



HBF BACKGROUND PAPER

Responding to market demand; *understanding private housing supply*

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Introduction

1. England has a large, long-term undersupply of housing, with serious economic and social consequences. Solving the crisis will require a significant and sustained increase in new build completions.
2. Given the scale of the task, we need to mobilise all sources of supply: traditional private home builders of all sizes, other private developers (e.g. commercial developers), self and custom-builders, housing associations, local councils, private contractors, etc. We also need adequate provision for all tenures. However, given public spending and borrowing constraints, and the recent Government switch in Affordable Housing provision from rental towards home ownership, the private sector will have to produce a large majority of the new homes required, at least for the foreseeable future, and most will be for home owners or private investors.

History lessons from post-war housing supply

3. Over the last 25 years, increasing state intervention in land supply (particularly the plan-led system introduced in 1991 giving local authorities tight control over the supply of permissioned land), the products house builders can offer (local building standards, local mix and density policies) and land values and the viability of housing development (e.g. planning obligations and affordable housing, CIL, local standards¹, public open space²) has severely constrained private housing supply.
4. The 1980s was the last period in which private housing supply was strongly responsive to market demand: private completions rose by 70% (+79,000³) from 1981-88, the number of small and medium-sized (SME)⁴ house builders expanded by 52% and their starts grew by 85%. By contrast, from 1993-2007, private completions rose by only 32% (+44,000), SME house builders contracted by 26% and their starts fell by 10%. (SME numbers fell by 80% between their peak in 1988 and 2014.)
5. There is one critical difference between these two periods: the presumption in

¹ Many local standards were not valued by home buyers, so that they added to costs without any compensating increase in sales values. Also the proliferation of different local standards meant home building costs were generally higher because it was much more difficult for the industry to achieve design and building standardisation, a key requirement for production efficiency. Ultimately local standards consumed scarce land value, with little or no benefit.

² Public open space requirements mean a proportion of the land cannot be developed, and so does not generate any sales revenue or land value. This reduces the price payable to the land owner, both the gross value and the price per gross hectare.

³ DCLG house building statistics

⁴ Using NHBC statistics for annual starts by size of company, we define an SME as starting 100 or fewer homes per year.

favour of development in the 1980s (local authorities had to have a good reason to refuse permission), encouraged house builders to bring forward sites for planning in response to rising market demand and encouraged new entrants and existing SMEs to expand; the presumption in favour of the local plan (the plan-led system) from 1991, which gave control over land supply to local authorities, discouraged house builders from bringing forward land that was not already allocated in the local plan, and so severely curbed the market responsiveness of housing supply. The broad principle is: once the plan is fixed, land and housing supply is fixed.

6. As the table below shows, in England in the 37 years from 1954 (when post-war materials rationing ended) to 1990, the private sector produced in excess of 150,000 homes in 17 years (peaking at 203,000 in 1968), including three years in the 1980s (peaking at 176,000 in 1988). By contrast, in the 24 years from 1991 to 2014, the industry produced in excess of 150,000 homes in only one year (2007).

Private house building completions: England

| | Number of years of: | | Peak (year) |
|---------|--------------------------|--------------------------|----------------|
| | ➤ 200,000 completions pa | ➤ 150,000 completions pa | |
| 1950-79 | 2 | 14 | 203,320 (1968) |
| 1980-89 | - | 3 | 176,020 (1988) |
| 1990-99 | - | 0 | |
| 2000-07 | - | 1 | 154,210 (2007) |

Source: DCLG

7. The post-1990 period saw a number of significant new trends emerge:
- Low levels of completions: 2001 saw the lowest peacetime completions since the early 1920s, while a one third rise by 2007 was achieved solely by sharply higher densities;
 - Significant consolidation within the home building industry: of the top 30 home builders in 1995, 15 had disappeared by 2007;
 - A collapse in SMEs: an almost continuous 80% fall from a peak of 12,215 in 1988 to 2,403 by 2014 (vs a 52% rise during the 1980s boom);
 - A major long-term reduction in the quantity of greenfield land used for new housing: between 1994 and the market's peak in 2007, annual greenfield land use fell 55%⁵; but brownfield land use failed to increase to

⁵ DCLG Land Use Change Statistics

compensate, despite a strong brownfield policy emphasis between 2000 and 2009⁶.

8. The plan-led system requires local authorities to lead the process of site identification, a lead role that also applies to Housing Zones and Brownfield Registers. However local authorities cannot possibly have the market knowledge and development expertise of experienced house builders in identifying available, suitable and viable housing sites. Also, because local plan housing requirements are often treated as a maximum, once a local plan is in place there is little incentive for house builders to respond to rising housing demand by bringing forward additional sites not already identified in the local plan. And when local plans concentrate development in a few large sites, this further stifles the market-responsiveness of supply (discussed later in this paper).
9. As noted above, as well as the plan-led system giving local authorities control over the location and quantity of permissioned residential land supply, local authorities steadily ramped up their extraction of land value in the 1990s and 2000s (planning obligations and Affordable Housing, local standards, public open space), often attempting to maximise land value capture on a site-by-site basis to “the margins of viability” so that viability became a central concern of the planning system. This has given them a heavy influence over site viabilities and the land value available to land owners. In addition local authorities introduced a range of policies to influence the products house builders could offer (e.g. local dwelling standards, mix and density policies). The Coalition Government’s local standards review significantly streamlined the chaos of local standards, but local authorities can still adopt additional local requirements for space, security, water and accessibility.
10. In effect market responsiveness was replaced by local authorities trying to second-guess, ignore or even over-ride the local market and micro-manage housing supply (land supply and location, viabilities, land values, products). Given our housing supply system’s heavy reliance on private supply since the late 1980s, it is hardly surprising that industry output was severely constrained between the early 1990s and 2007.
11. The credit crunch and subsequent recession had an extremely damaging impact on supply independently of the planning system. The Coalition Government and new Conservative Government have made significant efforts to reform planning and roll back local standards. However land supply is still controlled by local authorities, there is still a focus on maximising land value capture and squeezing viabilities and land values, and local authorities can still heavily influence the products house builders can build. And policies such as Brownfield Registers,

⁶ Planning Policy Guidance Note 3 (PPG3) required local planning authorities to operate a brownfield-first policy and a sequential test. It also established a minimum density of 30 units per hectare which tended to favour brownfield land.

Housing Zones and Local Development Orders are all local authority led, not market led.

12. The key lesson from the post-war history of housing supply is that if the private sector is to provide a large majority of the homes of the future, there must be less state intervention, freeing house builders to respond to local market demand by building the right products, in the right locations, at the right scale to meet demand⁷. State policy and regulatory intervention should be focused on growth and housing delivery - facilitating, encouraging, enabling, incentivising, removing barriers - and not attempting to micro-manage supply and second-guess or over-ride the market.
13. In a market economy, unless there is some binding external constraint (e.g. the planning system putting a ceiling on permissioned land supply, or prolonged unfavourable economic and market conditions), the industry should be able to build significantly higher numbers provided it has (a) the right economic and market conditions, and (b) the right policy and regulatory conditions, (c) for long enough to be able to increase supply and build capacity.

Sales outlets key to private housing supply

14. Two laws of private home building are relevant to the following discussion:
 - First, private housing production is sales led;
 - Second, all else being equal, sales are a function of the number of sales outlets.
15. The first law means that private home builders can only build if they have funded customers to sell to. These can include owner occupiers, small-scale private investors, corporate or institutional investors, affordable housing providers such as housing associations (e.g. for S106 units), custom builders, local or central government. Sales may be ordinary, plot-by-plot market sales, or they can be bulk sales, such as to a housing association or a large investor.
16. The second law means that market sales are a function of the number of sales outlets, and not just the number of sites (a large site can have more than one sales outlet) or the total area of permissioned land. All else being equal, we would expect more market sales (and production) over any given period from 10 sites of 100 units than from 2 sites of 500 units or one site of 1000 units.

⁷ Some organisations have argued that the supply problem is the result of a dysfunctional land market. This is nonsense. The land market has behaved just as we would expect it to, given severe restrictions on the supply of permissioned residential land over much of the last 25 years.

17. Sales from a single outlet will of course be influenced by external factors: e.g. sales may rise because the housing market has become more buoyant, or because the Government has introduced a new scheme such as Help to Buy Equity Loan. However “all else being equal” – i.e. putting aside such external influences over which the home builder has little or no control - the rate of ordinary market sales per outlet per time period will be dependent on local market conditions, often referred to as the local market’s absorption capacity. This will be a function of the size of the local market and types of demand, the types of products offered by the home builder and their prices in relation to local demand, the number of new home competitors, etc. Bulk sales will be driven by different influences, such as the requirements of a S106 agreement or an investor’s requirements.
18. Therefore the second law of home building means that if a home builder wishes to increase annual sales and production by, say, 10%, all else being equal the company will require roughly 10% more sales outlets. In other words, assuming no change in external influences, a house builder cannot simply decide to build and sell 10% more homes from the company’s existing sales outlets⁸.
19. However the second law needs to be qualified, in that beyond a certain rate of sales and production other constraints will kick in. Depending on the type of building (houses, flats in small blocks, flats in large blocks, etc.), at some point building and site capacity constraints will limit the house builder’s ability to increase production on a site (e.g. the number of trades working on a site, transport logistics, etc). If this happens before the site’s sales potential has been exhausted, it will limit the rate of sales. In addition, most mortgage offers are for six months. Therefore a house builder will find it difficult to sell properties scheduled for physical completion much beyond six months to customers requiring a mortgage as buyers’ mortgage offers will expire before legal completions can take place. The HtB1 scheme imposes a similar constraint: the HCA allows no more than six months between exchange of contracts and legal completion, which means buyers cannot exchange contracts on properties scheduled for physical completion beyond six months.
20. On large sites, home builders may open multiple outlets, or sell phases to competitors who open extra outlets, so the number of sales from the site can be increased. The different outlets will enable companies to offer different product

⁸ A frequent accusation is that house builders control the rate of sales and production on a site “to protect their profit margin”. This is quite true, but not for any sinister reason. House builders are price takers, in that the prices they can charge on a site will be determined by prices in the local market. If a house builder tried to factor lower prices than in the local market into their land purchase bid they would not be able to compete against other bidders factoring in local market prices. Once a site is purchased, the land value becomes a fixed cost and there is very little an efficient builder can do to cut other costs during production (e.g. build, infrastructure, fees, etc.). Therefore the only flexible element on a site already under production is the profit margin. Assuming constant market conditions, if the house builder were to cut sales prices, more homes could be sold. However the drop in revenue from lower sales prices would probably have to be absorbed by a lower profit margin. If this were done persistently, the company would go out of business. So protecting profit margins is simply another way of saying that companies must be able to stay in business.

ranges and brands. However there are likely to be diminishing returns, so that beyond perhaps four or five outlets, sales per outlet will decline.

21. So put simply, increasing aggregate private housing supply, all else being equal, requires (a) many more sales outlets, (b) allowing home builders to offer the widest possible range of products to meet the broadest range of market and other demand, and (c) ensuring the widest possible range of housing suppliers, of all sizes, have access to viable, permissioned land. All three require the widest possible range of sites, by size and location.

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About HBF

The Home Builders Federation (HBF) is the representative body of the home building industry in England and Wales. The HBF's members account for around 80% of all new homes built in England and Wales in any one year, and include companies of all sizes, ranging from multi-national, household names through regionally based businesses to small local companies.

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