POLICY SUBMISSION

HOME BUILDERS FEDERATION

2010 Spending Review

Executive Summary

1. Housing development creates economic activity and jobs in local markets throughout the country, it can respond very quickly to a demand or supply stimulus, and it offers high economic returns. New housing helps young people achieve their home ownership aspirations. A sustained increase in new home building is the only long-term solution to Britain's chronic undersupply of housing and persistent affordability problems. Private housing is a major source of Affordable Housing supply.

2. However the recovery in home building will be a long, slow process because of constraints on housing demand (mortgage funding and terms, affordability) and supply (loss of industry capacity, viability, development finance).

3. Because financial incentives are an absolutely essential ingredient in the Government's reformed planning system, it is of the utmost urgency that details of the New Homes Bonus are finalised and explained to local authorities, local communities and developers so as to remove unnecessary uncertainty, delay and cost, and to maximise the Bonus's early impact on home building, economic activity and jobs.

4. Because of the anticipated slow recovery in the mortgage market, we urge the Government to consider giving the very successful HomeBuy Direct (HBD) an ongoing role to support housing supply and Affordable Housing, and to increase access to home ownership, at least until mortgage availability is restored. For example, public investment of £200m per year would generate approximately 8,000 new home sales to first-time buyers, £1.3bn of new home sales and 8,000 net jobs. Any changes to the core terms of HBD should run in parallel to improvements in the mortgage market. A full review of HBD and HomeBuy Agents would, we believe, highlight a number of cost-effective improvements to the current scheme.

5. We also urge the Government to review and clarify the definition of Affordable Housing (AH) to encourage greater flexibility and innovation by local authorities, developers and affordable housing providers, especially nil-grant private sector solutions. At a time of severe fiscal constraint, this would (a) allow more dwellings to be provided per pound of land-value subsidy with no public subsidy, (b) open up Affordable Housing to a wider

group of qualifying households, (c) provide access to owner occupation for households who would not otherwise be able to own, and (d) reduce the threat to development viability from excessive local authority Affordable Housing demands. A review of the definition would be especially timely, given the growing mismatch between the need/demand for affordable housing and supply.

6. We believe there is an ongoing need for a scheme like Kickstart, given likely economic and financial conditions over the next few years (limited availability of finance, non-viability of schemes). Kickstart has been very successful because its design and operation has allowed developers to begin production very quickly, and because flexibility over funding streams has allowed it to address a variety of site-specific constraints. Government finance for Kickstart generates approximately three times this level of private investment.

7. The non-viability of many potential residential development sites due to the cumulative impact of policy and regulatory requirements will constrain the recovery in home building over the next few years. The Government should undertake a detailed review of all policies and regulations with an impact on residential development, including those imposed by local authorities which are too often made with little or no assessment of their impact on viability or housing production.

8. Because the public sector controls between a quarter and third of all potential residential development land, and because of the need to reduce the budget deficit and public borrowing, public sector bodies should be required to review their land holdings and dispose of surplus land. This may take the form of outright sale or deferred receipts to share in future land value uplift. The Treasury may wish to consider setting land disposal targets to assist with the fiscal consolidation.

The Economic Importance of New Home Building

9. New home building makes a significant contribution to the economy. Before the downturn, we estimate new home building accounted for:

   - 8.6% of Fixed Capital Formation
   - 1.5% of GDP
   - 335,000 direct jobs, with as many as four times this number dependent on home building in the wider economy
   - And 17% of construction industry output
   - New housing creates an estimated 11 net jobs per £1m of construction investment

10. New home building creates demand for skilled labour in local communities across the country. Because of its potential for job creation and its relatively low import content, housing produces high economic returns to the UK economy.

11. Once planning permission is obtained, home builders are able to respond very quickly to market conditions or to Government measures, rapidly creating jobs and economic activity in local communities.

12. New homes play a crucial role in the housing market. Although only about 10% of housing transactions, new homes allow many property chains to be completed because sales of new homes are not dependent on another purchase.

13. Higher levels of new home building offer the only long-term solution to poor housing affordability, and to enabling young people to meet their aspiration for home ownership.

14. A high proportion of Affordable Housing is provided through planning obligations (S106) agreements on private housing sites, so increased private home building will automatically bring an increased supply of Affordable Housing.

15. England suffers from a chronic undersupply of housing, a situation that has been seriously worsened by the housing market crash since 2007. Housing completions in 2009 were at their lowest peacetime level since 1923. This undersupply has many adverse social and economic consequences. To quote just two:

    - In the second quarter of 2008, of adults aged 20-34, 18% of women and 29% of men were still living with their parents[1];

    - The CML estimates that around 80% of first-time buyers receive financial assistance from parents or family, and the average age of those not receiving any form of assistance is 37[2].

16. There are a number of reasons why the recovery in home building is likely to be a long, slow process:

    - Mortgage funding is likely to remain severely constrained for some years, holding back a full recovery in effective housing demand, despite enormous latent demand. Wholesale funding and securitisations will take time to recover sufficiently to fund a

[1] *Social Trends 39*
[2] CML News and Views, No.15, 4 August 2009 *First-time Buyers – are they really getting older?*

significant increase in mortgage availability. In addition, the CML estimates that by 2015 mortgage lenders will have to refinance some £300bn currently supported by Bank of England and Treasury special schemes. And tighter mortgage regulation and the impact of Basle III seem likely to add further constraints to future lending. The restricted outlook for mortgage funding and lending suggests higher loan-to-value (LTV) mortgages will remain scarce. This will have a particularly large impact on new home building because the sector is more heavily dependent on buyers requiring higher LTV mortgages than the second-hand market. It will also continue to limit effective demand from first-time buyers, currently close to record low levels.

- On the supply side, the industry has lost significant capacity since 2007, and this will take time to rebuild. Development finance remains very constrained, a particular issue for smaller and medium sized home builders. And the industry is likely to be very cautious about expanding production as long as the economic and sales outlook is so uncertain.

17. The longer and slower the recovery, the more the mismatch between housing demand/need and supply will grow, and the greater the adverse social and economic consequences.

18. Housing shortages, and the fact that the relationship between house prices and earnings remains very stretched despite the fall in prices since 2007, will have a major impact on the ability of young people to become home owners. In addition, low levels of private home building mean a reduced supply of Affordable Housing through S106 planning obligations agreements, while expected cuts in public funding for Affordable Housing will further limit the supply of Affordable Housing, especially social rented housing for the most vulnerable in society which requires relatively high levels of subsidy per dwelling.

New Home Building and the Spending Review

Planning Reform and the New Homes Bonus (match-funding incentive)

19. We recognise that an incentives-based planning system is aimed, in the longer term, at producing better outcomes than a heavily top-down system.

20. While we understood introduction of the new system would inevitably lead to changes to local plans and the operation of the planning system, unfortunately the way the new system has been introduced has caused a great deal of unnecessary uncertainty and cost for housing developers, local authorities and the Planning Inspectorate. The top-down

targets were revoked almost immediately after the Coalition Government was formed, but the incentives have yet to be finalised and formally announced. Yet financial incentives are an absolutely essential ingredient in the new planning system.

21. **It is therefore of the utmost urgency that details of the New Homes Bonus are finalised and explained to local authorities, local communities and developers so as to re-balance the current one-sided position and maximise its early impact on home building, economic activity and jobs.**

22. At present, local authority behaviour is being heavily influenced by the revocation of targets: local plan preparation is being stopped, local targets reviewed (most downwards), sites are being de-allocated from local plans and schemes are being refused planning permission as a direct result of ministerial statements about regional targets. Evidence from almost 60 local authorities which have responded to these statements shows that these have been overwhelmingly directed at reducing housing numbers. This has resulted in significant short-term costs (e.g. in already-committed and now foregone investment in bringing developments forward), and losses to the future prospects for the home building industry, and so has had a very detrimental impact on share prices in the sector.

23. There is a risk the current hiatus will carry on for many more months, leading to lower housing completions in 2011 and beyond. We stress here that we support the principle of an incentives-based planning system. We simply wish to avoid unnecessary delay, uncertainty and financial loss which is currently being caused by the two-stage way in which the new system has been introduced.

24. HBF and its member companies recognise that in future we will have to put the positive case for new housing more effectively and persuasively to local authorities and local communities, including explaining the benefits the new incentives will bring, and we are preparing for this new role. But we can only do it effectively if the incentives-based system has been finalised and fully explained and implemented.

25. We would be most concerned in this regard if the Treasury reduced the New Homes Bonus from 100% match funding for six years. We need to make sure we maximise the value of financial incentives to local communities to enhance the chances of success.

An Ongoing Role for HomeBuy Direct (HBD)

26. We believe the Government should consider giving HBD an ongoing role to support housing supply and Affordable Housing, and increase access to home ownership, at least until mortgage availability is restored.

27. HBD has been very successful over the last 12-18 months, accounting for around 15-20% of the sales of larger home builders offering the scheme, with some 10,000 new home sales to first-time buyers expected by the 30th September deadline.

28. The current HBD scheme has been averaging around 650 sales per month over the last eight months. The average HCA equity share investment is just under £24,000. Therefore the Government would be able to generate 8,000 new home sales to first-time buyers per year from an investment of under £200m per year, generating approximately £1.3bn of new home sales, and around 8,000 net jobs.[3]

29. Anecdotal reports suggest a significant number of buyers may have come from local authority waiting lists (e.g. single mothers and a new partner buying their first home), although this would need to be checked from HomeBuy Agent records.

30. HBD has two major benefits for first-time buyers: it increases access to home ownership by closing the deposit gap; and it makes homes more affordable. (The alternative, a very high LTV mortgage, even if available, would be considerably more expensive.)

31. Because it requires only a 15% loan from the public sector, with match funding from the private developer, it represents excellent value for money for the Government. In time, as buyers redeem their shares, and once the index-linked interest rate begins to kick in after five years, funds will begin to flow back to the HCA for recycling into further HBD sales or other forms of Affordable Housing.

32. HBD is especially well designed in that it allows home building companies to integrate it into their normal site marketing. This is ideal for home builders, while it also means that most of the cost of marketing the scheme is born by the private sector, not the Government.

33. We understand the Government may wish to amend the terms of HBD, although the core principles should not be changed as these are now firmly established, understood and accepted by developers and lenders and, most importantly, by prospective purchasers. However we would urge the Government to be cautious about changing the terms, for the time being at least, because changes too early could undermine the fundamental access and affordability objectives of the scheme.

---

[3] In answer to a recent PQ (22 June 2010), Housing Minister Grant Shapps replied: “The Department has estimated that, in 2009, every £1 million of expenditure in new build housing supported 11 net jobs for a year.” The construction costs of new housing typically represent around 55% of gross development value. Therefore £1.3bn of gross sales value implies around £730m of construction costs, which would create 8,000 net jobs using the 11 net jobs multiplier quoted in the PQ.

34. If, as seems likely, the availability of higher LTV mortgages remains very restricted for some time, then reducing the equity share too early could undermine the success of the scheme. A shift to a lower equity share, such as 75/25 or 80/20, needs to run in tandem with improvements in the mortgage market, particularly increased availability of higher LTV mortgages at affordable rates. In any event, as mortgage availability improves, the scheme should be self-adjusting because HomeBuy Agents will reflect the availability of higher LTVs in their assessments of potential buyers. We would be uneasy about reducing the interest-free period, or raising the interest rate on the equity share, as this would begin to make the product less affordable, especially if it coincided with rising interest rates. We would not wish to create a situation in which buyers experienced a sudden sharp rise in their monthly expenses at, say, year 3, from a rise in the rate on their first-charge mortgage coinciding with the interest rate on the equity share second-charge kicking in.

35. We would encourage the HCA to undertake a full review of the role of HomeBuy Agents. We believe a more efficient and cost-effective arrangement could be devised, at much lower cost to the public purse. For example home builders and their IFAs could administer the scheme, with some form of periodic auditing to ensure they are correctly administering the scheme, at very little cost to the public purse. The parallel is with home builders receiving direct grant and the role of independent certifiers who periodically audit the home builder. The HBA fee of £1,500 per HBD sale could then to put towards funding additional HBD sales, or saved altogether (£15m for the current 10,000 HBD scheme). We would however wish to see the national HomeBuy Agent's role continue.

36. We would also encourage the HCA to review the current inflexible process of allocating funds to specific developments and plots, and the onerous requirements of the IMS computer system. Private home building is demand/sales driven – home builders build to meet sales, not visa versa. Therefore the scheme could be even more successful if, instead of pre-allocating certain plots to HBD and having to seek approval to change allocations to different plots, home builders could bid for funds and then sell any dwellings meeting certain specified criteria (price, type, etc.) as HBD products to qualifying buyers up to the limit of their funding allocation. This flexibility would not undermine the objectives of the scheme, but it would almost certainly increase its success rate by allowing home builders maximum flexibility to match qualifying buyers with qualifying dwellings. It would also significantly simplify the IMS process for home builders.

37. If there is to be a successor scheme, we would welcome a broad review of the operation of the current scheme in close consultation with the home builders who have operated the scheme, drawing on the positive and negative lessons learnt over the last 12-18 months. However we would stress that the current scheme is fundamentally successful and well

designed from the private sector's perspective. Any improvements will be largely procedural.

38. If the Government is persuaded to introduce a successor to the current time-limited HBD, it should give consideration to the timing of its introduction. If the current scheme ends on 30th September, but a successor scheme is not introduced until some months later, this will create an unfortunate hiatus of many months during which the momentum built up over the last 12-18 months would be lost.

Maximising the Supply of Affordable Housing

39. We would urge the Government to review the definition of Affordable Housing (AH). While the current definition in principle allows quite a wide range of housing needs to be met, in practice local authorities tend to adopt a very narrow definition. This limits the range of options available on housing sites and makes it is especially difficult to promote private sector, nil-grant solutions. Because the problem is largely one of local authority attitudes and understanding, a clearer definition would help encourage greater flexibility and innovation by local authorities, developers and affordable housing providers. A clearer definition would also be an important influence on local authority housing strategies, ensuring that they take adequate account of the full range of housing need and demand.

40. At a time of severe fiscal constraint, greater use of private sector solutions would allow more dwellings to be provided per pound of land-value subsidy, with no public subsidy required, it would help to open up Affordable Housing to a wider group of qualifying households and so encourage a greater mix of tenures and incomes, it would provide access to owner occupation for households who would otherwise be unlikely ever to be able to become home owners, and it would reduce the threat to development viability from excessive demands for social rented housing.

41. A review of the definition would be especially timely because there is likely to be a growing mismatch between the need/demand for affordable housing and the supply of housing in general, and AH in particular:

- Housing production is at extremely low levels and, as discussed above, it will take some years to recover to more normal levels. This in turn will tend to have an adverse impact on housing affordability.

- Public funding for AH is likely to be severely limited in the Spending Review period.

- The supply of AH through S106 agreements will be curtailed by low levels of private housing development.

- In addition, the cumulative impact of policy and regulation, combined with the fall in land values since 2007, means the subsidy available for AH from private development through S106 agreements is now severely limited and, with the looming cost of meeting the zero carbon targets in 2013 and 2016, will remain limited.

42. Yet at a time of severely constrained supply, the need for affordable housing will rise, especially demand for intermediate housing because of factors such as poor affordability, weak or even declining real take-home pay, and restricted mortgage availability and terms.

43. There is also a risk that very restricted AH supply will put pressure on local authorities to seek even higher levels of AH from S106 agreements, posing an even more serious threat to development viability and further reducing housing completions.

44. At present, many local authorities resist treating HBD as AH, even though the PPS3 definition includes “shared equity products (eg HomeBuy)”. Similarly there is resistance to allowing private sector “low cost homes for sale and intermediate rent”, despite these being explicitly included in the PPS3 definition. A revised definition should make it even clearer that these categories are to be treated as Affordable Housing.

45. One issue of particular concern to home builders is the tendency of some local authorities to require the home builder to deal with one of its favoured RSLs. PPS3's sister document, *Delivering Affordable Housing*, advises local authorities that 'This is a restrictive practice which could preclude innovation and competition between potential affordable housing providers'. In some cases this means home builders are not able work with their Strategic Partner RSL with whom they have a strong, ongoing partnership. It also precludes unregistered bodies owning and managing affordable housing. The advice to local authorities in *Delivering Affordable Housing* needs to be reinforced.

National Affordable Housing Programme (NAHP)

46. We believe Affordable Housing grant should be coordinated through a central body to ensure value for money, efficiency, common standards, adequate expertise and transparency and clarity about how decisions are made.

An Ongoing Role for Kickstart: Overcoming Obstacles to Development

47. While HBD is important on the demand side, on the supply side Kickstart has been very successful in bringing into production sites that, because of the recession, would not otherwise have been developed. We believe there is an ongoing need for a scheme like Kickstart, given likely economic and financial conditions over the next few years (limited availability of finance, non-viability of schemes). In time, as the housing market recovers, as development finance becomes more readily available, and as the burden of regulation is reduced and viabilities are restored, the need for such a programme will diminish. However these improvements are going to take time, and in the meantime some housing schemes will not progress, thereby holding back the supply of new housing and the creation of economic activity and jobs.

48. Kickstart has been very successful because its design and operation has allowed developers to bid for funds and begin production very quickly, and because flexibility over funding streams has allowed it to address a variety of site-specific constraints.

49. The 2010-11 cuts to Kickstart 2 have disproportionately hit more complex schemes, including regeneration projects, which have a very high value to local communities, but which took more time to negotiate than simpler HBD-based Kickstart schemes and therefore found themselves at the end of the queue. One option for an ongoing Kickstart scheme might be to focus funds on a limited number of large projects with a broad mix of housing and non-residential benefits for local communities.

50. Our estimate is that Government finance for Kickstart generates approximately three times this level of private investment, which suggests that Kickstart offers high economic returns.

Residential Development Viability: The Cumulative Impact of Policy and Regulation

51. The cumulative impact of escalating policy and regulatory demands on housing development over the last decade or more, combined with the fall in land values since 2007, the looming costs of achieving the zero-carbon targets in 2010, 2013 and 2016, and likely shortages of funding for significant infrastructure projects required to support development, mean many housing sites are not viable and will not be viable well into the future short of a sharp - and economically undesirable - burst of house price inflation. Non viability applies to almost all regeneration sites, most large strategic greenfield sites which require very substantial infrastructure funding, and many smaller mainstream housing sites outside the most affluent markets of London and the south.

52. While the viability problem was recognised by the previous Government, only very limited progress was made in addressing it.

53. HBF is current preparing a “solutions” paper on regulation and policy demands on residential development which we will forward to the Government in the near future.

54. We urge the Government to undertake a detailed review of all policies and regulations with an impact on residential viability, including those imposed by central Government, local authorities or public agencies. The review should assess whether each policy and regulation is necessary and cost effective, and its impact on viability and housing completions. This review, which would have to cover many complex and diverse areas, should be done in close cooperation with the industry. The Killian Pretty and Penfold Reviews offer a good start, but there is much more to be done.

55. Such a review needs to address a potentially difficult issue arising from localism, namely the ability of local authorities to impose policies and regulations without any proper assessment of their cost-effectiveness and impact on residential viability and housing production. We have seen this over the last four years with a proliferation of often ill-considered sustainability demands that add to development costs and offer little if any benefit to home buyers.

Public Land Disposal to Increase Housing Completions

56. Central government departments and agencies and local authorities face unprecedented budget cuts as the Government brings down public borrowing. In addition, as already outlined above, the recovery in home building from today’s historically low levels is likely to be a long, slow process.

57. In its 2008 report on homebuilding, the OFT said that the three databases it examined “suggest that the public sector accounts for between a quarter and a third of all land currently deemed suitable for residential development”[4].

58. Therefore the Treasury should actively encourage all public sector land owners to review their land holdings and, wherever possible, dispose of surplus land. Receipts from land disposals would help mitigate the impact of budget cuts and reduce public debt, while also increasing the supply of land for home building. The Government may wish to consider setting financial targets for surplus public sector land disposal, so that it becomes an

[4] OFT *Homebuilding in the UK. A market study*. September 2008

integral part of the deficit reduction programme of departments and public bodies. Disposals may take the form of outright disposal for cash up front, or alternatively receipts can be deferred so that the public body disposing of the land shares in the uplift in land value as the housing market recovers. Because home builders are experts at assembling and developing land, they are able to devise flexible and creative solutions, depending on the financial and housing requirements of individual public sector land owners.

59. By entering partnerships with private developers, public land owners help overcome the industry's development funding problems created by the credit crunch. And as is clear from the OFT's findings, the public sector has a major role to play in assisting housing development by bringing forward potential development land.

John Stewart
Director of
Economic Affairs