housing need and ownership clauses and affordable housing provision could do this in a populist and sensitive way.

Option 4: compulsory purchase.

The final option for a new approach to land acquisition and supply is for government to intervene directly in land purchase via Compulsory Purchase Orders (CPO).

These are non negotiable legal orders to sell land at a set level of compensation. Compulsory Purchase is a common method of land acquisition in France, Germany and the Netherlands for housing and infrastructure purposes and was used frequently in England under the New Towns programme. Often just the plausible threat of Compulsory Purchase can make landowners more willing to accept reasonable terms for sale.

In the Netherlands, for example, local authorities have traditionally purchased land at existing use value, provided infrastructure and sold it to developers at a price that captured associated land value uplift (Buitelaar, 2010). Whilst in Germany, 'land readjustment' in preparation for development is one of the main instruments in local planning and usually happens through voluntary agreements between

the government and landowners or compulsory purchase if a mutual agreement cannot be reached. (Monk et al 2013)

The most recent, and highly successful, example in the England was under the Olympic Delivery Authority, where 3,000 separate Compulsory Purchase Orders were made.¹⁰² Whilst both Boris Johnson and Ed Miliband have recently promised to make it easier for local authorities to compulsory purchase sites from private developers who are seen to be "hoarding" land.

Compulsory Purchase is highly effective in overcoming the problem of both recalcitrant landowners and the de facto monopoly control of the planning regime's future land supply by a small group of developers. It can also be highly effective in unblocking stalled schemes that have reached an impasse between developers and landowners. CPO also has the advantage over Community Land Auctions of allowing the purchase and supply of land in areas of greatest strategic importance, be it for transport, infrastructure or other issues.

However local authorities and central government have become unused to employing CPO in the past twenty years – partly because of ideological fashion and partly because of the greater fears of legal challenge, primarily via appeal to the European level.¹⁰³ Although this latter concern is hard to square given the widespread use of CPO on the continent.

c. Debt Financing

One of the main measures of the 2013 Budget was to enable increased borrowing by private sector house builders via government guarantees.

102. See <http://www.underwoods.co.uk/compulsory.htm> and <http://www.insidethegames.biz/sports/summer/aquatics/81-archive/archive-news/531-olympic-compulsory-purchase-order-confirmed?device=iphone>

103. Conversation between the author and UK government official

Government Guarantees: Budget 2013

The government has set out plans to greatly expand its role within the housing market by offering the state as guarantor behind loans in both the new build and the second hand housing market.

This includes:

- Help to Buy: equity loan scheme, which makes £3.5 billion of equity loans available on new build property. The scheme started in April 2013¹⁰⁴;
- Help to Buy: mortgage guarantee scheme, which make available £12bn of guarantees to lenders which will be sufficient to support £130 billion of high loan to value mortgages¹⁰⁵
- An additional £800m for Build to Rent on top of the £200m announced in September 2012
- The Housing Guarantee Scheme: Affordable Housing will underwrite new borrowing for affordable housing. It was announced alongside a new 25% lower grant rate of £15,000 per home.

The Help to Buy and Build to Rent schemes are both classified by the Treasury as 'financial transactions' in the government's accounts.

According to UK accounting convention, this means that the resulting liability and any spending implications fall outside of Public Sector Net Borrowing (BSNB) and instead are classified as Public Sector Net Debt (PSND) which means they fall outside of formal classifications of the deficit.¹⁰⁶ Any cash impact from the policies will be classified within the Central Government New Cash Requirement (CGNCR). The government will also impose a, to be confirmed, ceiling for contingent liability in the Help to Buy: Mortgage Guarantee Scheme. (HM Treasury 2013)

The government's willingness to offer guarantees to private market actors opens up the possibility of using the government's overall credit rating to lower the risks and costs of housing investment.

Instead of the government underwriting demand, via future higher loan to value (LTV) mortgage issuance, an alternative approach is to underwrite supply through guarantees on the borrowing of housing providers.

Enabling borrowing for investment in greater levels of house building would be an attractive policy option, and we examine here three possible options where changes to borrowing arrangements could lead to greater housing investment, by housing associations, local authorities and private sector actors.

Guarantees for investment by Housing Associations

The government has already announced a guarantee that aims to lower the cost of borrowing for Housing Associations.

Housing Guarantee Scheme: Affordable Housing

The Housing Guarantee Scheme: Affordable Housing will underwrite new borrowing for affordable housing. It was announced alongside a new lower grant rate of £15,000 per home – and the lower costs of borrowing are meant to support scheme viability in the most recent post Affordable Housing Programme release of funding.

At present Housing Associations (HAs) can access borrowing on a range of terms – depending on the size of the HA, the state of their overall financial health and the specifics of the development scheme involved. Most of HA borrowing has traditionally been through direct bank lending, but larger HAs have recently developed bonds and are able to attract a wider range of investors (notably pension funds) on more competitive terms. As a rough rule of thumb, smaller HAs face higher financing costs than larger HAs.

Because housing is a relatively secure asset and HAs have other assets and projected income in the form of rents, Housing Associations can borrow at relatively competitive rates – that range from between 4 to 6% based upon the scheme and the borrower.

The new government guarantees could enable financing costs at somewhere between gilts (the cost of borrowing for the UK state) and current HA market rates. This could potentially be a significant boost for borrowing terms of HAs. For example, if current HAs are borrowing at up to 6% and the terms of government guarantees create a rate of 3% this represents a halving of debt financing costs.

104. http://www.helptobuy.org.uk/help_to_buy.aspx

105. Which the government defines as mortgages between 80% and 95% of property value <http://www.hm-treasury.gov.uk/10012.htm>

106. As stated by the Chancellor the Help to Buy scheme is classified as "a financial transaction, with the taxpayer making an investment and getting a return, it won't hit our deficit," George Osborne <http://www.ft.com/cms/s/0/be53220a-9223-11e2-a6f4-00144feabdc0.html#axzz2OfHFNE7v>

There is however uncertainty about both whether these much lower financing costs will happen and the appetite of providers and lenders to take on new building as a result.

Lenders suggest there may be a lack of market appetite for a relatively illiquid bond at so close a level to current gilt rates when their portfolios already have exposure to both gilts and HA bonds.¹⁰⁷ Investment analysts also suggest that the terms of the new guarantee scheme require higher levels of asset cover than a standard bond. This means HAs will be forced to commit more properties as security against the debt and this will act as a deterrent for some.¹⁰⁸

Housing Associations have expressed concerns that lower borrowing rates, when accompanied by the lower grant rates implied under the scheme, will require increased borrowing in order to create the same level of subsidy previously available under the AHP programme.¹⁰⁹ In short, the current guarantees appear primarily a way to ensure even lower grant rates are viable via increased Housing Association borrowing – a finite policy given the limits to borrowing within the sector (outlined above).

A more sustainable approach would be to raise grant rates whilst also providing government investment guarantees – an approach that could increase the effectiveness of any new programme of government investment.

Private Rented Sector Guarantee

Additional borrowing in housing by new private actors would help provide an additional investment source for housing supply. This makes sense not just from the rationale of raising our housing performance, but also represents a way to tap current healthy private sector balance sheets.

Government guarantees could play a helpful medium term role in creating these new business models and helping overcome the initial high capital costs of entry.

In offering investors a product that is lower risk (compared to other market investments) and higher yield (compared to gilts) they should be an attractive

pull into the sector. Over the long term, large scale private sector housing investment, particularly of rented housing, offers to create good long term income streams that have proven themselves excellent hedges against inflation.

Any major scale forms of private sector development will also face significant upfront costs in the shape of land and infrastructure investments. The private sector may be able to overcome this by the issuing of bonds or using upfront capital, but in a relatively new market it may require some form of government guarantee. In some cases this may also merit direct government loans – for example in helping to capitalise new development vehicles, such as Garden Cities.

Again, this is an area where government has recently introduced new measures. The Housing Guarantee Scheme: Private Rented Sector opens up the ability for new private sector actors to invest in new supply – thus creating greater plurality amongst housing suppliers. It is hoped that the new guarantees could pave the way for the growth of a corporate-backed letting market.

At present, however, the scheme appears to be struggling to be implemented – with no private companies yet to express interest in running the scheme.¹¹⁰

Corporate involvement in new private rented development has some current examples. The Prudential Property Investment Management division – part of M&G, the insurer's asset management arm – recently concluded a deal to buy more than 500 homes at a value of £140 million from house builder Berkeley in April 2013.¹¹¹ According to industry insiders, these were existing homes that Berkeley had built, but had difficulty selling in the owner occupation market and preferred to move off its balance sheet at a discount to Prudential.¹¹²

But it is unclear whether this would lead to new actors building more supply or, as with the Prudential deal, just create a new buyer for existing house builders – and whether this latter phenomena would lead to any net increase in new supply. It would however appear to give house builders a client who is less vulnerable to the cyclical swings in the residential housing and mortgage markets.

107. Legal & General, one of the biggest buyers of social housing bonds, said it 'may look elsewhere' if government guarantees drove down the price of housing association bonds. 'If you want to buy government risk, you buy gilts [government bonds],' said Georg Grodzki, head of credit research at L&G. <http://www.INSIDEHOUSING.CO.UK//6523611.article>

108. <http://www.INSIDEHOUSING.CO.UK//6526315.article>

109. <http://www.INSIDEHOUSING.CO.UK//6526315.article>

110. 'Built to Let' scheme in disarray, Financial Times 11 June 2013

111. <http://uk.reuters.com/article/2013/04/01/uk-prudential-rented-housing-idUKBRE93008M20130401>

112. Conversation between author and housing analyst

The Prudential example cited above works only because a developer is willing to sell land at lower margins, due to viability issues and a remixing of a developers portfolio. This is unlikely to be a sustainable investment model in the long term.

At present institutional investment in house building has been deterred for several reasons.¹¹³ High on the list of barriers is the lack of access to land and the low yields available to investors at current prices.

Intervention in the land market, to offer low priced land into the hands of new investment and development actors offers the change to tackle both of these blockages head on: lower priced land being an important component in raising the yields of investment in property.

A New Model? Possible Features of a New Private or Public Delivery Model

A new development model, for example revisiting Garden Cities or New Towns, offers a wide range of choices for its eventual shape and powers. Creating a new model would mean deciding on new legal structures, financing methods, its place in the planning system, how it acquires and controls land, governmental oversight and the type of housing product it offers. This means balancing choices between private, mutual or public identities, local or central government control, its initial asset base or its long and short term borrowing costs. One set of options could be:

- Securing investment finance in a new delivery envelope (perhaps within a mutual structure or as a Special Purpose Vehicle or Development Corporation)
- Government guarantees to underwrite risk to make it an attractive part of investment portfolios
- Securing access to low priced land to raise investment yields
- Structuring to make the tenure a rented product – to give the investor predictable and secure income flows.
- Capitalising initial costs (notably land purchase) via bond issuance or using a National Investment Bank or Pension Fund Investment.

This would dovetail with previous Shelter recommendations for the development of an intervention to promote access to longer term finance in the housing sector. (FTI Consulting 2012)

Review fiscal rules for local authorities

Moderate changes to local authority borrowing powers have been outlined above.

A more substantial change could happen through a reform of government borrowing rules towards a European standard, in which local authority house building would be removed from the politically sensitive Public Sector Net Borrowing (PSND).¹¹⁴

Steve Wilcox makes the argument that the reclassifying of housing debt as investment in line with international accounting rules would have a transformative effect on the investment and output levels of new housing. Under these rules borrowing against revenues are allowed in much of Europe – including France and Germany (Wilcox 2012). This would mean local authorities' housing balance sheets were treated much more like those of housing associations, with positive implications both for local authorities ability to invest and the categorisation of this investment borrowing outside of government's formal debt levels.

This option would allow borrowing to match much more closely local authority housing assets. This would include local authority owned housing stock and the income from rent on these properties. At present local authorities own around 1.7 million properties. (Perry 2012)

Total local authority borrowing is currently about £81bn, including the additional borrowing taken on to enable council housing to be self-financing. Local authority debt accounts only for a fraction of total government debt – just over 6% (Perry 2012).

Local authorities see additional borrowing on their housing assets as enabling a significant increase in housing investment – at minimal extra risk.

If this were to happen one study estimates that local authorities could theoretically borrow up to £20bn in the next five years with their current projected income and up to £27bn if they charged higher Affordable Rents on newly built stock. (Perry 2012) This extra borrowing

113. These include reputation risk, management costs and lack of liquidity – based on discussions held at Shelter Roundtable 'Housing and the Economy' 14th October 2011

114. Public Sector Net Debt (PSND) is the key measure by which the supplementary debt target is measured by the Treasury and by the OBR. However, other countries and international organisations use other measures of debt. The most widely used measure is General Government Gross Debt (GGGD), which is the main measure used by the EU, IMF, OECD and the credit-rating agencies. This latter definition excludes the investment borrowing of public corporations, including local authorities.

(with no additional central government grant) would enable 170-230,000 extra homes to be built in total, if all the potential investment were devoted to new build.¹¹⁵

Unlike housing associations, local government borrowing against these existing housing assets is currently low, at an average of just over £17,000 a house, and therefore offers a way to significantly increase investment, whilst staying within safe levels of total borrowing and gearing. Local authorities proportion of debt to equity (the 'gearing ratio') is typically 50% below those of housing associations involved in current development. (Perry 2012)

d. New Delivery Agencies/ Development Vehicles

As well as being able to access and acquire land in new ways, bridging England's housing shortage of 100,000 homes a year probably requires new development vehicles, particularly if we plan to build settlements on scale.

Luckily, both international and UK history give us a wealth of experience to draw upon. These have either tended to be local municipal authorities themselves or separate special purpose vehicles, such as New Towns Corporations, set up by government or under government license.

These development vehicles often have a powerful combination of land acquisition and control and a method for development finance that allows (often state backed) borrowing over a longer time horizon and can cope with the high upfront investment costs. Both factors help overcome critical problems of risk and short term or cyclical barriers that all too often stymie more traditional market based house building.

Development vehicles are also able to facilitate the entry into the house building market of new development actors, for example self builders, and overcome conflicts surrounding infrastructure and financing.

Garden Cities and New Towns

Achieving large scale increases of housing on one site has been achieved before in England, using the New Town or Garden Cities model of development.

Garden Cities have been the subject of renewed political interest, with previous pledges from the government to explore the concept. In the 2011 autumn statement, the government pledged to support 'locally planned large- scale development ... which could include modern garden cities' (HM Treasury 2011).

In March 2012, in a speech to the Institute of Civil Engineers, David Cameron set out his support for the Garden Cities concept:

"It seems to me that our post-war predecessors had the right idea, embodied in the visionary plan prepared by Patrick Abercrombie in 1944. His plan underpinned the Southeast's economic success by proposing well planned and well located new towns, which would in time become new engines of economic growth. ...

... In the last century private and social enterprises also created places like Hampstead Garden Suburb, Letchworth, Welwyn Garden City, not perfect, but popular, green, planned, secure with gardens, places to play and character-full houses, not just car dominated concrete grids.

... We also urgently need to find places where we're prepared to allow significant new growth to happen. That is why we'll begin consultation later this year on how to apply the principles of garden cities to areas with high potential growth in places people want to live."¹¹⁶

However progress seems to have stalled, with no announcements in the most recent budget, despite pre Budget briefing suggesting that new 'Garden Towns' might be on the agenda.

The New Town / Garden City development vehicles were the most successful post-war development model, achieving large-scale house building and enjoying substantial cross-party support. New Towns were delivered by public corporations, created, appointed and funded (through loans and subsidies) by central government. A return to the New Towns model

115. There are however large questions about both the current capacity and willingness of local authorities to take on this level of new borrowing in the short term – Perry 2012

116. Prime Minister's speech to the Institute of Civil Engineering, 19th March 2012 <http://www.number10.gov.uk/news/pm-speech-on-infrastructure/>

could change this funding mix, increasing the level of private financing and borrowing – a shift that would be made easier by their separate corporate identity (DCLG 2006)

Milton Keynes, for example, was designated by government as a new town in 1967, had its Master Plan written in 1970 and had its first major housing development by 1971. It was expected to accommodate an incoming population of 150,000 over a period of 20 years. This with the pre-existing population and further natural growth was expected to result eventually in a total population of about 250,000.¹¹⁷

Much of this rested on the ability to purchase and control land cheaply and outside of the current planning system. This enabled developers to focus on building homes at a price and on a timescale that was able to avoid the cyclical risks and cost of buying expensive land on the open market.

“Unified land control was absolutely central to delivery.... Even more important was the acquisition of that land at, or close to, existing use values. This made it possible to reduce the land costs in delivery of housing to extraordinarily low levels. ... Obviously this had a major long term implications for the profitability of the New Towns, since renting or disposal of assets could reap handsome profits.” DCLG 2006

New towns and garden cities were outside of the then existing planning system, with substantial strategic powers for land purchase and development planning.

New towns development corporations had powers to acquire, own, manage and dispose of land and property, undertake building operation, provide public utilities and generally do anything necessary to develop the New Town. The corporations enjoyed exceptionally favourable arrangements for land purchase at existing (or close to existing) use values and were effectively able to acquire all the land needed to build the New Town. ... The very strong land acquisition, infrastructure provision, planning and especially house building powers of the development corporations were very effective in delivering the UK New Towns’ (DCLG 2006).

These powers already exist. The Homes and Communities Agency by statute has ‘a wide range of specific powers relating to the provision, facilitation and acquisition (including compulsory purchase, regeneration and development of effective use of land) of housing and infrastructure; establishing companies [and] providing financial assistance’, and has the

power to ‘do anything it considers appropriate for the purposes of its objectives or for purposes incidental to those purposes’ which include to ‘improve the supply and quality of housing in England’ and ‘secure the regeneration or development of land or infrastructure in England’.¹¹⁸

Local authority development management

As well as separate development vehicles or corporations, local authorities can themselves become more directly involved in development.

This can involve developing existing local authority owned land or more active involvement in new land acquisition and distribution.

In many countries local authorities have an active role in land assembly, for example in Germany, the Netherlands, Australia, France and parts of the USA. In Germany, the municipality assembles the land and shares the increase in value following development with landowners after accounting for associated infrastructure provision. (Monk et al 2013) In France, communes engage in pro-active development through the establishment of special purpose vehicles. In the Netherlands active land purchase and development planning has been a long held strategy for dealing with high pressures on land use and the need for greater housing supply.

“The standard approach to development in the Netherlands has been for the municipality to buy undeveloped land, provide the necessary infrastructure and services, parcel it into lots and sell them at prices that recover at least the costs involved. The sites are then developed by private companies, housing associations and individual owner-occupiers (self-build).” (Monk et al 2013)

More active local authority involvement is far from impossible in the English context.

As well as the New Towns and Garden Cities experience, in Cambridge several local authorities worked together in the 1980s and 1990s to create a new town and village in South Cambridgeshire combined with regeneration of brownfield land around the main Cambridge train station through the establishment of the ‘Cambridge Horizons’ development vehicle. (Monk et al 2013)

More strategic development management can also take a much smaller scale. There is already innovative good

117. <http://www.mkweb.co.uk/Heritage/Modern-Milton-Keynes.htm?ID=285>

118. See <http://www.homesandcommunities.co.uk/statutory-role-and-history>

practice from local authorities in making new social house building financially viable with much reduced grant levels.

Islington for example will produce 2,000 homes with social rented housing by 2015 by providing cheap local authority owned land and working in joint partnership with housing associations. Oxford has also set up a partnership involving the City Council and a finance partner to use council owned land to create an urban extension of up to 1,000 new homes with at least 40% of housing available for social rent. This is all the more impressive as both Islington and Oxford are local authorities that face highly constrained land availability due to their urban locations and tightly drawn city boundaries.

There is also a clear appetite from within local authorities for more active approach to land management. A recent LGA survey found that 75% of respondents said that their council released its own land for housing development over the last five years and 85% that their council planned to release housing development land in the next five years (LGA 2012).

Financing new development vehicles

Financing these new development vehicles can take on a variety of methods, although all have to structure finance to raise large sums of capital needed up front and structure for longer term returns, be it from rental income, land value uplift or increased tax receipts.

This can happen over a variety of time horizons – some quite short, for example European municipalities gaining land value uplift after they have performed the role of land acquisition and assembly prior to private development. Others have much longer time horizons, with the initial English New Towns borrowing from government over a sixty year period and repaying the debt with revenue generated by selling land at market value, from the long term income from rents and, in the 1980s, through selling houses via right to buy. (DCLG 2006) Although initial strong profitability was undermined by later New Towns when high interest

rates in the 1960 and 1970s were combined with the increasing repatriation of surpluses by the Treasury.

Financing calculations also become much easier if the major upfront cost (land purchase) can be reduced. Buying land at close to agricultural value enabled the first New Towns to become highly profitable.

In any re-established New Towns Model, financial support from central government is likely to be critical in establishing momentum in the early stages of growth.

In original New Towns this came in the form of fixed long-term loans from the Treasury. An alternative could be for government to guarantee a new delivery vehicle's borrowing or have bond issuance or a National Investment Bank give the initial capitalisation to these new corporate identities.

Given the emphasis on 'off balance sheet' borrowing of current Treasury policy it would also be worth exploring what distinct corporate identities and relationships with government would enable new delivery vehicle borrowing to be classified as outside of the formal deficit.

Among several European examples, the established role of municipalities in development vehicles has enabled many financing costs to be met by recycling previous revenues and from a variety of taxes on land value uplift or from businesses.

For local authorities other revenue sources are available – the most notable recent example being local authority pension funds, which is being used by the greater Manchester local authorities pension fund to invest in new affordable housing stock.

e. Table 4: How many homes could reform deliver?

	2015/16	2016/17	2017/18	2018/19
Current Supply Projections				
Housing Assocs	42,533	42,533	42,533	N/A
Market Housing ¹¹⁹	102,862	102,862	110,577	110,577
Local Authorities ¹²⁰	2,500	2,750	3,000	3,000
Total	147,895	148,145	156,110	113,577
Housing Need ¹²¹	250,000	250,000	250,000	250,000
Housing Shortfall	-102,105	-101,855	-93,890	-136,423
Reform Options – Annual Additional Housing Outputs				
Local Authorities				
Moderate Reform: Prudential Accounting	12,000	12,000	12,000	12,000
Radical Reform: European Accounting	17,000	17,000	17,000	17,000
Quick Changes				
Exception Sites ¹²²	1,500	1,500	1,500	1,500
Commercial to Residential ¹²³	10,000	10,000	10,000	10,000
Green Belt Swaps – to 1% of the Green Belt ¹²⁴	33,000	33,000	33,000	33,000
Structural Changes				
Garden Cities and New Towns ¹²⁵	43,000	43,000	43,000	43,000
Self Build / Reallocated Local Authority Planning ¹²⁶	15,000	17,000	19,000	21,000

119. This market housing output projection is based on the optimistic that private house building will undergo steady and continuous increases of 7.5% every two years, with no years of falling output. Base line 2012.

120. After a fall in Local Authority output in 2012, this assumes a steady growth in Local Authority housebuilding as the Housing Revenue Account (HRA) changes take effect. This then reaches the 3,000 annual level which is projected in the 'Let's Get Building' report (Perry 2012)

121. This is slightly above the Barker report recommendation of 245,000 private housing completions a year, but below projections made by the NHPAU and the Cambridge Centre for Housing and Planning Research.

122. Assumes a doubling of current Exception Site delivery.

123. Government figures put the number of empty non residential buildings at 266,000 units. Given looser regulation on empty shops and offices a ten thousand annual swap is feasible.

124. Assumes Green Belt Swaps would extend to allow building on 1% of the green belt. As of 31 March 2011, the green belt in England is estimated to cover a land area of 1,639,540 hectares and thus one per cent would constitute 16,395.4 hectares.

Building on this land at a low density of 30 homes per hectare (approximately village level density) would create 491,862 homes. If we built this over a 15 year period this would give us approximately 33,000 homes annually.

125. Letchworth target population was 32,000, Milton Keynes had a target population of 250,000 (of which 150,000 was to be new settlement), Welwyn Garden City has a current population of over 40,000. This figure presumes we build 1 new Milton Keynes, 3 new Welwyn Garden Cities and 5 new Letchworths over a ten year period

126. Author's calculations based on Policy Exchange 2013

5. What about the other options?

Mortgage liberalisation, planning reform and taxing land banks

Planning reform

More planning reform of the mainstream planning system is both time consuming, politically costly and unlikely to have the transformative impact needed on England's housing delivery capacity. The Coalition government's planning reform – the National Planning Policy Framework (NPPF) – has only recently taken effect and further reform would increase uncertainty and therefore hit development just at the time we need new homes the most.

Planning reforms that do happen would be better to focus on new parallel or separate interventions that tackle the problem of land availability, control and access or be targeted at specific new development vehicles, such as new Garden Cities.

Mortgage subsidies

There is undoubtedly a problem with the level of deposit requirements currently faced by First Time Buyers. This however needs to be set against both high house prices to income ratios and overall very high levels of mortgage debt. For example, the UK has one of the highest levels of mortgage debt to GDP among developed countries (McKinsey Global Institute 2010).

Encouraging greater levels of debt therefore risks pushing demand and house prices higher, with an accompanying increase in overall risk to households and the economy, but with little commensurate response in supply. IMF and OECD comparative studies of the impact of greater levels of mortgage credit have shown that those countries with the loosest credit conditions saw house prices rise the fastest in relation to underlying incomes (Andrews 2010). Greater levels of housing credit are thus counterproductive to overall housing affordability – as price rises outstrip any increase in initial accessibility (see also Chapter 1(b) on Help to Buy). Homeownership fell from 2003 despite the credit boom of the mid 2000s.

Taxing spare rooms

Taxing existing housing stock could have a place in an overall housing strategy, notably to encourage the return to use of empty properties. However as previous Shelter research demonstrates (Hughes 2009), the number of empty properties tends to be highest in those English regions with lowest overall housing demand, whilst the number of empty homes in England is low by international standards.

Under occupation is a significant factor in private English housing, but is itself a representation of the underlying problem of supply scarcity. More could be done to increase the efficiency of the use of the total housing stock, notably encouraging downsizing. But punitive measures on 'under occupiers' are likely to affect those on lower incomes disproportionately. It is also politically the most contentious area for housing policy, likely to be much more unpopular than simply building more homes. Any focus on this area should look at "pull" measures, notably increasing the supply of housing that older people want to live in, such as low density housing with gardens and bungalows.

Taxing land banks

A popular proposal on housing supply has been to tax developers' land banks in order to bring forward land for development faster.^{127, 128}

It is questionable whether penalizing land banks would bring forward housing development more quickly.

Currently only short term land banks (land with full or pending planning permission) are visible to government. Because larger strategic land banks are based on option agreements – private agreements between two private parties – there is no formal mechanism for public access or transparency. This is added to by the fact that the English land market is highly untransparent – lacking even a formal national record of land ownership.

The only method of taxing land banks, practically, is likely to mean taxing land that has been given planning permission.

127. See for example the Green Party proposal in 2012 <http://greenparty.org.uk/news/2012/11/09/'fair-and-progressive'-land-value-tax-would-help-stabilise-property-market/>

128. This idea has a long history and ties into wider ideas of a land value tax. For example in 2003 in his submission to the Barker Review John Muellbauer, professor of economics at Nuffield College, said a land bank tax would help reduce supply volatility. 'Holding land banks is clearly part of the legitimate business strategy of house builders ... Value taxes on land, even at a modest level, can play a useful role in anchoring prices.. one possibility worth serious exploration is a land value tax not on occupied residential property but on all other sites'

The response of the building sector is therefore either likely to withdraw from this land, bring it forward faster than they otherwise would, or ‘re-plan’ it. The short-term response could therefore be a short increase in supply.

But the more likely medium term response is for the sector to contract its short-term land banks to avoid taxation and introduce much tighter time scales for bringing land forward for planning permission and developing. The parallel of this will be a growth in its strategic land banks via option agreements. This would probably not alter the length of the sector’s land banks, but it would make them less transparent and more vulnerable to delays in their delivery pipeline.

Taxing land owners and speculative holders of land

A more promising approach would be to tax land owners directly, particularly those that owned land that had the possibility of being developed.¹²⁹

Our current planning system gives landowners great power to demand the maximum possible price for land and the ability to wait for long periods of time in the hope that a better price may be achieved.

‘Hope value’ when combined with relatively low costs for holding land means land owners have little incentive to sell except at the peak of the market. This can make obtaining land for new development at a reasonable price, particularly in depressed market conditions, very difficult.

There also appears to be a particular problem of speculative holding of development land by those who have no intention of development. A recent GLA study found that nearly half (45%) of all current planning permissions in London were held by owners who had no intention of building – an astonishingly high level.

Some of these owners may have valid reasons for holding onto land, but a large component was seen to be holding on to land in the hope of higher prices.¹³⁰

“Residual land value acts like an option. The developer has the option to develop at any time, and until that point the fluctuations of end value and cost are largely irrelevant. An asset with such characteristics is very valuable – certainly more valuable than ‘today’s’ residual land value. ... Leaving land undeveloped for a very long time can be logical” (GLA 2013)

There is therefore a case for some form of carrot or stick to incentivize land sales and “build out”.

A positive incentive could be to give planning permissions with a reasonable but limited time windows for development.¹³¹ But this would need to be combined with some sort of financial penalty if not delivered. Ed Miliband recently outlined the possibility of a more punitive approach, in his promise to incentivise developers to “use it or lose it”.

Other positive and punitive incentives for bringing land forward for housing development could use the inheritance tax regime¹³², which is an important consideration for many landowners.

A more muscular approach would be to tax all land in an area where development was seen as possible or planned. Combining this with new methods of land acquisition to limit ‘hope value’ in the planning system (see above) could help bring more land forward for development at lower prices.

129. From a view that wants more development, there is little point in taxing a dairy farmer’s agricultural land if they do not have the possibility of selling the land for any use except dairy farming.

130. “45% of the permitted homes are in the control of firms that are not builders – firms such as owner-occupiers, investment funds, historic land owners, government and ‘developers’ who do not build. ... Site-by-site interviews suggest the obvious: builders intend to build their sites, non-builders do not. So the fact that non-builders control of almost half of the planning pipeline is a constraint on housing development in London.” (GLA 2013)

131. Reasonable time scales would be desirable in order to accommodate legitimate developers time tables.

132. Inheritance tax postponement if bringing forward land for exception sites for example

Conclusion

The reforms presented here represent a radical set of options to help build the homes we need. The alternative to radicalism is not a comfortable middle way. It will mean England falling far short of producing the housing it needs, with serious detrimental consequences for the economic, fiscal, and social life of our nation.

Every year, year on year, failure to tackle the supply system ratchets up the pressure of England's housing crisis. More households will suffer from overcrowding, more families will struggle with rising rents and large mortgages, and fewer young adults under 30 will be able to leave their parental homes. Ultimately, having a decent, affordable home to call one's own will become the preserve of fewer and fewer people.

Appendix One

Extending the AHP as a spending option

This option would entail an additional £641 million in housing benefit costs for the state due to the higher rents charged on new properties under the Affordable Rent Regime.¹³³ This option also rests on housing associations taking on a greater degree of risk – both market risk and risk from changes to government welfare and housing policy.¹³⁴

Some commentators¹³⁵ therefore feel that the housing associations are beginning to reach the parameters of their ability to deliver under the AHP funding arrangements and that the current grant settlement is not sustainable in the medium term.^{136, 137}

This suggests limits to housing associations ability to borrow at lower capital grant rates. It also strengthens the case for widening the number of delivery actors to tackle England's housing supply challenge (see below).

For these reasons, extending the AHP as currently constituted is seen by many housing associations to be an undesirable option in anything but the very short term:

“This investment model is not sustainable in the medium-to-long term. Whilst it is arguable whether it could be repeated over the next spending period, continuation risks completely exhausting housing associations' long-term capacity”¹³⁸

133. Assuming a proportionate increase between AHP capital investment and development with housing benefit costs - based on the CLG AHP impact assessment of costs over 30 years.

134. The National Audit Office has expressed concerns that there were a number of new risks being taken on by housing associations in the AHP, and that these could undermine the ability to deliver current projections or impose longer term costs upon housing associations. These risks ranged from greater leverage, reliance upon external sources of lending, the health of the property market and the possible impact of changes to the benefit regime.

135. After the 2013 Budget Home Group chief executive Mark Henderson also said he was 'increasingly concerned about the sector's ability to deliver the new homes the UK desperately needs', as tenants were affected by welfare cuts and development funding was reduced. <http://www.INSideHousing.co.uk//6524915.article>

136. HCA figures show the RP sector's debt increased 7.6 per cent to £48.5 billion in the 2011/12 financial year. Anecdotal evidence suggests that some HAs are approaching the borrowing limits set by lenders. Others are already relying on market sales to cross-subsidise lower rents and some big players are now “drawing a line in the sand” in relation to further borrowing *Inside Housing* 28 March 2013 <http://www.INSideHousing.co.uk//6526315.article>

137. It is important to note that there is considerable diversity in the sector. Anecdotal evidence suggests that many older HAs with historically large stocks but little recent development remain with relatively little borrowing. However these providers have displayed little recent interest in building more houses to take advantage of their lower gearing.

138. NHF 2013

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