March 2010

Home Builders Federation (HBF)
Budget Submission 2010

The Home Builders Federation (HBF) is the principal trade association representing the interests of private housebuilders in England and Wales. Our members, who include companies ranging from major national firms, through regional companies to smaller local companies, are responsible for more than 80% of the new homes built every year.

1. EXECUTIVE SUMMARY

We have very much welcomed the early and very substantial Government measures to stem the fall in home building. However recovery in the housing market and home building remains fragile. Home building has a rapid and dispersed impact on the economy and employment, so that encouraging a recovery in home building will contribute to wider economic recovery.

On the demand side, the critical condition for home building is a restoration of **mortgage availability** and higher LTVs. We share the CML's concern that too early withdrawal of Government support for lenders could reverse the modest improvement in the mortgage market and abort the home building recovery.

In considering **mortgage market regulation**, the FSA and Treasury must be mindful of potential unintended consequences for the home building industry.

First-time buyers, who play a critical role in the housing market, are going to need support until the mortgage market fully recovers. We believe the **first-time buyer savings scheme** announced by the Prime Minister in 2008 should be developed. We wish to see **HomeBuy Direct** become a permanent form of support. And we believe HM Treasury could play a key role in helping with the development of **mortgage indemnity guarantee (MIG) policies** to encourage lenders to offer higher LTV mortgages.

The current unfair slab system for **SDLT** should be replaced by a fairer slice system. To help encourage expansion of private rented housing supply, SDLT should be charged on single dwellings when investors make multiple purchases

HM Treasury should consider allowing **housing investment within SIPPs**.

HBF was very pleased with the various **Pre-Budget Report announcements on housing**. We will continue to work with Treasury, CLG and other departments to carry forward the various initiatives.

The imposition of a positive rate of **VAT on new homes** would have a disastrous impact on new home building, it would undermine achievement of a range of other policies funded in whole or in part out of residential land value (e.g. Affordable Housing), and it would raise no additional public funds.

On the Government's **zero-carbon policy**, we very much hope HM Treasury will accept the important concept of Allowable Solutions and be willing to work with the industry to develop efficient, market-based means to deliver these. We remain concerned about how to get from the percentage energy saving that is technically achievable and cost effective through fabric efficiency to the 70% Carbon Compliance target set in the revised zero-carbon definition.

We would ask HM Treasury and HMRC to reconsider their proposed approach to changing the tax rules relating to **"false self-employment"** in construction given the acknowledged adverse impact these proposals would have on the flexibility of the home building industry and on the costs of regulation.

2. INTRODUCTION

Housing completions fell to a post-war low in 2009 (118,000 in England, around 142,000 in Great Britain). Although the market has shown some modest improvement, this is from an extremely low base, most forecasters expect a subdued recovery over the next three years, and we believe the recovery remains fragile. The industry has suffered a large-scale loss of capacity since the second half of 2007.

The most important conditions for a sustained recovery in home building are:

- **Demand**: sustained economic recovery, and a restoration of mortgage finance on affordable terms (especially LTVs);
- **Supply**: an adequate supply of viable, permissioned residential land in locations where people want to buy homes and live.

Based on the steep fall in housing completions since 2007, along with individual company announcements, it seems likely that somewhere between 100,000 and 150,000 house building jobs were lost during the recession, out of total house building employment in 2007 of an estimated 320,000. An academic study for HBF in 2005 found that, on average, there are approximately 1.5 direct house building jobs per new dwelling, with further employment benefits down the supply chain and on into the wider economy.

So for every 10,000 additional homes completed, we might expect 15,000 additional direct house building jobs, plus a multiplied increase down the supply chain. While a sustained economic recovery is required to support a recovery in home building, higher levels of home building will in turn help boost economic growth. Increased home building has a rapid and dispersed positive impact on the economy and employment.

HBF very much welcomed the Government's early and very substantial measures to stem the downturn in home building and assist the industry. We estimate that HomeBuy Direct, Kickstart, the stock purchase scheme in 2008, and the first phase of the Public Land Initiative, will result in over 40,000 additional new homes sales between 2008 and the end of Kickstart in 2012. For larger companies participating in HBD, we estimate that HBD accounts for around one fifth to one quarter of market sales. Many jobs will have been saved because of these and other more general measures such as the Stamp Duty holiday, action to stem repossessions, and the very significant funds allocated by the Treasury and Bank of England to support mortgage lenders.

3. DEMAND CONDITIONS

A firmly-established recovery in the wider economy and housing demand is a pre-condition for a sustained recovery in home building.

3.1 Mortgage Finance

The supply of mortgage finance on affordable terms remains a serious constraint on new home demand. HomeBuy Direct, along with house builders' own shared-equity schemes and other sales incentives, have helped home builders during the last 12-18 months. However these can only ever be temporary measures. We need a return of higher LTV mortgages, at more affordable rates and charges, to facilitate a sustained increase in home building. We should also note our continuing concern that many lenders offer less favourable terms (e.g. lower LTVs) for new home buyers than for those buying second-hand homes.

The CML has argued that the Government and Bank of England will need to consider extending their special support measures for lenders if refinancing some £300 billion of mortgage funding currently supported by Government schemes by 2015 is not to cause severe disruption to the flow of mortgage funds into the mortgage market. We share the CML's concern. If the current very modest relaxation in the mortgage market were to be reversed, the recovery in home building would be aborted.

Discussion about mortgage availability quite understandably tends to be focused on first-time buyers. However from an economic perspective, the health of the whole housing market - younger first-time buyers, families, older home owners - is important. For example, if older home owners are more easily able to sell their large family homes and trade down to smaller properties, this provides direct social, economic and health benefits to the older households themselves, but it also frees up homes suitable for families trading up to larger properties, which in turn frees up smaller units suitable for first-time buyers.

In our submissions to the recent FSA and Treasury consultations on mortgage regulation, we stressed that any tightening of regulation must take account of its potential impact on the new homes industry. In particular, regulation of buy-to-let and second-charge mortgages could have a disproportionate and unintended negative impact on new home sales.

3.2 Supporting First-time Buyers

First-time buyer numbers are at historic low levels. The CML estimates that around 80% of those able to buy receive financial assistance, and the average age of the remaining 20% of unassisted buyers is an extraordinary 37. The average first-time buyer deposit had risen sharply from around £11-13,000 between 2004 and the end of 2007 to almost £35,000 by the end of 2009.

While the current difficulties faced by first-time buyers have been seriously aggravated by the exceptional circumstances of the credit crunch, first-time buyer numbers were already in decline prior to the credit crunch. CML statistics show that from a quarterly peak of 167,400 in 2001 Q3, first-time buyer loans had already fallen to around 96,000 per quarter in the middle of 2007. The most important cause of this decline must have been declining affordability as house price growth far outstripped earnings growth.

As noted above, HBD has been a very positive support for new home sales to first-time buyers during the recession. However first-time buyers are going to need continuing assistance in the recovery. It is going to take time – possibly some years – before higher LTV mortgages allow first-time buyers to buy without a very substantial deposit. House prices are still very high in relation in average earnings, despite the fall in prices during the recession, so that average first-time buyer mortgages are going to remain substantial. Many first-time buyers already have sizeable student debt even before they contemplate taking out a mortgage to buy a home. And employment of young people has been particularly hard hit during the recession, so that many potential first-time buyers are going to take longer than in the past to achieve higher incomes through career advancement.

We strongly urge the Government to make HBD a permanent form of support for first-time buyers. Current indications are that high LTV mortgages are going to remain scarce, and their costs high, for quite some time. We are already holding very positive discussions with HCA officials about the future of affordable housing, including HBD.

But funding for HBD, and its overall impact, will always be limited. Therefore we believe the Government will need to do more to assist first-time buyers.

We were most encouraged when the Prime Minister announced Government support for a first-time buyer savings scheme in the 2008 Queen’s Speech. However subsequent discussions with HM Treasury suggest this proposal was not taken any further. We would urge the Treasury to give serious consideration to such a scheme, working with lenders and, if necessary, the home building industry.

We would also encourage the Treasury to consider whether the Government might play a role in encouraging the insurance industry to re-introduce mortgage indemnity guarantee (MIG) insurance. HBF has held discussions with the CML, lenders and some potential MIG insurers, but to date the only proposals to emerge have been either very expensive, or only the embryo of an idea. Whether or not Treasury can offer direct assistance, we would welcome it playing a facilitation role.

3.3 SDLT

The Stamp Duty holiday must have helped nurture last year's recovery in home building, so we were disappointed HM Treasury did not extend the holiday beyond 31st December.

For many years there have been calls for the current unfair slab system of SDLT to be reformed to a slice system in which buyers crossing one of the SDLT price thresholds pay stamp duty at the higher rate only on the price above the threshold. We would strongly urge the Treasury to consider this long-overdue reform in the 2010 Budget. The cost would be relatively modest, given the low levels of transactions at present, and it would provide further support for housing demand which remains very fragile.

We would also urge the Treasury to change the rules regarding the stamp duty treatment of multiple purchases by residential landlords. One of the deterrents to establishment of a large-scale, professional, institutionally-funded private rented sector is that multiple purchases are liable for 4% stamp duty as they are treated as a single transaction, whereas a private buy-to-let landlord will usually pay the lowest rate, or avoid stamp duty altogether, when buying one or two properties independently. This change should not mean any significant reduction in revenue for the Treasury because such transactions are currently not likely to be very common.

3.4 Residential Investment in SIPPS

As in last year's Submission, we would urge the Treasury to reconsider its previous decision not to allow housing investment within SIPPs. At the time there was a risk this might add fuel to an already booming market, clearly not an issue today. This would provide a new source of demand for housing and benefit private home building at no additional cost to the Treasury. We believe this would be a particularly attractive proposition at present with savings rates so low and house prices at more affordable levels. It would provide a more stable, long-term source of investment funds flowing into housing than the buy-to-let market which is unlikely to return on the scale seen up until late 2007.

4. SUPPLY CONDITIONS

4.1 Pre-Budget Report (PBR) Announcements (Box 5.2)

We were very pleased with the PBR's announcement of the National Baseline of regulatory costs, although we are disappointed it is restricted to central government, compulsory national policies and regulations. This omits large areas of the "cumulative" burden: a range of policies and regulations imposed by central Government other than those included in the National Baseline, and all of those imposed by local authorities and various government agencies (Highways Agency, Environment Agency, Natural England, CABE, etc). We continue to discuss the cumulative burden with officials across Government, and our HBF regulatory burden working group will be assisting the consultants undertaking National Baseline research for CLG.

We were also very pleased with the decision to postpone the introduction of Lifetime Homes until 2013 at the earliest. We believe this policy is seriously flawed and we look forward to the proposed consultation on the standard.

We also look forward to the forthcoming consultation on the appropriate usage of S106 agreements following the introduction of the Community Infrastructure Levy (CIL). We have throughout the many years of consultation on the Planning-gain Supplement and CIL been most concerned that the industry is not hit with a double charge. It is absolutely essential S106 demands are scaled back substantially, and that any items included within a CIL cannot also be demanded within a S106 agreement.

We were especially pleased with the PBR announcement of an investigation of local authority five-year housing land supplies. Feedback from HBF members suggests many of these are far from robust. We look forward to seeing the results of this study and hope CLG and PINS will be able to improve the way in which five-year land supplies are compiled and monitored in future.

4.2 VAT on New Homes

There has been some press speculation about a rise in the VAT rate and elimination of zero rating. An end to new home zero rating would have a disastrous impact on new home building and would not generate any additional funds for the public sector.

New homes represent only 10-12% of total housing market sales, so that home builders are price takers. Because a positive VAT rate could not be passed on to new home buyers, most of the cost would have to be met out of land values.

As HM Treasury is well aware, the cumulative burden of taxation, policy and regulation imposed by central and local government and various public agencies is already so onerous that many housing sites across England are not viable, especially when taken together with the sharp fall in land values since 2007. Non viability extends to virtually all regeneration sites and large strategic greenfield sites, including in the high-value south, and most brownfield sites outside the highest-value areas of the south.

If VAT were imposed, whether at the full 17.5% or a reduced rate, it would mean virtually no housing site in Britain would be viable and home building would collapse.

For example, for a site with a land value equivalent to 20% of the sales value <u>before</u> regulatory costs, VAT at 5% would reduce the residual land value by a quarter (assuming the full cost of VAT would have to be born by the land value), at 8% by 40%, and at 17.5% by 87.5%. In the case of a regeneration site with a much lower land value (say 5-10%), VAT would wipe out most or all of the entire land value <u>before</u> regulatory costs.

Given that the regulatory burden already eats up a very large proportion of the residual land value (in many cases more than the entire value, generating a negative land value), there is little or no land value available to carry any additional burden from VAT.

To avoid a positive rate of VAT on new homes causing a collapse in private new home building, the regulatory burden in other areas would have to be drastically reduced (e.g. zero carbon, affordable housing, community infrastructure, etc). Because residential land value acts as a substitute for public spending in many areas (e.g. affordable housing, community infrastructure), the net impact on the public finances of a positive rate of VAT on new homes would probably be close to zero.

4.3 Zero Carbon

We very much welcome the valuable work done by the Zero-carbon Hub to clarify the level of energy efficiency that can be achieved through improvements to the fabric of new homes. We also welcome the concept of Allowable Solutions set out in last July’s revised definition of zero carbon.

We understand HM Treasury is concerned that one leading proposal for delivering Allowable Solutions through a possible Buy-Out Fund may fall within the definition of a tax, and very much hope this concern will not form a barrier to adoption of this concept if it proves to be the favoured and most practical means to realise this element of the overall policy.

We must also stress that we remain concerned about how to get from the percentage energy saving that is technically achievable and cost effective through fabric efficiency to the 70% target for Carbon Compliance set in the zero-carbon revised definition. Further work is required to bottom out and resolve the challenges involved.

4.4 False Self-Employment

The Federation continues to have serious concerns about HM Treasury's and HMRC's proposed approach to changing the tax rules relating to self-employment in construction.

We have noted the Treasury and HMRC's recently published summary of responses to the consultation it conducted last year on its proposals that workers in construction should be deemed to be employed for tax purposes unless they qualify for one of three possible exemptions.

Having read the summary we are concerned that the Government still appears to wish to pursue an approach which it acknowledges would have an adverse effect on the industry's flexibility.

While it is welcome that the Government recognises it would be inappropriate to introduce its proposed changes in the current difficult circumstances affecting the housing and construction industries, the proposals would increase industry's costs and so must be considered unwarranted even were business conditions more favourable. Our concern is increased since we believe the evidence base used to justify the proposals is itself questionable and insufficient.

The Government's approach does therefore seem to us to be inconsistent both with its recognition of the need to tackle the increasing burden of regulation on home builders and the principles of better regulation. We would ask HM Treasury and HMRC to reconsider their proposed approach in the light of our genuine concern.

John Stewart
Director of
Economic Affairs