



cutting through complexity

Building the homes we need

A PROGRAMME FOR
THE 2015 GOVERNMENT

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ACKNOWLEDGEMENTS

This report is the result of a year-long joint project by KPMG in the UK and Shelter to contribute to the crucial national debate on the housing shortage. In October 2013 we published an interim report which summarised our findings from a series of roundtables in the West Midlands, and several other subsequent roundtable discussions.

We have now supplemented our findings from the West Midlands with expert input from the UK and abroad, and with a series of commissioned technical research reports led by Capital Economics, Europe Economics and IPPR, to develop a comprehensive package of solutions to the housing shortage.

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Recommendations in this report

Area for reform	Policy recommendations	Vision
Land Market	1. Introduce "New Homes Zones"	Our vision is for a land supply system that is transparent, efficient and stable and most importantly provides much more land at lower prices
	2. Incentivise the use of stalled sites	
	3. Build new Garden Cities	
	4. Open up the land market with far more data	
House building market	5. Help local builders access finance	Our vision is for a house building sector with many more local builders and more innovative models of development such as custom build. We need the big players running at full throttle, but alone they won't be able to solve the housing shortage. We need to help local builders thrive once more and new builders join the market.
	6. Prioritise stable house prices to help SME builders	
	7. Provide land for custom build	
	8. Level the playing field for builders with national space standards	
Affordable housing investment	9. Boost public and private investment in affordable homes	Our vision is for an affordable housing sector that's well funded, has a variety of developers and produces high quality homes for a wide range of income groups, including social rented homes for those on low incomes and shared ownership homes for middle earners.
	10. Set up a National Housing Investment Bank and use public land in joint ventures	
	11. Raise borrowing caps on local authority building	
Strategic local leadership	12. Put housing at the heart of new City Deals	Our vision is for cities and towns which plan strategically: linking jobs, services, transport and homes. Local leadership will be vital to get us building the new places we need.
	13. Assess housing needs across local authority boundaries	
	14. Integrate major new infrastructure with new homes	
	15. Increase flexibility to make green belt swaps	

Dear David Cameron, Nick Clegg and Ed Miliband,

Everyone now accepts that we have a desperate housing shortage in England.

Each year we build 100,000 fewer homes than we need, adding to a shortage that has been growing for decades. What's more our current house building system seems incapable of delivering growth on the scale required. Growing demand means that without a step change in supply we will be locked into a spiral of increasing house prices and rents – making the current housing crisis worse.

Despite modest efforts to improve supply over many years, there has been no comprehensive plan to get us rapidly building the homes the country needs. If the next government shies away from showing the strong leadership needed, having a home of your own to rent or buy affordably will become a distant dream for an increasing number of people in this country. Rents will rise and homelessness will increase. The economic recovery will be held back by high housing costs, an immobile workforce and unstable housing markets.

In short, the country needs a serious plan to transform housing supply. One that faces up to tough choices, but also sets a new tone for political generations to come – and all Parties need to sign up to it. Solving this problem will take leadership and vision from across the political spectrum at local and national level. All Parties share responsibility for the housing shortage, and all must commit to ending it.

KPMG and Shelter have put together a comprehensive, visionary programme for the next government to get the country building the homes it needs. Taking steps to lower the cost of land for development will reduce the profits made by some land owners, but allow better homes to be built and stimulate a new wave of SME builders who have been squeezed out of the market. Increasing investment to build genuinely affordable homes will mean tough fiscal choices, but reducing the cost of housing will also cut the welfare bill. Introducing new taxes on unused housing land and empty homes will be unpopular with some, but it will get development moving on stalled sites.

There are no easy solutions or silver bullets. Coherent and co-ordinated action is needed at each stage of the development process, to deliver a new vision in the way that housing is provided in England.

This report has been written through close collaboration between housing policy, financial and housing market experts in KPMG and Shelter. It draws on a wide range of expertise and new research to address the problems and propose solutions. We are confident that our programme will create the new generation of homes which are so desperately needed. We look forward to working with you to deliver it.



Marianne Fallon
– UK Head of Corporate Affairs,
KPMG in the UK



Campbell Robb
– CEO,
Shelter

Executive Summary

The housing shortage and its implications

We need to build more homes in England.¹

With rents and house prices rising, a great many are struggling and many more are worrying where their children and grandchildren will be able to live. Across England, a quarter of adults under the age of 35 are living in their childhood bedroom.²

If we do not take firm action to build more homes there will be very worrying consequences for our economy and society. The impacts will be felt in rising homelessness, stalled social mobility, declining pension saving and an ever rising benefit bill. High house prices and often unaffordable private rented housing is already impacting the country's competitiveness, particularly given that migration to the job market in London and the South East is increasing, but it is this market that has the highest housing costs.³

Changing demographics mean we need to build a minimum of 250,000 new homes per year in England to meet rising demand. Last year, we built just 110,000. But the housing shortage is not a new phenomenon: successive governments have failed to get us building at the rate we once did, and no party has yet presented a credible plan to fill that gap.

The broken housing supply system

Over the last 40 years house prices have risen by 3% annually in real terms,⁴ but this price signal has not produced a supply-side response. With every period of rapid house price growth supply has only responded slowly and then declined rapidly when house prices have fallen. Over a long period we can see that this has ratcheted down private market supply from cycle to cycle.

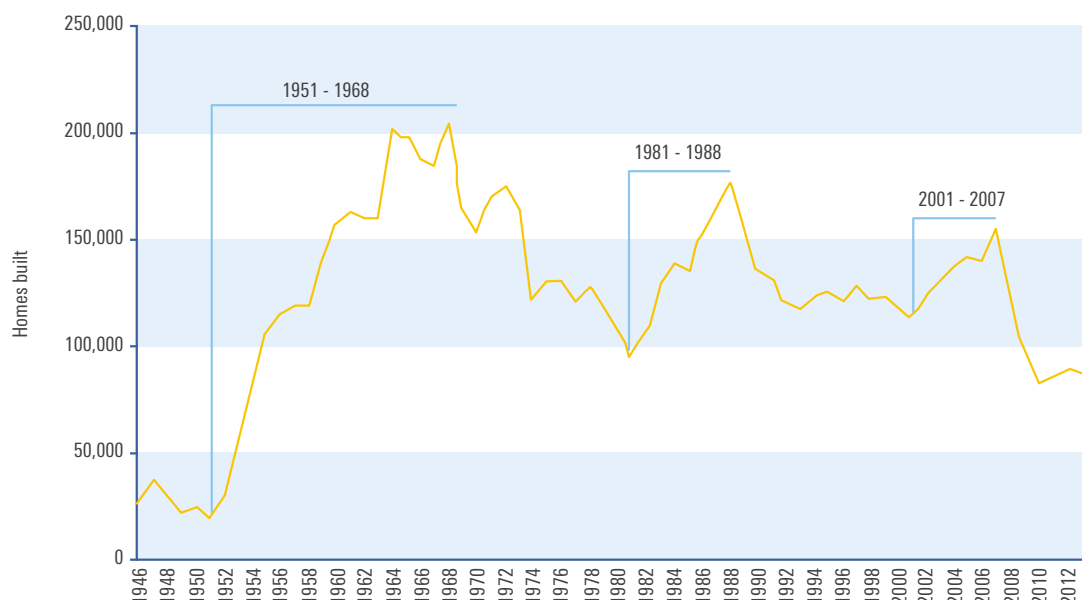
¹ Shelter in England has collaborated with KPMG on this report. Housing is a devolved issue for Scotland, Wales and Northern Ireland. Where possible, all figures in the report will be for England

² ONS, Young adults living with parents, 2013

³ Home ownership has been falling in England since 2003 while house prices have risen faster than inflation or earnings over many decades. DCLG, English Housing Survey and Survey of English Housing (homeownership trends). Barker Review 2004 showed that real mean house price inflation was 3.3% in England over the three preceding decades. Housing as a concern for businesses is demonstrated by CBI/KPMG, London Business Survey, July 2013. Average house prices in London and in the South East are over £300,000 in both regions, the only regions in the UK to be above that level. ONS, House Price Index January 2014

⁴ According to the Barker Review 2004, the long term trend of annual average real term house price growth is 3.3% in the UK

Graph 1: Private sector house building, England 1946-2013

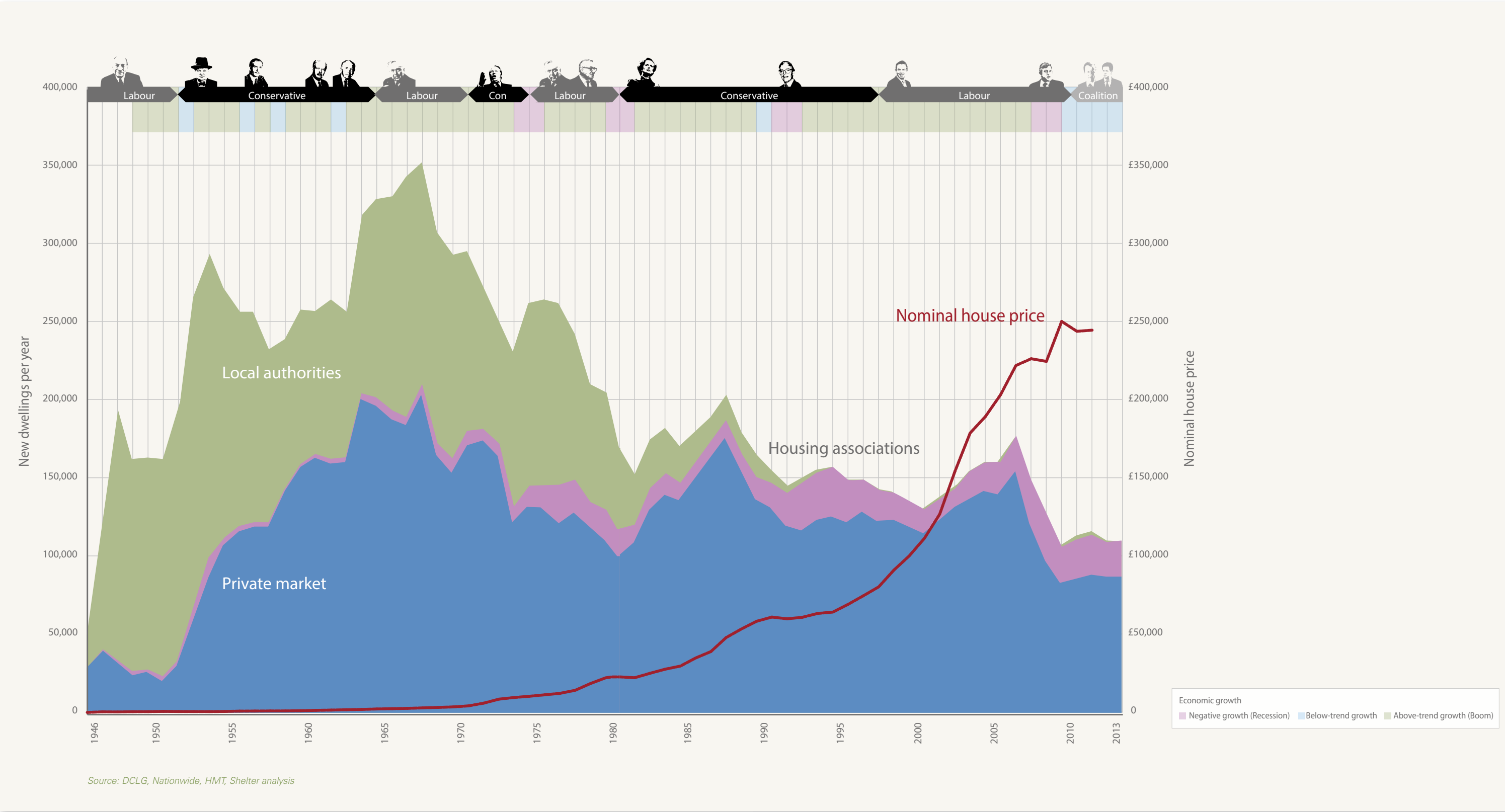


Source: DCLG

The reasons for this systemic failure are many and complex, because house building is a complex, time-consuming and expensive process. Crucially, it is one that takes place at the intersection between three markets: in land; construction; and home sales.

These interactions currently create a housing supply system that consistently delivers too few homes, of variable quality, at very high costs. In seeking to understand and reverse this dysfunctional pattern, our analysis identifies four main problem areas: the workings of the land market; the role of competition in the house building sector; investment in new affordable housing; and the difficulties in gaining local support for development.

House building since 1946



The land market

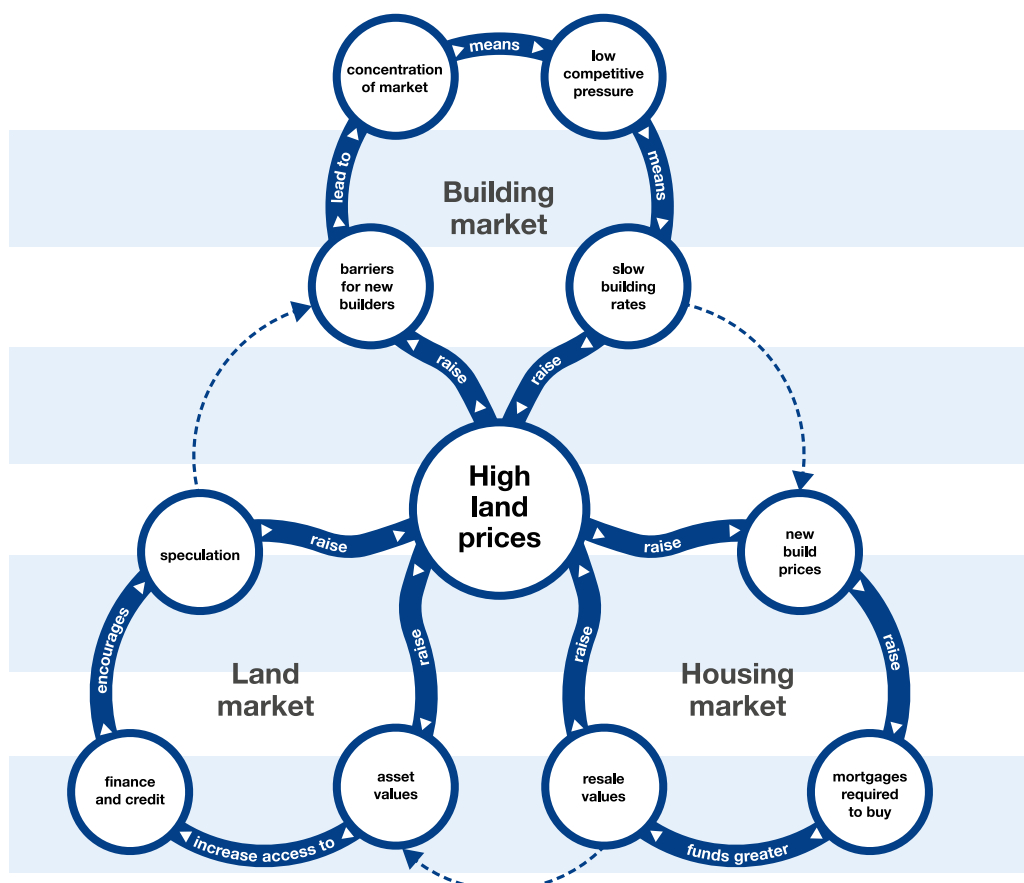
Land is the primary input into house building, but the unique features of the land market have been poorly understood. The primary consequence of the inherent scarcity and permanence of land, accentuated by the planning system and amplified by the financial system, is that land values tend to rise over time. The gain in value that planning permission delivers is generally very high, encouraging strategic land trading, rather than development and also resulting in the most profitable beneficiaries of residential development being the land owner – not the developers, the community or central or local government.

Developers must compete fiercely for scarce land, while remaining uncertain as to what planning permission they will be able to secure. The lack of transparency or published data on land market activity only serves to make this harder. The land market dysfunctions result in a 'land price trap' where development variety and quality is squeezed to increase the price paid to land owners to beat rival bidders. Price competition for land can systematically force down the quality and size of new homes.

Time lags between land purchase and home sales make development highly vulnerable to external shocks or local house price falls. The result is a vicious circle in which high land prices ensure housing output remains low and house prices high – which in turn sustain higher land prices.

Graphic: How the markets in building, land and housing all feed into land prices

High land prices are at the centre of our dysfunctional housing supply system



Competition that fails to benefit consumers

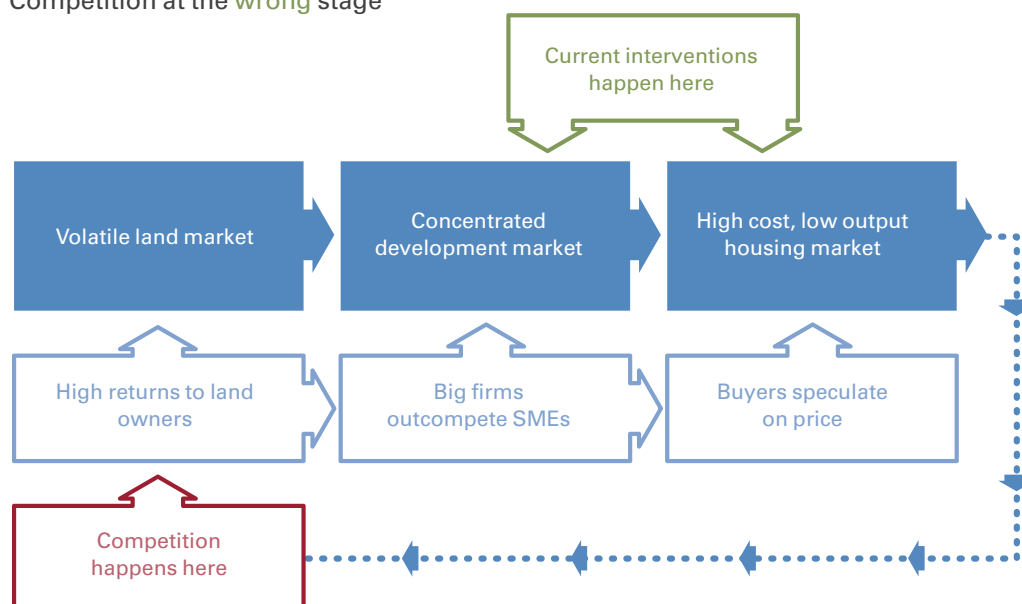
In a healthy market, competition will drive a better deal for consumers. But in house building, competition occurs at the wrong stage.

The rational business strategy to manage land market risks is to minimise build costs and maximise sale prices by releasing homes slowly. This strategy is only possible because there is little competitive pressure at the consumer end of the development process, which might otherwise push prices downward. Competition for expensive land makes it hard for small builders to enter the market or grow. SMEs also struggle to raise sufficient finance from increasingly risk averse banks, leading to ever greater concentration in the industry.

By 2012, 70% of homes in England were built by large house building firms, operating on very similar business models. When house prices soften, these firms tend to reduce output simultaneously, deepening the downturn. These market conditions also effectively exclude custom builders – who typically commission their own homes from local building firms – who in England contribute a far smaller proportion of housing supply than in almost all other countries.

Graphic: Competition is for land, not quality or price for consumers

Competition at the **wrong** stage



Declining investment in affordable homes

Housing supply has always been a mixed economy, and both public and non-profit sectors have critical roles to play. Since local authorities ceased to be significant builders in their own right, we have not built enough homes to satisfy demand in England. Housing associations now supply most of our affordable homes, but have never made up the gap. Despite some small recent steps to allow councils to build again, they remain constrained by caps on their borrowing which are unrelated to standard prudential borrowing rules.

Meanwhile, national government spending has been steadily switched from investing in new homes to subsidising housing costs via housing benefit. Central government now spends more than 20 times as much on housing benefit as on affordable house building grants. With more people now in expensive private rented homes than more affordable tenures, this pressure on the public finances may grow.⁵

Capital Economics' analysis is that "an increased budget for central government capital grant is the most straight forward, practical and efficient method for stimulating building."⁶ Capital Economics recommend increasing investment in affordable housing by £3.4 billion per year as fiscally sustainable and commensurate with the recovery to date.⁷

Not enough power locally

Planning, funding and winning popular support for new homes in these challenging conditions requires strong local leadership. It also requires the ability to co-ordinate plans and provide infrastructure across municipal boundaries. Unfortunately, England's city leaders have far less autonomy than those elsewhere in Europe or America, and England is now the only advanced economy to have no strategic planning for homes above the most local level.⁸

City and town leaders have few incentives or tools to build consensus, and infrastructure provision remains largely independent from housing. This means that support for new house building can all too easily wilt in the face of local opposition – particularly as, all too often, new homes are not matched with integrated social and transport infrastructure and can be densely planned with homogenous design without creating a sense of community. Local people need to know that new developments will work for both them and their children.

⁵ DCLG English Housing Survey, 2012/13 – the number of households in the private rented sector is higher than the number of households in the social rented sector

⁶ Capital Economics, Increasing Investment in affordable housing, 2014

⁷ Ibid. Due to the mixed nature of this package of reforms and investment, the KPMG/Shelter programme can deliver more homes for substantially less spending than this

⁸ JRF, International Review of Land Use and Planning Systems, 2013

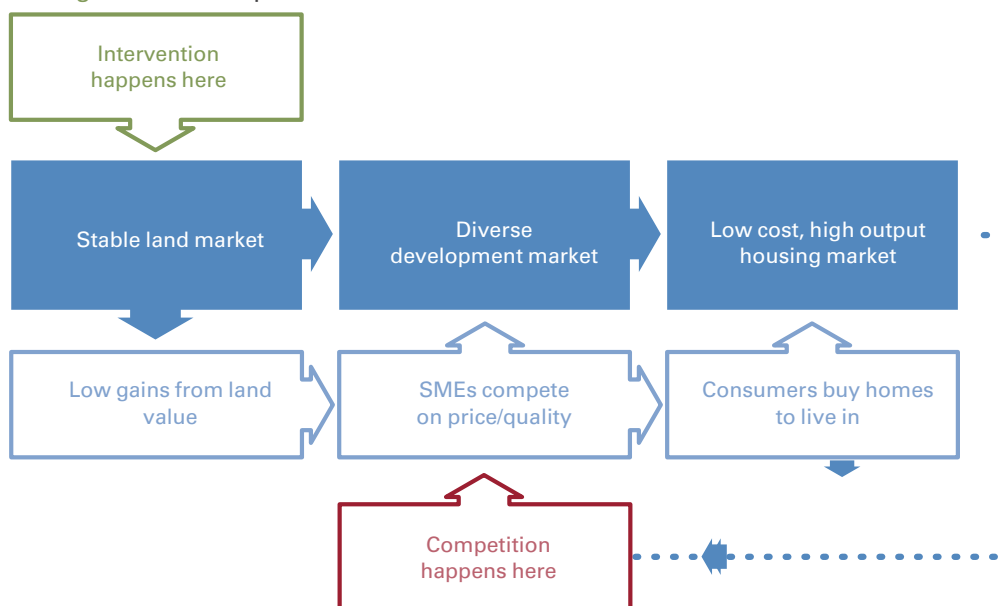
A new vision of housing supply

We need a dramatic step-change in home building. We have to unpick the dysfunctions of the existing house building model, and create a viable and sustainable model for housing supply. One that does not rely on high house price inflation alone to increase

supply; one that can meet affordable housing need; one that creates attractive new places, not comparatively small homes without access to local services. We must reverse the model of a high cost, low output housing sector to a low cost, high output one.

A development process that would benefit consumers

The **right** sort of competition



- **Our vision** is for a land supply system that is transparent, efficient and stable and most importantly provides enough land at lower prices. One in which the gains from development are channelled into supporting infrastructure and affordable housing, rather than into windfall land gains.
- **Our vision** is for a diverse, resilient house building sector, in which multiple builders with varied business models compete for customers on quality and price. We need large developers maintaining their delivery, but we also need to help local builders thrive once more, and to release the latent demand for custom build.
- **Our vision** is for a suitably funded affordable housing sector producing high quality homes for a wide range of income groups, including social rented homes for those on low incomes and shared ownership for middle earners.
- **Finally, our vision** is for cities and towns which can plan strategically for infrastructure, services and homes. Local leadership will be vital to unblocking stalled development, setting out positive local plans, and securing the support of local residents.

People on ordinary incomes should be able to buy or rent a high quality home at a price they can afford today, and have confidence they will be able to afford tomorrow.

If we can solve the dysfunctions at the heart of our housing supply system, we can create a market that builds enough homes,

at reasonable prices, without requiring endless public subsidy. This has already been achieved in comparable countries that have intervened to create more stable housing and land markets, and in doing so have transformed the quality and quantity of their housing stock. We can do so in England too.⁹

⁹ Hall and Falk, Good Cities, Better Lives, Routledge 2013

Recommendations

Achieving this vision will require action across a range of issues. We propose a package of policies to address each major dysfunction:

New powers to get more land in the right places into the hands of those who want to build high quality homes quickly:

- Giving local authorities the power to designate New Homes Zones on strategic sites, which, like Enterprise Zones, would foster low cost development and growth.
- Unlocking stalled sites by providing infrastructure first, then levying Council Tax if the site remains undeveloped.
- Opening up the land market with far more data, creating a level playing field so that small builders can find sites more easily and quickly.
- Building up to five new Garden Cities, using land market models that capture land value to fund infrastructure and high quality development.

Policies to help expand the house building sector, so that it becomes more diverse and resilient to market shocks:

- Helping small builders to access development finance, by switching some of the guarantees allocated for Help to Buy into a 'Help to Build' scheme.
- Taking steps to secure a healthy, stable housing market, following a government review of house prices and property taxes.¹⁰ Medium sized builders are more vulnerable to a volatile market and need stability to thrive.
- Supporting people who want to commission 'custom built' homes from local builders. 20% of land from our interventions outlined above would be set aside for custom build – helping local builders to access land.
- Setting minimum national space standards for new homes so that developers of all sizes have a level playing field and encouraging the highest standards of environmental and design quality.

¹⁰ We do not explore how house prices might be stabilised in detail in this report, but as our analysis argues it is very important to understand the link between the second hand sales market and construction

Recommendations

A package of private and public investment to build many more genuinely affordable homes to rent and buy:

- Increasing public and private investment in housing associations, so that they can build more homes and especially more low rent social homes. Investment by institutional investors should also be supported for private rented homes (e.g. through land market interventions) to relieve supply pressure.
- Introducing a new not-for-profit Housing Investment Bank funded by personal savings ISAs guaranteed by government to provide steady returns. The Investment Bank could provide low cost, long term loans to affordable home providers.
- Developing new models of public private partnerships to provide funding to accelerate regeneration.
- Gradually giving councils more scope to finance affordable housing provision and reform the rules governing their borrowing so that they meet international standards.

Devolving more powers and budgets to successful and growing cities, empowering them to lead smart development locally:

- Putting housing at the centre of City Deals, devolving house building budgets to cities which want to grow, and incentivising councils to work together cross-boundary on long term housing plans.
- Cross boundary assessments of housing need and increased support for planning departments to make them faster and more effective.
- Integrating infrastructure and housing development much more closely, so that new transport links and homes are planned and developed together.
- Giving local authorities more flexibilities to swap small amounts of green belt land and incentivising them to trade sites across boundaries.

Each of these policies is explored and set out in detail in Part III of this report.

Areas for further investigation

Although not explored in detail in this report, it will also be necessary to:

- Create the conditions to encourage institutional new private rented sector entrants to demonstrate a product that can give a genuine long term comparator to ownership.
- Facilitate capacity in the supply chain through: labour market expansion & training; innovation; and giving the sustainability of volume that creates the conditions for building materials providers to capacity build.
- Consider house building specifically for particular demographic needs, particularly housing for older people.¹¹

Programme for the next parliament

The complex interdependencies of the house building sector mean that piecemeal measures, or actions that address only one part of the system, are bound to fail. Clear and decisive interventions across the whole development process are required in order to secure the shift to a more effective and efficient model of house building.

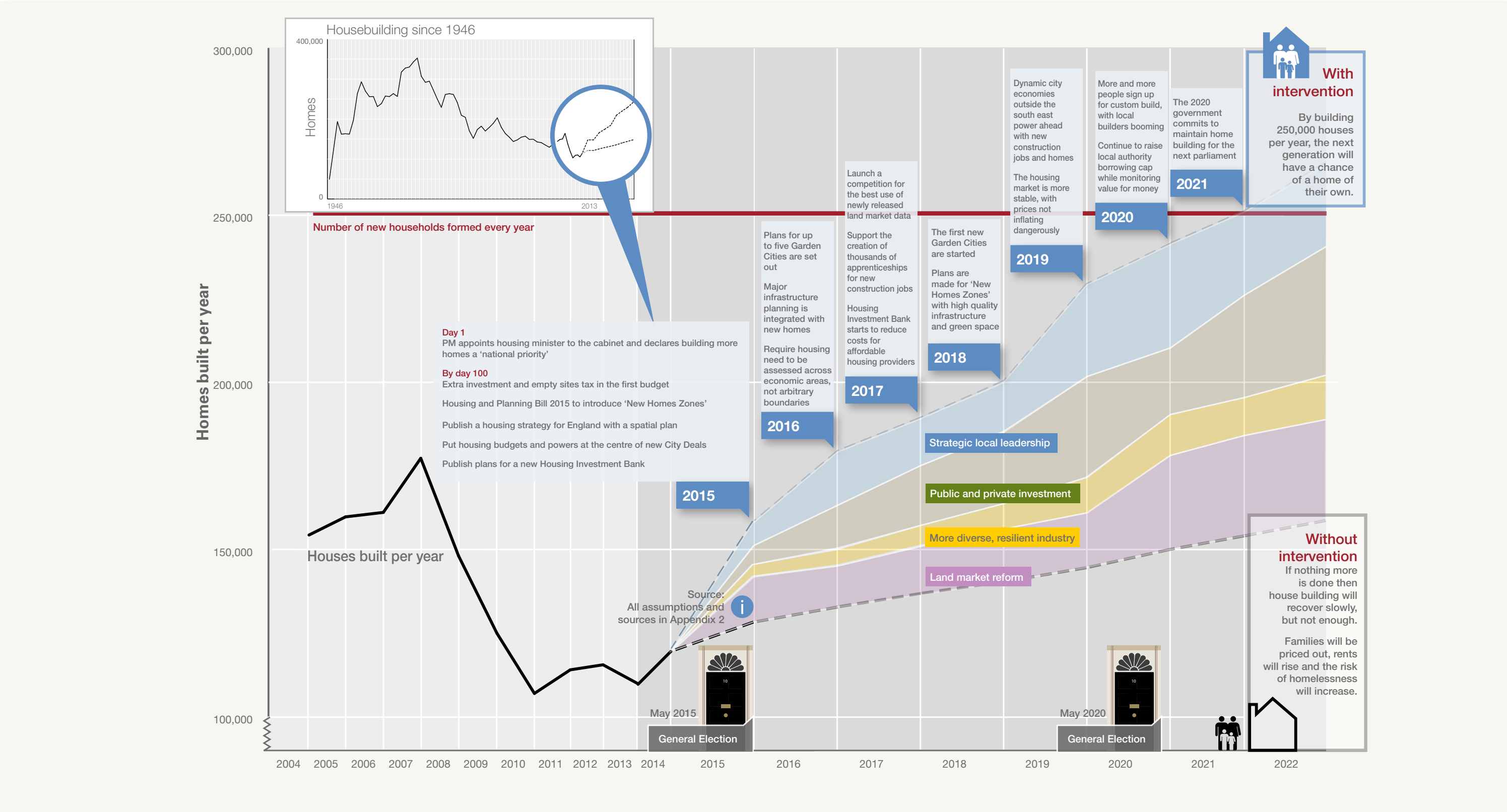
The measures in this ambitious but required package of reform are designed to be mutually supporting. The whole package should therefore be enacted in full and as swiftly as possible.

To achieve the scale of change needed in a politically feasible timeframe we have mapped out a programme for the next parliament, one that will raise output to 250,000 homes a year by 2021 and get the new house building system firmly established.

Whoever wins the next election, we would argue, must make this programme a leading priority for the next parliament.

¹¹ Shelter has looked at housing for older people in detail in Hughes, A Better Fit? Creating housing choices for an ageing population, 2012

KPMG and Shelter programme for the next government



1 The housing shortage and its impacts

The housing shortage and its impacts

England does not build enough homes

England's current house building rate is at less than half of what we need. Each year we fail to build enough homes, we add to the growing backlog of unmet need.

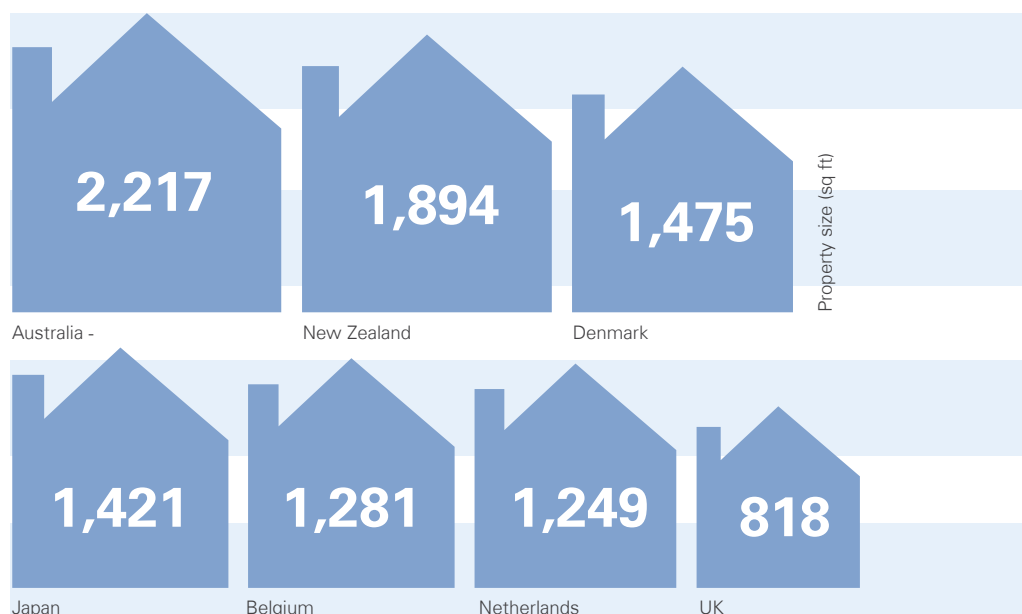
In 2013 just 109,660 new homes were built in England. Apart from 2010, this was the lowest annual level of home building since 1946, the year of recovery after the Second World War. But this homes deficit is not new. For decades, successive governments have failed to ensure the building of enough homes in all tenures.

Not only have we been building far fewer homes than we need, the homes we have built have been getting smaller.¹² Data on average floor-space for new builds is scarce, but industry estimates suggest that new homes in the UK are on average smaller than they used to be, smaller than they need to be, and smaller than those of our European neighbours and other countries worldwide.¹³

¹² RIBA, The Case for Space, 2011

¹³ Housing Statistics in the European Union 2010. Data is for the UK only

Graphic: Average new build home size (sq ft)



Sources: various, collated by Demographia.com

We need to build 250,000 new high-quality homes every year just to stand still

Each year, the total number of households who need a home in England grows by around 250,000.¹⁴ Household growth is typically higher than population growth, as people are living in smaller family units. Total household growth is driven by the birth rate, net migration and changes in the existing population, such as longer life expectancy and the divorce rate.

While these trends may change (for example net migration has declined since 2010),¹⁵ the overall picture is clearly of a growing number of households and an ageing population.¹⁶ Recent projections suggest that the growth in housing need will come particularly from lone parent households and families with three or more children.¹⁷

¹⁴ The government's latest projections are that household growth from 2011 to 2021 will be 221,000 households per year in England. Independent projections by the Centre for Housing and Planning Research, the TCPA and the National Housing and Planning Advice Unit estimate household growth is closer to 280,000 per year. Recent research by the RTPI suggested that the ONS figure could be an underestimate by up to 30% due to the impact of the recession and migration on household formation rates. RTPI, Planning for Housing in England: understanding recent changes in household formation rates, 2014

¹⁵ ONS, Migration Statistics Quarterly Report, August 2013. Net migration (to the UK) in the year ending September 2010 was 255,000 individuals, while in the year ending September 2012 it was 153,000 individuals

¹⁶ ONS, Summary UK Population expected to hit 70 million by mid 2027, 2011. The population of England is expected to grow by 10 million from 2010 to 2035

¹⁷ Holmans and Whitehead, New and Novel Household Projections for England with a 2008 base, TCPA, 2011

Demand is not uniform across the country, with some areas experiencing much higher population growth.¹⁸ Unsurprisingly, the highest levels of projected household growth over the next decade are in London and the South East, with high growth also expected in the South West and Yorkshire and Humber.¹⁹

Years of undersupply have also left a backlog of housing need, manifested in concealed households, rising overcrowding, homelessness and the rise in young adults living with their parents. The most recent estimates suggest the backlog may be as large as two million households.²⁰ To clear this, England would need to build well over 250,000 homes each year for many years, or change the distribution of the existing housing stock - or most likely both. Our target of 250,000 new homes per year is the bare minimum that we need – but it requires more than doubling current output.

Changing dynamics of house building

The most obvious decline in house building has come from the withdrawal of local councils. In all but one of the 30 years from 1948 to 1978 local authorities were responsible for building more than 90,000 homes each year. This was a time of higher rates of demolition of existing stock, especially stock damaged during the war which needed to be replaced and the demolition of slum housing. However, by 1990, the number of homes built by councils had declined to under 15,000 and in 1999

it hit its lowest point at just 50.²¹ Council building has been partly replaced by not-for-profit housing associations, but this has not been nearly enough to plug the gap left. From 1978 to 2013 housing associations delivered on average 18,800 new homes per year.²²

More recently the numbers have fallen further following a 59% cut to the government's capital investment budget in 2010.^{23, 24} To maximise the numbers built with less grant, the government has also changed the definition of affordable homes to include those let at rents of up to 80% of those in the private market.²⁵

Since the decline of local authority house building the total number of homes built annually has become more and more dependent on the private house building industry. Unfortunately private sector output has also trended downward over recent decades.

Private house building in England has been through three major periods of expansion followed by contractions since the Second World War. Each growth period has been shorter than the previous one, and each has peaked at a lower point. The expansionary periods have been more dependent on high house price inflation, and after each crash the recovery has been slower. The result is that, for more than half the period, private house building has either been contracting or stagnant, and total output has ratcheted steadily down with each cycle.

¹⁸ ONS, Household interim projections 2013

¹⁹ Holmans and Whitehead, Ibid

²⁰ DCLG, Estimating Housing Need 2010. In 2010 DCLG estimated backlog housing need at 1.99 million households in 2009, falling gradually as a proportion of all households out to 2021.

²¹ DCLG, Live Table 244

²² DCLG, Ibid

²³ HM Treasury, Spending Review 2010. The definition of 'affordable' was changed in the Localism Act 2011 to include a new tenure product 'affordable rent' which is up to 80% of market rents. Therefore, the fall in the number of affordable homes built masks the fact that there has been a much sharper fall in the number of low social rent homes built since 2010

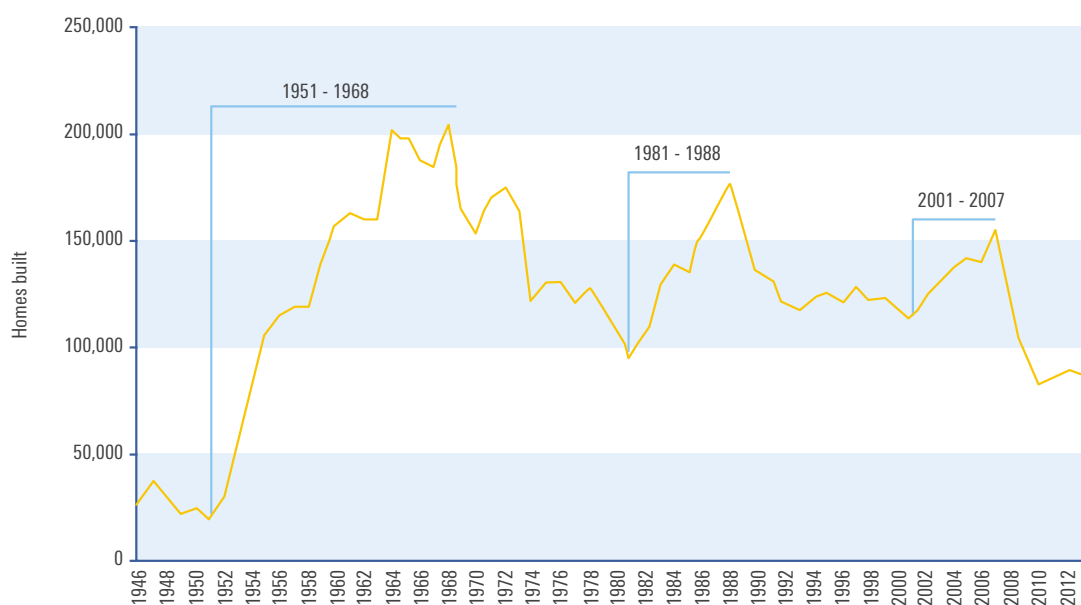
²⁴ DCLG, Affordable Housing Supply: April 2012 to March 2013, England, 2013

²⁵ Localism Act 2011

Cycles in private house building

Expansion Period	Average increase in homes built per year ²⁶	Peak to peak change	Annual house price inflation over period
1951 – 1968 (17 years)	10,770	(203,320)	5.5%
1981 – 1988 (7 years)	11,017	(176,020) -13.4%	11.8%
2001 – 2007 (6 years)	6,560	(154,210) -12.3%	10.8%

Graph 2: Private sector house building, England 1946-2013



Sources: DCLG

The house building industry in England was particularly badly hit by the 2007-08 recession. The market capitalisation of major house builders plummeted, their revenues collapsed and many underwent severe financial stress.

Support from government, leniency from creditors and low interest rates meant that the major builders survived intact, indeed

their market share increased. Most are now seeing rapidly rising revenues, profits and stock prices, as the effects of economic recovery and the government's Help to Buy schemes start to be felt. Nonetheless, industry leaders recognise that the existing private house building sector alone cannot be expected to increase production dramatically.²⁷

²⁶ DCLG, Live Table 244

²⁷ Major house builders were quoted in the Financial Times in September 2013 saying that increasing house building to 200,000 per year was not "physically possible". Builders Attack Ed Miliband's 'wild' plan for 200,000 new homes, FT 25 September 2013

The current impacts of the housing shortage

The failure of the English housing system to deliver the number, quality and types of homes that the country needs is already having serious social impacts, the most obvious of which is that homeownership is now in decline after a century of growth.

Spiralling prices and receding affordability

The failure of housing supply to meet demand inevitably increases house prices and rents – although the lack of building is not the sole cause.²⁸ Between 1971 and 2012 nominal property prices increased by 4,268%. Shelter research has shown that if food prices had risen at the same level an average weekly food shop would now cost over £450.

It is not only food prices that have been outstripped by house prices. If wage-growth had kept pace with house price inflation since 1997, **the average person would be earning £29,344 more a year.** This disparity between house price inflation and wage growth has led to a long-term reduction in the affordability of housing. In the 1950s the average house cost just over four times the average salary, but by the peak of the property boom in 2008 it had risen to over eight times the average salary.

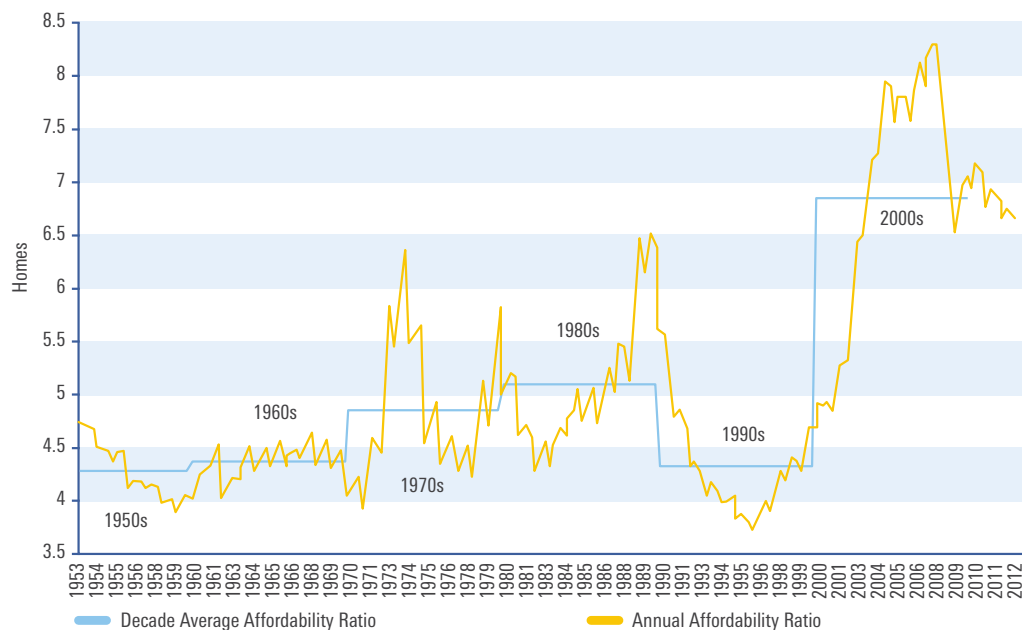
Cost of common food items if they had tracked house price inflation since 1971 ²⁹

Item	2012 Price
A chicken	£51.33
4-pint carton of milk	£10.48
6 bananas	£8.49
Average weekly expenditure on food for a family of four	£454.55

²⁸ For example, rising house prices are also a function of changes to mortgage markets (such as higher loan to income ratios) and the rise of double income mortgages

²⁹ Shelter, Food for Thought, 2014

Graph 3: Affordability ratio as a proportion of gross nominal salary 1953 - 2012³⁰



Sources: Nationwide

³⁰ Nationwide house prices and Lawrence H. Officer, 'What Were the UK Earnings and Prices Then?' Measuring Worth, 2012

It is often assumed that house price growth is popular. But high and rising house prices make it harder to work and save enough to achieve home ownership, so it is no surprise that in fact the majority of people do not want house prices to rise.³¹ Two thirds of the public want house prices to fall or stay the same, compared to a quarter who want prices to rise. As homeownership is now in rapid decline, this trend is likely to continue.

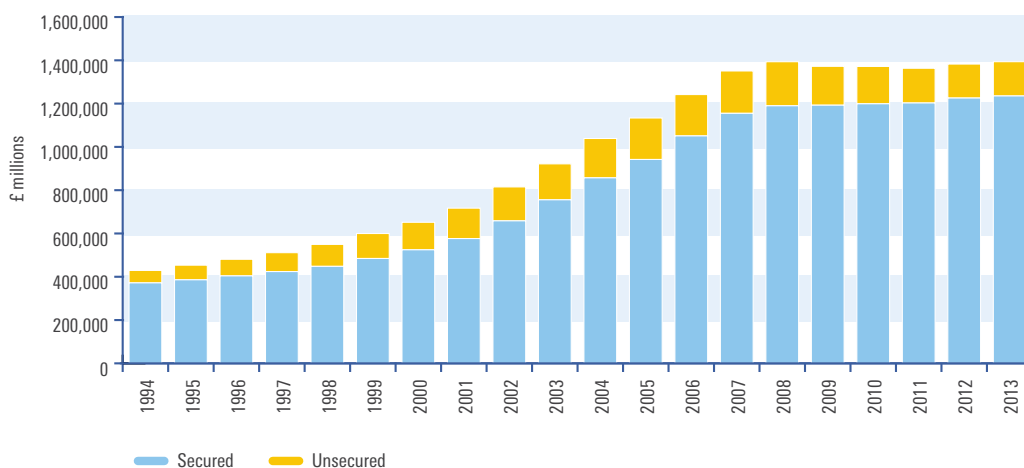
High levels of personal debt and an increasing reliance on the 'Bank of Mum and Dad'

The increasing cost of buying a home has led to a growth in mortgage debt. From 1999 to 2007 the supply of secured lending to individuals grew by 271%.³² National total personal debt levels now stand at £1.4 trillion or £53,000 per household, almost

double the levels of a decade earlier and well above total government debt.³³

But house price inflation has not only driven an increase in the growth of formal credit from lenders. The housing market is now increasingly skewed towards those who are able to access financial support from their parents. In 2011, only a third (35%) of those who took out their first mortgage did so without any assistance, compared to 69% in 2005.³⁵ The 'Bank of Mum and Dad' is now a huge source of finance in the housing market, lending and gifting more than £2 billion per year to help struggling first time buyers, at an average of £17,000 per purchaser.³⁶ While this financial support has helped some people onto the housing ladder, the growing dependence on parental assistance to buy a home has worrying implications for social mobility.

Graph 4: UK household debt³⁴



Sources: Bank of England, Council of Mortgage Lenders Secured and unsecured debt, not including lending to HAS

³¹ YouGov poll for Shelter, total sample size was 4,500 adults. Fieldwork was undertaken 3-9 October 2013. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+). 65% said they would like to see 'house prices stay at their current level' or 'house prices go down'. 10% said that they don't know and 25% that they would like prices to rise

³² Bank of England, Table LPQVTVQ, March 1999 to March 2007

³³ Based on data from Bank of England and Council of Mortgage Lenders. Bank of England table LPMBI2O

³⁴ Bank of England, Council of Mortgage Lenders

³⁵ CML, First Time Buyers and Assistance. Over this period much of the shift was due to higher deposits being required as a result of the banking crisis of 2007, however a return to pre-2007 lending ratios may be neither possible nor desirable

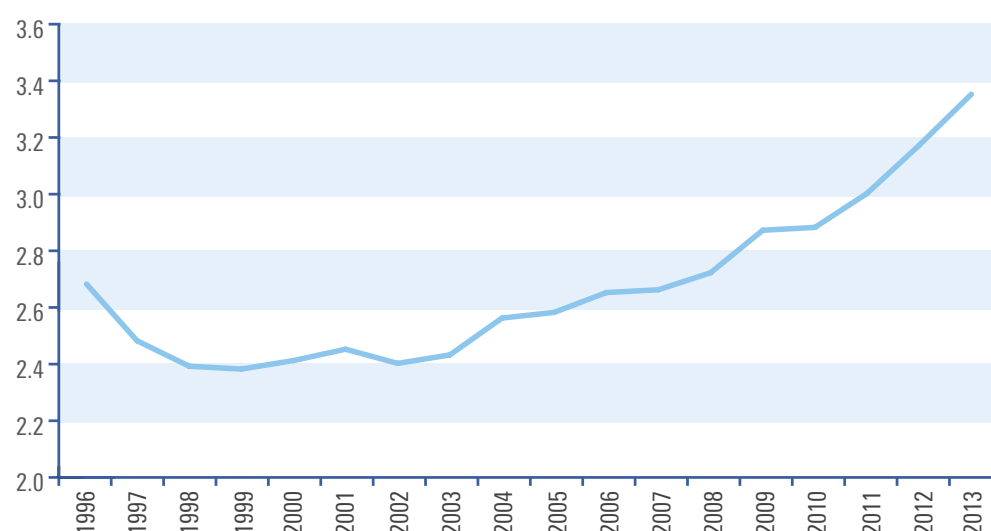
³⁶ NatCen, Support for First Time Buyers, 2013

More young adults are living with their parents and fewer are able to buy

The increasing unaffordability of homes also means parents are being called upon to house their children later into adulthood. Since 1996 the UK has seen the number

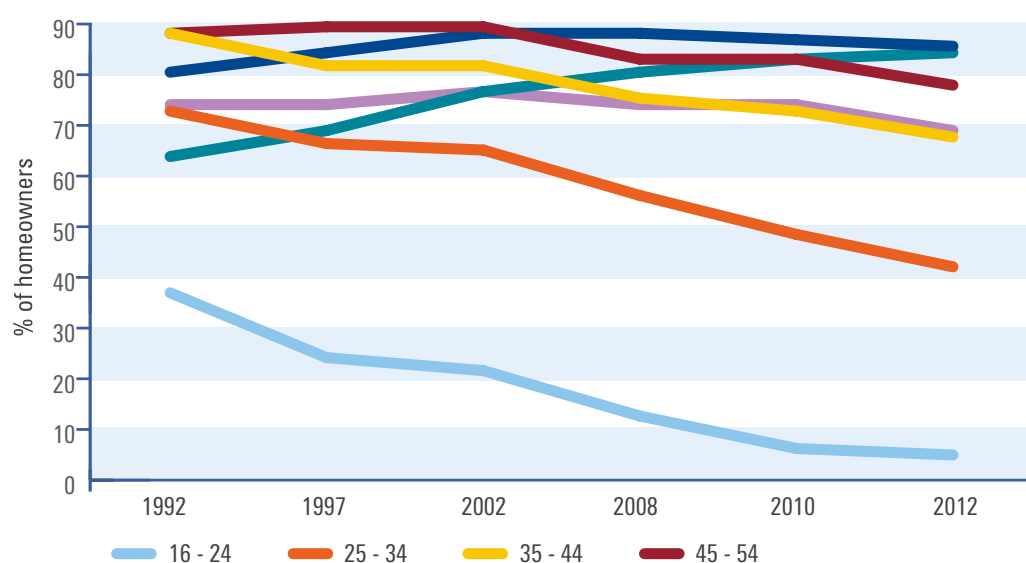
of 20-34 year olds living with their parents grow by 25%, to reach 3.35 million in 2013 – 72% of whom are in work.³⁷ This figure represents one in four young adults and is growing steadily.

Graph 5: Adults aged 20-34 living with their parents³⁸



Source: Labour Force Survey, Office for National Statistics

Graph 6: Home ownership rates, by age group (%)³⁹



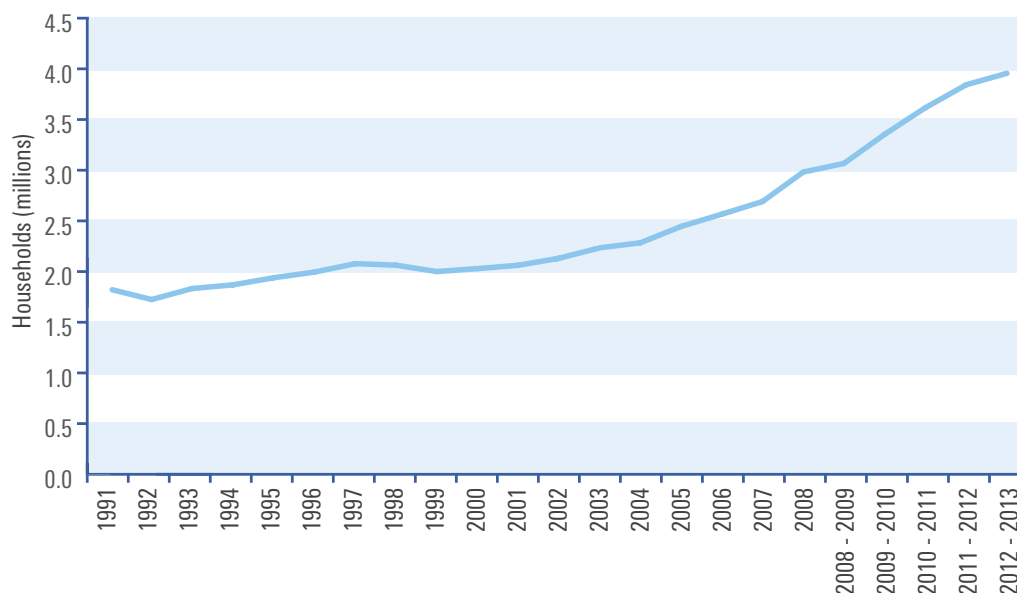
Source: UK Housing Review analysis of Labour Force Survey

³⁷ ONS, Young adults living with parents, 2013

³⁸ Y-axis arbitrary. Labour Force Survey, Office for National Statistics – figure is for the UK

³⁹ UK housing review analysis of Labour Force Survey

Graph 7: Total growth in number of households in the private rented sector⁴⁰



Source: DCLG, English Housing Survey

More people are privately renting

Declining homeownership has also driven a surge in the levels of private renting.⁴¹ In the decade to 2011 the number of households headed by someone under 35 privately renting increased from 1.1 million to 1.9 million. But these young adults are now only a small part of the private rented sector: there are now more than nine million people (in four million households) now living in private rented accommodation in England.

The private rented sector now accounts for 18% of all households⁴² and is increasingly the only option for families; the number of households with dependent children who rent privately has more than doubled in the five years to 2012/13.⁴³

The dramatic shift in tenure has significant impacts on both affordability and security. Private renting is the most expensive tenure, both in cash terms and as a proportion of income taken by housing

costs.⁴⁴ Consequently, more families renting privately means more families spending a greater proportion of their income on housing costs – increasing the squeeze on their overall family budget, and reducing their ability to save for a deposit.

Designed to primarily cater for the young and mobile, the private rented sector is far less stable than other tenures and has the highest turnover rates. Private renters losing their tenancy is now the leading cause of homelessness⁴⁵ and despite the fact that a greater proportion of people still own than rent, in 2013 the number of possession claims within the private rented sector overtook those for mortgagees.⁴⁶ The lack of affordable social housing means that local authorities are increasingly using the private rented sector to house people that they have a statutory duty to help under homelessness legislation, which risks a cycle of homelessness and insecure private renting.

⁴⁰ English Housing Survey / Survey of English Housing (pre 2008-09)

⁴¹ Financial Times, Young People Lose Out as UK's Housing Wealth Gap Widens
<http://www.ft.com/cms/s/0/8d6f2b4e-94bf-11e3-af71-00144feab7de.html#axzz2tbAtYlyi>

⁴² Department for Communities and Local Government (2013) English Housing Survey: Headline Report 2012/13

⁴³ DCLG, English Housing Survey Live Table FT1241 (S117), 2012/13

⁴⁴ DCLG, English Housing Survey Household Report, 2011/12

⁴⁵ DCLG Live Table 774

⁴⁶ Mortgage and Landlord Possession Statistics, October-December 2013

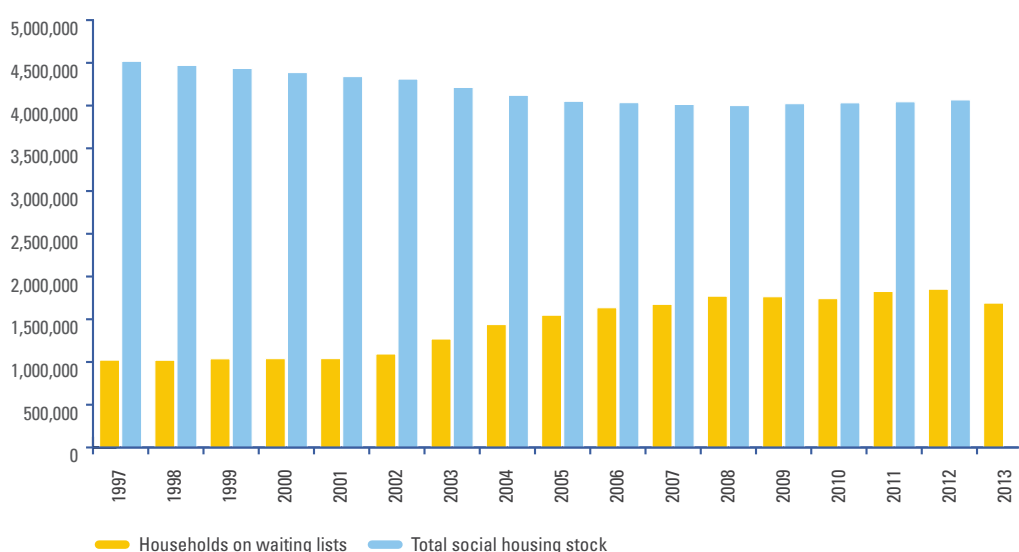
Housing waiting lists have got longer and the housing benefit bill has ballooned

As private housing has become less affordable the number of people in need of affordable housing has grown. The failure of successive governments to deliver new social housing while existing units were sold off under the right to buy has pushed waiting lists upward, although recent changes to the rules on who can apply have led to a slight decline in total numbers on official waiting lists.⁴⁷

The lack of social housing has led to an increasing reliance on the comparatively-

expensive private rented sector to provide housing for those who cannot afford their own home, which has inflated the annual housing benefit bill. Although the rise in unemployment caused by the 2007/08 recession did increase the housing benefit bill, the shift from social to private rents remains the largest driver of the rise in housing benefit expenditure.⁴⁹ This long term trend has seen the amount spent on housing benefit double in twenty years, from £12 billion in 1992-93 to over £24 billion in 2012/13 in real terms, despite recent falls in the rate of unemployment.⁵⁰

Graph 8: Social housing waiting lists and stock⁴⁸



Sources: DCLG Live tables 600 and 104

⁴⁷ Housing Strategy Statistical Appendix Data 2010, Communities and Local Government, 2010. DCLG Live Table 600

⁴⁸ DCLG Live Table 600 and 104

⁴⁹ Shelter, Bricks or Benefits, 2013

⁵⁰ DWP, Benefit Expenditure and Caseload tables 2013. ONS, Labour Market Statistics February 2014

What will happen if we take no further action?

One of the options for our politicians is to treat the housing shortage with 'more of the same'. This would mean a continuation of piecemeal efforts to stimulate housing supply, combined with a focus on stoking housing demand with finance products. This has been the approach to housing supply of successive governments for decades.⁵¹

More of the same means that we will never build as many homes as we need just to keep up with our growing and ageing population, let alone address the backlog of housing need. It also means that the quality of our new homes, their size and their affordability are very unlikely to improve for the next generation compared to the previous.

More people will be priced out of a home of their own

If nothing is done to increase the supply of homes, house prices will almost certainly continue to rise faster than wages, pricing yet more people out of home ownership. The Office for Budget Responsibility (OBR) currently expects house prices to rise faster than average wages across the UK for the period 2014 -2016,⁵² while Oxford Economics suggest that house prices will rise 35% by 2020 and Savills forecast prices will rise 25% by 2018.⁵³

Forecasts suggest that without significant intervention home ownership will continue to fall, led by a decline in mortgaged home ownership among younger age groups.⁵⁴ This is likely even with the intervention of schemes such as the Help to Buy equity loan, which is targeted at first time buyers. The Help to Buy equity loan scheme provides £3.5 billion of subsidy and is expected to help up to 74,000 households in three years, not nearly enough to reverse the trend of declining home ownership.⁵⁵ There is also a risk that the scheme will contribute to increasing house prices, especially in the new build sector, making it harder for new households to afford a home over the medium term.

⁵¹ SMF, The Politics of Housing, 2013

⁵² OBR, Economic and Fiscal Outlook, December 2013

⁵³ NHF, Home Truths, 2013 and Savills, Residential Property Focus Q4 2013, October 2013

⁵⁴ CCHPR, Trends in Tenure, Shelter and Resolution Foundation 2011

⁵⁵ [Help to Buy Equity Loan, gov.uk](http://www.help-tobuy.gov.uk)

Home ownership will be determined by inheritance, not hard work

The trend towards less affordable housing will mean that the increasing reliance on 'The Bank of Mum and Dad' will continue. Over time it will become ever more likely that home ownership will become determined by inherited wealth, rather than hard work and careful saving, leading to a deepening social divide between those with access to equity and those without. Already it is estimated that a third of purchases of homes in 2013 in England and Wales were by cash buyers rather than those leveraging a salary with a mortgage.⁵⁶

More adults will have to live with their parents, and more families will be stuck renting

With house prices out of reach and rents relative to incomes stubbornly high in many parts of England, it is likely that the trend towards young adults staying in their childhood bedroom will continue.⁵⁷ Attempts to reduce the growing housing benefit bill (see below) are also likely to accelerate this trend.

As house prices climb further out of reach and with affordable housing in short supply, the private rented sector will also continue to grow. Increasing demand will make securing and affording a private rented sector home increasingly difficult, meaning that renters as well as first time buyers will increasingly find themselves priced out.⁵⁸ Without substantial changes in the way the private rented sector operates, this will serve to widen the social divide between families living in insecure rented accommodation and those with the security of ownership or a social tenancy.

⁵⁶ Hamptons International Research, Focus Cash Buyers, 2013

⁵⁷ Shelter, The Rent Trap, 2013

⁵⁸ Crisis, Homelessness Monitor, 2013

Homelessness is likely to rise

Short term tenancies and high market rents also make the private rented sector precarious for many renters. Evicting private tenants is relatively easy, so increased demand pressure may increase the risk of homelessness and deter tenants from challenging landlords. Likewise the shortage of suitable accommodation will make households less likely to challenge poor conditions, driving down standards.

With more people unable to find any accommodation at a price they can afford the number of hidden and statutory homeless households will increase. Nonetheless, the official statistics may underplay the extent of housing need because of changes to the ways local authorities can respond to homeless households seeking help, and the pressure to reduce the numbers of people accepted as homeless.

Pension saving will fall and pensioner poverty increase

Recent research by the Strategic Society Centre has shown that being a private renter is the single largest correlating factor with someone choosing not to save for a pension, despite being eligible to do so.⁵⁹ This is particularly important as we move towards an opt-out workplace pension system, which will allow those eligible to choose not to save. Growing numbers of private renters are a clear risk to the government's preferred pension policy.

These trends make it likely that a large group of private renters with high housing costs will reach retirement age without any financial assets (homes or pensions). This is not just a problem for the distant future. Already, almost half of all privately renting households are headed by someone over the age of 35, and more than a million are headed by someone over the age of 45.⁶⁰

Housing benefit spend will grow and put pressure on the total welfare bill

If we don't build enough homes, the numbers who cannot afford to keep a roof over their head will grow and the bill for housing benefit needed to support them will increase. The government currently forecasts that spending on housing benefit will rise from £24 billion in 2013/14 to over £26 billion in 2018/19 in real terms.⁶¹

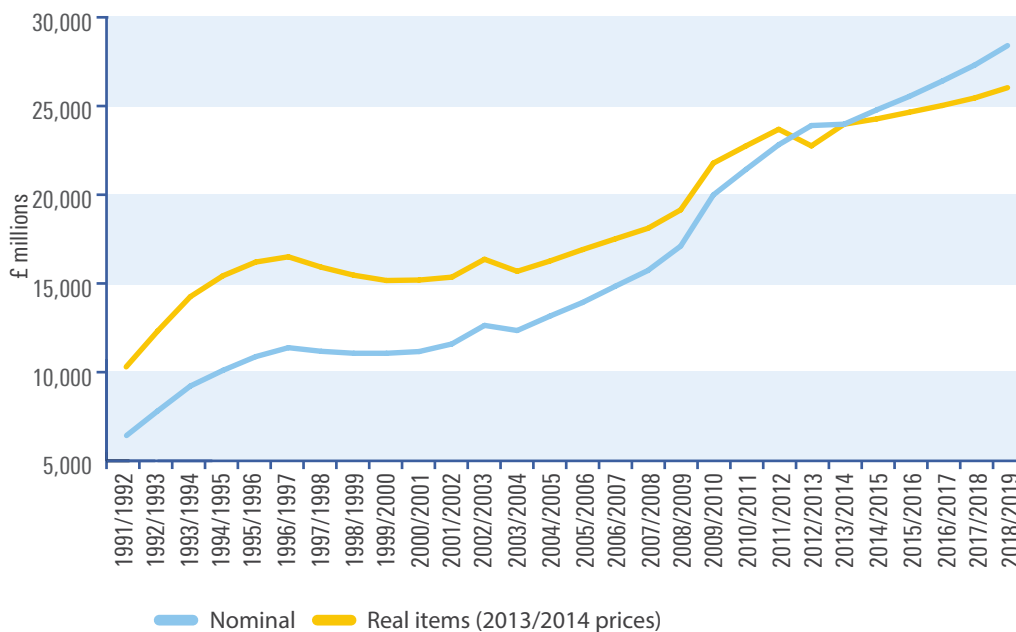
Without an increase in spending on affordable housing, the growing call on housing benefit and the introduction of a cap on the total welfare bill from 2015 will create difficult policy choices for government. A number of proposals for how to limit spending on housing benefit have already been mooted, including removing entitlement for under 25s. How much any of these measures would save without significant consequences for those impacted by the cuts, however, is uncertain.

⁵⁹ Bryan and Lloyd, Who saves for retirement 2: Eligible non savers, Strategic Society Centre

⁶⁰ DCLG, English Housing Survey, 2012/13

⁶¹ Autumn Statement 2013, Table 1b: Expenditure by benefit, £ million, real terms (2013/14 prices)

Graph 9: Housing benefit expenditure nominal and real (including forecast) ⁶²



Source: DWP, Benefit Expenditure and Caseload Tables 2013

⁶² DWP, Benefit Expenditure and Caseload Tables 2013

2 England's broken supply system

England's house building system is broken. Over the last forty years, the price of the product it makes has risen by 3% annually in real terms.⁶³ In any properly functioning market, this sort of price signal would lead to a supply-side response. But our private house building market has gone in the opposite direction, ratcheting down supply after each recession and delivering the housing shortage that England faces today. There is no individual problem in the housing supply system which is causing this outcome, but a number of self-sustaining and self-reinforcing problems that must all be addressed if the housing shortage is to be rectified. Shelter and KPMG have identified four main problem areas lying behind this dysfunction in the housing supply system:

- the land supply system
- the house building sector
- investment in affordable housing
- building local consensus

In the next section, we propose the ways to fix these problem areas.

Problem: The land supply system

Land is the primary input into house building, and is traded freely in the market with the only restriction that transactions must be recorded at the Land Registry. But the land market is like no other. A finite supply, long time lags, information asymmetries, and extremely high and volatile prices create large risks, incentivising speculation and distorting the behaviour of all the participants in the market.⁶⁴ The price of development land is based on the sales value of the homes that can be built on it. But unlike any other market, the price that new homes will fetch is determined by the market in existing homes. Land differs from all other raw materials in this regard: for example, the price of steel to build new cars is not dependent on the price of second hand cars. Understanding its particular characteristics is central to our analysis of the failure to build enough homes.

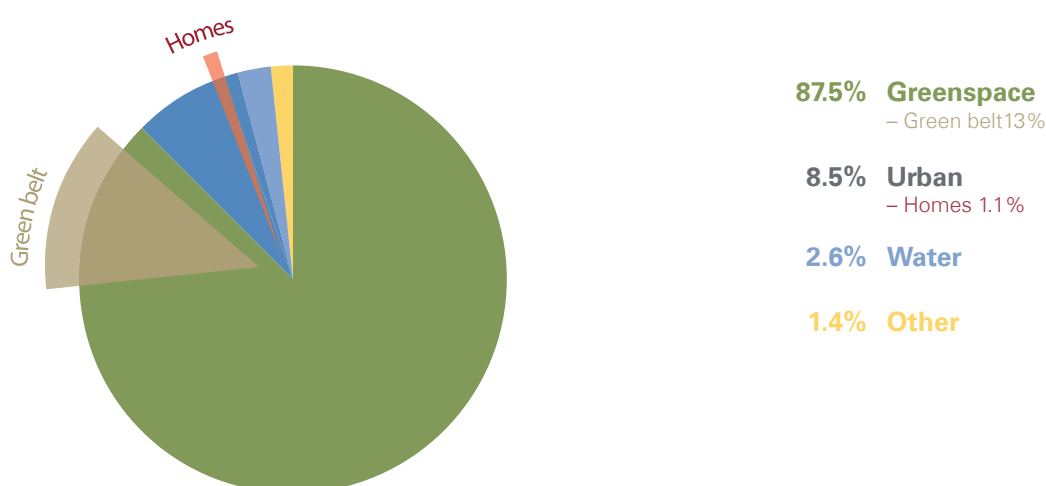
⁶³ According to the Barker Review 2004, annual average (mean) real terms house price growth is 3.3% in the UK (1971 – 2001). This is much higher than the European average 1.1%

⁶⁴ FTI, Understanding Supply Constraints in the Housing Market, 2012

Peculiarities of the land market

Land is unique among the primary factors of economic production because it is naturally scarce. The total amount of land does not change (barring small amounts of coastal erosion and reclamation), and the right locations for development are even more limited in number, and so tend to be very valuable. Land is inherently scarce in the economic sense - which is not to say that there is not enough land for new homes. The major part of England is undeveloped: just 10% of land is classed as 'urban' and only 1% has domestic buildings built on it.⁶⁵ Rather, inherent scarcity makes the land market operate differently from other markets. Naturally limited supply, concentrated land ownership and a restrictive planning system means that the normal economics of supply and demand fail to operate, as higher demand for land does not translate into an equal supply side response.⁶⁶

Graphic: Land use in England, including green belt and homes



Source: Generalised Land Use Database, 2005; Green Belt (Parliamentary Note, Green Belt 2014).

While soil richness or mineral resources can be depleted, the locational value of a site is essentially permanent. Being inherently both scarce and permanent, land holds value over the long term, making it a desirable asset class for those with capital to store. It also makes landed property ideal collateral for loans, encouraging the financial sector to allocate credit to buyers and owners of land.⁶⁷ Leveraged investment makes the land market (and the home ownership market) even more prone to volatility, which increases the opportunities and incentives to speculate on future land price rises.

The land market is also unusually opaque. Land prices are difficult to obtain, and harder to benchmark against anything else. Despite compulsory registration, the ownership of land is not always clear in practice and private 'option agreements' between land owners and developers mean that much of the potential development land is tied up in private agreements hidden from competitors, local residents and public authorities. It is very difficult for developers to know how much a piece of land is really worth, as its value depends on a whole host of contingent variables, not least the planning system and future house prices. This uncertainty makes development a risky business.

⁶⁵ Defra, Natural Ecosystems Assessment, 2011

⁶⁶ FTI, Understanding Supply Constraints in the Housing Market, Shelter 2012

⁶⁷ Where does money come from? Tony Greenham, Josh Ryan-Collins, NEF, 2012

RESIDUAL LAND VALUATION

Every site is different, and the value of it depends on what planning permission can be achieved, and what market conditions will prevail when development is completed. In conditions of such uncertainty, how does a developer know what to pay for land? Those in the development and property industries have to estimate the 'correct' price for a piece of land using what is known as the 'residual land value' methodology.

Graphic: Land prices are set through competition to squeeze other costs



At its simplest, this method works backwards from the end of the development process. The developer starts with the number of homes they expect to fit on the site, and what they expect to sell them for to give a total scheme value. They then subtract how much it will cost to build them and their own profit. The remainder is the 'residual land value' – the price they can offer the landowner. Several developers are likely to make offers, based on the same method but with varying assumptions, and the landowner can accept the offer of whoever pays the most for land. Once this is paid, the landowner has no further risk – but the developer carrying a whole series of risks, such as planning delays, construction problems, interest rate changes and, most importantly, house price variation. The residual land value model of bringing land into the system, means that high density development with the lowest possible affordable housing and infrastructure provision is systematically prioritised, with windfall gains for land owners.

Finally, the land market is subject to a unique form of regulation. While land ownership is mainly private, and transactions occur in a free market, the right to develop land is publically controlled via the planning system. As the value of land depends almost entirely on what it can be used for (see table below), the planning system is a major driver of the motivations and activities of all the economic participants involved in development.⁶⁸ Restrictions on land use reduce the supply of land at the right price in the right places. For example, green belt designation in the South East restricts development around London and forces expansion beyond the green belt with people commuting across it in huge numbers.⁶⁹ The land-use planning system

is also subject to intense, localised political pressures, as planning decisions are typically taken by elected local councillors, which serves to increase the uncertainty faced by developers.

But although the planning system institutionalises the scarcity of land, and provides a political mechanism for allocating its use, planning is not in itself responsible for land being scarce. It is the other way around: all modern societies have some sort of land use planning system because land is inherently a scarce resource.

Table: The value of land is dependent on its use ⁷⁰

Area	Residential land value (£/Ha)	Industrial land value (£/Ha)	Agricultural arable land value (£/Ha)
East	2,900,000 (Cambridge)	740,000 (Cambridge)	16,055 (Cambridgeshire)
East Midlands	1,200,000 (Nottingham)	500,000 (Nottingham)	16,055 (Derbyshire)
London Outer	4,037,500 (Croydon)	2,000,000 (Croydon)	19,760 (Kent)
North East	1,300,000 (Newcastle)	225,000 (Newcastle)	14,254 (Northumberland)
North West	1,500,000 (Liverpool)	450,000 (Liverpool)	N/A
South East	4,000,000 (Oxford)	1,000,000 (Oxford)	19,760 (Oxfordshire)
South West	2,200,000 (Bristol)	850,000 (Bristol)	17,290 (Wiltshire)
West Midlands	1,200,000 (Birmingham)	650,000 (Birmingham)	18,525 (Shropshire)

⁶⁸ Examples are given in Leunig, Community Land Auctions: working towards implementation, Centre Forum 2011. In Oxford, the difference per plot between industrial and residential land use is £75,000

⁶⁹ Hall, Good Cities, Better Lives, 2013

⁷⁰ Valuation Office Agency, 2010. Data has not been collected since 2011. Data taken from three reports: The Agricultural Land and Property Market, The Industrial Land Market and the Residential Building Land Market

Consequences of the unique nature of the land market

The primary consequence of the inherent scarcity and permanence of land, accentuated by the planning system and amplified by the financial system, is that land values tend to rise over time, as they absorb the gains from economic growth.⁷¹ Crudely, most of the value created by development accrues to land owners. In practice land values do not capture all the gains of economic growth, but even a cursory glance at the housing market will confirm that land markets successfully capture much of the financial gains from public investment in, for example, new train stations or better schools, and translate these into higher property prices.⁷²

On top of the long term tendency to rise, land prices are driven by short run expectations of house price growth which is highly volatile and determined by a large number of factors, most of which are external to house building,

such as interest rates.⁷³ The land market amplifies this volatility as speculators and builders bid for a finite supply of development land based on expectations of future house price growth, meaning that land prices are even more prone to rising rapidly in booms and falling heavily in busts.⁷⁴

The high gains to be made from land trading or the granting of planning permission create strong incentives for entry into the land market by intermediaries and speculators. Land owners, or speculators who acquire cheap land and promote it through the planning system, can demand extremely high prices from developers desperate for shovel ready sites – extracting value that could otherwise support build quality, affordable housing, and developer margins. Speculation is not restricted to private market firms: public bodies can have exactly the same incentives to hold land out of the market as values rise. In the Netherlands local authorities have recently run into fiscal difficulties after speculating in the land market.⁷⁵

⁷¹ IPPR, *We Must Fix It*, 2011 shows data on rising land values through the house price cycle

⁷² Why aren't we building enough homes? Toby Lloyd, in *Green Conservatism*, Green Alliance 2013

⁷³ Other factors are credit market conditions and consumer sentiment. A developed list can be found in *Shelter*, *At any cost?* 2013

⁷⁴ IPPR, *Forever Blowing Bubbles: Housing's Role in the UK Economy*, 2011

⁷⁵ Author conversation with KPMG in the Netherlands

LAND BANKING

There has been much debate around whether 'land banking' by house builders is a problem – and even whether it occurs at all. Given the time it takes to get sites through the planning system and built out, retaining a stock of land with permission can be an appropriate business strategy for managing pipelines and smoothing out the peaks and troughs in resource allocation. Various studies have argued that the amount of permissioned land held by developers is not excessive, for example, in 2008 the OFT found that these 'current land banks' amounted to only just over three years of land supply.⁷⁶

But developers also hold 'strategic land banks' – sites without planning permission that they may wish to promote one day. These sites are more likely to be green field, and are often held under option – meaning that they are not recorded as being in the developer's ownership at all, and that there is no public record of where or how large such strategic land banks are. The OFT estimated that 82% of developers' land was in strategic land banks. These may present barriers to effective market operation – but as there is no public record of options agreements it is difficult to assess if this is a problem.⁷⁷ We believe that the incentives to get strategic land through planning are very high given the value uplift that it drives, so expect any issues to be more at the strategic and local planning level, with a lack of visibility over land control and intent meaning that it is less easy to match planning strategy with land that is controlled by developers and hence more likely to be able to be brought forward quickly for development. More worryingly, much developable land seems to be held out of production in the hands of owners who do not intend to develop it, but seek to make speculative profits from land trading. There is evidence that since the financial crisis hit, a growing proportion of developable land has come to be held by non-development firms. A Greater London Authority (GLA) study found that 45% of sites with planning permission in London were owned by non-developers.⁷⁸

So while 'land banking', narrowly defined, is not the primary problem, the rational motivations and business strategies of the owners of developable land can contribute to many of the dysfunctions of our housing supply system. Getting more developable land into the hands of those with the incentive and the ability to build rapidly must be a key objective of housing supply reform.

High land prices, the lack of market transparency, and the growth of non-developers speculating on future price gains all make it difficult for new developers to enter the house building market. The absence of any serious competitive threat to the existing business model of land acquisition helps to explain why house building has become increasingly concentrated in recent decades, and why historically the industry has proved relatively slow to innovate.

Lack of transparency makes it more difficult for local authorities to understand and operate effectively within their local development market. Not knowing who really controls which sites reduces their ability to plan strategically, particularly when identifying their five year land supply, while lack of clear market price data weakens their hand in negotiating Section 106 agreements with developers.

⁷⁶ Office for Fair Trading [OFT] (2008) Homebuilding in the UK: A market study, London: OFT

⁷⁷ For an explanation of how house builders operate land banks see Shelter, Solutions for the Housing Shortage, 2013

⁷⁸ Molior, Barriers to Housing Delivery, GLA, 2012

Impact on the business model of developers and house builders

Because house building starts with land, all of these land market issues feed through to the development process and fundamentally shape developers' behaviour and business models.

Developers must guess the future sales price of homes many months or years in advance of a sale in order to determine how much to pay for land. This creates the land price trap: whoever bids most optimistically – either betting on higher house prices or lower build costs will win the site. This ratchets up the target price at which builders must sell homes to make their profit margins, forces down the quality and size of new build homes, and puts downward pressure on affordable housing obligations.

The land price trap also means that development tends to be close to the margin of viability – and hence vulnerable to any shock. Falls in house prices leave land owners and developers with assets which cannot be developed at a sufficient margin over the price paid for them. Developers then have

a choice between selling at a lower margin, or even at a loss, or waiting for prices to regain the level previously expected. In recent cycles, the evidence is that market participants choose the latter strategy wherever possible.⁷⁹ This means that even a small fall in house prices can cause house building to collapse, as developers wait for margins to recover. Such 'stalled sites' may or may not be entirely uneconomic to develop under current conditions – it may simply be that their owners have calculated that better returns can be made by delaying development. The impact on land values is even more accentuated. Selling the land to someone else, therefore, is more likely to crystallise a loss. These calculations are driven as much by the investment strategies of the owners and the specific financing arrangements of the site, as by general development market conditions.

House price volatility and time lags means that developers are exposed to risk on their balance sheets throughout the development process, making them risk averse.

⁷⁹ See discussion of major developers' annual reports in Solutions for the Housing Shortage, Ibid

Impact of the land market on housing supply

The surest way to reduce risk is to minimise the chances of localised over supply under cutting sales prices by limiting the number of homes built. A developers' rule of thumb is that a show flat in a new scheme will result in around one sale per week – meaning that it is unwise to complete more than 50 units per year on any one site. Building out at a rate to sustain sales prices is a rational, even inevitable, response to the high land costs and volatile housing market that make development so risky.

The combined effect of these interrelated features of the land market is that market participants compete fiercely for scarce land, pushing up the price and delivering windfall gains for landowners. This means the development process is highly vulnerable to shocks, requiring developers to minimise build costs and maximise sale prices by building at a rate that is not related to demand for homes, but demand for homes at certain prices. This strategy is only possible because barriers to entry and market concentration mean there is little competitive pressure at the consumer end of the development process, which might otherwise drive down margins. Competition is focused on acquiring land, rather than satisfying consumers. The result is a vicious circle in which high land prices ensure housing output remains low and house prices high – which in turn feed back to sustain higher land prices.

Is major planning reform necessary?

Demand for homes has grown steadily stronger but the amount of new land made available for homes via the planning system has been falling for decades.

Land-use planning is clearly central to the supply of land into the market, so it not surprising that many commentators have identified major reform of the planning system as a silver bullet to solve the housing shortage.⁸⁰

Broadly, proposals for systemic planning reform fall into three groups:

- (i) liberalising planning by relaxing restrictions on land use (such as green belts and SSSIs) and reducing the obligations on developers.
- (ii) changing the way land use planning is conducted to reduce the role of 'top-down planning' and increase community involvement.
- (iii) moving to a less discretionary, more plan led system.

In practice, planning is a complex system and each of these approaches may have merits in particular circumstances. For example, in this report KPMG and Shelter endorse more flexibility for councils in setting their green belt boundaries and a more strategic planning system. The Coalition government has already introduced significant reforms to the planning system, including scrapping Regional Spatial Strategies, simplifying planning principles into a 50 page National Planning Policy Framework and devolving many powers to a local or neighbourhood level. These reforms can be seen as a combination of the second group, while others like the renegotiation of Section 106 agreements under the Growth and Infrastructure Act 2013 are clearly in the first category.

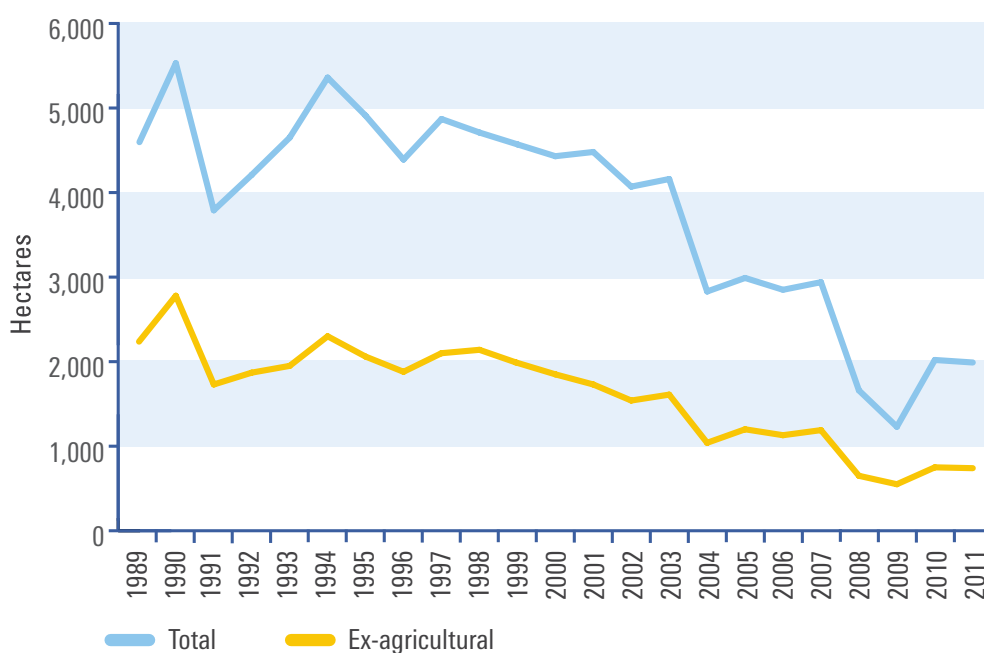
⁸⁰ See Leunig, Community Land Auctions, Moving Towards Implementation, 2011 or Morton, Why Aren't We Building Enough Attractive Homes? 2012

But despite these changes – or even partly because of them – house building remains well below peak levels, prompting calls from some quarters for further substantial reform. Some have gone as far as to argue that planning is the entire source of housing undersupply.⁸¹

We think that there are better options than wholesale planning reform, which could help achieve increased housing supply at lower overall cost. The downsides to further major planning reform are likely to be:

1. Planning reform is extremely tough politically. The Coalition government's planning reforms faced strong opposition from conservation groups and rural local authorities. Further planning liberalisation would face equally tough opposition and may not be politically possible, especially if it involves major changes to green belt policies. Recent polling has shown that planning reform is one of the least popular options to tackle the housing shortage with voters.⁸²

Graph 10: Land use change to residential⁸³



Source: DCLG

⁸¹ Abundance of land, shortage of housing, Kristian Niemietz, IEA 10 Apr 2012

⁸² **Opinium 2014**, 1,972 online interviews. Support for planning reform (39%), support for a "mansion tax" (65%), support for "use it or lose it" powers for land-banking (70%), support for mortgage guarantees (58%), support for direct funding of homes for sale (57%), support for new tax rules to reduce foreign investment (58%).

⁸³ DCLG, Live Table 226. There is no data for 1999 and so it is presented as an average of 1998 and 2000. Data excludes land with previous use as residential

2. Major planning reform could lead to a drop in output for several years.

Initial evidence suggest that the Coalition government's planning reforms led to a drop in housing output in the short run. This is not surprising, as when new rules come into force it creates uncertainty and takes time for actors to adapt to the new system.⁸⁴ Another major planning reform now is likely to slow development even further, and seriously undermine investor and developer confidence in the long term predictability of the system.

3. Planning reform without market reform may not increase housing supply.

The land market and house building market both have significant structural flaws, as argued in this report. Changing planning rules – for example reducing the obligations on developers to fund infrastructure or affordable housing – may prompt short run increases in developer margins and hence build out rates, but risk entrenching the current dysfunctional model and further undermining public support for development in the medium term.

The recommendations we advocate in this report do include planning reforms within the current National Planning Policy Framework, but on balance we think that using the planning system alone to try and solve the housing shortage would be ineffective and politically unachievable.

The planning system is far from perfect, but it does not follow that sweeping planning liberalisation would be a silver bullet for the housing shortage. The Coalition has already enacted extensive planning reforms which are only now bedding in. It would be more productive to allow the new system to establish itself and improve it where needed, rather than fundamentally re-design planning at this stage in the economic cycle.

THE IMPACT ON THE GROUND

In the KPMG and Shelter study into the West Midlands housing market it was clear that dysfunctions in the land market are the major problem holding back house building. Private developers reported that land was their biggest cost and risk but that 'land banking' by builders had declined since the recession.

The risks associated with land in the West Midlands were particularly tied up with the sort of land being used for development. Higher risks with brownfield or other 'contaminated' land meant that developers would want to prioritise green-field land where possible – but that this was harder to push through the planning system.

Local authorities also saw land supply as a significant barrier to house building. Some felt 'hemmed in' by land use constraints and they acknowledged that not enough development land had been identified to meet future need.

House building is a complex and risky business, shaped by market forces, regulation and industry practice. As land is the indispensable primary input into house building, it is unsurprising that many of the systemic failings

of housing supply have the origins in the land market. At the very least, it is time that public policy shifted its attention from the later stages of the house building process to the early phases which shape so much of what follows.

⁸⁴ Hephher, National Planning Policy Framework: One Year On, Savills 2013

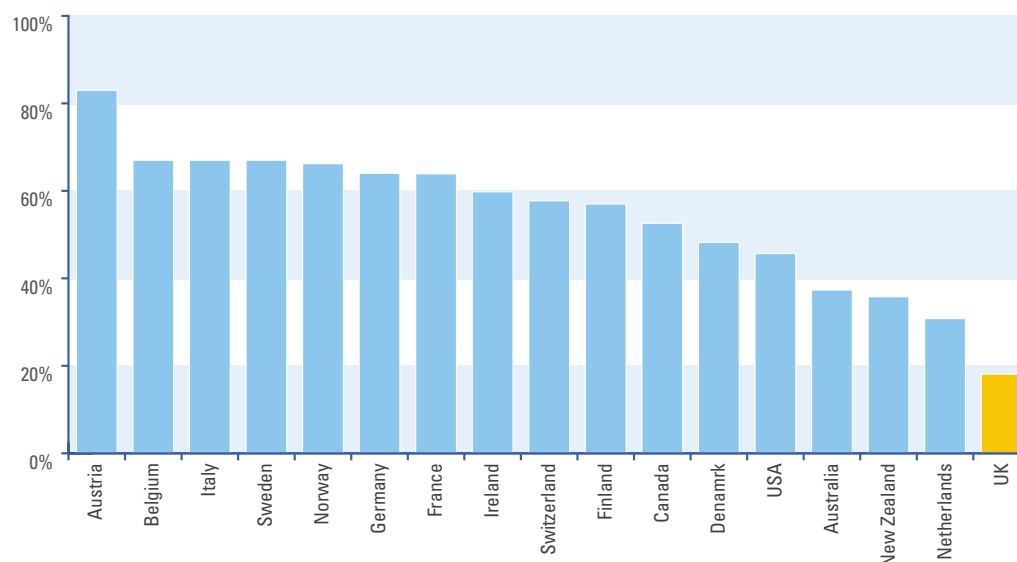
Problem: The house building sector

Even if the dysfunctions of the land market are improved, the building industry as it is currently constituted would not be able to build as many homes as we need in the near future, with some major house builders doubtful that the sector could currently build 200,000 homes per year, let alone 250,000.⁸⁵ This doubt is supported by evidence and experience, with the average annual output of private house builders since 1950 at just below 130,000 per year and showing a clear trend of decline.⁸⁶ Driving this lack of capacity within the house building sector is the small number of people commissioning building work, the small number of firms delivering it and the lack of available skilled labour to do the work.

A small and shrinking number of people commissioning house building

Compared to our European neighbours, England is over-reliant on a small number of large developers to commission new house building. In much of the rest of Europe – and in other comparable countries – large developers commission a smaller proportion of new homes, with significant numbers commissioned or procured directly by the individuals and families who go on to live in them. For example, in Austria 80% of homes are procured in this way, in Sweden 63% and in France and Germany around 60%. In the UK only around 10% of new homes are self-commissioned, self-procured or self-built – and the number is falling.⁸⁷

Graph 11: Proportion of homes self-commissioned, self-procured or built in comparable countries



Source: based on a historic study by the University of Sussex

This illustrative graph, widely used to demonstrate the negligibility of the proportion of self-built homes in the UK relative to other countries (the Housing Strategy for England, National Self Build Association (NaSBA)) is based on a historic study by the University of Sussex. While no such wide-ranging comparison has been gathered since and is therefore reproduced here, narrower comparisons such as van der Heijden, Dol and Oxley (2011) and Housing Statistics in the EU 2010 show levels of self-building in the UK as being low by international comparison. The figure for the UK – although not a national statistic – is corroborated by regular domestic market research based upon official statistics from HMRC (Homebuilding & Renovating Market Research, 2013).

⁸⁵ Major house builders were quoted in the Financial Times in September 2013 saying that increasing house building to 200,000 per year was not “physically possible”. Builders Attack Ed Miliband’s ‘wild’ plan for 200,000 new homes, FT 25 September 2013

⁸⁶ DCLG, Live Table 244

⁸⁷ NaSBA, Custom build as a volume house building solution, 2008

The lack of diversity in the people commissioning new homes and reliance on a small number of key players makes production by the industry more vulnerable to market shocks and price volatility, with a knock on impact for builders.⁸⁸ In contrast, people who commission their own homes are less likely to bring building to a stop when the process has begun in response to short-term market shocks, as they are not wholly dependent on future sales prices and are, instead, more affected by building delays.⁸⁹ As such, a larger proportion of people commissioning their own homes could help to smooth the peaks and troughs of overall supply and reduce the business risks faced by smaller builders.

In this way, scaling up self-commissioning, self-provision or custom build homes could be a useful part of increasing the diversity and strength of those commissioning homes. As a cautionary note, however, if the 'custom build' brand is adopted in the English housing system in a way that does not fundamentally increase the number of commissioners of new house building, such as through part-customisation (i.e. developers offering consumers the opportunity to choose the layout of their kitchen), then it is not likely to make such a contribution.

Fewer and fewer house builders

Just as the number of people commissioning homes in England is relatively small, the private house building market has become increasingly concentrated over the last fifty years. In the early 1960s the top ten house builders contributed only 8 or 9% of total production; by the peak of the last boom in 2006 they were responsible for almost half of all homes built.⁹⁰ Since the recession the number of builders producing fewer than 30 units per year has declined by half while the number of medium sized builders has shrunk 60%.⁹¹

The trend towards industry concentration is even greater in the areas where homes are needed the most. In London, just 23 firms were responsible for 70% of all homes built in the year to June 2012. Housing has gone from a diverse local industry to a national scale 'too big to fail' model.⁹²

The concentration of the house builder market does not mean that any firms are acting irrationally or in an anti-competitive way. On the contrary, the large house building firms are currently acting rationally to maximise profit. Certainly, performance measures suggests that the major developers are operating a successful business model.⁹³ Private companies do not exist to build the socially optimum or economically essential number of homes; as the Calcutt Review noted: *"Housebuilders are not in the business of serving the public interest, except incidentally. Their primary concern is to deliver profits for their investors"*.⁹⁴

⁸⁸ The DCLG's *The Credit Crunch and Regeneration: Impact and Implications* describes how, for example, one national developer 'effectively pulled their south east operations' following the credit crunch

⁸⁹ Molior, *Barriers to Housing Delivery*, GLA, 2012

⁹⁰ OFT, *Housebuilding Market Study, 2008 and the Calcutt Review*

⁹¹ *Solutions for the Housing Shortage*, 2011

⁹² Parvin and Saxby, *A Right to Build*, 2011

⁹³ Persimmon plc experienced an increase in pre-tax profits of 49% on a 16% increase in sale completions for the year to December 31 2013 while Bovis Homes Group plc experienced an increase in pre-tax profits of 48% on an increase in sale completions of 19%. *Annual Reports 2013*

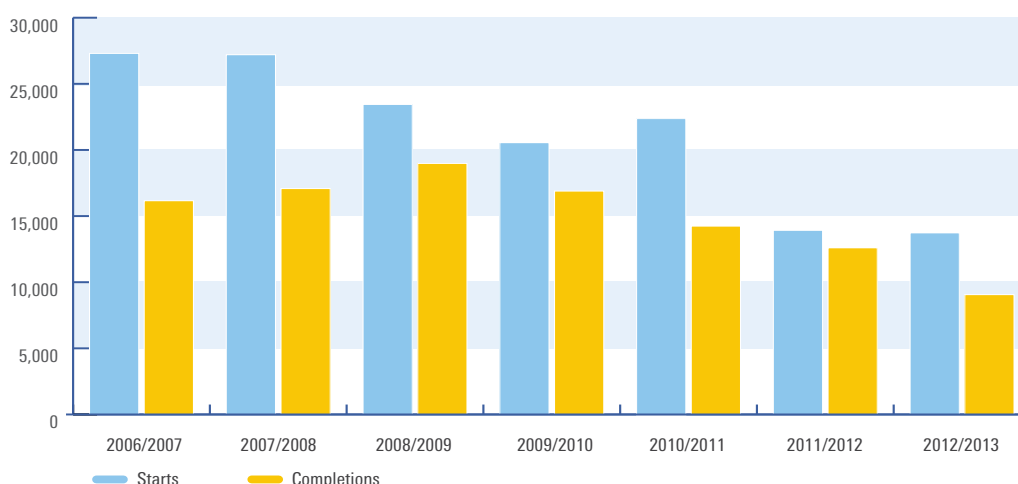
⁹⁴ CLG, the Calcutt Review, 2007

Insufficient skilled labour

In response to calls to increase production, major house builders have identified a lack of readily available skilled construction workers as a significant barrier to meeting the country's needs.⁹⁵ Compounding this existing lack of capacity is the limited prospect for future growth, with experienced construction workers forecast to leave the industry and employers scaling back training for new entrants. According to the Construction Industry Training Board 400,000 construction workers are expected to retire from the industry in the next decade, while 60% of house builders have already significantly cut training budgets and 49% have no plans to invest in new training.⁹⁶ Mirroring this, the number of people starting construction, planning and built environment apprenticeships has halved since 2006/07 with fewer than 10,000 people completing a construction apprenticeship in 2012/13.⁹⁷

Tracking the exact contribution that migrant labour has made to filling England's construction skills shortage is difficult due to employment practices within the industry.⁹⁸ However, official statistics show that over 35,000 migrant construction workers were formally registered as working in the UK from the EU's A8 accession states in 2004-2008 alone.^{99, 100} Given domestic constraints, it seems clear that migration from within the EU will continue to contribute to the supply of skills within the English construction industry. It is unclear, however, what effect the policy pressure since 2010 to reduce net migration may have on the capacity of the industry to respond to a call to considerably increase new house building when combined with the absence of domestic skills growth from apprenticeships.

Graph 12: Construction apprenticeships starts and completions



Source: Skills Funding Agency, BIS 2014

⁹⁵ HBF, Home Building Skills Report, 2013

⁹⁶ CITB website, 'UK construction industry facing skills timebomb', August 2013

⁹⁷ Skills Funding Agency data on sector specific apprenticeship starts and completions

⁹⁸ The Joseph Rowntree Foundation found that 58% of construction workers were self-employed and a further quarter working on an expired visa. <http://www.jrf.org.uk/system/files/1617-migrants-low-wage-employment.pdf>

⁹⁹ Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia

¹⁰⁰ UKBA, Accession Monitoring Report, May 2004-March 2009, A8 Countries

Problem: Public investment

The two problem areas so far identified in England's housing supply system are associated with markets, which are failing to deliver the socially optimal number of homes. But house building has always been a mixed economy, and the public sector remains a critical part of the system. So our third problem area is a decline in political priority for new affordable home building.

A shift in public spending from bricks to benefits

Some degree of public spending on housing will always be necessary to avoid socially unacceptable living conditions and homelessness for those least able to pay. This has been accepted in practice by every UK government since the First World War. What form that public spending takes is a governmental choice. Successive governments since the late 1970s have decided to follow the logic of subsidising individuals rather than buildings, by switching public spending from investment in new homes to support for housing costs.¹⁰¹ Over the last 35 years central government funding¹⁰² for affordable home building has declined, with a partial and temporary reversal in the late 2000s.¹⁰³ At the same time housing benefit expenditure has risen rapidly.¹⁰⁴

While this shift in spending was designed to improve the targeting of subsidies and unlock efficiencies by increasing the role of the private sector¹⁰⁵, it did not lead to an increase in new private sector supply.

The reduction in supply-side spending by central government has placed affordable housing providers under pressure to borrow against their existing assets and future rents in order to build more homes, exposing them to greater financial risk. Shelter and KPMG's research found that declining grant funding has in some cases made housing associations much more cautious in planning for new development in line with this increased exposure (see box), reinforcing the suppressing effect that the reduction in subsidy has had on new supply.

Affordable housing providers have also been incentivised to change the nature of the homes that they produce so that they deliver relatively higher levels of output per pound of subsidy within a smaller envelope. This has meant shifting towards building homes which are more expensive for consumers: the current 2015-18 funding prospectus prioritises the 'affordable rent' model which allows providers to charge up to 80% of local market rents.

¹⁰¹ Lord Heseltine in SMF, The Politics of Housing, 2013

¹⁰² Spending on new affordable homes by government is set within multi-year spending programmes run by the Homes and Communities Agency (HCA). The programmes provide up-front grant funding for housing associations who bid for a share of the pot, with funding allocated against a set of criteria such as number of homes built. The cost of building a home is split between this grant funding and borrowing by the Housing Association against future expected rents

¹⁰³ SMF, The Politics of Housing, 2013

¹⁰⁴ While a large part of the shift in recent years can be explained by the 2007/08 recession and subsequent capital investment cuts to house building, the shift in public spending from bricks to benefits has been going on for decades, Shelter, Bricks or Benefits? 2013

¹⁰⁵ SMF, The Politics of Housing, 2013

THE IMPACT ON THE GROUND

KPMG and Shelter's investigation into housing supply in the West Midlands found that affordable house builders are pessimistic about the number of genuinely affordable homes that can be delivered in a low public investment environment. Cuts to both grant funding and to welfare, as well as uncertainty about future budgets, mean that their primary future funding streams are at risk. Consequently they are conservative in planning for more homes.¹⁰⁶

Equally the shift towards funding programmes which rely on higher levels of borrowing and lower levels of grant funding¹⁰⁷ for house building increases the debt and risk for housing associations. In the West Midlands, there was a concern about how sustainable this trend would be given that the limits of borrowing would be reached and some housing associations may run out of 'headroom' to borrow. There is an ongoing debate about the total headroom of housing associations across England, but undoubtedly borrowing capacity will reach limits at the current low level of grant funding, unless housing associations switch their stock towards homes which are much less affordable for renters themselves.

A failure to recognise housing as a part of national infrastructure that is critical for growth

Even in the current straitened financial circumstances, there is cross-party consensus that investment in national infrastructure by both private and public sectors is essential for future growth, particularly during the economic recovery. The current National Infrastructure Plan includes £100 billion of planned public investment in infrastructure projects as varied as a new high-speed rail line, a new Thames sewer, new offshore wind farms and the extension of superfast broadband and smart meters for energy use. The £100 billion from the public purse has also been used to generate further private capital, bringing the total value of the plan to £375 billion.

HM Treasury justifies this investment spending, even at a time of other cuts, because "infrastructure equips a country for future economic growth, and is often a pre-requisite for economic expansion to occur."¹⁰⁸

It not only "creates the need for additional material to be produced and services to be employed, leading to job creation across the relevant parts of the supply chain" in the short-term, but also "allow[ing] the economy to function more efficiently" in the long-term.¹⁰⁹ Importantly the quality of transport and social infrastructure in an area has a direct impact on house and land prices.

Housing is not currently recognised formally as a national infrastructure asset, despite being vitally linked to other forms of infrastructure, and despite being a particularly effective route to economic growth. For every £1 spent on housing construction it is estimated that a further £2.09 of economic output is generated and 56p returns to the Exchequer of which 36p is direct savings in tax and benefits.¹¹⁰

¹⁰⁶ KPMG and Shelter, *Homes for the Next Generation: Lessons from the West Midlands*, 2013

¹⁰⁷ The current 2011 – 2015 Affordable Homes Programme (AHP) provides around £22,000 grant per home whereas the previous 2008 – 2011 National Affordable Housing Programme (NAHP) provided around £60,000 grant funding per home. HCA website and UK Housing Review 2011, York University Table 2.4.1

¹⁰⁸ National Infrastructure Plan 2013, HM Treasury

¹⁰⁹ Ibid

¹¹⁰ FTI Consulting *Investment in Housing and Its Contribution to Economic Growth*, October 2011

A lack of widely available affordable housing is not only socially undesirable but also restricts labour mobility,¹¹¹ raises the wage bill for businesses (potentially contributing to inflation during boom years) and increases the drag that high housing costs place on household consumer spending. Historically low interest rates, set at 0.5% since 2009, make the UK's economic recovery further exposed to already high housing costs should rates rise. In short, the role of housing supply in the economic health of the nation has been under appreciated.

Local councils' role shifted from strategy to mitigation

In addition to cuts to central grant funding, investment in new affordable homes has been constrained by restrictions set by government on the borrowing capacity of councils, effectively preventing them from strategically responding to housing need

through funding new building. While these restrictions on borrowing have been partially eroded through reform of local authorities' Housing Revenue Accounts,¹¹² the borrowing caps and accounting rules faced by councils in England remain much more restrictive than in comparable European countries.¹¹³

Instead of playing a direct strategic role in shaping local housing supply, local authorities have been pushed towards cross-subsidising affordable housing through Section 106 agreements, a planning tool designed for the mitigation of the negative impacts of new development. This has made the role of local authorities almost entirely dependent on new private development, effectively precluding the production of new affordable homes in periods or areas of low private development. It also makes affordable housing provision reliant on development gain, which in turn depends on rising house prices. The use of Section 106 to provide affordable housing, then, is predicated on worsening affordability in the market.

¹¹¹ For example, FTI research for Shelter in 2011 found that almost half (44%) of businesses in London regarded house prices as a constraint to business expansion in the city

¹¹² In the 2013 Autumn Statement

¹¹³ Perry, Treating Council Housing Fairly, National Federation of Arm's-Length Management Organisations, 2013

Problem: Building local consensus

Local authorities and city leaders in England have far less autonomy from central government than in Europe or North America. There is a particular gap in strategic leadership across local authority boundaries, with England now the only advanced economy to have no strategic planning for homes beyond local level.¹¹⁴ City leaders have few incentives, budgets or tools to build consensus in order to deliver the required level of building, either in the market or affordable sectors. As well as promoting an arbitrary inward focus, this lack of strong consensus means that general support for new house building can all too easily wilt in the face of site-specific opposition.

Incentives and rewards to develop are not strong enough

In principle, facilitating new housing supply is one of the few areas in which local authorities can exert direct influence. Even while councils' responsibility for other areas of policy, such as education and policing, have reduced, they have retained primary responsibility for land use planning. There is therefore a mismatch between the ability to align transport and social infrastructure provision with housing provision, which can create imbalanced supply and demand. However, political cycles that are far shorter than development timescales, combined with limited rewards and incentives can drive politicians and leaders to take a very cautious approach to development that can prioritise the preference of current residents over the longer term needs of the community and the economy. Perversely, housing shortages push up house prices, which can increase homeowners' desire to preserve asset values and hence their resistance to new homes, worsening the shortage.

When city and local authority leaders make the case for jobs growth or even transport there are clear political and financial rewards. However, making the case to build enough homes is much harder, with major political risks and few immediate economic rewards. In aggregate, this builds up a pattern of low house building and growing housing pressure. The government's 'New Homes Bonus' tries to address this flaw, but assessment by the National Audit Office (NAO) suggests that it is simply rewarding current behaviour rather than incentivising behaviour change.¹¹⁵

Local boundaries don't reflect economies

While current local authority boundaries are not entirely arbitrarily chosen they do not reflect the functional economic area in which they are located. People live, work, commute and seek services and leisure across a collection of authorities in their area. However, strict centralised departmental budgets are allocated to individual local authorities. In housing, the responsibility for need assessments and land use planning rests at the individual local authority level, when the reality is that people live and work across administrative boundaries.

There is limited scope to pool resources, funding and powers across these boundaries. This means that even though spending on, for example, housing in one authority, infrastructure in another and employment in a third would benefit the region as a whole, spending may be fractured across boundaries between uncoordinated councils. If local authorities could capture more of the returns of their spending across a functional economic or "travel to work" area, it may incentivise those areas usually resistant to a certain type of development to coordinate.

¹¹⁴ JRF, International Review of Land Use and Planning Systems, 2013

¹¹⁵ NAO, The New Homes Bonus, March 2013

There is no real pressure to co-operate across boundaries

Not only is there limited opportunity to coordinate between and direct funding across authority boundaries, the pressure for councils even to cooperate is limited. With the abolition of the Regional Development Agencies and the Regional Spatial Strategies, the 'Duty to Co-operate' was introduced for neighbouring local authorities within the National Planning Policy Framework. The Duty states: *"Public bodies have a duty to co-operate on planning issues that cross administrative boundaries... Local planning authorities should work collaboratively with other bodies to ensure that strategic priorities across local boundaries are properly co-ordinated and clearly reflected in individual local plans."*¹¹⁶

Evidence on the Duty as a replacement to regional strategic planning is not comprehensive, but there is an emerging view that as currently constituted it is not strong enough to ensure sufficient strategic housing growth:

- A study within 'Housing and Planning 2013' undertaken by Building Product reported that out of 16 Heads of Planning interviewed 15 were of the opinion that the Duty alone would not address contentious cross boundary matters. The greatest tensions were found to be between constrained urban authorities and their adjacent rural neighbours.¹¹⁷
- The number of homes planned had dropped by 6.1 % one year after the Regional Spatial Strategies were introduced with larger falls in South East local authorities.¹¹⁸
- A study of the Bristol city region found that "[in the Bristol city region] the new system has clearly allowed local authorities to significantly scale back proposed levels of development." And: "Whilst the constituent local authorities in the region have set up a variety of voluntary partnership arrangements, these have been seen as falling well short of collaboration at the city region level."¹¹⁹

THE IMPACT ON THE GROUND

KPMG and Shelter found in the West Midlands that the Duty to Cooperate was not regarded as a strong tool to ensure sufficient housing growth across the City region. Those we spoke to emphasised the need for joined up assessments of housing need and plans for cross-boundary growth, based upon economic or travel to work areas.

¹¹⁶ National Planning Policy Framework

¹¹⁷ Hopher, National Planning Policy Framework (NPPF): one year on, Savills 2013

¹¹⁸ Hopher, National Planning Policy Framework (NPPF): one year on, Savills 2013

¹¹⁹ Boddy and Hickman, The demise of strategic planning? The impact of the abolition of the Regional Spatial Strategy in a growth region, TPR 84 (6) 2013

3 The Solutions

A new vision of housing supply

We need a new vision for home building in England.

One that does not rely on high house price inflation alone to increase supply; one that is responsive to affordable housing need and can meet it; and one that creates attractive new places, not relatively small homes without access to local services. We must reverse the model of a high cost, low output housing sector to a low cost, high output one.

Our vision is for a land supply system that is transparent, efficient and stable and most importantly provides much more land at lower prices. Supply of land should match demand by economic catchment area to result in more house price stability.

Our vision is for a house building sector with many more local builders and more innovative models of development such as custom build. We need the big players running at full throttle, but alone they won't be able to solve the housing shortage. We need to help local builders thrive once more and new builders to join the market.

Our vision is for an affordable housing sector that's suitably funded, has a variety of developers and produces high quality homes for a wide range of income groups, including social rented homes for those on low incomes and shared ownership homes for middle earners. This will mean increasing the burden on public finances in the short term, but there will be substantial long term savings from housing benefit.¹²⁰ Without some additional investment, our programme cannot deliver the 250,000 homes per year needed to meet minimum need.

Finally, our vision is for cities and towns which plan strategically: linking jobs; services; transport; and homes. Local leadership will be vital to get us building the new places we need. Local leaders can't win support for new homes without people knowing that infrastructure and services will be able to cope.

¹²⁰ Building lower rent homes reduces the housing benefit bill by reducing the cost of home building borne by rents. DCLG estimated that over a 30 year period using a higher rent model (such as Affordable Rent) rather than lower rent (such as Social Rent) would result in increased housing benefit costs with a net present value of £1.4 billion, or £17,500 per home. Shelter, Solutions for the Housing Shortage, 2013

People on ordinary incomes should be able to buy or rent a home at a price they can afford today, and have confidence they will be able to afford tomorrow. That simple goal necessitates a housing supply system that delivers the number of homes we need.

If we can solve the dysfunctions at the heart of our housing supply system, we can create a market that builds enough homes, at reasonable prices. Nothing less will do. The good news is that this has already been achieved in comparable countries that have intervened to create more stable housing and land markets, and in doing so have transformed the quality and quantity of their housing stock.¹²¹ We can do so in England too.

Solutions: reforming the land market

Our vision is for a land supply system that is transparent, efficient and stable, and most importantly provides much more land at lower prices.

1. New Homes Zones – mixed-use, high quality developments

The current land use planning system in England is largely reactive, rather than proactive. Local authorities identify their required five year land supply by issuing a call for sites from private and public sector land holders, and then plan on the basis of the sites brought forward.

In many other countries, planning takes a much more proactive role in shaping the pattern of development. We need to introduce a pro-active planning tool to get sites moving quickly in the right places, in such a way that makes best use of both the private and public sectors.

THE VINEX PROGRAMME

The Dutch government's VINEX programme, which started in the 1990s and lasted over 15 years, took an 'active land' approach to the development of 90 urban extensions.¹²² Operating under a national spatial framework that identified towns for growth, local authorities formed development corporations, often as joint venture partnerships with private investors or developers. These corporations took the lead on assembling new sites, while central government and a municipal bank provided funding to make land purchases and decontaminate brownfield land. The basic principle was that by acquiring land at or close to its existing use value (typically agricultural value) the development corporation could use the value uplift resulting from planning permission to fund the necessary infrastructure such as roads, schools and flood defences. The development corporation would then prepare the master plan for the area before selling plots to developers and custom builders.

¹²¹ Hall and Falk, *Good Cities, Better Lives*, Routledge 2013. Case studies are presented in this report

¹²² JRF, *International Review of Land Supply and Planning Systems*, 2013

Although local authorities had the power to acquire land compulsorily, under the VINEX programme most of the land acquisition deals were made voluntarily, as the land owners knew that they were likely to achieve a higher price rather than holding out and facing compulsory purchase.¹²³ The model was extremely successful in the densely populated country, increasing the Netherlands' housing stock by over 7% over the lifetime of the scheme.¹²⁴ One down-side, however, was that in becoming major land market participants themselves and buying up sites, local authorities sometimes found themselves competing with other speculative land buyers and were exposed to price falls during the financial crisis of 2007/08.

Proactive land assembly models are also widely used in Germany, via 'land pooling' which incentivises land owners to put their land into a collective vehicle, and in some parts of the United States. In England, public-led land assembly for housing typically occurs only when multiple public agencies own adjacent sites (e.g. MOD and Homes and Community Agency (HCA)). Use of compulsory purchase to assemble private land does happen, but it is usually for infrastructure schemes, rather than for housing.¹²⁵

There is an opportunity to take the best of these international and domestic examples while learning from some of the difficulties encountered. The core objectives of a more proactive approach to land assembly should be to capture the gains from development for the benefit of the community by acquiring land at close to existing use value, and to harness competitive forces to delivering better quality and lower prices for consumers. This means shifting the focus of market competition in the development process away from land acquisition and on to the construction phase, by shifting the focus of public intervention onto the land market and away from development.

New Homes Zones

We propose that planning authorities (whether local authorities, cross-boundary authorities, the GLA or other) be given the power to designate New Homes Zones. These would be areas appropriate for development of significant numbers of new homes but short of new major settlements like Garden Cities (e.g. more than 200 units and less than 5,000 units). Designation should be predicated on the provision of high quality, well serviced, mixed tenure developments, offering attractive homes affordable to the local community on all incomes. The hugely successful redevelopment of the port area of Hamburg from 1999 onwards is based on a similar model (see page 55).

New Homes Zones would also bear some resemblance to Enterprise Zones in England. Enterprise Zones are specific areas within Local Enterprise Partnership (LEP) boundaries that offer incentives to businesses such as reduced tax rates. A New Homes Zone could offer similar incentives, so long as the land value uplift generated is used to improve the scheme, as well as compensate land owners, and to provide value for the local community. For example, by capturing land value to pay for infrastructure directly the requirement on developers to pay Community Infrastructure Levy and S106 could be removed.

¹²³ Author conversation with KPMG in the Netherlands

¹²⁴ Hall, Good Cities, Better Lives, 2013

¹²⁵ For example, the Olympic Park used land assembly and compulsory purchase under the Olympic Delivery Authority. Planning Resource, 'We planned the Olympics', June 2012

The Mayor of London has already indicated that he would like to set up "Housing Zones", but has not yet published details on how this would work.¹²⁶ This sort of intervention would be most appropriate and effective for high land value areas such as around London and the South East, which have the biggest difference between residential and non-residential land values.

Our proposed approach is to clearly separate the process of development into three phases: the planning designation of a New Homes Zone and land assembly; master planning and infrastructure provision; and the construction and sale of new homes. By clearly identifying these distinct functions many of the inefficiencies in the development process identified in this report can be avoided, including ever-rising land prices and the uncertainties caused by reactive planning and residual land pricing.¹²⁷

The first stage is for an authority in an area of housing need to identify sites which may be suitable for a New Homes Zone. The authority would need to look at their local area strategically, considering the best sites for jobs, growth and connectivity. The authority should then designate one or more strategic 'New Homes Zones', which would form an additional part of their local plan. The designation of a site as a New Homes Zone would signal to the market that (1) development will happen on this site (2) there will be no taxes on the site for developers (such as Community Infrastructure Levy or S106), (3) the land will be brought into the system closer to existing use value than residential value.¹²⁸

The authority would establish a public-private development partnership for the New Homes Zone, which would take ownership of the land and deliver the scheme through its lifetime. Landowners would be able to invest their assets in exchange for shares in the partnership, or sell the land to it. Public agencies and private investors, including pension funds and local individuals, would be able to invest capital and take a long term return on their investment.

As an incentive to encourage landowners to invest in the development partnership or sell land to it, the authority will make the credible threat of buying the site at existing use value plus a compensation after a defined period of time using improved compulsory acquisition powers. In the event that compulsory acquisition is used as a last resort, agricultural land owners will receive full current use value for their land plus an additional 100% existing use value as compensation. For owners of land already developed, the acquisition will be on the basis of 120% of existing use value. The aim is to use the credible threat of compulsory purchase to incentivise landowners to invest their assets at reasonable prices, and take a long term interest in the success of the development.

¹²⁶ GLA, Draft London Housing Strategy, 2013

¹²⁷ The development model outlined was developed by KPMG and Shelter for an entry to the Wolfson Economics Prize 2014, for delivering a new Garden City, which will be published shortly

¹²⁸ Existing use value for the land is required to allow the development to capture more of the 'land value uplift' from planning permission than under the existing model

The second stage is for a competition to be held for the right to join the partnership as the promoter – the day-to-day manager of the development partnership that will lead the development of the Zone. The promoter would invest seed capital and acquire a stake in the land-owning development partnership, but would not control it. Potential promoters would submit bids to the planning authority setting out their long term vision for the Zone and their plan for delivering it. The criteria for judging bids would be informed by national guidelines, existing local plans & needs assessments, and input from Local Neighbourhood Forums. Broadly, the criteria should prioritise aspects of quality, affordability and delivery such as:

- Green space.
- Affordable housing provision and tenure mix.
- Clean up costs for brownfield sites.
- Quality of homes and their size.
- Provision of custom build plots.
- Community compensation.
- Fair compensation for land owners.
- Sales price of plots.
- Speed of development.
- Transport links and service improvements.
- Mix of residential, commercial, leisure and other uses.

Holding an open competition between rival promoters will force them to compete on the quality of the offer for consumers and local communities, rather than solely on achieving the highest land price to offer the land owners. Bids to be the promoter of a New Homes Zone could come from a wide range of different organisations acting either alone or in partnership: private developers; local businesses; public agencies; housing

associations; or community groups. Opening up the competition to a wide range of organisations would encourage innovation.

Once selected, the promoter will lead the process of master planning and submitting a planning application, on the basis of their winning proposal for the scheme. Once outline planning has been granted, the partnership would raise the necessary grants, equity investment and loan finance to provide infrastructure and landscaping, such as public parks.

In the third stage of the New Homes Zone process, the partnership would divide the site into multiple serviced plots with outline permission, and invite bids for building them out within agreed time frames. Bids for construction would be judged on quality. With planning risk removed and infrastructure in place, bidding builders would only need to carry construction and sales risks, potentially reducing their required margins as a result, and enabling them to sell homes at lower prices and so build out at a faster rate. Providing smaller, de-risked plots would open up opportunities to local building firms, housing associations, new entrants, and custom builders, all of which would increase the overall build out rate and support the growth of a healthy and diverse local development sector.

New Homes Zones would be an addition to the land supply planning system that would give planning authorities a stronger hand in their local land market, to the benefit of those who need an affordable home. A likely additional benefit of New Homes Zones is that they would dis-incentivise speculation in the land market, as market participants would know that paying over the odds for land without planning permission could lead to losses if the land is included in a New Homes Zone.

CASE STUDY: HAMBURG'S 'HAFENCITY'¹²⁹

In May 1997, Hamburg's Mayor presented a vision for a major growth area for the city, 'HafenCity', which comprised an area of 157 hectares with mixed residential, employment and cultural uses based around the inner city port district, much of which had fallen into disuse.

In 1999 a competition to develop the master-plan for the site was launched, with a Dutch-German planning company winning the rights. The master plan fixed the major elements that would govern the development process: spatial planning; flood defences; public parks & green spaces; the tenure mix for the site; and sites of employment. The plan also specified how the development would happen (west to east) allowing for simpler procedures and faster build out rates. The development company with overall responsibility for implementing the master plan (owned by the Municipality in this case) provided basic infrastructure – such as heating systems – upfront.

Within the fixed template of the master plan, the development company then set out strict rules and procedures for the development of each stage of the project. Those who develop sub-sections of the scheme compete for development rights on the basis of quality as well as cost. Prospective developers must articulate their brief, provide architectural plans and gain approval from the development company based upon fixed criteria set down from the master plan. Housing sites are advertised with a fixed bid price, so that developers cannot speculate on future house price growth.

HafenCity has seen the introduction of a new developer type: the joint building venture. In HafenCity co-operatives of future residents purchase plots and procure the design and construction of custom built homes, facilitated by the development company.

Not only is HafenCity providing many new homes, it is also providing high quality homes. Hamburg has an average of 323 square feet living space per person, with apartments costing roughly half as much as in London's Docklands. A study of the new residents in HafenCity found that they were of all ages, including singles, families, older couples and retired people – the study concluded that the social and age mix had given the residents a sense of place and community in a remarkably short time.

¹²⁹ An in-depth exploration of HafenCity and other European exemplars of development can be found in Hall and Falk, *Good Cities, Better Lives*, 2013

Recommendation

Planning authorities should be given the power to designate New Homes Zones and run a competition for the right to develop the site as part of revisions to the National Planning Policy Framework. New Homes Zones would capture development gain within the scheme to fund infrastructure and affordable homes and escape the land price trap.

The developer – which would be a public/private joint venture – would lead land assembly, master planning and infrastructure provision, and sell serviced

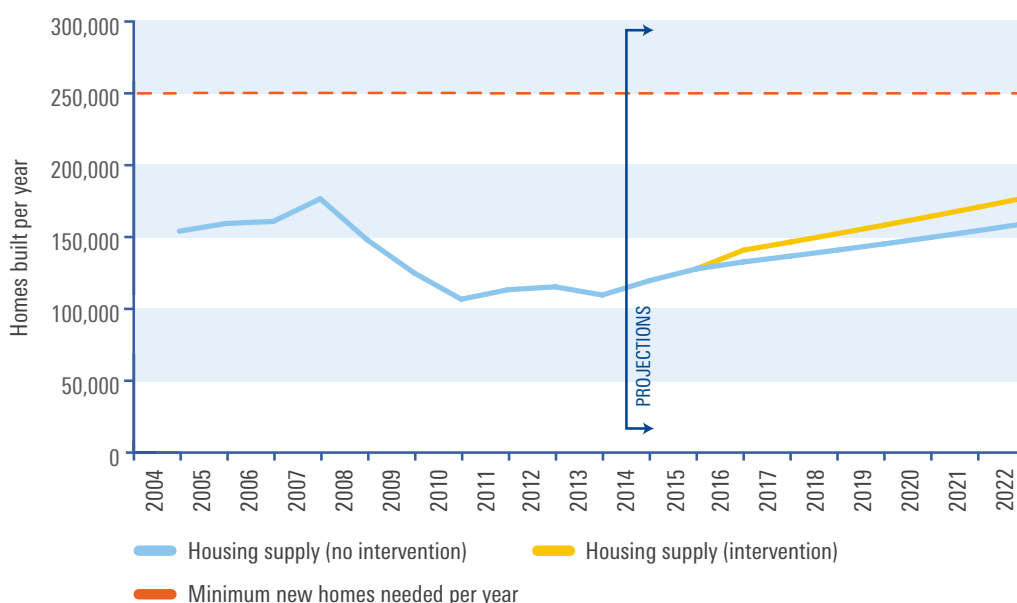
plots to small builders and custom builders to construct the homes, within a set timeframe, as well as provide plots for custom builders. As an incentive to ensure that deals are reached between land owners and developers on New Homes Zones, local authorities will need a more effective compulsory purchase power as a credible threat. In the rare event of a compulsory purchase order (CPO), landowners should receive compensation at existing use value plus 100% for agricultural land or 20% for developed land.

Impact on housing supply

We have made only modest assumptions about the immediate impact of New Homes Zones on housing supply, as most early designations are likely to be of land already identified within the existing planning system. If 10% of local authorities (such as city authorities in high land value areas) use the new powers each year to start developing fairly large sites of around

500 units over two years, then New Homes Zones would generate over 8,000 additional units per year. But the real impact would be felt over the longer term, as uptake by local authorities increases and the new development model initiated by the Zones begins to transform the housing supply system.

Graph 13: Impact of New Homes Zones¹³⁰



Source: KPMG/Shelter illustration

¹³⁰ KPMG/Shelter illustration – see Appendix 2 for assumptions

2. Incentivise the use of empty sites and empty homes

As discussed in Part II, developers require current land banks to plan ahead and ensure that they will have adequate sites to fulfil their business plans. However, in a volatile housing market development schemes can easily become 'unviable' and stall if falling house prices mean developers cannot make their required margin. There is suggestion that intermediary companies are acquiring, trading and holding sites with planning, thus potentially delaying the build out of consented schemes.¹³¹

Brownfield sites in urban locations may be particularly prone to stalling. This is partly due to the additional and uncertain costs of remediation, which can erode developer margins, but may also be due to the fact that such sites are obvious candidates for development, making them targets for speculators and more likely to succumb to the land price trap. These stalled sites can be particularly frustrating for local people and planning authorities due to their high visibility and tendency to block local regeneration efforts.

In 2013, the Local Government Association (LGA) estimated there were 380,000 units with planning permission yet to be completed, of which 152,000 had not started.¹³² In January 2014 the Planning Minister told the House of Commons that there were 55,800 units on sites with planning permission that are classed as 'on hold or shelved'. There are 202,900 units with planning permission that are 'progressing towards a start'.¹³³

In response to the problem of stalled sites the Chancellor launched a £474 million Local Infrastructure Fund, which was extended in 2013 to a £1 billion fund to provide infrastructure for large stalled sites up to 2020.¹³⁴ The HCA expects this to unlock 250,000 homes over six years, not all of which will be from existing stalled sites.¹³⁵ The government has also provided continued funding for ATLAS (Advisory Team for Large Applications), a team based in the Homes and Communities Agency tasked with providing support for getting major schemes through the planning process.

There are a plethora of schemes across several departments which exist to boost local growth, housing and infrastructure.

¹³¹ Molior, Barriers to Housing Delivery, GLA, 2012

¹³² LGA Press Release August 2013

¹³³ Hansard, 16 Jan 2014: Column 611W The Minister's figures include all kinds of housing units, whereas the LGAs exclude certain types of housing and permissions more than three years old. Both are drawn from Glenigan data

¹³⁴ HMT, Local Infrastructure Fund, 2013, Autumn Statement 2013

¹³⁵ Local Infrastructure Fund, HCA website

Scheme	Administrator	Size (total)	What it does
Get Britain Building	DCLG	<i>£570 million</i>	Equity loans and guarantees for developers who can't access finance
New Homes Bonus	DCLG	<i>£2.2 billion</i>	Incentive fund for councils with higher rates of house building based on Council Tax receipts
European Structural and Investment Funds Growth Programme for England	BIS	<i>Not specified</i>	Innovation, skills, SMEs, social inclusion and low carbon
Local Growth Fund	BIS	<i>£2 billion (inc £400 million from NHB)</i>	Supports growth priorities
Business Bank	BIS	<i>Support up to £10 billion lending</i>	Brings together government support for small business growth
Growing Places Fund	DfT and DCLG	<i>£500 million</i>	Establishing revolving infrastructure funds
Regional Growth Fund	BIS	<i>£3.2 billion</i>	Supporting job creation with loans to businesses

Consolidating and devolving these funds was a key recommendation of Lord Heseltine's 2013 review *No Stone Unturned: in pursuit of growth*.¹³⁶ While there has been some progress towards this goal the 2015 government could go further by consolidating and devolving £250 million from these funding pots to expand the Local Infrastructure Fund, to fund infrastructure to unblock stalled sites. Recent evidence from the National Audit Office suggests that the £3.2 billion Regional Growth Fund is still largely unspent.¹³⁷

Equally, the tax system could be used more proactively to incentivise the use of stalled brownfield sites and empty homes. Currently, there are no tax levers available to local authorities to encourage the development of stalled sites. Modelling by Europe Economics for Shelter has shown that taxing permissioned sites with the equivalent of the Council Tax that would be paid if the homes were built would increase the speed at which such sites were built out. This could act as a significant

spur toward development for the owners of the remaining stalled sites in the system, especially when combined with the carrot of more infrastructure funding.¹³⁸ Together with greater transparency of the land market – as outlined above – local councils could even target this tax on non-builder owners of land. In London it is estimated that up to 45% of all stalled sites are owned by non-building firms.¹³⁹

Finally, the Coalition government has already acted to increase councils' ability to levy higher taxes on empty homes to incentivise bringing them back into use. In 2013, the rules were changed so that councils could charge up to 150% of Council Tax on homes empty for more than two years. However many councils are not yet using these powers to their full potential. Giving councils greater discretion to charge even higher rates of Council Tax on long term empty homes (of which there are around 280,000 in England)¹⁴⁰ and strongly encouraging them to do so could further incentivise their re-use.

¹³⁶ Lord Heseltine, *No Stone Unturned*, BIS, 2013

¹³⁷ NAO, *Progress Report on the Regional Growth Fund*, 2014

¹³⁸ Europe Economics, *Ibid*

¹³⁹ GLA, *Barrier to Housing Delivery*, Molior 2012

¹⁴⁰ Housing Strategy Statistical Appendix 2010

Recommendation

The government should increase the funding for infrastructure for stalled sites by rationalising existing local growth and infrastructure funding pots, and devolving budgets to local leaders where appropriate. In addition, local authorities should be given the power to levy Council Tax on stalled sites with planning permission after a given period if no progress has been made on the site.

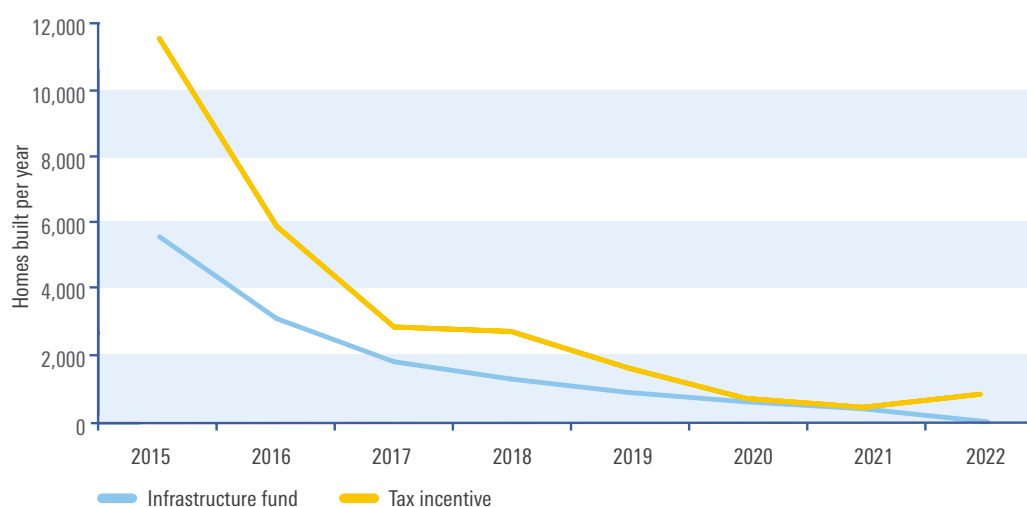
Finally, the incentives for local authorities to get empty homes back into use could be strengthened, with authorities able to levy Council Taxes at higher rates on long term empty properties. Government should strongly encourage local authorities to use these tax powers to get empty homes into use. These higher rates could then also be applied to stalled sites, if they remain neglected for years on end.

Impact on housing supply

To illustrate the sort of impact that this policy could have on housing supply, we have constructed a basic model based upon analysis by Europe Economics.¹⁴¹ We have assumed that there are 55,800 stalled units with planning permission in England as per the government's 2013 figure, and that extra infrastructure investment of £250 million could unblock around 13,500 units over seven years.¹⁴² For the development tax, Europe Economics modelled the impact that this

would have on developers' business models and their incentives to bring sites forward. The policy would have a disproportionately 'front-loaded' impact as developers on the margins of viability decide it would be more profitable to build out. We have not provided an estimate for the impact of increasing Council Tax rates on empty homes, as the level set for Council Tax would be discretionary for local authorities.

Graph 14: Impact of infrastructure incentive and stalled site tax¹⁴³



Source: KPMG/Shelter illustration

¹⁴¹ Europe Economics, How to Increase Competition, Diversity and Resilience in the House building Market? 2014

¹⁴² See Appendix 2 for full assumptions

¹⁴³ KPMG and Shelter modelling based on Europe Economics Ibid. Full assumptions at Appendix 2

3. Open up the land market with far more data

The land market could be far more transparent to development actors, local people and public authorities alike. More readily available data would improve decision making and hence overall market efficiency, and would increase the ability of authorities to intervene intelligently if required. Data on land prices, ownership and options agreements, and how they link to planning history, are particularly important to anyone seeking to make the land market function more effectively.

A sensible package of reforms to open up the land and housing markets would include appropriate public bodies (such as the Valuation Office Agency (VOA), MOD, NHS, Land Registry, Office for National Statistics (ONS) and local authorities) collecting and publishing data on:

- Land prices by site and by hectare in a format that could easily be used by non-experts.¹⁴⁴
- Land ownership in a format that could be mapped. This would make it easier for land assembly to take place as currently it can be difficult for planning bodies to understand the geography of land ownership.
- Planning permissions granted in a form that can be mapped, with date of permission granted, what the permission is for, i.e. number of units, and status of the development.
- New housing units granted planning permission by floor space. This would make it easier to assess trends in the size of new build homes, and hence to measure value properly.
- Ownership of new build, by type of owner and nationality. This would make it much easier to assess across England who is buying new build homes and how they are buying them.
- Data on the local private rented sector (PRS) for local authorities. Central government data that reveals which properties are rented privately should be released and made easy to access and track.

Recommendation

The government should require all appropriate public bodies to collect and make available all possible data on land price, transactions, ownership and options agreements, in standardised data and spatial formats that can be readily combined with planning information. Data on new build homes should also

be collected and released, covering floor space, ownership, nationality of purchasers and initial tenure. The government should hold a competition to encourage entrepreneurs to use this data to make the land market more transparent, for example by designing apps.

¹⁴⁴ At a minimum this could include re-introducing the VOA's Land Price data that was scrapped in 2011

4. Build new Garden Cities in high demand areas

The New Towns and Garden Cities of the 19th and 20th centuries were major achievements for housing supply in England, leading to the construction of hundreds of thousands of new homes as well as businesses, green spaces and community infrastructure.

More than 1.4 million people now live in the postwar New Towns like Stevenage and Milton Keynes.¹⁴⁵ These were driven by central government, with public development corporations buying land at existing use value and providing infrastructure. Garden Cities were built earlier, as private or co-operative enterprises based on a philosophy of healthy living, high quality lifestyles and wellbeing. A Garden City was originally defined as: “a town designed for industry and healthy living; of a size that makes possible a full measure of social life, but not larger; surrounded by a permanent belt of rural land; the whole of the land being in public ownership or held in trust for the community.”¹⁴⁶

We believe that the scale of the housing shortage makes a new Garden City programme an essential part of the solution. New settlements cannot be expected to meet all the demand for new homes, but they can make a substantial contribution to total supply, and act as beacons and catalysts in the drive to project house building into a new era. Projects on the scale of new Garden Cities would create opportunities to trial new technologies and increase skills, and give new builders the chance to enter the market and scale up.

Garden Cities in the 21st century do not need to take any one particular governance structure, delivery or ownership model. Indeed, the Wolfson Economics Prize 2014, which will be awarded to the best model for delivering a new Garden City, should ensure that policy makers are given a broad sweep of options to consider. However, any model for a new Garden City will need to tackle a number of common problems:

- Acquiring land in ways that offer land owners reasonable compensation, while ensuring that sufficient development gain is captured to support the development.
- Reducing the impact of development on existing communities, and building consent among local residents and local authorities. This was a particular challenge for the last government's Eco Towns programme.
- Ensuring a balanced mix of tenures and that enough homes are bought for occupation rather than investment to make the development a sustainable community.
- Ensuring that there are mechanisms to continue the economic development and growth of the town after the initial development phase is complete.

In the 2014 budget, the Chancellor announced that a development corporation-led Garden City would be started in Ebbsfleet in Kent, backed up with planning powers and government investment in infrastructure. This was followed by a prospectus for new Garden Cities published by the government in April 2014 which set out principles for garden city development, including capturing land value for community benefit. We believe that there is scope for further new settlements in the South East using a development corporation or public – private partnership model.

¹⁴⁵ Transferable Lessons from the New Towns, ODPM, 2006

¹⁴⁶ Garden Cities and Town Planning Association from 1919, quoted in TCPA, Creating Garden Cities and suburbs today, 2013

A MODEL FOR A 21ST CENTURY GARDEN CITY

The Wolfson Economics Prize 2014 will provide many different delivery models and visions for new Garden Cities. The key challenges are to secure the land at reasonable prices, so that development gain can fund the infrastructure required, and to win the consent of local people. Letchworth, the original Garden City, achieved the first aim through philanthropic donation of the land. The postwar New Towns did it via an Act of Parliament, which gave development corporations the right to compulsorily purchase land at existing (agricultural) use value. Neither had to appease local communities.

One alternative approach is to incentivise land owners on sites suitable for new Garden Cities to invest their assets voluntarily. A public and private joint venture partnership could offer landowners 125% of the existing use value of their land, plus shares in the partnership, plus a buy back option if the land is not put to use within ten years. The landowners would have one year to negotiate and accept before the land would be bought at existing use value via a CPO by the local authority. As a result of pooling land and taking shares, landowners have no incentive to promote their individual land holdings ahead of others. The shares in the partnership could deliver upside returns for landowners over time, through the positive impact of regeneration on value, although the details of how this would work would need to be established.

Local residents could also be offered opportunities to invest in the partnership, giving them a chance to share in the long term economic growth of the Garden City, and incentivising them to support its success rather than oppose development.

Recommendation

The 2015 government should consult on and propose sites for up to five new Garden Cities of around 30,000 dwellings of all tenures each in high demand areas, taking account of the ideas generated

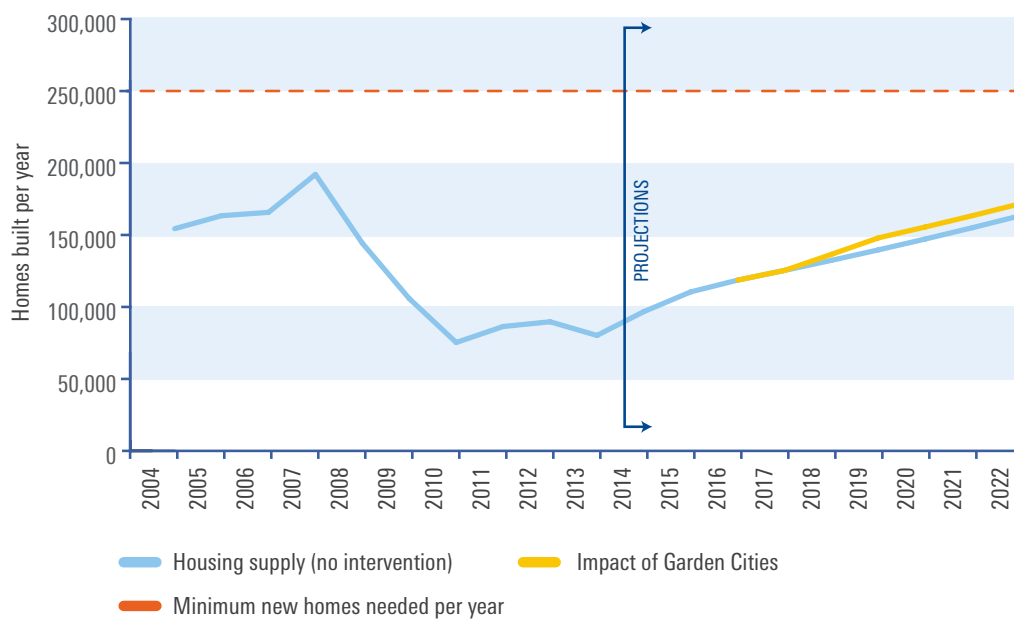
by the 2014 Wolfson Economics Prize. Planning and consultation on the programme should begin immediately, and construction should start within the lifetime of the 2015 parliament.

Impact on housing supply

Due to the long lead in times required to plan and consult on entire new settlements, Garden Cities are unlikely to contribute substantially to new housing supply within the lifetime of the 2015 parliament, but they should be an important legacy of the next government, much as the New Towns programme was.

We have assumed that five new Garden Cities of 30,000 units each are started within the 2015 parliament and that each has a development period of 15 years. The first additional homes should start to come on stream by the end of the parliament, adding around 5,000 homes to total output per year.

Graph 15: Impact of new Garden Cities programme



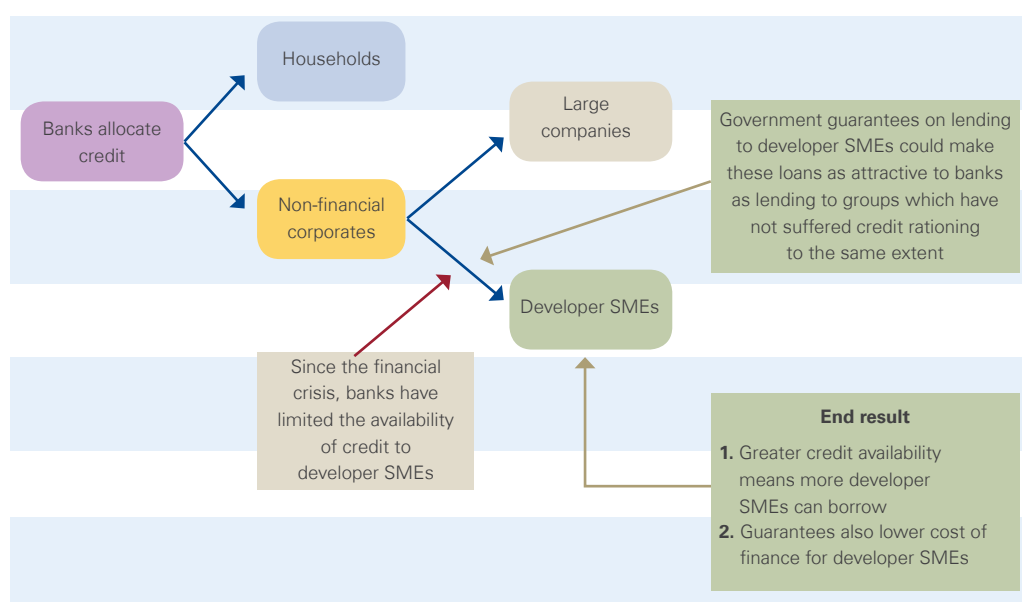
Source: KPMG/Shelter illustration

Solutions: a more diverse and resilient house building sector

Our vision is for a house building sector with many more local builders and more innovative models of development such as custom build. We need the big players running at full throttle, but alone they won't be able to solve the housing shortage. We need to help local builders thrive once more.

5. Help small building firms access development finance

A major concern expressed by small and medium sized developers is the difficulty in accessing development finance. Credit rationing to SMEs in the development sector is reported to have become a major barrier to market entry and growth, particularly since the credit crunch and subsequent recession. One way to help small firms to access the credit they need to grow would be to provide government guarantees for bank lending.¹⁴⁷



This would work through a guarantor bank, which would guarantee certain tranches of the loans to SME builders, conditional on the funding being used to develop homes. The loan guarantees would be made by government, but this doesn't mean that government would take all of the risk. Risk sharing arrangements would be put in place, to reduce the government's risk and ensure that the guarantor bank remains incentivised to lend to those firms most likely to succeed.

¹⁴⁷ For a full discussion of this option see Capital Economics, Increasing Investment in affordable housing, 2014

This proposal is a mirror of the Help to Buy: Mortgage Guarantee scheme already in place, and therefore could be funded from the contingent liabilities already allocated for that scheme. Addressing the imbalance in credit allocation between SME firms and other borrowers would enable them to re-access credit markets and expand their activity. The biggest impact would be on the percentage of loan to value (LTV) that they could achieve, which has halved for SMEs since the downturn. Most can now only access senior lending once the SME's equity has been put into the scheme upfront. With a 70% LTV, the average LTV through the life of the loan is approximately 35%. A 70% LTV revolver would give double the lending power. It would also reduce the cost of funding – improving the viability of schemes. There is unlikely to be an impact on the funding costs of credit allocation for larger firms, who will still be able to access development finance as at present.

In the 2014 budget, the Chancellor announced a £500 million loan fund for SME builders called the Builders' Finance Fund, with the aim of unlocking 15,000 units from 2015. There would be no debt cost to the Treasury for this scheme unless firms defaulted on their loans, just as with the Help to Buy scheme.

Recommendation

The 2015 government should switch a proportion of the Help to Buy: Mortgage Guarantee contingent liabilities into a new 'Help to Build' scheme to guarantee lending to small and medium sized house builders. The aim should be to restore credit allocation to SMEs to pre-financial crisis ratios which Capital Economics estimate will cost £40 million.

Impact on housing supply

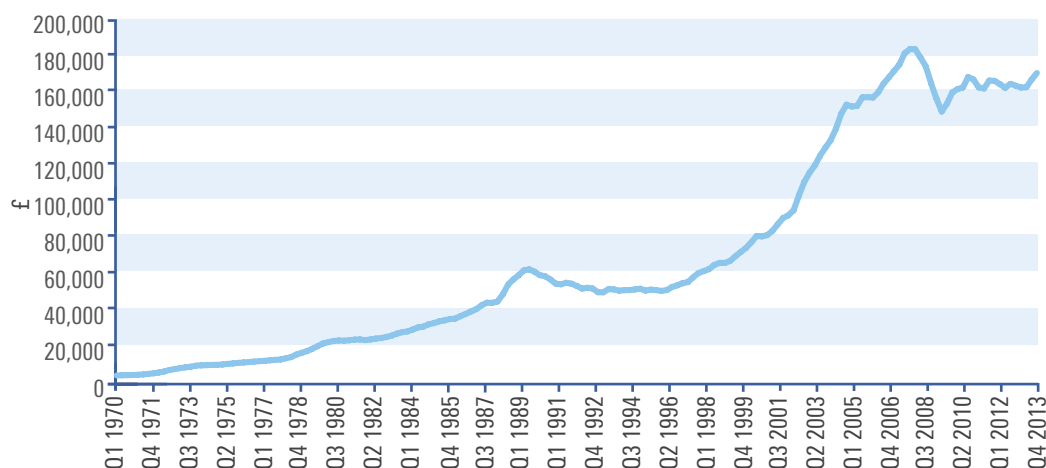
Capital Economics estimate that reducing SME builders' funding costs and restoring their credit allocation to pre-2007 ratios would support the development of an extra 3,000 homes per year - some 15,000 extra homes over the course of the parliament.

6. Stabilise the housing market

This report is focused on the supply-side measures needed to transform England's house building performance. But we recognise that the house building sector is highly dependent on the housing market, which is predominantly a market in existing, second hand homes, shaped mainly by demand factors. Matching supply and demand in economic catchment areas on a timely basis is key to maintaining stable house prices.

Increasing the supply of homes will help stabilise house prices. But this causal relationship works the other way too, as house price volatility acts as a major constraint on housing supply.

Graph 16: Nominal house prices (Nationwide)



Source: Nationwide

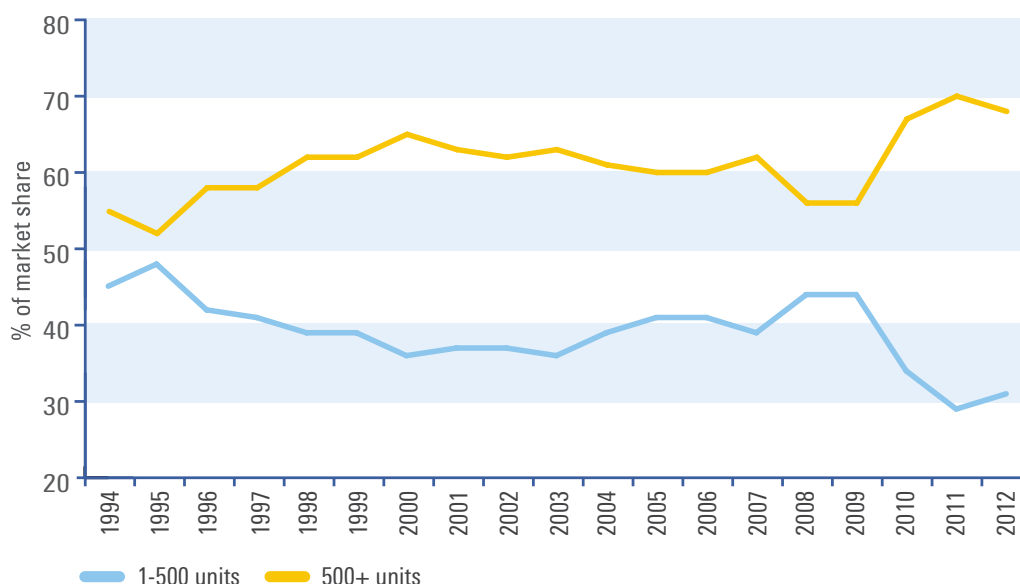
As discussed previously, one of the biggest sources of risk in house building is the time it takes between starting on site and selling completed units. If house prices fall after a site has been paid for, the developer's margin falls and the scheme runs the risk of being deemed unviable and stalling. House price volatility is amplified in the land market, so relatively small house price movements cause major booms and busts in the land market. All this means that developers face very real risks of overpaying for land during market upswings.

The UK housing market has experienced repeated booms and busts since the early 1970s, making it both difficult and costly for developers to effectively price in market risk when buying sites. The financial crash in 2008 not only triggered a rapid price crash, it also initiated a period of unpredictable price volatility as different policies were enacted to respond to the recession. With house price inflation bouncing around, market calls become even harder to make, and business planning inevitably suffers.

Volatile prices also have a secondary effect on the development industry. Large swings in prices – like land price booms or house price crashes – will hit all businesses, but larger developers have a greater chance of riding out difficult times, thanks to their larger portfolios, asset bases and access to credit. This is a luxury that small and medium sized developers don't have. When the downturn and subsequent drop in prices comes, SMEs are most likely to go bust. Following each of the last two house price crashes, larger developers have increased their proportion of total housing starts as SMEs have declined.¹⁴⁸

¹⁴⁸ Data from NHBC – in both the FTI and Europe Economics reports for Shelter

Graph 17: Size of market share by size of house building firm



Source: National House-Building Council

These market risks are well understood, making banks increasingly reluctant to lend to smaller developers – especially when their overall capital allocation to house building is being scaled back.

Intervention to control house prices is highly complex and we do not discuss in detail the measures that may be required, however any discussion of house building must recognise the symbiotic relationship between construction and second hand house sales and prices.

Recommendation

The 2015 government should launch an immediate review, led by the Bank of England, on the impact of house price volatility on the economy and the policies that would be required to stabilise prices relative to incomes over the long

term.¹⁴⁹ The government should also launch an immediate review of property taxation, both to consider potential extra revenue for the affordable house building programme but also in the context of economic and housing market stability.

Impact on housing supply

In order to show how greater price stability in the market could bring a change to the construction patterns of firms, a simple, theoretical model was constructed.¹⁵⁰

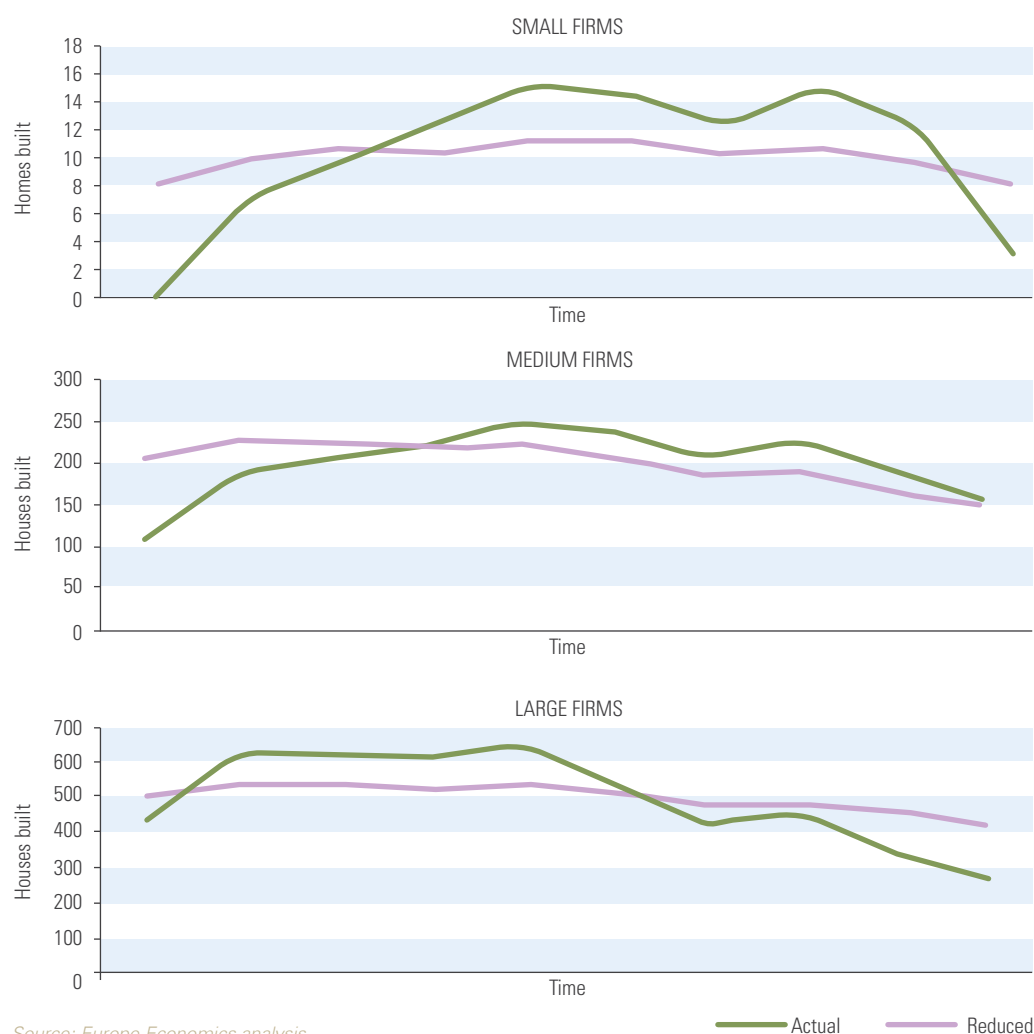
The model looks at house builders of different sizes and suggests a build profile over time which would allow them to maximise their profits, subject to many variables such

as the cost of purchasing land, the cost of construction and the cost of finance, constraints on the number of houses that can be built in a year, and the total size of a site. The model also incorporates a 'cost of waiting' variable - i.e. holding land without building houses on it – to suggest optimal construction timescales.

¹⁴⁹ Some such measures are discussed in Europe Economics, How to increase Competition, Diversity and Resilience in the house builder market, 2014

¹⁵⁰ Europe Economics for Shelter – How to increase competition, diversity and resilience into the housebuilding market – February 2014

Graph 18: How might house builders change their build out profile in response to reduced house price volatility?



Reducing house price volatility reduces the risk in the development process for builders of all sizes so the developer can operate at lower margins with greater confidence about the price at which they can sell.

One effect of reduced volatility is to smooth the optimal build out profile.¹⁵¹ The charts above illustrate that firms of all sizes would potentially build a greater number of properties in the earlier years under the reduced volatility scenario. In proportional terms, this modelled

effect is particularly large for small and medium firms, whereas the absolute impact would obviously be larger for medium and large firms. The modelling implies that fewer houses would be built in the later years, but this is due to constrained totals in the model. In reality we would expect higher output in earlier years to foster greater confidence in the sector, which should result in sites being acquired and a greater number of homes being built in the medium term and long term.

¹⁵¹ Europe Economics for Shelter – How to increase competition, diversity and resilience into the housebuilding market – February 2014

7. Provide sites for small developers and custom builders¹⁵²

Although fewer than 10% of new homes in England are currently custom built, six million people in the UK are actively interested in building their own homes.¹⁵³ But the benefits of growing the custom build sector extend beyond meeting people's individual aspirations. Making custom build a more mainstream means of delivering homes would be beneficial for the whole housing supply system, not just to those who want to build them:

- **Custom build delivers higher quality homes.** Because custom builders intend to live in their homes once they have been built, their homes tend to be larger and more energy efficient, and be built to higher quality specifications.¹⁵⁴

- **Custom builders can deliver homes more quickly and are more resilient to market shocks.** Where volume house builders working across large sites must limit completions to preserve their margins, a large number of custom builders working on the same site can deliver their own homes in parallel, meaning that overall output can be increased. Similarly, where volume house builders dramatically reduce building when markets fall due to lower sale values, custom builders' incentives are typically not determined by short-term sale values.¹⁵⁵

In 2008 the number of custom build completions actually increased, while total housing supply fell by 17% from 2007/08 to 2008/09.¹⁵⁶

- **Custom build delivers more diverse housing types.** The enhanced customisation offered through custom build adds diversity and flexibility to local housing stocks. Not only does greater diversity of design add to the character of a locality and reduce the risk of bland, uniform housing, but it also means internal spaces designed to meet different needs and tastes.

- **Custom build could help build support for new homes.** If more local people have an active stake in releasing land for development, and can see that it is going to produce homes built by and for local people, it should help create constituencies of support for development and reduce local political pressure to deny planning permission.

All political parties have stated their support for custom builders and recognised the central role that custom build should play in a solution to the housing shortage. The Coalition government made a commitment in 2011 to doubling the level of custom build in a decade and backed this commitment with a package of measures to boost custom building, which was followed in late 2013 with a second package. Despite these efforts, however, the numbers of custom build completions have fallen since 2008.¹⁵⁷

In order to bring about the custom building revolution that all political parties want the next government should set a clear commitment to increasing the proportion of new homes delivered through custom build to an appropriate amount (say 20%) by 2020. This would still be a lower proportion than is found in comparable countries.

¹⁵² We use the term 'custom build' to cover the full range of models for individual and collectively self-organised housing provision. The term 'self build' is often used interchangeably, but more properly applies to only those projects where the residents actively work on the construction themselves. 'Custom build' includes projects where the resident hires professional teams to act on their behalf

¹⁵³ Polling for National Self Build Association (NaSBA) by Ipsos MORI, March 2013

¹⁵⁴ Parvin, A Right to Build, 2011

¹⁵⁵ Parvin, A Right to Build, 2011

¹⁵⁶ UK Self Build Market Report, Home-building and Renovating and DCLG Live Table 209

¹⁵⁷ UK Self Build Market Report, Home-building and Renovating

The greatest barrier that custom builders must overcome is finding a suitable plot of land on which to build.¹⁵⁸ A commitment to increase the proportion of self-built new builds will, therefore, require strong support to increase access to serviced and permissioned land.¹⁵⁹ As a minimum this should mean that 20% of all land in new Garden Cities and New Homes Zones should be dedicated to custom build, divided into suitable plots and advertised publicly.

Suitable sites can often be best identified by communities themselves, so the Community Right to Bid should be extended to land that could be used for custom build. The Community Right to Bid currently allows communities to nominate buildings and land with cultural, recreational or sporting value in order to place a moratorium on their sale (in the event of their sale) so that the community has the chance to raise money to bid for them. The extension of the Right to sites suitable for custom build would allow communities to prioritise it as a means of housing delivery for their area.

The next government should also take steps to ensure that the latent demand for custom build is mobilised by encouraging and supporting people to take up the opportunity. To meet the expansion in available suitable plots, aspiring custom builders should be empowered through a charter of rights. These should include the Right to Register an interest in building your own home with your local authority, to have the opportunity to access suitable plots that have been made available in Garden Cities and New Homes Zones in the area, and to get official advice on how to find a plot and get building. Mortgages for custom build should also be made easier to access – perhaps through a specific allocation of Help to Buy support through the new Housing Investment Bank (see page 75).

Recommendation

The 2015 government should make custom build a mainstream means of delivering homes in England by reserving 20% of all new serviced and permissioned plots as part of all new Garden Cities and New Homes Zones (with some scope for flexibility according to local circumstance), and the extension of community rights

under the Community Right to Bid. People who want to custom build should be empowered to do so, through official advice, advertising of available sites, availability of mortgage/development finance and a new Right to Register interest.

¹⁵⁸ NaSBA, 2013

¹⁵⁹ That is, sites with access to infrastructure and utilities and outline planning permission

8. Level the playing field on space and design standards

Our focus in this report is on the economics and politics of overall housing supply, rather than design considerations. But the two are not entirely separable, as aspects of design – particularly the size of new homes – have a direct impact on the viability of development. Space standards, aesthetic quality and environmental performance of homes also influence local people's willingness to support new development.¹⁶⁰

England is one of the only advanced countries to not have an established set of minimum space standards for new homes, so it is not surprising that we also build some of the smallest new homes in the developed world. In recent years, growth in development has been in city centre flats, often without outdoor space and with very small inside space. Other countries, including those with higher population densities such as Holland, manage to build larger homes which are also more affordable.

The design and quality of homes matters not just to the families who live in them, but also to those who are impacted by new development. Clear and robust space standards for new homes can make a real difference to local attitudes to development:

- Twice as many people would support land in their area being used for homes if the homes were built to minimum space standards.
- Even those who do not think that their local area needs homes at all are more likely to support the development of larger homes than the development of smaller ones.

While the majority of our recommendations are locally led, we think that an exception should be made for minimum space standards which should be enshrined within national Building Regulations. Clear national rules on the minimum size for new homes in all tenures will allow developers to plan effectively on a level playing field, giving them confidence that rival bidders for sites will not be able to offer the land owner a higher price by squeezing a higher number of smaller homes onto the site. New rules should be introduced with sensible lead-in times to avoid undermining the viability of existing schemes and ensure that costs are passed through to land prices.

Recommendation

A new government should set minimum space standards for the 21st century in Building Regulations, with sensible

lead-in times. A new government should encourage excellence in design and environmental standards.

¹⁶⁰ Survey carried out by YouGov plc for Shelter. Total sample size was 4005 adults. Fieldwork was undertaken between 25- 28 March 2013. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

Solutions: Investment in affordable homes

Our vision is for an affordable housing sector that's well funded, has a variety of developers and produces high quality homes for a wide range of income groups, including social rented homes for those on low incomes and shared ownership homes for middle earners.

9. Prioritise capital investment in affordable housing and link it more closely to infrastructure

The 2015 government will have to make tough choices on public spending and investment, but within whatever spending envelope is set building more homes must be prioritised. Housing investment boosts economic growth, creates thousands of jobs in construction and the supply chain, and the returns to the Treasury from extra tax generated are substantial.¹⁶¹

- Every £1 spent on construction generates a further £2.09 of economic output, higher than the return to most other sectors from investment including advanced manufacturing and finance.
- For every £1 spent 92p stays in the UK.
- For every £1 invested by government, 56p returns to the Exchequer of which 36p is direct savings in tax and benefits.¹⁶²

House building is vitally linked to infrastructure provision, and should be considered a form of nationally significant infrastructure in its own right. We therefore recommend that the Treasury looks closely at how housing investment can be better linked in to the National Infrastructure Plan. The current National Infrastructure Plan has a pipeline of over £375 billion of public and private investment in transport, energy and other sectors.¹⁶³ This dwarfs committed future investment in affordable housing.

The Coalition government has allocated a £2.9 billion extension to the Affordable Homes Programme for the Comprehensive Spending Review (CSR) period 2015/16 to 2017/18.¹⁶⁴ This represents a cut from the 2011 – 2015 CSR, which in itself was 60% smaller than average annual spending in 2008 – 2011.¹⁶⁵ Further cuts to public investment after 2015 are simply not sustainable if we are to maintain any prospect of building enough homes. To achieve the level of building required to meet need, it will take up front additional investment from government. However, over time the pressure on investment will decrease as reforms to the land market increase private developer market output.

Direct public investment in new homes has several functions. Most simply, HCA grants subsidise the building of affordable homes, primarily by housing associations. Despite recent changes to the grant funding regime, the channels for translating public spending into construction activity and new affordable homes are well established. Increased spending here could have an immediate impact on the ground.

¹⁶¹ FTI Consulting, Housing and its contribution to economic growth, 2011

¹⁶² UK Contractors Group (2011) Construction in the UK Economy: The Benefits of Investment, London: UK Contractors Group

¹⁶³ HM Government, National Infrastructure Plan 2013

¹⁶⁴ HCA, Affordable Homes Programme 2015-2018, 2014

¹⁶⁵ HCA, National Affordable Housing Programme and Affordable Homes Programme

Extra investment would increase the number of homes built, but it would also change the type of affordable homes subsidised. Under the currently planned 2015-2018 prospectus for funding housing associations, investment in new homes will only be available for homes let at 80% of market rents or for shared ownership. These homes are simply not affordable to those on low incomes in many parts of the country. Reducing grant funding by raising rents is already proving a false economy, and will only increase the housing benefit bill further.¹⁶⁶

Thirdly, as most housing schemes are – rightly – mixed tenure, affordable housing grants also help boost house building activity more generally. Capital Economics' analysis is that *"an increased budget for central government capital grant is the most straight forward, practical and efficient method for stimulating building."* They estimate that the government can borrow and spend an additional £3.4 billion per year on affordable housing over the next parliament. Our proposal in this programme is for just £1.22 billion per year extra public investment – and we have identified potential revenue sources.¹⁶⁷

Public investment can also serve as a powerful lever to enact reform and change incentives in the industry. The aim of the reform programme in this report is to initiate a paradigm shift in housing supply, and many of the measures designed to support that shift have little or no direct costs associated

with them. But the experience of recent years demonstrates that institutional reform can only achieve so much, especially in the short term: kick-starting the transformative housing programme outlined in this report will require additional spending, especially in the early years, while other reforms are bedding in.

Finally, public spending can leverage investment from private sources too. Our vision of a more stable market is one that will be attractive to institutional investors who need secure assets with predictable returns to match pension liabilities. Specifically, land market interventions such as Garden Cities and New Homes Zones will lower the input cost of land, increasing the yields from privately rented and affordable rented homes to levels that are attractive to institutional investors.¹⁶⁸

The total investment package we recommend is an additional £12.1 billion of public and private investment over the next parliament (to bring total investment in affordable housing over the parliament to £15 billion), of which we would expect half to come from new private investment. Direct grant funding by government would therefore need to be increased by £6.1 billion over the course of the parliament, or £1.22 billion per year. This mix of funding represents better value for money over a 30 year period than the current mix of tenures, mostly due to saving that would be made on the housing benefit bill.¹⁶⁹

¹⁶⁶ The government estimated that the introduction of Affordable Rent led to an increase in future housing benefit payments of £482 million. Impact Assessment for Affordable Rent, 2011

¹⁶⁷ Capital Economics, Increasing investment in affordable housing, 2014

¹⁶⁸ There is clear demand for such opportunities. Legal & General have plans for £15 billion investment in housing and other capital projects over the next ten years

¹⁶⁹ NAO, Financial Viability of the Social Housing Sector, 2012

The £6.1 billion extra public grant funding could be funded in several ways, but the main choices for a 2015 government are:

1. Fund capital investment programme through increased revenue (tax) and/or shifting spending from other programmes.
2. Fund capital investment by bringing forward future investment programmes, meaning that capital investment would be cut after 2020.
3. Fund capital investment by increasing prudential government borrowing.
4. Capture increases in the value of land created by infrastructure investment and re-invest these into housing (as with development corporations).

We do not recommend a particular course of action on direct capital investment funding for the 2015 government, as it will be up to the government to set their priorities in the first budget.

However we note that:

- i The OBR's projection for Stamp Duty Land Tax is that the Treasury will receive £12.5 billion in 2015/16 compared to £8.9 billion in 2013/14 (a £3.6 billion per annum increase). The increase from the March 2013 forecast to the December 2013 forecast alone was £3.2 billion for 2015/16.¹⁷⁰ This substantial extra revenue more than covers the extra house building spending we recommend.
- ii HMRC estimate that private landlords are evading at least £550 million of tax on rental income per year, roughly half the amount that we recommend investing in new affordable homes.¹⁷¹
- iii The NAO has cast doubt on the value for money of the New Homes Bonus which costs £2.2 billion per year.¹⁷² Further evidence of its impact is required, but it may be that some of this budget could be diverted to house building.

Recommendation

The 2015-2018 Affordable Homes Programme should be boosted, extended to 2020 and its terms changed to prioritise a more mixed balance of tenures, including genuinely affordable homes to rent. Increasing public investment in housing associations over

the lifetime of the parliament by £1.22 billion per year and bringing in additional private investment through land market interventions would lead to the delivery of over 250,000 new affordable homes, including half at low (social) rents and a quarter for shared ownership.¹⁷³

¹⁷⁰ OBR, Economic and Fiscal Outlook 2013

¹⁷¹ HMRC official quoted in Guardian, March 2014

¹⁷² NAO, The New Homes Bonus, 2013

¹⁷³ Shelter, Solutions for the Housing Shortage, 2013

10. Develop new ways to finance house building

The post 2015 spending envelope will be tightly drawn, no matter which party or parties are in power. We need to find new ways to boost investment in affordable housing, which will be more resilient to future pressures on public spending. The options below would increase investment in affordable housing without contributing to government debt.

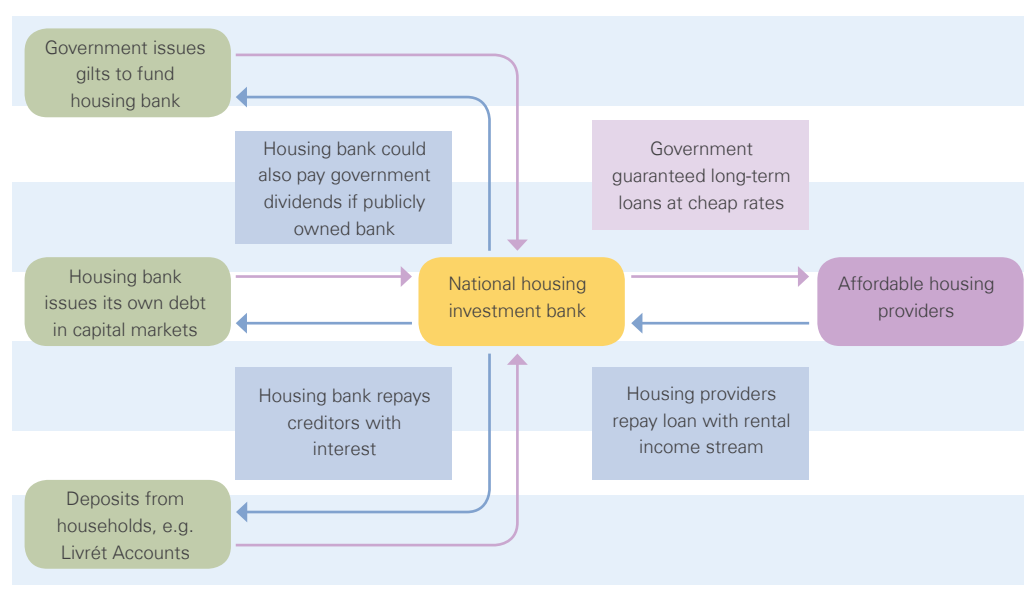
Creating a Housing and Infrastructure Investment Bank, funded from Housing ISAs

We propose that a national Housing and Infrastructure Investment Bank be set up as a public corporation, to lend to the providers of affordable housing.¹⁷⁴ This idea is not new - the Dutch *Bank Nederlandse Gemeenten* (or BNG) is a well-established, specialised lender serving local and regional authorities as well as housing, utilities, healthcare, welfare and educational institutions. This business model provides the basis of how a dedicated bank could work in the United Kingdom.

Ownership of BNG is restricted to the Dutch public sector: the Dutch State's shareholding

is 50% with the remainder held by Dutch local authorities and one water board. Being a specialist lender to the public sector helps to minimise the costs of providing social services to the public. In 2012 the effective interest rate for the funding of BNG through debt securities was 1.7% and the effective interest rate on lending extended by BNG was 3.6%.

A similar structure could be set up in the United Kingdom, with ownership of the bank exclusively in the hands of the government, shared with local authorities or as a not-for-profit vehicle. The bank would need to raise finance so that it could extend loans to housing associations and other providers of new affordable housing. This could come from issuing bonds to the capital markets, as is the case with BNG, and the bank could also use special savings accounts (Housing ISAs) to raise finance from retail deposits, as in the French *Livrét A* scheme. The Bank could be a new institution, or part of an existing or planned institution such as the Green Investment Bank, British Investment Bank or Homes and Communities Agency (HCA).



¹⁷⁴ The proposal for a National Housing Investment Bank and Special Purpose Vehicles are explored in more depth in Capital Economics, *Increasing investment in affordable housing*, 2014

Housing ISAs could be guaranteed by government to provide steady tax free returns to depositors, with the funds aggregated and lent out as low cost long term loans to affordable housing providers.

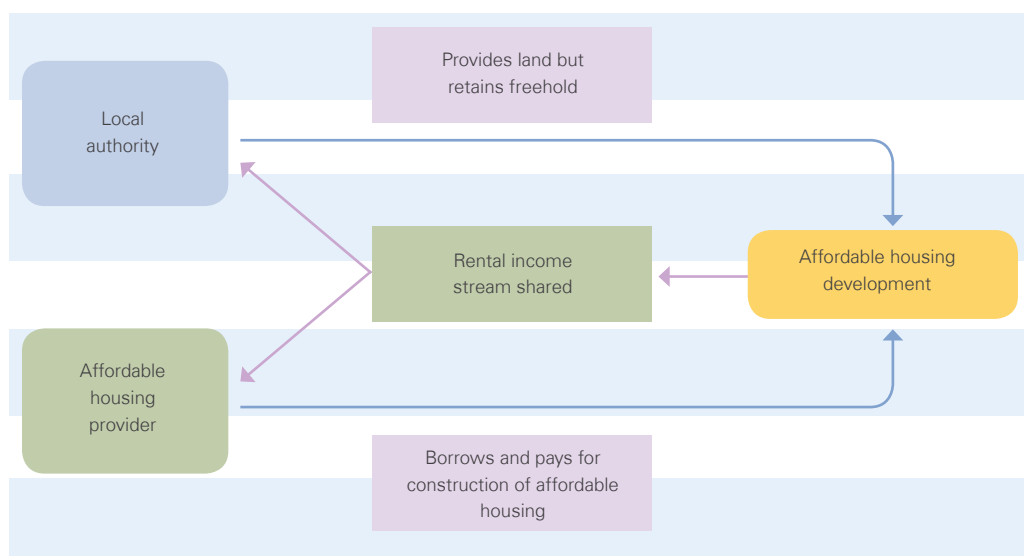
Joint ventures: deploy publicly owned land

A joint venture model of local authorities leasing land to affordable house builders, or even institutional investors, while retaining the freehold could provide good value for money to the public purse. By some estimates, local authorities own up to 20% of the land suitable for building new homes but are constrained from building council homes on the land by their debt caps (see page 78).¹⁷⁵ Local authorities could put in the land while housing associations or other investors provide finance, addressing both the cost of land problem and debt constraints on the public purse.

This sort of joint venture model has been used successfully already. A mixed tenure housing scheme led by Grainger plc was completed in Kensington and Chelsea while Birmingham Municipal Housing Trust adopts a similar approach with a range of developers.¹⁷⁶ In Birmingham the trust owns the plot of land for development and it remains under the ownership of the trust until after the sale of the home is complete.

By leasing the land to developers, local authorities could receive a share of rental income. Capital Economics modelling shows that such a model could be set up which requires no upfront grant funding to build the affordable homes and returns between 15% and 30% of rental income to the local authority dependent on location. The downside to local authorities would simply be the opportunity cost of not selling the land to a developer for full market value at that point (although freehold ownership would be retained). To

Graphic: Illustrative public sector land lease model (Capital Economics)



¹⁷⁵ Andy Hull, (Institute for Public Policy Research) in written evidence to: Communities and Local Government Committee, Financing of new housing supply: Eleventh Report of Session 2010-12 (The Stationary Office, London), 2012

¹⁷⁶ For further details see Capital Economics, Ibid

avoid this problem, government should look at ways in which local authorities could have flexibilities to dispose of its freehold should the authority need or wish to do so, during the lifetime of the lease.

One barrier for housing associations in delivering this type of housing would be that they may run into their own loan covenants when borrowing to build homes on leased

land. To avoid this constraint, joint ventures could attract private investment – especially from long term institutional investors such as pension funds. Legal & General are developing a model which could work well with this particular sort of joint venture, which involves funding the construction of homes and then leasing them to a housing association or council to manage.

Recommendation

Direct public investment will be needed to kick-start house building but with public finances under pressure we also need to develop new ways of paying for homes which don't inflate house prices, or damage government fiscal credibility. We recommend that the 2015 government

sets up a Housing and Infrastructure Investment Bank – similar to the model used in the Netherlands. Finally, a third option is to encourage the use of public sector land in joint venture deals with institutional investors and/or housing associations.

LONG TERM INVESTMENT IN THE PRIVATE RENTED SECTOR (PRS)

The options outlined in this programme are designed to increase the supply of all tenures, particularly affordable housing tenures such as social rent and shared ownership. However, there are ongoing opportunities to also leverage private investment into the private rented sector (PRS).

The government's Montague Review in 2012 identified barriers to PRS investment, particularly the problem that the price of sites for new rented housing are driven by prices in the for sale market. This means that developers wishing to buy land for rented housing are in competition with developers in the sales market and cannot compete.¹⁷⁷

One barrier to long term investment in the PRS, is the difficulty of securing finance for homes with longer term tenancies. The government's PRS taskforce should look into making it easier for small scale landlords to access project finance on the basis of secure five year tenancies.¹⁷⁸

Land market interventions identified in this report could offer opportunities to expand long term institutional investment in the PRS, if covenants are put on sites acquired at a lower cost, requiring the homes to remain available for rent for a set number of years. This would mean that developers would no longer be competing with the private sale market. A quid pro quo for developers and investors in this instance would be that properties should be let with the option of long term family friendly tenancies such as Shelter's Stable Rental Contract.¹⁷⁹

¹⁷⁷ HM Government, Montague Review, 2012

¹⁷⁸ Shelter, A better deal, 2012

¹⁷⁹ Shelter, A better deal, 2012

11. Increase the borrowing capacity of local authorities

The major group of housing developers to have fallen out of England's supply system over the past few decades are local authorities. Reviving these 'sleeping giants' of house building must be part of a balanced programme to increase supply, but any policy intervention must acknowledge the varying levels of capacity and appetite for development among councils.

Local councils have planning powers and often own significant land assets with which they could build new homes: the missing element is finance. In 2012, changes were made to the £28 billion Housing Revenue Accounts (HRA) through which 171 local authorities manage their retained housing stock.¹⁸⁰ The reforms gave greater financial autonomy to local authorities by allowing them to borrow against future revenue streams (the rent from their social homes). Any extra borrowing secured this way is added to Public Sector Net Debt (PSND) which means that the Treasury strictly limits additional borrowing, no matter what the financial position of local authorities.

Tight artificial borrowing caps for local authorities were therefore set which allow a certain amount of headroom for authorities to borrow and invest should they wish, but not to their full prudential limits.¹⁸¹ This headroom is unevenly distributed between local authorities, with some having almost no scope to expand borrowing.¹⁸² In late 2013, the Treasury announced an extension of the borrowing cap on the HRA of £300 million, of which £150 million would be allocated in 2015/16 and a further £150 million in 2016/17.¹⁸³ Current headroom within the

existing borrowing caps is around £2.8 billion with which councils plan to build 4,000 new homes per year.¹⁸⁴

There are several options for policy makers for further reform to increase building by local authorities:

- Allow local authorities to 'pool' their headroom, thus freeing up borrowing capacity within current HRA caps. This is likely to have a limited impact on supply, as authorities will want to retain some headroom individually.
- Raise borrowing caps incrementally, for example by indexing them to inflation. Again the impact would be limited, especially with inflation targeted at 2%.
- Continue to raise the borrowing cap, as with the 2013 Autumn Statement. This could have a much larger impact depending on the scale and how the borrowing is accounted for. Some recent estimates have suggested that an extra £7 billion of borrowing capacity would easily fit within councils' established prudential borrowing limits.¹⁸⁵ This is the equivalent of 12,000 extra homes per year.

¹⁸⁰ The reform of Housing Revenue Account, Commons Library Standard Note

¹⁸¹ Prudential borrowing for capital investments is regulated by the Chartered Institute of Public Finance and Accountancy Prudential Code, which was introduced in 2003. This states that local authorities should only borrow when the debt repayments are affordable. Capital Economics, Increasing Investment in affordable housing, 2014

¹⁸² National Federation of ALMOs, Treating Council Housing Fairly, 2013

¹⁸³ HM Government, Autumn Statement 2013

¹⁸⁴ Perry, Let's get building: The case for local authority investment in rented homes to help drive economic growth, National Federation of ALMOs 2012

¹⁸⁵ Perry, Let's get building: The case for local authority investment in rented homes to help drive economic growth, National Federation of ALMOs 2012

Giving greater flexibility to local authorities to borrow within prudential limits would increase their borrowing, but this does not have to increase the more politically sensitive measures of national public debt. The UK is unique in Europe in classifying a very wide range of bodies within the definition of 'public sector' used to measure public debt. Not only is direct central and local government spending counted within the definition used, but so are 'public corporations'. Other EU countries and most other OECD countries split out certain types of public corporation borrowing from general government expenditure when reporting public debt.¹⁸⁶ In practical terms, the UK's accounting

rules mean that grant funding for housing associations, local councils and ALMOs¹⁸⁷ all count towards total public current debt (PSND), as does local council and ALMO borrowing within their HRA, but housing association borrowing does not.

This is despite the fact that for local authorities, housing associations and ALMOs the cost of their borrowing is serviced by their ring fenced housing revenue, not by taxes or other public funds. The government should review the UK's accounting practices against those of other countries.

Recommendation

Gradually raise the cap on councils' HRA borrowing towards the local authority prudential borrowing levels, extending the government's recent reforms. Capital Economics estimate that at a cost of £1.4 billion per year to local authority HRA

budgets, local authorities could build 9,800 new homes per year. There is a case to reform accounting rules to be in line with OECD norms so that these debts do not count against total public debt.

¹⁸⁶ Perry, Treating Council Housing Fairly, National Federation of ALMOs, 2013

¹⁸⁷ Arm's Length Management Organisation

Total impact of capital investment programme

To quantify the impact of the total capital investment programme that we recommend, we have analysed:

- How much investment is required per unit of different affordable housing tenures.
- How quickly the housing association and local authority sectors could reasonably be expected to grow to accommodate the extra investment.

In keeping with our analysis of the industry and the land market, there is real risk that much of the value of increased levels of investment would go into inflating land prices. It is therefore essential to combine additional investment capacity with the land market reforms outlined previously.

Table: Impact of the capital investment programme on public finances

Policy	Extra investment	Adds to public debt? ¹⁸⁸
Boost the Affordable Homes Programme (public)	£1.22 billion per annum ¹⁸⁹	<i>Yes. We have identified measures that could fund it.</i>
Housing Investment Bank funded by savings ISAs	£1.05 billion per annum ¹⁹⁰	<i>No. It can be a not-for-profit vehicle.</i>
Help to Build guarantees for small builders	£40 million ¹⁹¹	<i>No. Contingent liabilities only.</i>
Raising local authority borrowing cap	£1.4 billion per annum ¹⁹²	<i>Yes. Under the current rules for classifying the debt of local authorities, but we recommend adopting standard international rules under which local authority capital borrowing would not count towards total public debt.</i>

¹⁸⁸ Here defined as gross general government debt. Analysis of the impact on general government debt and public sector net debt in Capital Economics, Ibid

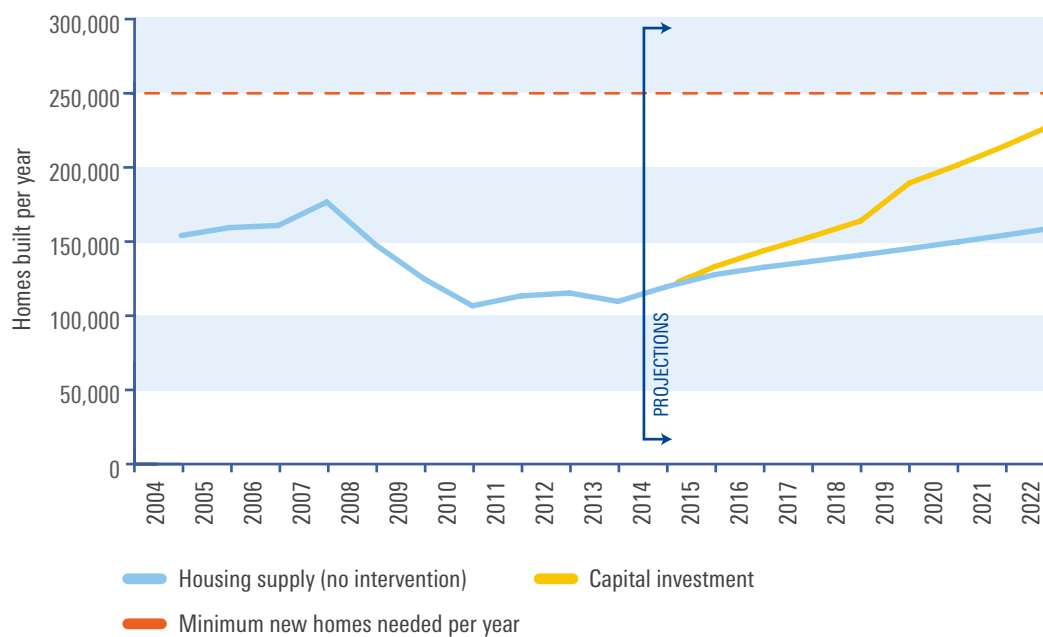
¹⁸⁹ This recommendation is to contribute towards the £12 billion public and private investment package required to build 250,000 genuinely affordable homes over the course of the next parliament. Without this investment, house building will not meet required levels within that timeframe

¹⁹⁰ Calculation is from Capital Economics, Ibid

¹⁹¹ Capital Economics, Ibid

¹⁹² Capital Economics, Ibid

Graph 19: Total impact of capital investment programme¹⁹³



Source: KPMG/Shelter illustration

¹⁹³ Full assumptions at Appendix 2

Solutions: Strategic Local Leadership

Our vision is for cities and towns which plan strategically, linking: jobs; services; transport; and homes. Local leadership will be vital to get us building the new places we need. Local leaders can't win support for new homes without people knowing that infrastructure and services will be able to cope.

12. Plan at a city region level

England is one of the most centralised countries in the world – and one of the few to lack a standard metropolitan tier of governance, outside of London.¹⁹⁴ Decades of centralisation have meant that few powers, budgets and responsibilities are really controlled at a local level, despite some recent changes under the localism agenda. The incentives for local authorities to find local solutions need to be stronger, as do the mechanisms for ensuring effective cross boundary collaboration. England's cities are the engines of its economy and the natural places to lead housing growth. We need to empower them to take a strong strategic leadership role in planning, funding and delivering that growth.

Housing development depends upon good transport infrastructure to get people to jobs and services. This relationship also works the other way around, as new infrastructure that local people want can be rendered viable by opening up sites for new homes. Opportunities for new homes need to be properly considered as part of infrastructure planning and funding – which requires consistency across local and sub-regional planning and budgeting processes.¹⁹⁵

City Deals, under which central government hands powers and budgets to local authorities in return for them taking on greater responsibility to stimulate economic growth, could be a very useful innovation in reviving the strategic leadership role of our urban centres. By devolving funding streams they give local

leaders greater power and responsibility to drive change – and explicitly recognise the national economic and fiscal benefits of investing in city growth.¹⁹⁶ The last round of City Deals focused largely on jobs and skills, with a little on transport. While these factors are vital for local economies, the government should also incentivise local authorities to work together on larger infrastructure and housing projects by making them central in future City Deal negotiations.

One option would be to devolve Home and Community Agency budgets and responsibilities to key cities that want to grow, as has already happened in London. This would increase their ability to shape their own places and economies – with the quid pro quo of better cross-boundary planning for homes and much stronger co-operation with neighbouring authorities. The funds that LEPs can bid for could also be ringfenced for housing and infrastructure.

This proposal is about more than just extra funding: it is also about joining up strategic planning and delivery at the right geographic level. Functional economic areas are almost always driven by a city's location in its wider city-region, so the powers and budgets to solve local issues need to be located at the city-regional level. Clearer and stronger leadership will have wider impacts on the local economy by boosting efficiency, market confidence, local accountability and borrowing ability, to name a few.

¹⁹⁴ Paun, A. et al - Centralised Power and Decentralised Politics in the Devolved UK (UCL) http://www.ucl.ac.uk/spp/people/robert-hazell/centralised_power_Sept08.pdf

¹⁹⁵ Sarling, J. and Blyth, R. - Delivering Large Scale Housing – 2013 (Royal Town Planning Institute: London)

¹⁹⁶ Unlocking growth in cities, Deputy Prime Minister's Office, HM Treasury, DCLG, 2011

Lessons from abroad suggest that decentralisation can be a power tool to trigger urban growth and regeneration. In the late 1960s, the French government promoted the importance of the Communauté Urbaine, a device to give greater powers to the provincial cities outside of Paris. Mayoral

leadership and powerful city-regional federations have secured transport and housing investment on a scale that has kept many cities in competition with Paris. A similar story can be seen in Germany and also the USA, which both have more powerful city leaders.¹⁹⁷

Impact on housing supply

Modelling the full impacts of properly integrated city-regional planning is beyond the scope of this report, as each city-region will require its own plan and each City Deal will be different. For the purposes of this report we have looked at the central government funding pot open to bids from LEPs, which is worth £2 billion each year for five years.¹⁹⁸ We propose allocating 20 per cent of this pot to housing and infrastructure, ensuring that LEP bids bring infrastructure and housing together with other funding streams and plans. This would supply an annual budget of £400 million. In order to estimate how many houses this could help unlock, we need to know how much local authorities would raise from new development in order to fund the necessary infrastructure on a site. Charges on grant of planning permission now take the form of the Community Infrastructure Levy, for which each local planning authority sets its own

schedule of charges.¹⁹⁹ CIL can be charged for most categories of planning application, not just strategic development, so CIL rates vary widely and may not reflect the full cost of the infrastructure required for strategic sites. To estimate the impact of extra infrastructure investment we have therefore used a proxy for total scheme infrastructure costs, based on plans for development in Cambridge. Our proxy is £55,000 per unit for infrastructure.²⁰⁰

Using this benchmark tariff of £55,000 per dwelling and a total allocated pot of £400 million, we estimate that over 7,000 homes could be unlocked through this funding stream each year. In practice we would expect smarter integration of infrastructure and housing funding across functional economic areas to reap greater benefits and unlock key strategic development.

¹⁹⁷ Hall and Falk, *Ibid*; Institute for Government, *What can elected Mayors do for our cities?* 2012

¹⁹⁸ <http://www.insidermedia.com/insider/midlands/93106-2bn-lep-funding-pot-pays-lip-service-devolution-business-leaders>

¹⁹⁹ For the latest CIL schedules, see <http://www.planningresource.co.uk/article/1121218/cil-watch-whos-charging-what>

²⁰⁰ Falk, *Beyond Ecotowns: the economic issues*, 2008

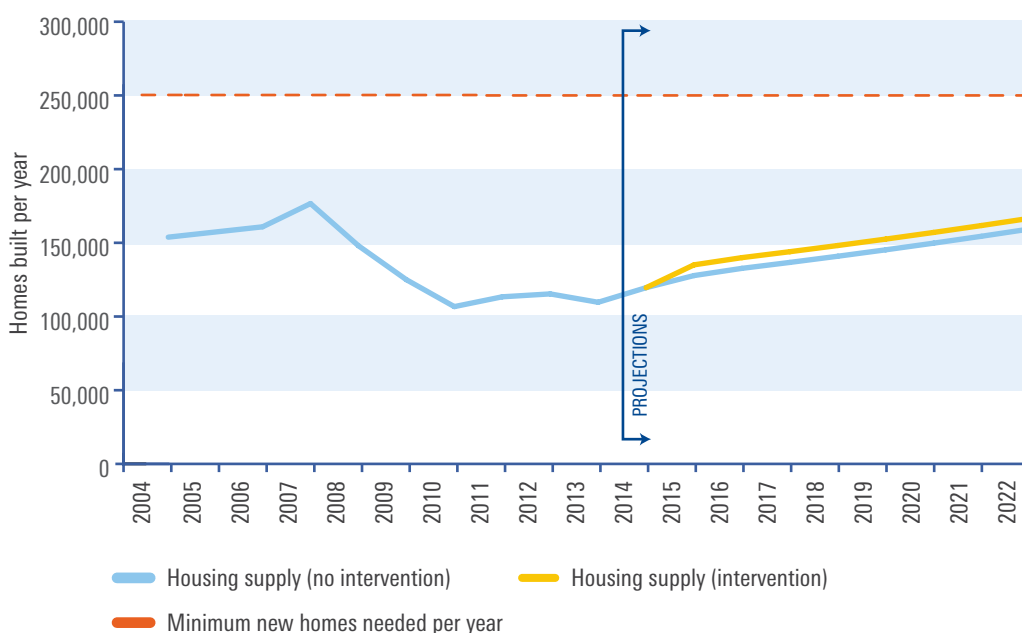
13. Assess housing needs across functional economic areas

Effective local leadership requires clear plans that are rooted in a strong evidence base. The National Planning Policy Framework states that planning authorities should “use their evidence base to ensure that their Local Plan meets the full, objectively assessed needs for market and affordable housing in the housing market area”.

The evidence base on housing need must be developed through a Strategic Housing Market Assessment, which the National Planning Policy Framework (NPPF) states local planning authorities should use “to assess their full housing needs, working with neighbouring authorities when housing markets cross administrative boundaries.”

The National Planning Practice Guidance published in late 2013 went further, stating that “needs should be assessed in relation to the relevant functional area: either a housing market area, a functional economic area... or an area of ‘trade draw’ in relation to main town centre uses”.²⁰¹ The Guidance defines a housing market area as “a geographical area defined by household demand and preferences for all types of housing, reflecting the key functional linkages between places where people live and work”. Finally, the Guidance states that, in assessing local housing need, authorities must take account of “market signals, such as levels and changes in rental values, and differentials between land values in different uses.”

Graph 20: Impact of ring-fencing 20% of LEP funding for housing and infrastructure



Source: KPMG/Shelter illustration

²⁰¹ DCLG, National Planning Practice Guidance, 2013

Despite this clear requirement, in practice housing needs are not being assessed consistently or objectively across functional economic areas. The Duty to Cooperate is open to interpretation in regard to assessing housing need, and there is already substantial evidence that this new system has led to housing targets being revised downward, contrary to objective housing need.²⁰² There is also strong anecdotal evidence that some local authorities are watering down the methodological framework behind Strategic Housing Market Assessments (SHMA) to achieve lower numbers of assessed need.²⁰³

LEPs are already co-ordinating needs assessments cross-boundaries in some areas and could be one way to ensure that a cross-boundary approach is always taken. Currently, planning guidance and the NPPF require them to be consulted on the SHMA. There is a legitimate concern about the fact that LEPs are not democratically elected and so we would not propose devolving new powers or budgets to them. However, the co-ordination and commissioning of an objective SHMA could be an addition to their duties.

Recommendation

To ensure that housing need is robustly assessed across functional economic areas, LEPs should be encouraged to deliver Strategic Housing Market Assessments on behalf of local authorities within an economic region

alongside their current role for promoting economic development. This would also serve the secondary purpose of making housing more central to the strategies of LEPs.

Impact on housing supply

Assessing housing needs robustly will not in itself build more homes. However, recent changes to the planning system have resulted in 270,000 fewer homes being planned for than under the previous regime.²⁰⁴ We therefore assume that more robust

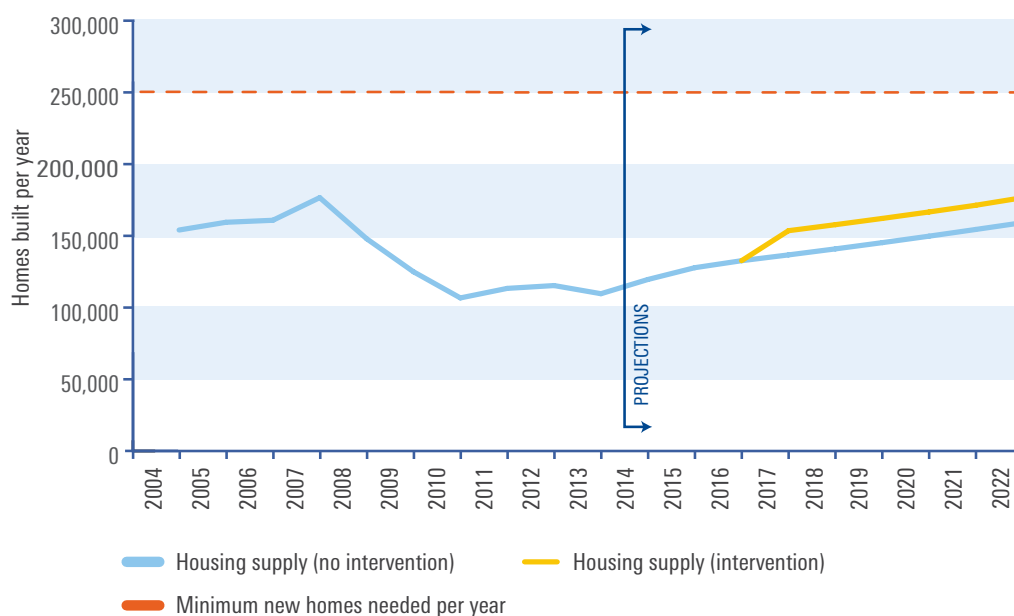
assessments of housing needs, co-ordinated across borough boundaries, would return planned numbers of new homes to the level achieved under regional spatial strategies over 16 years, or 16,800 additional units per year.

²⁰² Hephher, National Planning Policy Framework (NPPF): one year on, Savills 2013; Boddy and Hickman, The demise of strategic planning? The impact of the abolition of the Regional Spatial Strategy in a growth region, TPR 84 (6) 2013

²⁰³ Conversations with report authors housing sector representatives across England

²⁰⁴ Analysis by Tetlow King showed that in 2012 local authorities were planning for 270,000 fewer homes than in 2010 (**Policy Exchange funded research**). Savills found in 2013 that there had been a 6.1% fall in planned dwelling from regional strategies to local plans

Graph 21: Impact of returning to strategic housing targets on housing supply



Source: KPMG/Shelter illustration

14. Integrate major infrastructure and new large housing sites

The government's long term infrastructure plan commits £100 billion of capital investment to energy, transport and other critical national infrastructure over the next parliament.²⁰⁵ This plan does not include housing, which means we could miss the strategic opportunity to plan new homes – or whole new settlements – alongside improved infrastructure. Settlements of around 1,500 units could be planned for the long term alongside major transport investments like Crossrail, HS2, electrification of the West Coast line and any new airport capacity.

To make the most of these opportunities we need mechanisms to deliver new homes which are reliable and robust enough to deliver in the timescales set by infrastructure projects, and which can benefit from the uplift in land values created. The main process required currently would be planning permission under the Town and Country Planning Act 1990, which for a development of this scale is likely to take a considerable amount of time in its own right,

even before other necessary consents are also considered.

An obvious candidate would be the Nationally Significant Infrastructure Projects (NSIP) procedure. This planning-led consent regime was initially enacted to deal with nationally significant transport, energy and waste infrastructure projects. It has since been extended to include business and commercial projects – but does not cover housing schemes.

A developer of an NSIP must apply for a Development Consent Order (DCO) which authorises its construction. The application is considered by an examining authority appointed by the Planning Inspectorate, the independent planning appeals body, which then reports to and makes a recommendation to the Secretary of State with responsibility for the relevant sector. The Secretary of State then makes the final decision whether to grant or refuse permission.

²⁰⁵ HM Government, National Infrastructure Plan, 2013

The NSIP regime represents a more streamlined approach to the consenting process because it requires a decision within one year of the application being made. It provides a 'one stop shop' for consent as it allows for a range of other regulatory consents to be obtained alongside the DCO as part of the same consent process.

Extending the NSIP regime to include major residential developments would maximise the benefits from transport investment by allowing new homes to be integrated into infrastructure plans.

The existing NSIP regime includes rigorous processes of consultation and there is a clear emphasis on local engagement and consultation built into the statutory framework and throughout the guidance. To empower local leaders however, additional requirements should be built into the NSIP process for large scale housing applications to have the backing of the local authority. This would not only have the effect of reinforcing local democratic involvement but would also result in a pooling of resources, expertise and skills from the private and public sectors.

Recommendation

The 2015 government should amend the Planning Act 2008 so that residential schemes linked to new transport infrastructure can be included as a

category of Nationally Significant Infrastructure Projects, with the backing of the local planning authority.

■ ■ ■ Impact on housing supply

Integrating major new infrastructure and housing development would build additional homes alongside major infrastructure projects. There are currently around 100 NSIPs

in progress.²⁰⁶ We assume that there will be five opportunities per year to link housing sites to these projects, with a build out rate of 250 units per project per year.

²⁰⁶ Author conversation with major law firm which represents NSIP clients.

15. Increase green belt flexibility

The green belt is an important constraint on urban sprawl in England, but it also has the effect of reducing the responsiveness of house building to rising house prices. The extent of the green belt is very large, covering around 13% of land in England, compared to 10% of land which is 'urban' (mostly parks, rivers and gardens), and just 2% which is actually built upon. The green belt is not only large, it has also grown rapidly, doubling in size from 1979 to 2011.²⁰⁷

Green belt land is often portrayed as having intrinsic qualities of beauty or public amenity value. But there is no test of aesthetic or environmental quality that land must pass to receive green belt designation. The green belt is rather a tool to preserve and improve the quality of urban areas, something it has been very effective at doing over the past decades.²⁰⁸

One impact of having a tightly drawn green belt around England's major urban areas is that some cities in high demand areas grow beyond their green belt. London and the South East for example, is assessed by some urban geographers to be a mega-city region of some 18 million people and 50 major settlements many of which are miles beyond the city's green belt.²⁰⁹ People commute across London's green belt from as far away as Bath, Brighton and beyond. In Cambridge over 40,000 commuter journeys per day are made over the city's green belt.²¹⁰ Other countries manage green belts by revising them periodically, so that they serve the purpose of supporting sustainable growth, rather than acting as complete blocks on all development.

Some limited green belt swaps of brownfield land are already being encouraged by the government, although the NPPF is not clear on planning authorities' ability to swap green belt land.²¹¹

Recommendation

The 2015 government should clarify and extend the use of green belt swaps and green belt reviews so that local authorities have a stronger set of tools to manage their local green belts. These should make it easier for local authorities to swap small amounts of agricultural land out of the green belt, if there is a strong case for new homes, and replace it by

giving land green belt status elsewhere. The onus of any new policy should be that land swapped in to the green belt should be of higher aesthetic or natural value than land swapped out. The government should also consider including specific incentives for trading green belt designation between authorities in new City Deals.²¹²

²⁰⁷ Green Belt, Commons Library Standard Note, January 2014; Defra, Natural Ecosystems Assessment, 2011

²⁰⁸ The NPPF describes five purposes for the green belt: to check unrestricted sprawl; to prevent the merger of towns; to assist in safeguarding the countryside; to preserve the character of towns; and to assist in urban regeneration by encouraging the recycling of derelict land

²⁰⁹ Hall, Good Cities, Better Lives (Routledge 2013)

²¹⁰ Cambridge Futures

²¹¹ Shelter, Solutions for the Housing Shortage, 2013

²¹² Options on cross boundary land use will be explored in more detail in a forthcoming IPPR and Shelter paper

Alongside allowing greater flexibility for councils in reviewing green belts and swapping land in and out, it will be necessary to prevent price speculation on land that may gain planning permission. Speculation in anticipation of a green belt review threatens to extract value and undermine the viability of high quality development. One solution would be to link green belt swaps to rural exception sites. These are sites located on the edge of existing rural settlements that are unlikely to gain planning permission for housing, but which are treated as exceptions as long as they provide affordable housing to local people in

rural communities. While they deliver a small proportion of total housing output, exception sites are responsible for more than half of government grant funded affordable housing in communities of 3,000 homes or less. If green belt swaps are made on the edge of small rural communities, rural exception site policies could ensure that such sites provide homes that are affordable and accessible to local families.

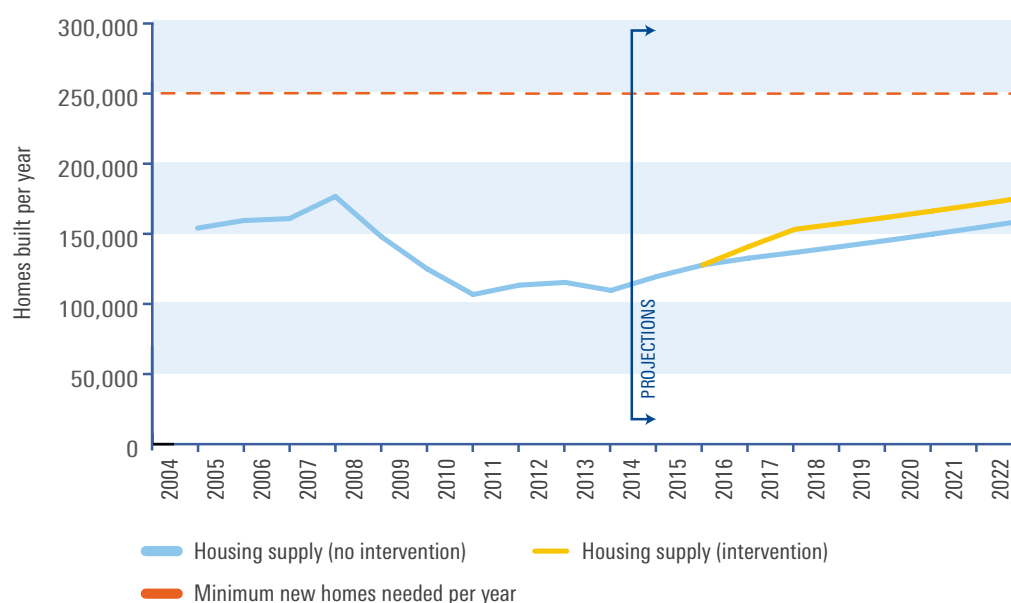
An alternative way to prevent speculative price pressure working against housing objectives would be to combine green belt swaps with New Homes Zones, as proposed in this report.

Impact on housing supply

If only 0.5% of current green belt land is swapped in this way over a 15 year period, and all the resulting sites were built out at average village densities, it would provide over 16,000 additional homes each year for that

15 year period (see Appendix 2). In our overall illustrative modelling we assume that green belt swaps are combined with New Homes Zones to avoid double counting.

Graph 22: Impact of green belt swaps alone on housing supply



Source: KPMG/Shelter illustration

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Housing programme for

HM GOVERNMENT

2015-2020

4 A programme for government

The new housing principles our country needs

The housing shortage is one of the major strategic weaknesses that our country faces. The shortage is holding back our economy, hurting businesses and pricing people out of a stable home of their own. It has been caused by decades of building too few homes.

HM Government 2015-2020 will learn from the mistakes of the past and reverse the decades-long trend towards fewer homes and higher prices.

Objectives for the 2015-2020 Housing Programme

We will get the country building homes that people want to live in.

Homes will be attractive, large enough for families and well-connected to jobs and local services. Where new homes are situated will reflect local demand and building will focus on where the shortage is most acute.

..... ■

We will get the country building homes that people can afford to live in.

People of all incomes will be able to buy or rent a home at a price they can afford. This will mean building a mix of tenures, including social, shared-ownership and owner occupied homes.

..... ■

We will get the country building homes in communities that will last.

Homes will genuinely integrate into and extend existing communities, or form entirely new communities capable of sustaining themselves. Public and private green spaces will be prioritised and environmental factors, such as flood risk, will be taken into account.

..... ■

We will ensure that house prices remain stable.

The housing market will not be allowed to distort or destabilise our economy again. People will have the confidence that their children will be able to afford a decent home in the future.

..... ■

We will work with both the public and the private sector.

Land owners, banks and developers will be able to make a profit from the housing market, but cannot expect to extract disproportionate value from development that the nation needs.

..... ■

We will usher in a new era of strategic local leadership.

Local leaders will have the powers and the confidence to set out positive visions for the future of their areas, and the resources to implement them.

..... ■

Our government will set the standard for future generations of political leaders.

The numbers of homes built over the course of our government will dramatically increase. In the process we will transform our housing supply system into an effective engine of economic growth that will meet the needs of our people now and for the next generation.

..... ■

Our programme to kick-start a long-term change

To put our principles into action, HM government 2015-2020 will deliver an ambitious programme of change.

ON DAY ONE

Explicitly state our commitment to new housing

We will announce that one of the defining missions of our new government will be to tackle the desperate housing shortage, commit to the transformative principles that our country needs, and announce a five year programme to kick-start a long-term change.

Promote housing to the Cabinet

We will promote housing back to the top table of government for the first time since 1970, to confirm house building as a top political priority within our administration.

WITHIN 50 DAYS

We will set out our full agenda and get serious momentum behind our priorities through the following measures:

Put new housing at the heart of a post-election Budget

In an emergency budget following the election we will:

- Launch a rapid review to rationalise the many funding streams that local authorities and LEPs currently draw on for local growth, homes and infrastructure. The emphasis will be on increasing access to investment to unblock stalled sites with infrastructure investment.
- Start setting up a Housing & Infrastructure Bank to reduce housing association borrowing costs and help fund initial land purchases by development corporations and joint ventures. The Bank will be partly funded by tax-free housing ISAs.

- To incentivise building, introduce new tax powers for local authorities to levy Council Tax on sites with planning permission if homes have not been built within a set timeframe.

- Increase the powers of local authorities to tax empty homes, by building on the Coalition's reforms. We will aim to reduce long term empty homes to below 1% of the private housing stock in England.²¹³

- Double the size of the Affordable Homes Programme per year (to £2.2 billion), extend it to 2020 and change its terms to prioritise lower rent tenures.

- Extend local authorities' borrowing caps for those which have HRAs by £1 billion, building on the £300 million extension in 2013.

- Provide government guarantees to incentivise banks to lend to small builders, using resources from existing contingent liabilities in the Help to Buy scheme.

Together these measures will signal to the market that our government's policy will focus on boosting housing supply and will target stable house prices.

■ WITHIN 100 DAYS

We will embed the reprioritisation through initiating the following legislative and regulatory change:

Introduce a new Housing and Planning Bill 2015

In landmark new legislation we will:

- Give local planning authorities the power to create New Home Zones – strategic growth areas with no development taxation and a competition to gain development rights.
- Require the Valuation Office Agency to start publishing land price data at an appropriate spatial level and the Land Registry to collect and publish data on option agreements for land. Data on land ownership will be made freely available and more easily accessible for both public and market participants alike.

²¹³ There are around 288,000 long term (more than six months) privately owned empty homes in England. This represents around 1.6% of the stock. Shelter, Taking Stock, 2011

- Extend powers for local authorities to swap low value agricultural or marginal land out of green belt land, adding equivalent areas to the green belt elsewhere. This will be linked to mechanisms such as rural exception sites which can limit destructive speculation on land price.²¹⁴
- Extend the Nationally Significant Infrastructure Projects planning process to enable new housing sites to be combined with major infrastructure schemes, such as new rail or road links, with the approval of local planning authorities.
- Strengthen the ability of local authorities and other bodies (such as development corporations) to buy land at existing use value plus a premium (e.g. 125%) and streamline the process. An independent, fast, land tribunal will decide the appropriate price and whether the purchase meets all statutory requirements, modelled on the Dutch and US compulsory acquisition processes.

Publish a new Housing Strategy for England

Our new housing strategy for England will contain:

- **A spatial plan which allows local leadership.** This will set out how housing policies can be tailored by local leaders to London, core-cities, buoyant towns, rural villages and low-demand markets. There will not be a one size fits all approach.
- **A tenure mix plan.** Housing need will be objectively assessed and met locally. Independent assessment of metrics such as house price to income ratios, rent levels, household growth and un-met housing need will be commissioned by LEPs to give local leaders a clear steer on the housing needed.
- **A plan to stabilise the housing market.** Working with the Bank of England and the Treasury the strategy will set out policies to ensure that house prices are stabilised, taking into account the divergent position of local markets across the country.
- **A plan to ensure construction skills shortages can be met with new apprenticeships and that the industry has the stability for investment in the supply chain.**

²¹⁴ Shelter, Solutions for the Housing Shortage, 2013

Include housing in a devolution settlement for England

Building on the Heseltine Review we will provide a clear agenda for greater city autonomy, including housing as a core part of our devolution agenda.²¹⁵ We will:

- Use renewed City Deals with the 'core cities' to promote a housing and growth agenda. In particular, we will look at devolving Homes and Communities Agency budgets and powers to successful city-regions, if they can prove that they will provide long term, cross-boundary strategic leadership on housing and infrastructure growth.
- Offer local authorities the chance to sponsor New Garden Cities as equity partners in development corporations, with the promise that they will gain from the land value uplift of sites in the short term, and make long term revenue from their equity stake.

Launch a review to set clear space and quality standards for new homes

We will task an independent review set clear space and quality standards, to create a level playing field for developers and ensure that the homes we build are homes that people want to live in, and are suitable for changing needs and demographics.

²¹⁵ Lord Heseltine, No Stone Unturned, BIS, 2013

■ WITHIN ONE YEAR

We will have made serious progress on house building and established a clear direction of travel. Legislative change will have been enacted and early spending decisions taken. We will see an uplift in completions, especially in the affordable sector which can respond rapidly to investment.²¹⁶ Further action will be needed however to lock-in the growth in home building. We will:

Publish plans for new Garden Cities

Taking account of the Wolfson Economics Prize and initial interest from local authorities, we will publish plans for five new Garden Cities, towns or urban extensions to be started within the life-time of the parliament. This will build on the plan for a new Garden City already announced for Ebbsfleet in Kent. We will draw on lessons from the postwar New Towns programme, earlier Garden Cities, and successful international examples.

..... □

Link homes and major infrastructure more closely

We will update the National Infrastructure Plan, amending its objectives on transport and energy infrastructure to include new homes. Extending the Nationally Significant Infrastructure Projects (NSIP) process to cover large residential developments linked to new major infrastructure will make it easier to plan on this basis.

..... □

Require housing needs to be assessed across economic areas

We will create a defined statutory role for LEPs in commissioning objective, cross-boundary needs assessments to give planning authorities much better data on what new homes are needed where.

..... □

Launch an independent review of property taxation

Property taxes could be an important lever for stabilising housing markets and realigning developer incentives, and could provide revenue sources for house building. An independent review will provide evidence and recommendations to the new government.

²¹⁶ In 2008, the £8 billion National Affordable Housing Programme was introduced which saw output by housing associations grow more than 25% over the subsequent two years

■ WITHINTWOYEARS

We will have consolidated our new vision for housing supply and enacted many of the reforms necessary to realise it. We will see:

- More investment flowing into affordable housing with housing associations increasing the number of homes they start building, including homes for shared ownership.
- Local authority home building increasing as those constrained by borrowing caps – especially in London and the South East – access the finance they need to build on their own land.
- Private builders either starting stalled sites or selling them to those who will build. More and more small builders accessing new sites and getting building.

To continue to drive the change that the country needs we will:

Consult on the plans for the first new Garden City, town or urban extension

We will learn from the failure of the 'Eco-Towns' initiative under the 2005-2010 government and build consensus for the homes we need.

..... □

Test whether the changes implemented are increasing or decreasing councils' five year land supply and the number of sites with planning permission

We will follow an approach that is responsive to success and adapts quickly when measures are not working. Comprehensive testing and monitoring of the programme will be essential.

..... □

Continue to work with small and medium sized builders to overcome the barriers they face

Small builders will play an absolutely essential role in increasing the level of house building. We will take the necessary steps to get the investment that small and medium-size enterprises need to turn building skills and entrepreneurial endeavour into new homes.

Monitor the supply chain, the cost of raw materials and labour to ensure that industry is able to gear up to the expansion in home building

A significant upturn in the level of house building will require a significant upturn in the number of skilled builders that our country produces. It will be necessary to invest in skills for the many thousands more who could be employed in construction, architecture, planning and many other industries to take full advantage of the economic opportunities and make it possible.

..... □

Launch a competition for the best use of published land and housing market data to improve the effectiveness of the private land market

The 2015 - 2020 government will see an effective housing market free from market-failures as being central to increasing supply. This will mean more competition between suppliers and house builders, not less. We will use the effective influence of government to bring greater transparency to housing markets.

..... □

Continue to raise the borrowing cap on local authorities with Housing Revenue Accounts if they prove to be able to deliver affordable homes at scale

In budgets through 2016 - 2020, the government should continue raising local authority borrowing caps towards prudential borrowing levels. This should not impact on measures of public sector net debt, as the government should bring accounting into line with international practice.

..... □

■ BY THE END OF THE 2015-2020 GOVERNMENT

By the final years of the next parliament, we will target a major increase in house building with the number of homes built per year heading over 200,000 for the first time in decades.

We will secure a step-change in house building for the long-term by:

Starting the first new Garden Cities, towns or urban extensions

Before the end of the 2015 – 2020 government we will begin building work on the first new Garden Cities, towns or urban extensions.

..... □

Quickly growing the custom build sector by giving as much scope to local authorities and others as possible to innovate on different models to make land available

We will unlock the huge potential that currently exists for people to build and commission their own homes, further increasing quality and creating spaces that are genuinely tailored to them.

..... □

Ensuring that local authorities are using stronger compulsory purchase, tax and land assembly powers to bring more land into the market at an affordable price

We will work with landowners to get the country building, but where there is no movement we will not shy away from taking the strong measures that the country needs. As such, we will empower councils to use a variety of tools to free-up suitable land for building.

..... □

Raising the local authority borrowing cap further if councils prove they can deliver homes at scale and value for money for the tax-payer

Many local authorities are desperate to build new homes to find homes for people on their housing waiting lists. Where councils are able to demonstrate their capacity to deliver those homes they will be empowered to do so.

..... □

Conclusion



People on ordinary incomes should be able to buy or rent a home at a price they can afford today, and have confidence they will be able to afford tomorrow. That simple goal necessitates a housing supply sector that delivers the number and type of homes we need.

If we can solve the dysfunctions at the heart of our house building system, we can create a market that builds enough homes, at reasonable prices. Nothing less will do. The good news is that this has already been achieved in comparable countries that have intervened to create more stable housing and land markets, and in doing so have transformed the quality and quantity of their housing stock.²¹⁷

We can do so in England too.

²¹⁷ Hall and Falk, Good Cities, Better Lives, Routledge 2013

A Summary of evidence

KPMG and Shelter have worked together on the analysis and solutions for this report for over a year, building on the evidence set out in several prior reports as well as new evidence and analysis. Below are listed some of the main pieces of evidence feeding into our analysis.

Appendix 1: Summary of new research

West Midlands Evidence Report

KPMG and Shelter, Homes for the Next Generation: Lessons from the West Midlands, 2013

KPMG and Shelter conducted a series of joint round-tables in the West Midlands in 2013 to speak with all players in the housing supply system about why not enough had been built over recent years and what interventions they felt could increase housing supply. We spoke with local authorities, small and large house builders, housing associations and the LEPs in three round-tables, with a final round-table bringing all parties together. This was followed up by a series of meetings with other stakeholders in the West Midlands led by KPMG.

The evidence from these round-tables suggested that the dysfunctional land market, falling investment and the lack of a strategic vision across all parties were the main factors, which informed our analysis in this report. Participants did not think that development finance or the planning system were the most significant barriers, although they did think that the planning system was far too slow.

The house building industry

Europe Economics, How to Increase Competition, Diversity and Resilience in the House Builder Market, 2014

Declining competition and resilience to economic shocks in the house building industry was identified as a major barrier to expanding housing output in KPMG and Shelter's West Midlands analysis. Europe Economics were commissioned to look in greater depth at why the house building industry was increasingly dominated by a few major players and test different policy interventions designed to increase the diversity of firms in the market and their resilience through the market cycle.

Their analysis found that the single most important intervention to boost competition and resilience long term was to stabilise the house price cycle to reduce volatility. However, they found that a range of interventions could have a net positive impact on supply by improving competition, diversity and resilience of the sector:

Policy		Impact	Impact timescale
1	Introduction of diversity of supplier guidelines or rules in procurement policy for the HCA	Would increase diversity and choice within the sector, resulting in a more responsive supply in the longer term.	<i>Medium- to long-term.</i>
2	Assembly of sites owned by the public sector to create a property portfolio for local authority pension funds	Around 24,000 units over ten years if the model used in the Housing Investment Fund by Manchester City Council is rolled out nationally.	<i>Short-term.</i>
3	Introduction of a stronger principle of avoiding the creation of house price cycles through policy	Faster, early build-out rates which may have lasting effects as reduced house price volatility improves responsiveness of supply.	<i>Short-, medium- and long-term.</i>
4	Creation of a special administration regime for 'zombie house builders' whereby the Crown reasserts its fundamental ownership of the land if a house builder becomes financially distressed (e.g. insolvent)	Up to 36,000 units over three years on the basis that the downturn is advanced. Future downturns would be well served as distressed land is made available, allowing for a more responsive supply.	<i>Long-term.</i>
5	Introduction of the relevant change of use taxation as soon as planning permission is granted	Faster, early build-out rates as a result of the increased cost of holding undeveloped land.	<i>Short-term.</i>
6	Government ensures that capital requirements reflect systemic risks associated with house building	Potential to increase build-out rates, as finance becomes more readily available, reducing a key barrier to growth and allowing a more responsive supply.	<i>Short- to Medium-term.</i>

Long-term investment in affordable housing

Capital Economics, 2014

Shelter commissioned Capital Economics to develop and stress-test a number of investment options for affordable housing which could be used to help attract the extra £12 billion of public and private investment in affordable housing that is needed for this programme.

Capital Economics looked at:

- An affordable Housing and Infrastructure Investment Bank
- Savings products (such as Housing ISAs) to provide ongoing funding for such a bank
- Special Purpose Vehicles for housing associations
- Increasing local authority borrowing caps
- Tax increment financing
- Public sector land lease
- Guarantees for SME builders

Capital Economics ran a stress-testing workshop with senior figures from lenders, house builders and other industry players in February 2014.

Land market interventions

IPPR and Shelter, for publication 2014

Shelter have partnered with the think-tank the Institute for Public Policy Research (IPPR) to understand how local land markets could release more development land.

In particular, the two organisations have looked in detail at the land markets in dynamic cities with particularly acute housing affordability problems i.e. York, Bristol, Oxford/Bicester and Cambridge. Shelter and IPPR interviewed senior figures in the planning and leadership teams of the relevant local authorities to understand the local context and stress-test ideas for land market interventions.

The detailed findings will be published in a separate report, but initial findings have fed into the analysis for the joint KPMG and Shelter report.

A Assumptions and methodology of the policy illustrations

Appendix 2: Assumptions and methodology of the policy illustrations

In this report, KPMG and Shelter present some illustrations of what may happen to housing supply with no intervention and what might happen if the interventions that we recommend are put into action.

These illustrations are simple and based on a set of assumptions set out below. The housing supply system is extremely complex and linked into the performance of the wider economy. We have not attempted to provide a fully robust forecast for housing supply out to 2020 and beyond, rather what we have done is shown broadly the scale of impact we would expect from the individual policy interventions and the programme as a whole, all things being equal.

1. No change base-line scenario

Our scenario for future housing supply with no intervention is based on the following assumptions:

- For private building of homes for sale we have assumed 7.7% annual growth for 2014 and 2015 and then 3.85% from 2016 onwards. This is based on historic completions data for the 50 years before the 2007 slump. Private market housing grew on average 7.7% in periods of expansion, but more than half the years over that 50 year period private market house building either contracted or stagnated.²¹⁸
- Housing associations continue with the same level of annual output of affordable homes as for the five year period since the recession in 2007. While the government has ambitious plans for housing association delivery²¹⁹, the budget for affordable home building 2015 – 2018 is smaller than for 2011 – 2015 and there is no confirmed budget post 2018.
- In 2013 local authorities built just over 800 affordable homes in England. We project that without intervention local authorities will expand to 3,000 units per year by 2017 due to extra financial autonomy from HRA reform and current expansion plans.²²⁰
- The base line for all data is 2013 annual data on completions by tenure (Live Table 244).

²¹⁸ DCLG, Live Table 244 Completions Private Enterprise and Shelter calculations

²¹⁹ HCA, Prospectus 2015-18 AHP Programme, 2014

²²⁰ Perry, Let's Get Building, LGA 2012

2. KPMG and Shelter programme (total)

Our scenario for the KPMG and Shelter programme is based on an aggregate of the individual policy interventions, with units that may be double counted removed.

- The total output from land market interventions has been deflated by one third, to account for units which are funded through the investment package but may be built on land brought forward by land market interventions.
- The impact of New Homes Zones is taken out of the total figure entirely, as it is quite possible that local authorities would combine this policy with green belt swaps.
- The coloured bands for each of the four 'themes' (strategic local leadership; diverse and resilient industry; public and private investment; and land market reform) are highly illustrative. We have grouped together the total output from the policies that fit under the four categories and subtracted the units deflated from the total as set out above. We have taken 20% of the land market intervention total and grouped that into 'diverse and resilient industry' as we expect 20% of the plots from major land interventions to be used for custom build, which will help provide plots for local builders.
- Assumptions for each individual policy intervention are listed below. Not all interventions could be quantified and so are not included either as a quantum or as a multiplier. The 'total' scenario may therefore be an underestimate of what the programme could deliver.

3. Investment package

Assumptions:

- To understand how many new affordable homes could be built from extra investment we need assumptions on how many units can be built for an amount of spending (units per £ spent) and also an assumption about how quickly affordable house builders could expand their production to meet the extra level of investment (absorption rate).
- Units per £ spent. We model an additional £12 billion of capital investment for affordable home builders for the period 2015 – 2020. This is on top of the already allocated £3 billion for 2015 – 2018. The additional investment would be capable of delivering over 200,000 new homes on the assumption that half are social rent, a quarter are intermediate rent and a quarter are shared ownership. We assume half of this additional investment is extra grant investment from central government and half is direct investment from private institutional or other investment. Shelter and Legal & General have estimated that two major institutional investors could fund 5,000 new affordable units each per year, but that this would rely on new land market innovations (such as New Homes Zones or local authority land joint ventures). We model the private investment as having the same supply impact as public grant.
- Absorption rate. To model how quickly the extra investment could be absorbed we assume that grant funded affordable house builders are able to expand their total output by a maximum of 19% for three years and then by 13% for the following five years. In 2008/09 following the introduction of the £8.5 billion National Affordable Housing Programme (NAHP) the number of affordable homes built by housing associations increased by 19%. We assume 13% growth for the following years so that the programme delivers the 200,000 additional affordable homes we are funding through public and private investment. Our assumption is that expansion is fast, but with additional investment and land market interventions affordable home builders will have a lot of support.
- To calculate the number of additional affordable homes built by local authorities we assume that the caps on Housing Revenue Accounts are raised progressively through the parliament until they are in total £7 billion higher than current (2014) levels. We assume that it takes eight years to make full use of the caps with local authority output rising from 2,600 units in 2015 to 9,600 in 2022.
- Capital Economics calculate that a new National Housing Investment Bank could increase the supply of new affordable and market homes by 7,400 per year from 2019 onwards (if it is set up in 2015). Their calculation is based on a 100bp cut in the cost of funds to housing associations and the impact this would have on their own development and ability to buy S106 properties from private developers.
- Capital Economics calculate that more use of joint ventures on local authority land could increase the supply of new affordable and market homes by 6,800 homes per year from 2018 onwards based on 2005 – 2013 average build rates and the assumption that removing the input cost of land would increase the ability of housing associations to borrow and build, all things being equal.

4. Stalled sites and build out rates: Infrastructure boost and development tax

Assumptions:

- It is difficult to calculate what impact extra infrastructure investment would have on stalled sites, as each site is different. We have therefore used a proxy to calculate what impact our proposed £250 million infrastructure pot would have across the 55,800 stalled units in England.
- We use the Milton Keynes Development Tariff as a proxy. The Development Tariff is a charge to land owners within the urban development area to pay for the additional infrastructure requirements created by building new homes. The Tariff is £18,500 per unit which (unlike the Community Infrastructure Levy) gives us a stable figure from which to calculate the impact of a national infrastructure fund. We assume that a subsidy of £18,500 per unit would be enough to ensure viability of a proportion of units that are currently stalled.
- £250 million of infrastructure subsidy would unlock 13,500 units if we take the Milton Keynes figure above. To deliver those 13,500 units we assume that a higher proportion are unlocked in year one (8% of stalled units) with declining marginal impact each year out to year seven (2% of stalled units). This is because those sites closest to viability would be started first with declining impact per site over time.
- In addition to the infrastructure subsidy we have proposed a 'change of use' taxation across all sites in order to speed up build out rates (stalled or otherwise). The taxation would apply after a reasonable period of time to incentivise build out and would be based on the Council Tax that would be generated if the homes were built and occupied.
- Europe Economics constructed a model to determine what impact the tax would have on the build profiles of different sizes of house builder. The table below shows a hypothetical 2,000 unit site being built out over ten years by a medium sized house builder. With no tax, the build out rate starts slow and remains steady across ten years. With the tax, build out speeds up and is concentrated towards the start of the ten year period.
- Using Europe Economics calculations for medium sized house builders in conjunction with infrastructure spending across England's 55,800 units on stalled sites, we calculate that an additional 26,400 units would be built across the seven years modelled from 2015.

Medium House-Builder –Hypothetical 2,000 unit site

Year	Units built – no tax	Units built – with tax	% difference
1	109	134	23
2	187	218	17
3	208	230	10
4	222	247	11
5	250	269	8
6	239	247	4
7	208	213	2
8	226	236	5
9	193	197	2
10	158	9	-94

5. New Garden Cities

Assumptions:

- We assume that a new government will build five new Garden Cities of a similar size to Welwyn and Letchworth. We assume 30,000 units at full completion.
- The build out rate will be 1,000 units per year on each new site. Milton Keynes which started building in the late 1960s is now a town with over 100,000 dwellings, showing that this build out rate is achievable.
- We assume that the first two sites will start in 2018 at the earliest, due to the period of design and consultation.

6. New Homes Zones

Assumptions:

- We assume that the average size of a New Homes Zone will be 500 units. This is a conservative assumption and many could be larger. The North West Cambridge Development which is the type and scale of development we envisage is for 3,000 new homes.
- We very conservatively assume that just 10% of local authorities in England will use New Homes Zones each year, rising by 2% per year to hit 22% by 2022. In the Dutch VINEX programme, from which this policy takes much of its inspiration, total Dutch housing stock was increased by 7.6% with ninety urban extension schemes as well as inner city developments.²²¹
- The build out rate will be 250 units per year. The build out rate planned for the North West Cambridge Development averages 230 per year for 13 years.²²²

7. Green belt swaps

Assumptions:

- 0.5% of England's 1,639,540 hectares of green belt land will be swapped over a period of 15 years. We have assumed a small amount of land is swapped in this way as any local decisions on green belt land will require public consultation. City of York Council has recently proposed to develop 1.8% of green belt land over 15 years suggesting our assumption is moderate.
- Development will happen at village density of 30 units per h.a.
- It will take one year to implement the legislation to allow more green belt swaps (start date assumed to be 2016).

8. Nationally Significant Infrastructure Projects

Assumptions:

- There are currently 100 NSIPs in progress since the process was introduced in 2008/09, we estimate that five opportunities to link medium housing sites to major new infrastructure will be identified per year in England.
- The build out rate will be 250 units per year per project as with New Homes Zones.
- We assume 500 units per project.
- Construction assumed to start in 2017 due to passing legislative changes and identifying appropriate sites.

²²¹ Hall and Falk, Good Cities, Better Lives, 2014

²²² North West Cambridge Planning Application, Phasing and Implementation

9. LEPs to co-ordinate cross-boundary needs assessments

Assumptions:

- When regional spatial plans were scrapped, there was a net loss of 270,000 planned units in England.²²³
- We assume that over a 16 year period, strategic SHMAs commissioned by LEPs move us back towards a more strategic overview of housing need within functional market areas and therefore back to the RSS level. 16 years is the time period considered in the cited Tetlow King study for the development of the 270,000 planned units.
- This is the equivalent of an extra 16,800 planned units in England per year.

10. Help to Build

Assumptions:

- Capital Economics estimate that a minimum of £40 million guarantees are needed to return commercial lending to SMEs to pre-recession levels. This may be higher depending on the risk appetite of lenders. Capital Economics estimate that this will deliver 3,000 extra units per year.

11. Expanded City Deals

Assumptions:

- It is very difficult to estimate what impact extra infrastructure spending will have on house building. We assume the total scheme cost of infrastructure works is £55,000 per unit based on a proxy. We use plans for development in Cambridge as our proxy for total scheme infrastructure costs.²²⁴
- The annual pot available to LEPs for local growth is £2 billion. We assume that 20% of this is earmarked for unlocking homes and infrastructure.
- This will deliver 7,000 extra new homes per year.

²²³ Tetlow King and Policy Exchange, 2012

²²⁴ Falk, Beyond Ecotowns: the economic issues, 2008

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