

# Reversing the decline of small housebuilders:

Reinvigorating entrepreneurialism  
and building more homes



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## About the HBF

The Home Builders Federation is the representative body for home builders in England and Wales. HBF's membership of more than 300 companies build most of the market sale homes completed in England and Wales, and encompasses private developers and Registered Providers. The vast majority of home builder members of the HBF are small and medium sized companies.



# Acknowledgements

**We would like to thank Savills and Hometrack for the data provided, and also NHBC which has provided much of the historical record for the activity and output of small housebuilders.**

HBF appreciates the input that members of its Small Developers Group and Metropole Group have provided in discussions over the past six months as the analysis and conclusions of this report have been developed. In particular, we would like to thank the Chairs of those groups, Gerald Malton of Fairview New Homes, Chair of the Metropole Group representing medium-sized home builders and David Bryant of Halsbury Homes, Chair of the Small Developers Group. In addition, Steve Midgley of Fairgrove Homes, and long-time Chair of the Small Developers Group who stood down from the position during the course of 2016, has helped HBF to represent small housebuilders over many years.

We are indebted to the builders who took time out of their schedules to take part in the in-depth interviews that have proven extremely informative in helping to explore the challenges and potential of smaller developers.

Finally, special thanks goes to Neil Fitzsimmons, an HBF Board member and former housebuilder Chief Executive, who conducted the interviews and has acted as a sounding board throughout.



# Forewords



**The recent period has been a successful one for the home building industry as a whole. Responding to Government policies to promote home ownership and increase housing supply, the sector has expanded its output**

**at an unprecedented rate following a very difficult time in which survival was the name of the game for even the largest of companies. Indeed, the Global Financial Crisis, its impact on the housing market and the effect on our industry qualifies as the most challenging time in my 35 years in home building. However, the vast majority of the growth witnessed since 2013 has been attributable to the largest companies which is in stark contrast to the experience after previous downturns when new entrants and small firms made a greater contribution to upswings in housing supply.**

The industry is often mischaracterised as only really consisting of a dozen or so large companies operating at significant scale. That is understandable given the contribution that the major home builders make in terms of overall supply and, in particular, their rapid expansion to achieve the growth we have seen over the last three to four years.

But even in spite of the challenges, obstacles and frustrations set out in this report, the home building industry remains remarkably diverse in its makeup with firms operating at a very local level or on a regional scale, building specialist housing or traditional homes for first-time buyers in different market areas and employing different strategies. While we have lost thousands of SMEs during the last 30 years there are still many individuals eager to start out and so many companies aspiring to expand and build more homes.

There are still success stories but they are nowadays fewer in number and achieving goals has never been more difficult. In assessing the scale of the challenge it is instructive to consider the growth trajectories of the major companies operating today. In many cases they were founded in the 1960s or 1970s by an enterprising visionary and were able to grow over a period of decades less encumbered by bureaucracy and our often sclerotic planning process. While there were – and will always be – risks involved, today the balance of risk is weighing too heavily against the next generation of entrepreneurs. Our industry's plurality is a major strength that helps to sustain the vibrancy of the sector and we must do all that we can to maintain it by reversing the long-term decline of small firms.

**Stewart Baseley**  
Executive Chairman  
Home Builders Federation





**I founded Redrow in 1974 originally as a civil engineering contractor and it was only as a result of the squeeze on public spending of the early 80s that I decided to steer the business in a different direction - home building.**

The transition was easy. Land with outline planning permission was in ready supply and the time to go from a 'red line' permission to a start on site was no more than six weeks, often less. There were four or five conditions to clear – colour of bricks, roof tiles, landscaping, etc, then off you went. With bank finance readily available there were few, if any, barriers to entry.

Young entrepreneurs like myself, Tony Pidgley, and Lawrie Barratt before us, were able to start fledgling home building companies from scratch and build them into national builders – something that would be almost inconceivable today.

This report provides an in-depth study into the reasons behind the decline of the small and medium sized home builders. This decline is the principle cause of the housing crisis and can be traced back to the 'Genie out of the bottle' 1990 Planning Acts; combined with the financial crisis of the late 2000s. Obtaining planning permission today is a bureaucratic nightmare and beyond the resources of many SME builders; it is a real barrier to entry – even if they can obtain finance.

In order to solve the housing crisis and build more homes, we need to reverse some of the faux pas of the past. Young building entrepreneurs deserve the same opportunities today that I and my contemporaries enjoyed historically.

**Steve Morgan CBE**

*Chairman*  
Redrow plc



## Key facts

- Post-war housing supply peaked at the same point that entrepreneurial SMEs in the sector were flourishing.
- In 1988 small builders were responsible for 4 in 10 new build homes compared with just 12% today.
- The advent of the plan-led planning system in 1990 has also contributed to a reduction in medium-sized builders, while national housebuilders have also reduced in number.
- The average permitted housing scheme has increased in size by 17% in less than a decade suggesting many sites allocated in local plans are out of reach for smaller companies.
- Small sites are consistently efficient in their delivery of new homes across multiple market areas.
- Delay and risk during the planning stage has influenced lender attitudes to housebuilding meaning that terms SMEs borrow on are restricting growth opportunities.
- In just the period 2007-2009, one-third of small companies ceased building homes.
- Returning to the number of home builders operational in 2007 could help boost housing supply by 25,000 homes per year.
- Even a return to 2010 levels could help increase output by 11,000 homes per year.
- Measures to remove blockages in the planning system, reduce red tape and bring about fairer finance for SMEs would enable more companies to realise their ambitions, reinvigorating the entrepreneurial spirit of previous decades.



# Summary

**Housing supply indicators are overwhelmingly positive. A generally more attractive environment for housebuilding investment, improved economic conditions and political action to tackle blockages and support first-time buyers has contributed to unprecedented increases in housing supply which has risen by more than 50% in just three years.**

However, while the number of homes being built continues to rise rapidly, the number of home building companies has dwindled over the course of almost three decades even as positive policies such as the introduction of the National Planning Policy Framework (NPPF) and the creation of the Help to Buy scheme theoretically makes the sector an attractive one for prospective start-ups and small firms planning to grow.

The 1960s to 1980s was a period in which small housebuilding companies could start up, grow quickly and establish themselves as significant contributors to regional economies. Most of the firms nowadays responsible for a vast chunk of housing supply were founded during this period. Since the late 1980s **a structural decline has taken place** which has seen the number of smaller active companies shrink from more than 12,000 in 1988, when nearly 4 in 10 homes were completed by SMEs, to around 2,500 companies responsible for just 12% of new builds today.<sup>1</sup>

Periods of straitened economic circumstances have generally accelerated the diminution of SME housebuilders but the structural decline began with landmark planning legislation in 1990 which tipped the balance of control significantly further away from entrepreneurial home builders towards Local Planning Authorities. This long-term trend was compounded by the Global Financial Crisis in the late 2000s when the availability of development finance became a significant cause of concern for existing small developers. Indeed, **between 2007 and 2009 around one-third of active companies ceased building homes.**

Rebuilding plurality in the industry would help bring about dramatic increases in housing output. Experience of the 1980s shows that post-war housing supply peaked at precisely the same point as small, entrepreneurial companies were flourishing. Decades of red tape and additional risk in the planning system makes a return to the level of SME activity as 1988, a momentous challenge. However, **even returning to the number of firms operational in 2007 could help boost housing supply by 25,000 homes per year.** Increasing the number of firms operating in the industry would also bring major benefits for the long-term health of the sector and for the economic vitality of towns and cities around the country. SMEs traditionally played a vital role in the employment and training sphere.

Barriers to entry and growth in the industry are many and varied. In many cases small and medium-sized firms share many of the frustrations experienced by larger, national companies but some obstacles are specific to the SME.

<sup>1</sup>For ease of reference throughout, small companies are defined as those building 1-100 homes per year. Medium-sized companies are generally defined as completing between 101 and 1,000 homes per year unless specifically referenced.



# Summary (cont...)

## Land and planning

**The availability of suitable housing sites, and the constant struggle of securing an implementable planning consent through a planning process beset by delays and bureaucracy, create delays and costs for SMEs that have a tangible impact on their ability to grow. While larger companies can mitigate risk across dozens of sites in some cases, small firms encountering delays on one or two sites will be the difference between a year of growth and a year of contraction.**

Whilst large sites are extremely efficient in their delivery in strong market areas, small sites are consistently efficient across all areas. But pressures on local Government finance and the political rationale employed by councils when establishing its five-year land supply mean that a growing number of housing allocations are for very large sites out of the reach of local companies.

**The average permissioned housing scheme has increased in size by 17% in less than a decade.** Thus, today the number of units granted planning permission is higher than in 2007 but the number of sites permissioned in the year to June 2016 was still some way short. In many cases the local planning authority's five-year land supply is highly theoretical and a greater diversity of sites would help achieve housing requirements more effectively. Even when a headline planning consent can be obtained on suitably sized sites, the process for progressing the site through the remaining planning and legal obstacles can lead to extensive delays.

*To address these problems we propose:*

- **Altering the definition of a small site:** Various measures and policies exempt small sites – usually defined as being around the 10 unit mark – from certain red tape. This creates an arbitrarily defined incentive to focus development on certain sizes of schemes. Increasing to 20 dwellings would remove this disincentive to growth and broaden the potential site base for SMEs.
- **Introducing a presumption in favour of residential development on appropriate brownfield sites:** Rather than a continued reliance on public sector-led solutions through Brownfield Registers, or overly restrictive planning use regulation, a presumption in favour of brownfield development within settlement boundaries would free up private builders to seek out suitable sites and bring them forward for housing with some degree of confidence that they will receive planning permission. Within the bounds of our plan-led planning system this would help to reinvigorate entrepreneurialism.
- **Increasing the 'buffer' required in Five Year Land Supplies:** Local Plans effectively set an upper limit on housing supply in an area through five-year land supplies (in those areas where local authorities have a plan). By planning for a 'buffer' of 20% additional dwellings over and above the minimum it is far more likely that housing need will be met.
- **Planning for a wider range of sites within local plans:** A greater variety of sites, including more small sites within local plans will help support SME consolidation and growth and speed up housing supply.



- **Creating a duty to properly test actual delivery from allocated sites and plan for additional allocations where supply falls short (ongoing trajectory planning):** Too few local plans are effectively monitored to assess delivery on an ongoing basis. Doing so on an annual basis will identify early on where areas of concern are and allow suitable sites (likely to be small in scale) to come forward to help plug delivery gaps.
- **Changing the classification of garden land:** The change in classification in 2010 of garden land to greenfield was based on oversimplified analysis and political motivations. The change in approach removed a source of land for small builders many of whom had been adept at developing sustainable and low density schemes on previously under-utilised land. The introduction of the NPPF allows for such sites to be considered in a more holistic way taking account of sound planning principles without a specific direction rooted in dogma.
- **A new phased planning application fee schedule:** The lack of resources within Local Authority planning departments is a concern to housebuilders of all sizes but its effects are particularly harmful for SMEs. A phased fee structure for planning applications which, in total, would see revenues for LPAs increase could be introduced which would incentivise good performance and timely decision-making and discharge of conditions.
- **A 'Help to Plan' scheme for micro builders and start-ups:** Direct support for fledgling businesses should be available to provide technical and planning services for those starting out.



# Summary (cont...)

## Finance

**Availability and terms of financing for residential development has become extremely difficult for small housebuilding companies over the past decade or so. Lenders have drastically changed their attitudes to the sector since the Global Financial Crisis. Of course, lenders' risk appetite correlates to the risk and uncertainty inherent in the planning process on which all developers are reliant.**

Most SMEs building fewer than 100-150 homes per year are now reliant on project finance agreed on a site-by-site basis, in itself inefficient for both lender and borrower, with significant additional fees for entry, exit and legal agreements which turns the headline interest rate of perhaps 6% into something more like 7-8% or higher.

While nominal Loan-to-Cost (LTC) ratios are typically around 60-65% of the project in practice, because of the cost trajectories involved and the fact that sales begin preferably before final completion of the site, in many cases the realised LTCs are more likely to be 40-50% because the developer's equity will be entered into the scheme first and then only be returned at the back end of the development when the lender has recovered its funds.

The uneven release of equity from the scheme has a direct impact on the ability of the individual builder to begin future development projects and significantly limits overall supply from this segment of the industry.

*To address these problems we propose:*

- **Government action to get lenders lending:** Whilst lenders make positive statements and have good intentions, when it comes to lending to small builders, the reality experienced by HBF members can be somewhat different. Through discussion between builders, lenders, Government and the HCA, we should be able to highlight and address the structural issues that prevent SMEs accessing finance on reasonable terms.
- **Lifting barriers for builders to access Government support enjoyed by SMEs in other sectors:** Initiatives such as the Enterprise Investment Scheme explicitly preclude SME housebuilders from access to investment incentives. A review of these decisions should be taken.
- **A 'Help to Build' scheme using Government guarantees to support SME expansion:** Government should provide guarantees to lenders to bridge the gap between current terms and more realistic, higher LTC lending. Whilst this would inevitably attract a slightly higher rate of interest, lending would be at a higher overall level (probably 80% LTC rather than 60%) and the guaranteed debt would be withdrawn from the scheme at the same level as the housebuilder's equity is withdrawn. Whereas recent Government support schemes have focused on direct lending to companies that might not otherwise access finance, this scheme should be available to all SMEs with the specific aim of enabling small companies to withdraw its capital on a more *pari passu* basis to increase output. For builders currently completing 10-50 homes per year this could be transformational, unlocking their potential to significantly increase completions. An illustrated example of how such a scheme could work is set out in Appendix A, showing how, with higher LTCs and on more equitable terms a builder's average monthly equity balance in a scheme could move from 27% to 18%, freeing up capital for additional future development.



## Red tape

**Bureaucracy in the development process in addition to that directly linked to planning is a source of frustration for most housebuilders but, again, while larger firms are adequately resourced and well equipped to negotiate the delays and excessive costs involved, for small developers and, in particular, start-ups, these considerations are critical to the survival, let alone growth, of the business.**

There are three main areas where red tape can be particularly harmful for SMEs' prospects: highways, water and land registration all of which can cause significant delay and uncertainty around costs.

*To address the problems caused to SMEs by excessive red tape we propose:*

- **Seizing the opportunity of Brexit:** On behalf of HBF's members we would like to work closely with Government over the next 18 months to identify the areas of EU regulation that could be reformed, reduced or removed to help create the conditions for small housebuilders to thrive and for the industry to deliver more homes in areas where they are needed.
- **Earlier participation of Highways Authorities in pre-planning discussions:** Signing off highways layouts earlier in the process would reduce cost and delay.
- **The use by Highways Authorities of a single set of national standards:** These are often highly technical matters and there is no reason why there should be such a significant local variation.
- **An overhaul of the Highways Act 1980:** Introducing competition in the provision of inspection and other services would help to engender a more efficient process.
- **Using existing legislation to open up technical approval and supervision of highways:** The current environment not only introduces several opportunities for delay but can involve SMEs tying up considerable capital in the form of bonds.
- **Deemed discharge of Section 38 and Section 278 conditions where Highways Authorities do not make a decision on approval.**
- **Resist attempts by Ofwat to give water companies free reign over the fees they charge to developers:** In response to the regulator's proposals, HBF has suggested an alternative approach that would help create strong incentives for brownfield development and ever more innovative forms of Sustainable Drainage Systems (SuDS), both of which are political priorities.
- **The creation of a single water and sewerage infrastructure charge:** Simplification of the process to restrict water companies' ability to levy exorbitant fees which amounts to a general over-reliance on builders to fund long-term investment in the water companies' assets.



# Introduction

**The headline indicators of housing supply are unremittingly positive. Housebuilding has increased by more than 50% in just three years; and builders increased their output by 11% in the last year alone. In broader terms, measuring supply in floor space or the number of new bedrooms in the dwelling stock, the growth in supply is even greater than this headline figure.**

Furthermore, HBF's largest member companies report that they have serious and realisable plans to expand investment even further in the next three years. These statements are frequently echoed in the reports of publicly listed companies and others, even in a period of greater uncertainty following the outcome of the EU Referendum earlier this year and a slowing housing market brought about by Stamp Duty changes. Evidence of the appetite to build more homes can also be seen in recent data on planning permissions. In the year to June 2016, consent was granted for 275,000 new homes.

These positive developments mask an underlying and worrying trend. Over the past 30 years, housing supply has become more dependent than ever before on a small number of providers. Small, private housebuilding companies have dwindled in number, very few new entrants have secured a foothold, and even established firms have struggled to grow.

Even with more positive conditions in recent years, in a policy environment that notionally supports small housebuilders, this trend has continued. The introduction of the National Planning Policy Framework (NPPF) has created a much more positive planning system than that which prevailed between the early 1990s and 2012, with more land coming through the system and the Help to Buy scheme to support purchasers which, unlike other previous schemes of its type, is accessible for developers of all sizes. However, over the period in question, burgeoning red tape, a policy decision to make sustainable development of existing residential land more difficult, and an increasingly costly planning process fraught with risk has decimated the SME housebuilding sector.

From 2008 onwards, the effect of a system that consistently works against the interests of small builders has been exacerbated by a shortage of development finance available on reasonable terms and at an affordable price. Even as banks have increased lending to small businesses generally, the situation for small housebuilders has improved little over the recent period with lenders still generally very cautious about the sector. Indeed, the recovery from the recession has been rather more muted for SMEs than larger builders. Even as overall supply continues to grow at an unprecedented rate – 52% in three years – small builders are still producing fewer homes today than during the depths of the 2008-9 recession.



The industry shares the Government's aim to build on recent growth in output. Larger housebuilders with the financial muscle to realise their growth ambitions have ramped up investment. The largest companies have been responsible for around 90% of volume growth since the recession and while most still have plans to expand over the medium-term the exponential increases of recent years cannot continue indefinitely. We must look to others to supplement sustainable growth of the major home building companies. Ministers are interested in exploring new models of delivery such as offsite construction and the public sector directly commissioning construction of new homes, and there may be a greater role to play for housing associations and local authorities, but a wholesale reinvigoration of the SME housebuilding sector would help propel housing supply towards the ambitious targets that we all wish to see achieved. The experience and output of the 1980s is instructive in this regard.

This paper explores the causes and consequences of the long-term decline in housebuilding activity in a sector that was once a hotbed of young, entrepreneurial companies operating at a regional level. It explains how driving additional investment amongst smaller firms could help to achieve speedy and sustainable growth in housing supply, and describes the conditions needed to bring about this change.



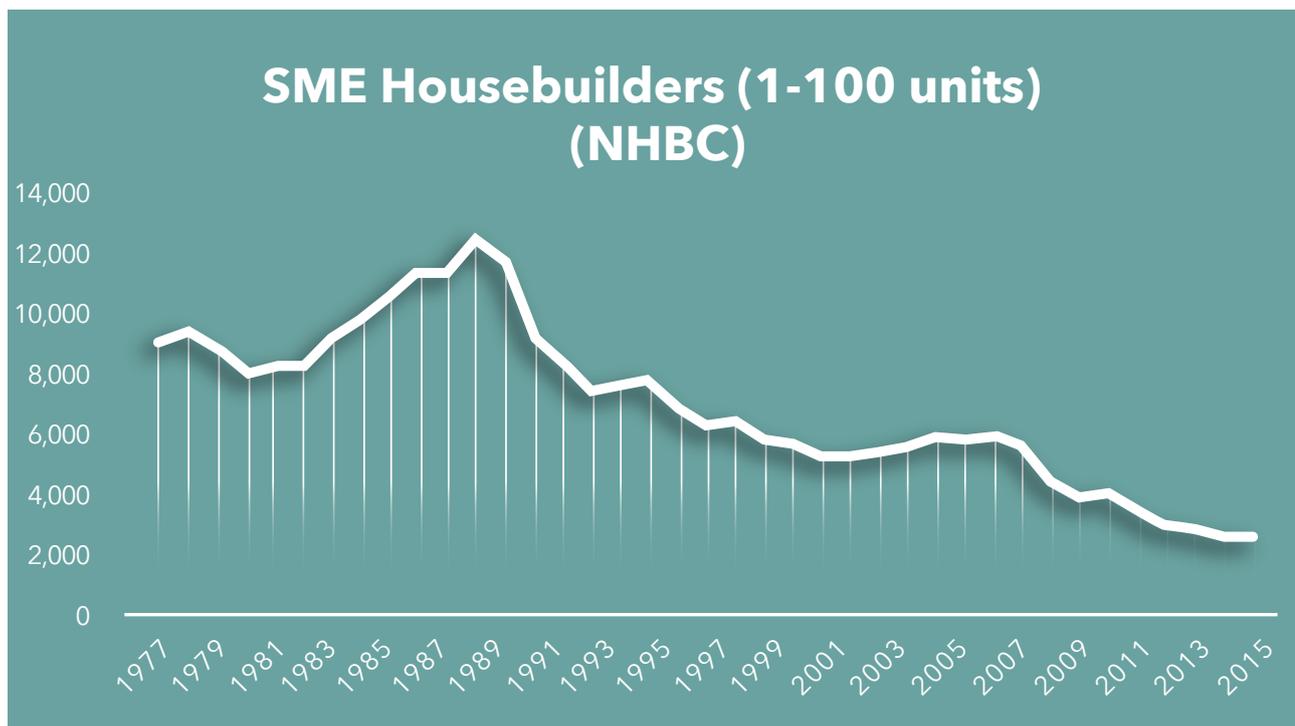
# Historical context: Charting the diminution of SME housebuilders

**Up until the early 1990s the home building industry had enjoyed significant plurality of building companies. The 1960s and 1970s, in particular, were periods that saw vast numbers of start-ups and the rapid expansion of a large group of firms, including many still operating today as major home builders and FTSE 100 listed companies. Companies that were founded during this period could grow from small, regional concerns into national players responsible today for thousands of new homes each year.**

Over the course of the last three decades there has been an 80 per cent reduction in the number of small builders.<sup>2</sup> The impact of the recession and the credit drought has hit small builders harder than many other sectors or sub-sectors, but this is also a structural decline created out of a series of well-intended policies over the course of more than a generation and exacerbated by economic shocks.

Before 1990, small housebuilders were responsible for an annual average of 39 per cent of all new UK homes. Through the 1990s the average contribution fell to below 30 per cent before a continuation of the steady decline into the new millennium. This gradual wane was accelerated by the long-lasting effects of the financial crisis to 2015 when fewer than 1 in 8 new homes were being built by smaller companies.

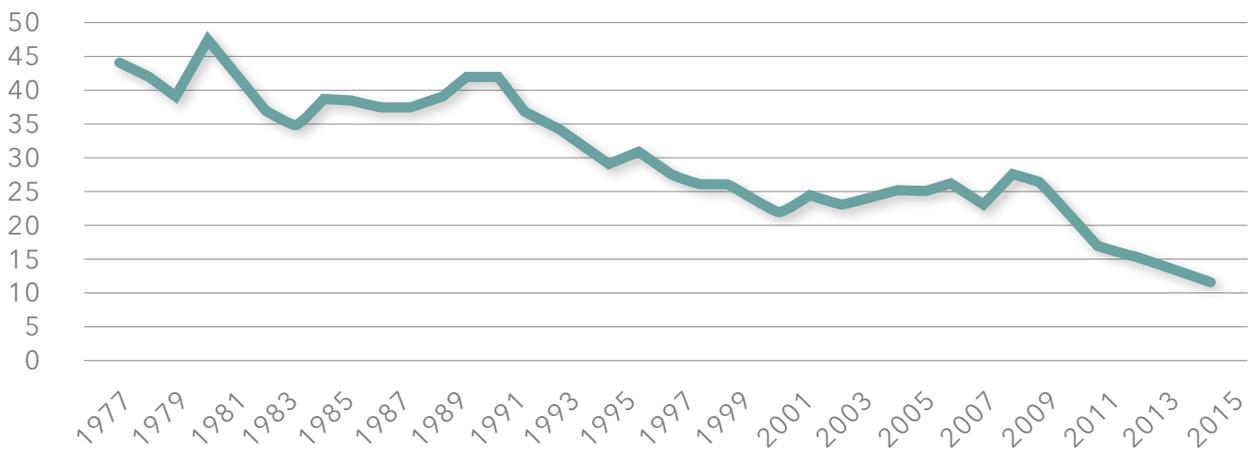
Purely looking at the providers of between one and 100 units cannot tell the whole story. For instance, growth of companies within this category of builders that pushed more firms into the 100-2000 'medium-sized' or 'regional' definition of home builders would represent progress, expansion and a path to growth for others. However, there are also fewer companies in this category than there were during the 1980s and, indeed, fewer than in the pre-crash 2000s. Likewise, the 14 companies classified today as 'national' builders registering more than 2,000 units per year, differs little from the long-term average of 12 companies in this category.



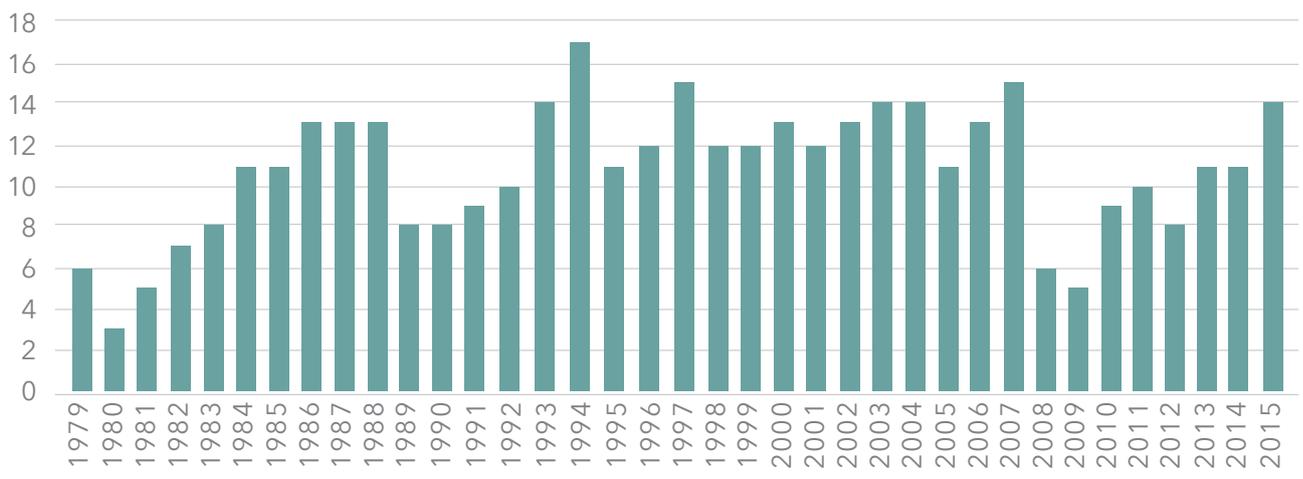
<sup>2</sup> Although there is no definitive definition, reference to 'small' house builders usually includes companies building 1-100 homes per year



### Percentage of new homes built by SMEs (1-100 units p.a.), 1977-2015

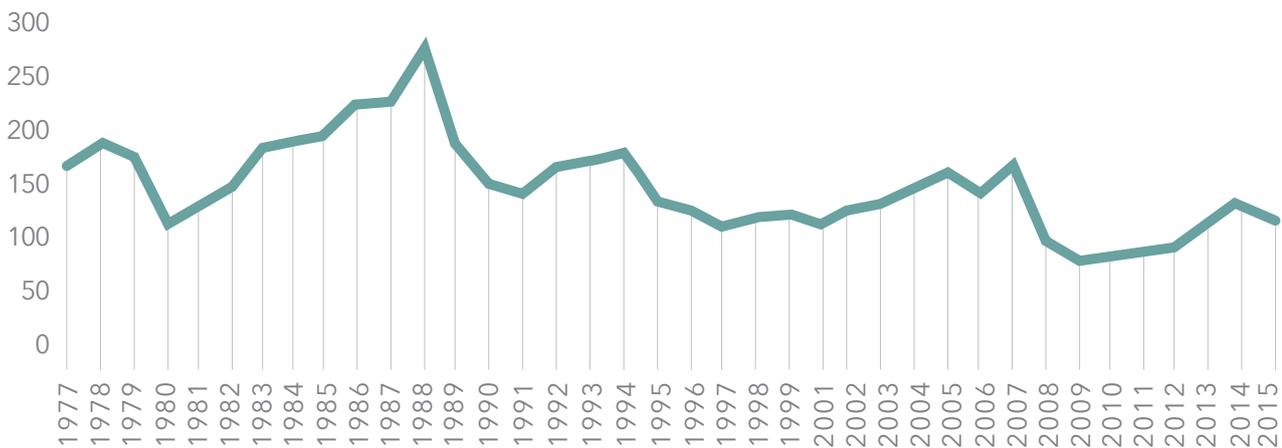


### Companies registering 2000+ units per year, 1979-2015 (NHBC)



# Historical context: Charting the diminution of SME housebuilders (cont...)

## Companies registering 101-2000 units per year, 1977-2015 (NHBC)



### Change in number of active builders by size category, 1988 to 2015

	Small (1-100 units)	Medium (101-2000)	National (2000+)
<b>Change</b>	-9,823	-140	+1
<b>Percentage</b>	-80.4%	-53.6%	+7.7%

Output is, thus, reliant on fewer and fewer companies. To illustrate this we can examine two years in which the number of new homes added to the dwelling stock was identical. In 2004, there were 171,000 additional homes supplied in England, exactly the same number as recorded in 2014.

However, this level of output in 2014 was produced by fewer than half as many builders as a decade earlier. There had been 5,863 active builders (of all sizes) registered with NHBC in 2004 compared with 2,527 in 2015.<sup>3/4</sup> Going even further back, in 1990, 166,000 net additions to the housing stock were made at a time when nearly 9,000 companies were active in the house building market.

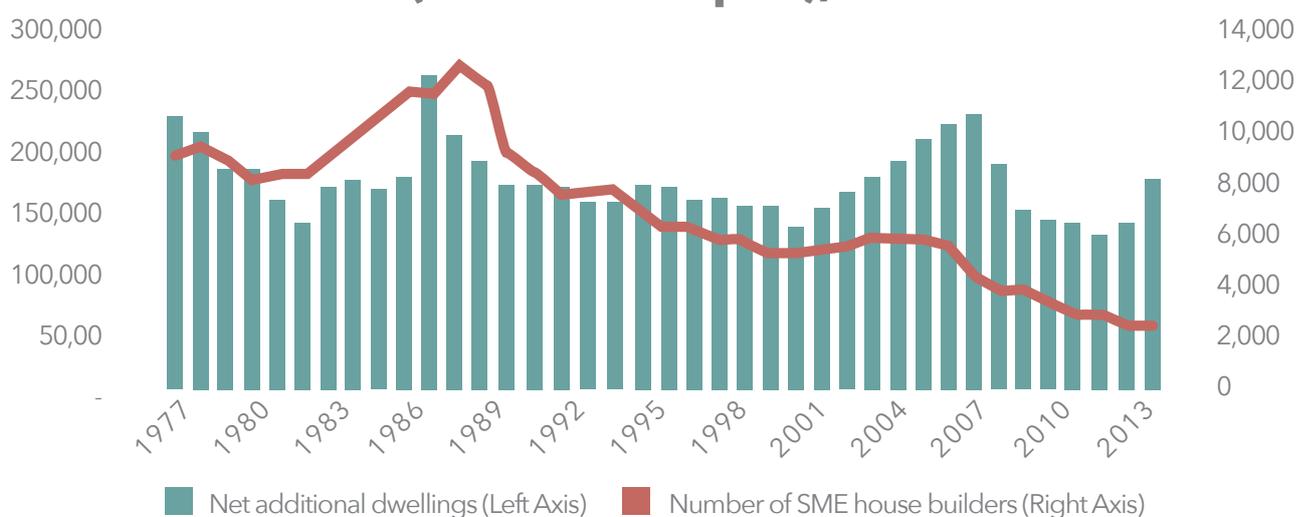
We estimate that small developers were responsible for around 15,000 to 20,000 new build completions in 2015/16. This is fewer even than the total output from SMEs during the depths of the 2008-09 recession.

<sup>3</sup> Includes any builder registering at least one housing start with NHBC, ranging therefore from builders registering one unit to the very largest companies in the country.

<sup>4</sup> Net additional dwellings are for England. The number of companies includes all UK.



## New homes and number of SME home builders (1-100 units p.a.), 1977-2015



### 1980s

It is no coincidence that a clear correlation can be seen between the post-war peak in net supply of housing in 1987 and the prevalence of SMEs building homes which peaked the following year in 1988. The immediate post-war period saw gross supply at higher levels, but an estimated annual average of 50,000 demolitions per year between 1955 and 1985 meant that while the capacity of the industry in the 1950s and 1960s was remarkable, in land use terms the output of the late 1980s was equally if not more impressive. The experience of this period is indicative of a far more entrepreneurial environment in which SMEs and new entrants were free to identify potential development opportunities and create new homes.

As plurality in the sector has waned, larger home builders have taken on a greater role in overall housing delivery and been able to sustain the recent increases largely on their own, but ambitious targets for housebuilding are more effectively and sustainably met by a wider range of providers. Unfortunately, even as housing supply increases more rapidly than at any other time over the course of a generation, the role of SMEs has further diminished.

The pinnacle of SME involvement in the housebuilding industry in 1988 when 12,215 companies were each building between one and 100 homes was swiftly followed by the passage of legislation which radically altered the land and planning environment for home builders, transforming the relationship between developer and Local Planning Authorities.



# Historical context: Charting the diminution of SME housebuilders (cont...)

## 1990s

The Town and Country Planning Act 1990 tipped the balance of control significantly away from private, entrepreneurial companies and towards authorities. The Act was the most momentous planning legislation to receive Royal Assent since the Town and Country Planning Act 1947 which effectively nationalised the right to develop land and introduced the concept of charges for 'planning gain' or 'betterment'. However, following the implementation of the 1947 Act, there was still a presumption that private landowners and builders would be permitted the right to develop on their land. Whilst successive Governments have brought forward swathes of planning legislation, guidance and policy, most of which has been open to interpretation and compliance at a local level, none since 1990 has proven to be as far-reaching as the Town and Country Planning Act 1990.

The 1990 Act further extended the nationalisation of development rights, tightening the grip of planning authorities on land use regulation by introducing a plan-led system of planning in England and Wales. When implemented, the Town and Country Planning Act 1990 established for the first time a presumption against development unless in accordance with Development Plans. Achieving an allocation in a local plan was now necessary to provide a degree of assurance that a planning application for new homes might secure consent. The plan-led model of land regulation thus, in turn, strengthened the reliance on land promotion through the various stages of a local planning authority's plan adoption process. This immediately made the task of obtaining planning permission on a site a much lengthier – and more expensive – endeavour. By essentially introducing an additional stage in the planning process, the consequence of the Act was

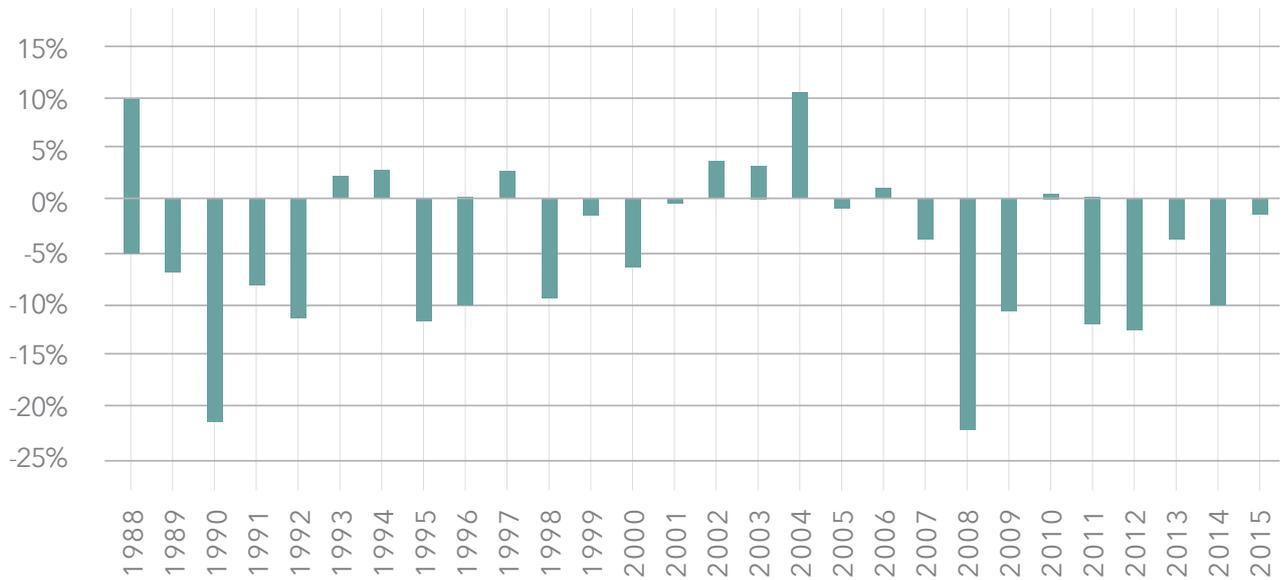
to create a requirement for a much more long-term commitment to sites tied to the particular timescales of a local planning authority's development plan-making and adoption processes. Unsurprisingly, the Act resulted in persistent undersupply of housing over the next two and a half decades.

The identification of small developable sites became significantly more difficult following the passage of the Act as the financial and time commitment necessary to secure an allocation in a local plan became prohibitive, even before considering the expense associated with obtaining a planning permission.

It was not just the legislative environment that became more testing for SMEs during this period. June 1990 marked the start of a period in which the UK's economic output contracted in seven of the following eight quarters. The recession which engulfed the UK economy in the early 1990s was deeper and arguably harder felt for a greater number of households than the most recent recession period of negative growth in the late 2000s. Conditions in 1991 were more challenging for households with unemployment peaking at 10% compared with 8% in the late noughties; record levels of home repossessions and Bank of England base rates of interest between 10% and 14%. This contributed to a steep decline in the number of companies building homes which was compounded by the new planning framework to prevent the numbers ever bouncing back.



## Annual change in number of small and regional builders (1-2000 units per year), 1988 to 2015



In the years that followed the 1990 to 1992 recession, as GDP returned to growth, any annual increases in SME numbers were marginal. For instance, small active companies grew in number in 1993, 1994 and 1997 (by 2.1%, 1.9% and 2.0% respectively) but this was significantly outweighed by the collapse during the recession (-36.5%), or in 1995, 1996 and 1998 (-11.5%, -9.9% and -9.0% respectively). In short, the recession

killed many of the companies that had been active during the late eighties, and by the time the headline economic conditions had improved the new planning framework was challenging for SMEs and so anti-entrepreneurial that only a limited number of SMEs re-emerged, very few new entrants appeared and many that managed to weather the storm soon found continued survival impossible.



# Historical context: Charting the diminution of SME housebuilders (cont...)

## 2008-2011

Much has been written about the catastrophic consequences of the 2008 Global Financial Crisis and its effect on the housing market, but its impact on the SMEs operating in the home building industry cannot be underestimated. By the early 2000s the number of small builders had levelled out following a decade of consistent decline. In the 2000-2006 period there were 5,000 to 6,000 small (1-100 units) and medium (regional) (101-2,000 units) housebuilders in the market each year. Still fewer than half of the pre-1990 peak but more than twice as many as are in operation today. During the years 2007-2009 the industry lost more than one-third of its companies (34.3% of all housebuilders).

Major home builders were not immune to the headwinds as the number of companies building more than 2,000 homes fell from 15 to five but while most simply contracted temporarily, the smaller companies that were not able to survive invariably did not return to building homes.

The economic recovery following the crash and resultant recession was a long one. Indeed, housebuilding activity remained stubbornly low for several years after the end of the technical recession. The credit crunch made development finance extremely hard to come by for many housebuilders of all sizes but for SMEs the situation was particularly dire.

A relatively innocuous change in policy guidance in June 2010 further exacerbated the troubled situation for the few SMEs that were still able to identify and purchase land and obtain development finance. In one of the Coalition Government's first Communities and Local Government announcements, then Decentralisation Minister, Greg Clark in an effort to prevent 'garden grabbing' so that councils "do not have to sit by and watch their neighbourhoods get swallowed up in a concrete jungle", reclassified garden land as greenfield, making development of such sites more challenging in planning terms. This was formalised in the National Planning Policy Framework (NPPF) two years later through the explicit exclusion of private residential gardens from the definition of 'previously developed land' (brownfield). Until 2010, the development of infill sites such as private gardens, where sustainable, had been a specialism of small housebuilders and sustained many companies that were well equipped to use their local knowledge to identify potential schemes and bring forward sustainable developments.



## 2012-present

The introduction of the NPPF in 2012 engendered a much more positive environment in which to plan for new housing. This can be seen very clearly by the impact it has had on the number of planning permissions that have been achieved in the years following its 'bedding in'. As more (albeit still too few) Local Planning Authorities have adopted NPPF compliant local plans there has been a gradual increase in the number of planning consents granted for new homes, eventually, in mid-2016, surpassing the pre-Crash peak. Combined with the creation of the Help to Buy Equity Loan scheme in April 2013, this has led to a huge increase in investment by builders in the people and land required to build homes. Unlike previous schemes designed to support purchasers to buy new build homes, the Help to Buy scheme has proven less onerous to administer and less restrictive for builders in registering and taking part. That is why some 2,000 builders are registered for the scheme.

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*'I think that we've got reasonably ambitious plans for growth. The various Government initiatives on demand side with mortgage availability and so on have been significant. A third of our sales are on Help to Buy. I think that's given us a bit of confidence to crack on, but we might have been a bit cautious otherwise.'*

(Housebuilder interviewee, June 2016)

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Land, even with the NPPF now in place, is hard to come by for SMEs. What is effectively a framework that makes the pre-existing plan-led system of planning more effective – essentially strengthening the predominance of the plan – and at a time when local planning authority budgets have been severely squeezed, has led to local authorities allocating more large sites than ever before.

While this helps to satisfy the requirement for a five year land supply on a nominal basis it will often fail to actually deliver. Furthermore, fixed costs (in the form of both money and time) differ little between a site of 10 units and one significantly larger. The overheads and timescales involved with getting on site are broadly consistent across the majority of sites aside from the very largest.

The fragility of the standard SME business model and the inherent risk associated with planning are a source of frustration for all builders but these challenges can be disastrous for the smallest of companies. It is accepted that when a planning authority is unable to decide on a planning application within the statutory timescales, developers are encouraged to withdraw the application and resubmit or, worse still, have the application rejected and be forced to pursue an appeal. This has developed into a vagary of the system that is disliked but accepted by developers but the cost and time involved makes it extremely hard to do business for small companies. The growth in appeals as a means of securing a satisfactory response within reasonable timescales is another example of how SMEs are disadvantaged by the current planning system and its arcane processes.



## Historical context: Charting the diminution of SME housebuilders (cont...)

More recently, the Government, recognising the benefits of a more diverse, healthier sector with a greater number of companies providing homes, has sought to use policy to limit the cost of regulation for developers of smaller sites. Exemptions for small sites (defined usually as either 'fewer than 10 units' or '10 units or fewer') have been introduced for Section 106 affordable housing, Community Infrastructure Levy (CIL) payments and the forthcoming Starter Homes requirement; and fast-tracked planning for converting certain use classes into residential has created new opportunities for SMEs. While these measures have proven helpful, they are far outweighed by the proliferation of regulation and the raft of unfavourable planning policies and practices introduced over the past three decades.

A succession of initiatives have been announced to help SME builders secure access to development finance, which has been in short supply since 2008. Until the Home Building Fund was unveiled by Secretary of State, Sajid Javid in October 2016, the most high profile package was the Builders Finance Fund which launched in April 2014. Initially only available on sites of at least 15 units, the scheme had limited success. In addition to being prescriptive, financial assistance was generally only available for developers on sites with detailed planning permission. Developers also reported that the process used by the administrator, the Homes and Communities Agency, remained onerous and terms were not hugely attractive.

The Home Building Fund (HB Fund) promises to be more flexible and involve a longer-term relationship between the Agency and the developer. It is too soon to judge how successful the HB Fund will be and early feedback from companies that have initiated contact has been mixed, but in any case, it is unlikely to be of the scale to completely transform the environment for SMEs and, indeed, is broadly unavailable to new entrants. With some improvement to the indicative timescales, the fund could, however, prove successful in supporting established small firms and ambitious medium-sized companies to expand more quickly than would otherwise be possible.



# Methodology

## To inform the analysis and recommendations in this report, the Home Builders Federation has:

- Surveyed its Small Developers Group to gauge views on broad topics and barriers to growth.
- Conducted new research, including:
  - New analysis of NHBC data on numbers and activity of small and medium sized builders
  - Estimate of the potential additional delivery capacity if decline in SME numbers could be reversed
  - Analysis of average consented housing schemes over the past decade
  - Interpretation of original research from Savills to estimate the 'delivery efficiency' of sites based on size of scheme.
- Held group discussions with HBF's Small Developers Group and its Metropole Group of predominantly medium-sized companies.
- Conducted 16 in-depth and wide-ranging interviews with representatives of companies from start-ups and small firms building a handful of homes per year to medium-sized enterprises responsible for hundreds of new homes.

The interviewees were:

Stephen Brazier	Aquinna Homes
Paul Pedley	Archway Homes
Ian Burns	Cameron Homes & Galliers Homes
John Cawrey	Cawrey Homes
Jim Cropper	Duchy Homes
Steve Midgley	Fairgrove Homes
Myles Bridges	Fresh Developments
David Bryant	Halsbury Homes
Terry Roydon	Hansom Property
John Lagan	Lagan Homes
Nicholas King	Nicholas King Homes
Colin Tutt	Octagon Developments
John Slater	Stewart Milne
Richard Werth	Troy Homes
Robert Westerman	Westerman Homes
Chris Lacey	William Lacey Group



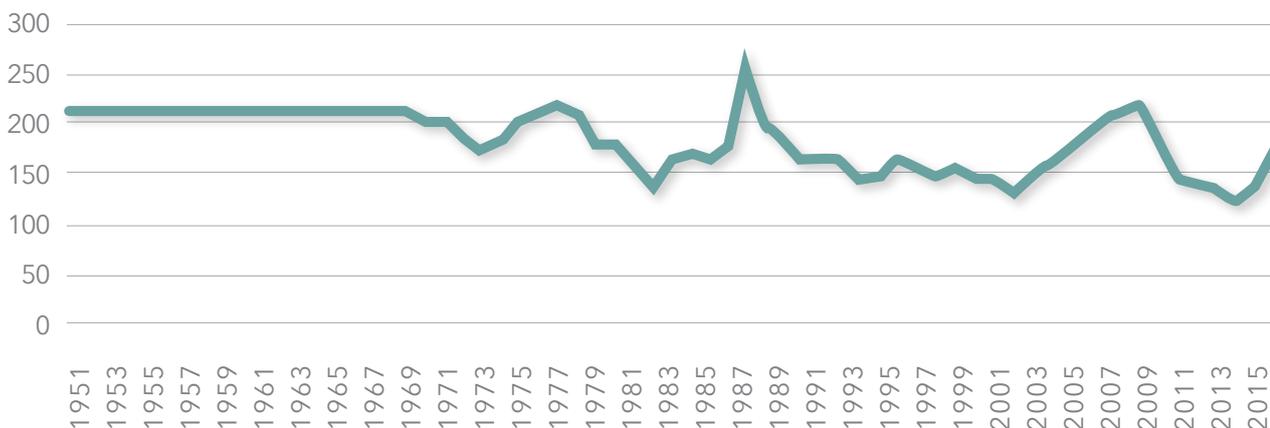
# Benefits of rebuilding plurality in the industry

**There is a much-peddled myth that there exists an upper limit to the number of homes that can be produced by the private home building industry. However, while individual companies may couch their statements in this regard in terms of sustainable growth or ‘soft caps’ there is no arbitrary cap on the potential delivery from the private sector as a whole. In a well-functioning market without prohibitive barriers to entry, economic forces will ensure that the providers will supply a product or service at, or close to, a reasonable level of demand. For new homes the market is far from perfect. Barriers to entry are significant and land, the most important raw material for a prospective home builder, is heavily rationed by multiple external actors and tightly regulated by a myriad of authorities and agencies based primarily on geography and, often amorphous, political motivation.**

Those who argue that the private sector, because of its profit motive, will always fail to deliver the homes the country needs often point to the housebuilding boom of the 1950s and 1960s. This theory is usually based on an over-simplified analysis of historical precedent. Of course, the public sector did make a significant contribution during this time but what is often omitted from this analysis is the more pertinent data on net additions to the housing stock.

The Post-War rebuilding effort achieved huge levels of supply but more modest increases in the number of homes available as demolitions are estimated to have averaged just under 50,000 dwellings per year from 1955 right up until 1985. Allowing for demolitions, in terms of land use, the ‘boom’ led to net additional dwellings of, on average, 215,000 in the 1950s and 216,000 in the 1960s; not dissimilar to those seen in the decades after when public sector delivery had receded.

## Annual increase in dwelling stock, 1951-2015 (DCLG Live Table 104)



NB: Figures for 1951 to 1961 and 1961 to 1971 are based on average as data is only available for decade-long periods.



The housing crisis we face today is a very different one to that which we were confronted with in the 1950s. The availability of land is a much more important consideration now than it was back then.

The private sector can deliver further steep increases in housing supply but this is more achievable with a larger, more diverse range of providers. Highlighting the importance of land availability, the downward trend in net additional dwellings began just prior to the introduction of the plan-led system of planning in 1991 which effectively set an upper limit on the number of homes that could be provided.

It is no coincidence that the late 1980s spike in net additions to the dwelling stock occurred at a time when small builders were flourishing in a freer, more entrepreneurial market when less restrictive land use regulation allowed enterprising firms to identify sites for residential development.

Returning even to the number of active small housebuilders just prior to the financial crisis could have a major effect on housing supply. The average SME (1-100 homes per annum) produces just under eight homes per year. If the SMEs that have disappeared since 2007 were replaced and were able to maintain supply at the same annual rate as their current contemporaries, **we could expect to see an additional 25,000 homes produced each year**. Even if the number of companies operating in this space returned to the levels of 2010 when the economy was still stuttering, and before the successful Help to Buy scheme had been introduced, when finance was at its most difficult to obtain, we could expect to see **an additional 11,000 additional homes each year**.<sup>5</sup>

Small housebuilders also traditionally played a vital role in the employment and training environment for new recruits to the industry. The smaller scale of such enterprises provides an excellent training ground for apprentices and trainees embarking on their journey in the industry. Much has been written and spoken of the skills challenge that the industry faces and the rapid expansion in output over the past three years has stretched capacity. Working across the entire sector and led by the Homebuilding Skills Partnership, companies of all sizes are addressing this duty but a greater number of companies is an obvious and attractive shortcut to training many more individuals.

<sup>5</sup>SMEs are currently responsible for around 19,000 homes per year (12-13% of all new build homes). Since 2007 the number of SMEs has decreased by more than 3,000. The decrease between 2010 and 2015 was almost 1,400 (NHBC).



# Barriers for SMEs

## Land and planning



**The availability of suitably sized sites and the operation of the planning system was a regular topic of discussion in interviews with small and medium-sized companies. Indeed, whereas in relation to other issues there are quite disparate experiences, broadly corresponding to size of enterprise, the difficulties companies face in finding land, obtaining planning permission and negotiating the planning process to the point at which construction can commence, were observed equally by very small companies and those delivering hundreds of homes per year.**

More providers, building homes on a wider array of sites would also help to accelerate the **speed** of supply increases, as well as the overall quantum, of housing. The key to increased private-sector production is the number of sales outlets, which in turn is dependent on: (a) the number of planning permissions for single-outlet sites, and (b) the number of permissions on large, multi-outlet sites. Outlets are critical because:

- There are sales and production limits to any single outlet/site in a given period;
- Maximising sales (and therefore production) in a market area requires the widest possible range of sites, by size and location, so housebuilders can meet all segments of market demand by offering the widest possible variety of products, locations, brands, price points, scheme sizes, etc.

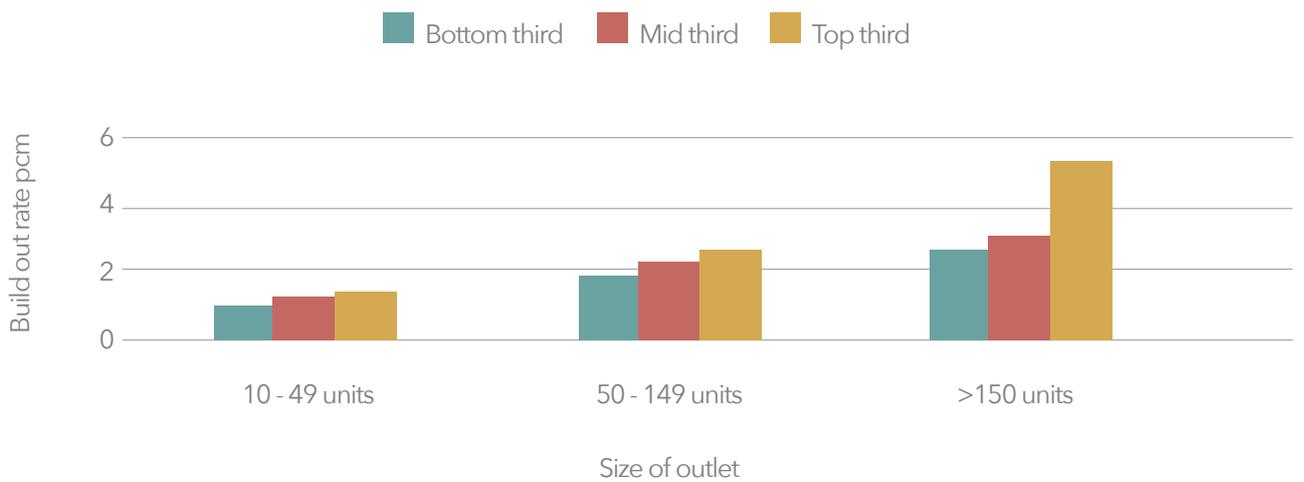
Smaller sites, usually developed by small builders, invariably consist of a single outlet but in terms of 'delivery efficiency' small sites are consistently efficient across all strengths of local housing market. This is shown best by new analysis by Savills and Hometrack, using data from NHBC, which shows that the time taken to complete a site of 10-49 units varies only by a few months regardless of the strength of the local housing market. Large sites on the other hand, can be built out very quickly in the strongest market areas whereas maintaining a good source of effective demand in the weaker market areas is more difficult. This suggests that the delivery efficiency of small sites means that more sites in the range of between 10 and 50 units in size are an important component of unlocking supply across the entire country.



## Market Strength (HPI ranking)



## Market Strength (HPI ranking)



# Barriers for SMEs

## Land and planning Problems



The planning system of 2016 works inherently against the interests of SME builders. This is the fault of no one policymaker, but over a series of decades conditions have been created that are designed predominantly to vest power in the hands of local authorities. Large companies, with many specialist teams of planners, technical experts and ready access to finance, are able to absorb the additional costs associated with ever more complex and risky processes but that is not a luxury shared by SME builders. Understandably, the heightened risk and potential for delay colour the views of lenders, many of whom deem housebuilding for companies smaller in scale than large, national firms to be extremely unattractive.

For a site to be allocated in a planning authority's local plan, it will usually have been promoted by a specialist land promoter, the landowner or a developer. In some cases these are not mutually exclusive or may be in partnership, i.e. a landowner and a developer with an option on the site. This practice, a vital part of the planned system that has operated in varying degrees in theory and in reality since the early 1990s, requires an emphasis on much longer-term thinking and commitment on the part of builders. Again, with the costs associated and the constant risk that the site may never achieve allocation in the local plan, this is a perilous, costly and long-term approach for a small company to pursue. Meanwhile, the volume of housing allocated in local plans is generally treated by councils as a maximum rather than minimum level of delivery.

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*'We started buying land to the west of the village we're in... and we put in planning two years ago now for a site of 150-odd, which was all going through nicely with the planning department, and then in December 2014 the planning committee decided to vote it out. They said that they didn't want this development to the west of the village, and they were voting everything out at that meeting, everything was being kicked out because they were pushing on with their Strategic Urban Extensions around the urban area where they're planning to build 4,500 houses... We're next to the motorway, so it's fairly urban. The village is about 1,800 dwellings, something like that. It's almost a town, really.'*

*'We're five miles from [the city], we're a more sustainable location in terms of transport and travel, good transport links, and the council has basically turned its back on this area. There are four villages that would support a good level of development, a couple of which have had big extensions, but they've decided against anything. The local members actually seem to be leading it because it makes them seem more popular and get some votes because they're resisting development.'*

(Housebuilder interviewee, May 2016)

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For understandable political and financial reasons, planning authorities have increasingly sought to allocate very large strategic sites for residential development in order to satisfy its requirement to demonstrate a five year land supply. Large sites on the edge of settlements can be less likely to spark political controversy as they are slightly removed from existing communities. For the very same reason, however, they may require substantial infrastructure and up-front financing resulting in relatively lower delivery rates in the early years of the site's existence making rapid delivery unrealistic.

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*'Local authorities will say we need 'x' units and we'll do that all on one big site on the edge of the town. Probably a good example is a site where I've bought land for 40 units. It's part of a bigger brownfield site which is being regenerated. The council has said "we've got our five year land supply, so we're not going to entertain any application. We'll just reject it"... And as more and more councils begin to gather five-year land supplies, I'm getting increasingly concerned at what will happen in two or three years' time, where no new applications will be granted.'*

(Housebuilder interviewee, June 2016)

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Once allocated, LPAs are systematically failing to assess on an ongoing or regular basis, the actual delivery achieved against the targets indicated in its local plan. For instance, by allocating one or several very large sites to achieve a five-year supply of land, delays progressing one site through planning will have a substantial impact on the ability of the authority to adequately plan for the number of homes required.

Over-optimistic assumptions that do not take account of development programmes or market absorption rates inevitably result in under-delivery of dwellings against requirements but for some LPAs this can be a convenient scenario. Ongoing assessment of current and anticipated delivery against annual targets would likely lead to the allocation of more small sites capable of swift build out to plug gaps in local housing supply.

In addition to these political considerations, local authorities have experienced significant reductions in spending power over the last five years. When faced with decisions on future funding, discretionary services like planning departments have borne the brunt of cuts to overall resources to help preserve expenditure on priorities such as social care. Between 2009/10 and 2015/16 Local Authority planning departments have seen a 55% real terms reduction in funding.<sup>6</sup>

As capacity has been constrained, many authorities have recognised that allocating a handful of very large sites can help focus resources but these internal management factors do not necessarily translate into effective and sound local decision-making. Inevitably, too, the reduction in resources has had consequences for the quality of service provided by many Local Authority planning departments when it comes to processing planning applications, pre-application services and post-planning discharging of conditions etc. The impact of this has been felt by companies of all size but delays on individual sites will predictably cause more damage to a business operating on two sites than for a national company working on many sites across dozens of Local Authority areas.

<sup>6</sup> National Cuts, Devolved Growth? (NLP, November 2015)



## Barriers for SMEs (cont...)

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*'There are council district areas that a number of the PLCs just won't touch because they're such a pain to deal with. And being small, you've got to try and work with the people who are, in effect, controlling your major supply line.'*

(Housebuilder interviewee, May 2016)

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*'I know everyone's banging the same drum about pre-commencement conditions. The local authorities now accept those only when it is a mini planning application whereas previously it used to be an exchange of correspondence with some samples. If it was materials or drawings, if it was technical information, and you used to get a response perhaps in three weeks or so, from a planning officer, a qualified officer, now everything is taken to committee or officer delegated decision but it always seems to take a long, long time to clear pre-commencement conditions.'*

(Housebuilder interviewee, June 2016)

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The pressure on Local Authority planning and legal departments has influenced development outcomes in several ways. As we have discussed elsewhere, the allocation in local plans of increasingly large residential sites has restricted the potential land available to small companies without the capability nor the inclination to take on large schemes. Furthermore, the impact of stretched resources throughout the entire planning process has also been felt disproportionately by SMEs. Delays, or the risk of delay, are natural if frustrating facts of life for housebuilders but the larger the company and the more sites within a company's portfolio, the more that risk can be spread and mitigated. For small firms delays of months or even weeks on a single site can be the difference between increasing output on the previous year or standing still. To support overall growth in supply, it is vital that builders of small developments can get 'in and out' of a scheme as quickly as possible; that is minimise the time between start and completion on a site. It is at this stage of the planning process that the paucity of resources is at its most frustrating and damaging. As discussed above, 'planning by appeal' is simply not feasible for small companies for whom it would mean tying up vast amounts of equity with uncertain timescales, burgeoning costs and an inability to sustain a workforce and supply chain.



The headline rate of planning permissions obtained by builders and others suggests that the capacity exists in local Government to support continued growth in output but the high level numbers includes schemes that do not necessarily have a full, implementable planning permission. Over the past few years the time taken to move the scheme through the latter stages of planning and legal processes has lengthened. Excessive numbers of conditions are often attached to a planning consent, often unnecessarily tagged as a condition which must be met prior to commencement of the build. Once a builder believes that he or she has met the requirements set out construction can then be delayed until discharged by the planning department. Frustrations with this process led to welcome measures by the Government in 2015, introducing the principle of 'deemed discharge' of conditions where the council has failed to determine an application for approval of a condition within eight weeks. The detail of these measures has neutralised much of the positivity the industry had initially responded with. With so many categories of condition exempted from the deemed discharge procedure it is considered by most home builders to be of minimal benefit.

Demand for new homes remains very strong and over the last three years home builders of all sizes have increased their investment or willingness to invest in the land, skills and materials needed to build homes but at the very same time the planning services that the whole industry relies upon have been almost halved in real terms.

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*'The biggest struggle is the old one of planning, which we've all talked about for years. I'd say getting planning permission itself at the moment is probably the easiest I've known it for many, many years. But it then comes down to the discharge of conditions. It took eight to nine months to discharge conditions on one site. We had 56 conditions on a site. Each condition had several sub-conditions that required discharging. For example, there seems little point in trying to discharge a condition on landscaping which could be resolved, instead, prior to occupation. They want to know exactly what we're going to do on every plot. It was awful.'*

(Housebuilder interviewee, June 2016)

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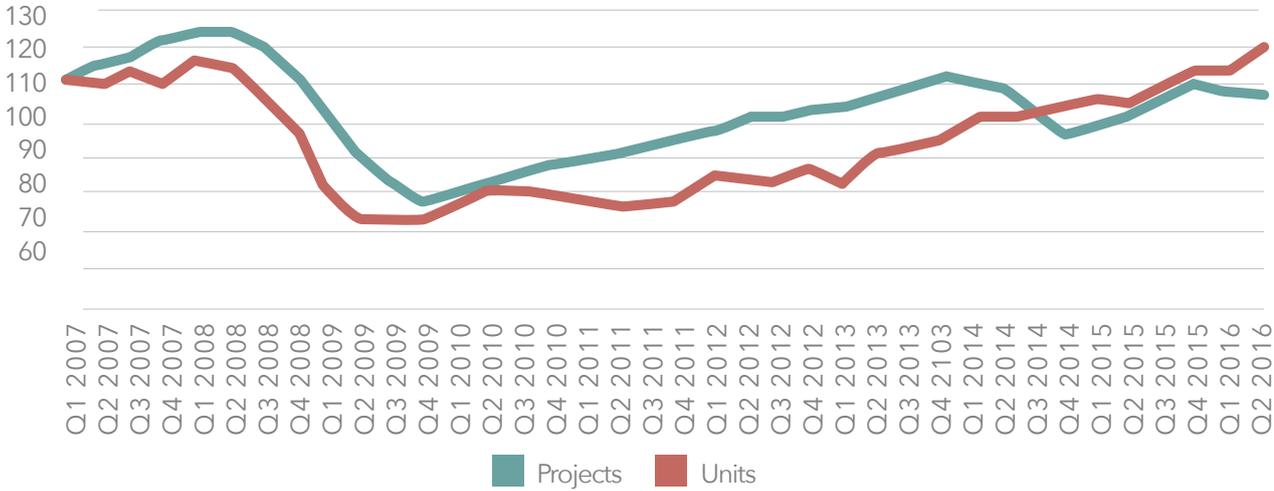


# Barriers for SMEs (cont...)

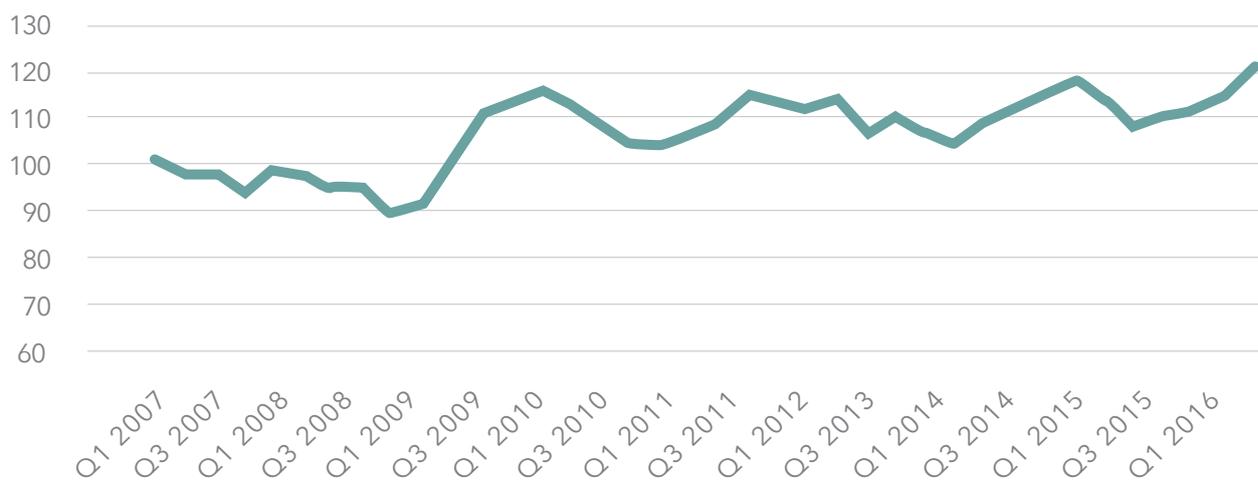
Using data collected by Glenigan for the HBF Housing Pipeline Survey of new planning permissions, we can observe a marked change in the permissions coming forward. The 12 months to Q2 2016 saw 8.5% more units granted planning permission in England compared with the year to Q1 2007, but on fewer sites. In real terms the difference means that 275,515 permissions (+21,673 on Q1 2007) were granted on 19,060 sites (-567 on Q1 2007). So, whilst we now have a planning framework delivering the most planning permissions since the HBF Housing Pipeline survey began just over a decade ago, the number of projects is still broadly similar to the numbers consented in 2013 and 2014.

Since 2007, the average size of a site granted planning permission in England has increased by 10.5%. Excluding schemes of one and two units which will very often be an individual or family self-build, and are overwhelmingly one unit projects (the long-term average in the '1 & 2 unit' category is 1.15 units per scheme), the average scheme has increased from around 21 units in 2007 to almost 26 homes per project today, a rise of 17.0%.

## Indexed planning permissions (rolling annual total projects and units), 2007 to 2016



## Indexed rolling annual average planning permission (exc. 1 & 2 unit schemes)



## Barriers for SMEs (cont...)

### Land and planning Solutions

#### *The definition of a small site in planning policy*

The policies of recent years to exempt small sites from certain development taxes or regulation to support smaller developers have been very welcome but could go further. For the purposes of such exemptions, Government policy usually categorises a small site as one with either fewer than '10 homes' or '10 homes or fewer'. There may also be an additional threshold included, usually based on the total residential floor space provided by the development. While this has helped smaller companies to compete, it can limit growth aspirations of some firms and create an incentive to minimise site sizes to fall within the exemption qualification threshold.

If exemptions for Section 106 affordable housing and Starter Homes are intended to support small home builders to grow and expand their contribution to overall housing delivery, a threshold of more than 10 units should be adopted. A 15, 20 or 25 unit categorisation of small sites would remove the potential disincentive for small companies exploring the development of larger sites, broadening the potential site base on which they can viably develop.

#### *Presumption in favour of development on appropriate brownfield sites*

Great emphasis has been placed in recent years on the development of brownfield land. Incentives or reliefs for remediation or brownfield regeneration reflect the significant costs for preparing and building out often complex sites. The publication of the NPPF in 2012 terminated the national 'Brownfield First' policy which had effectively become a "Brownfield Only" policy in many areas, and replaced it with a more general emphasis on sustainable development. This has introduced more flexibility where there had once been dogma, because while large numbers of brownfield sites are sustainable locations for residential development, many are not. In 2014, NLP found that almost one-fifth of brownfield sites were outside of built-up areas so may not have the benefit of accessibility, reasonable amenity or proximity to employment and services.<sup>7</sup>

Smaller brownfield sites within settlement boundaries are a useful source of land for SMEs and an appropriate and sustainable option for planning authorities with a need to swiftly increase housing supply. However, as we have outlined above, fewer of these sites have come forward in recent years as Local Planning Authorities have, for various reasons, allocated a growing number of large sites often with complex and expensive infrastructure requirements and processed applications more slowly as the importance of effective resourcing of planning departments has receded in light of capacity constraints in highly sensitive areas of local Government spending.

<sup>7</sup> Brownfield Land Solution? (NLP, May 2014).



Recent Government measures have focused on public sector-led solutions. Local authority controlled housing zones, use of Local Development Orders or council initiated Brownfield Registers have been announced and legislated for. This effectively puts local Government in firmer control of the development process at a time when its resources are being constrained. A solution led by the development sector (both private and public) is far more likely to yield positive results for housing supply. As envisaged, the Brownfield Registers placed on statute in the Housing and Planning Act 2016 will involve local authorities identifying potential development opportunities on brownfield land.

Developers themselves are far better equipped, and more motivated to fulfil this role effectively than town hall officers are. Judgements on whether a prospective site is suitable, viable and developable are best made by professional developers.

A residential brownfield presumption, introduced through a change to the NPPF, would require a local planning authority to have a very strong reason to reject a planning application for residential development of a brownfield site within a settlement boundary regardless of that site's status in the local plan or its position on a Brownfield Register. Such development would, thus, be **additional** to local plan allocations. This would go some way to replicating the positive planning environment of the period up until the enactment of the Town and Country Planning Act 1990 but within the bounds of the current plan-led system.

The proposal would specifically encompass land 'within the boundary of settlements' to cover settlements of all sizes rather than merely 'urban areas'.<sup>8</sup> This definition would, however, rule out presumed permission on free-standing or remote brownfield land. The suitability of development on those types of sites should continue to be subject to local considerations, planning policy, infrastructure assessments and housing market dynamics.

This brownfield presumption would ensure that local plan housing allocations are treated as a baseline for housing supply rather than an absolute maximum which is generally the case at present. For a variety of reasons, including viability, landowner issues or other unforeseen site-specific problems, some sites included in local plans will inevitably fail to come forward. Dame Kate Barker, in her seminal review of housing supply in 2004, termed this the 'implementation gap'.<sup>9</sup> Delays in the planning process, the availability of development finance and changes in the market can all restrict planned output. This means that planning for the number of homes the area needs will almost inevitably guarantee an undersupply and, at best, the minimum target will be achieved.

<sup>8</sup> The latter terminology has been the subject of legal challenge in relation to the classification of gardens as greenfield land in urban areas.

<sup>9</sup> Barker Review of Housing Supply (March 2004), pp. 41-43



## Barriers for SMEs (cont...)

We do not reference 'sustainable development' in the context of this proposed brownfield presumption because sustainable development is the guiding principle of the overarching planning system rather than a factor for individual sites. A presumption in favour of brownfield development within settlement boundaries would not alter the way that local plans are prepared and adopted. Plans would still need to be based on long-term objectively assessed housing need. The presumption would then apply to any brownfield sites allocated in the local plan and also any additional sites that may come forward in subsequent years.

It is important to note that a brownfield presumption would not be equal to the 'brownfield first' policy which was in place throughout the 2000s. Combined with other policies at the time, such as a sequential test and a minimum density requirement the brownfield first policy was used to thwart development, regularly characterised by developers as a "brownfield first, greenfield never" policy excluding any consideration of respective viability or sustainability.

### **Increase the 'buffer' required by Local Planning Authorities in Five Year Land Supplies**

Local Planning Authorities are currently required to meet their housing requirements over a five year period and allocate an additional buffer of 5% 'to ensure choice and competition in the market for land'.<sup>10</sup> In reality this addition is inadequate to address the near inevitable 'implementation gap', the inordinate time that the planning process can take, and the increasing frequency with which authorities allocate very large sites with complex and expensive infrastructure needs. The objectively assessed housing need figures should not be seen as the maximum housing supply for the area but at present these limits constrain the market helping to maintain low levels of affordability.

Recognising that some sort of 'buffer' is necessary within our heavily regulated plan-led system, a higher figure of 20% would be more effective and far more likely to result in supply matching local housing need.

### **A wider range of sites in local plans**

In preparing local plans and identifying sites for residential development, LPAs are already encouraged through guidance to 'assess a range of different site sizes from small-scale sites to opportunities for large-scale developments such as village and town extensions and new settlements where appropriate'.<sup>11</sup> In practice, however, the need to allocate the volume of land necessary to meet local housing requirements over a five-year period, combined with the pressures on resources, has led to a preponderance of large sites in local plans, as shown through the 17% increase in the average size of a permissioned site.

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*'I think it's just developed out of the planning system in the last 20-odd years. It's easier for planning authorities to have two or three big fights than a whole load of little fights with the public. And, yet, actually if you go back historically, people object to smaller sites less frequently.'*

(Housebuilder interviewee, May 2016)

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The choice should not necessarily be a 'zero-sum' one. To meet demand for housing, we need more sites of all sizes allocated. Indeed, large sites often deliver new homes at astounding rates, particularly in areas where the market is strong, but small sites are consistently efficient in their delivery. For this reason, the allocation of a wider range of sites within local plan allocations would not only help increase plurality in the housebuilding sector, it would also improve the chances of local authorities' meeting ambitious supply trajectory plans. Achieving this all-round positive outcome need not involve overly prescriptive diktats. A subtle shift in policy emphasis, along with a greater focus on ongoing delivery within a local plan period would help to achieve a positive change in behaviours at a local level.

### **Trajectory planning to test actual delivery from allocated sites and plan for additional allocations**

The bedrock of the NPPF, introduced in 2012, is a requirement for LPAs to have a demonstrable supply of land for housing sites to meet the area's need for homes over a five-year period. This is a concept that the industry and authorities now rely on but too often the five year land supply is simply a snapshot at the time of the plan's adoption. Through policy and guidance, local authorities are theoretically asked to confirm a trajectory of delivery from allocated sites to meet housing need. Paragraph 47 of the NPPF states:

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*'Local planning authorities should... identify and update annually a supply of specific deliverable sites sufficient to provide five years worth of housing against their housing requirements with an additional buffer of 5% (moved forward from later in the plan period) to ensure choice and competition in the market for land... To boost significantly the supply of housing, Local Planning Authorities should... for market and affordable housing, illustrate the expected rate of housing delivery through a housing trajectory for the plan period and set out a housing implementation strategy for the full range of housing describing how they will maintain delivery of a five-year supply of housing land to meet their housing target.'*

(Paragraph 47, National Planning Policy Framework)

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This is supported by guidance which states that such reporting should outline:

- The potential type and quantity of development that could be delivered on each site/broad location, including a reasonable estimate of build out rates, setting out how any barriers to delivery could be overcome and when;
- An indicative trajectory of anticipated development and consideration of associated risks.

The assessment should also be made publicly available in an accessible form.

(Paragraph 28, National Planning Practice Guidance)

This reporting, once again though, tends to be based on a specific moment in time, i.e. at the time of the plan's adoption and there are few incentives to accurately assess the projected output from allocated sites based on realistic build out rates.



## Barriers for SMEs (cont...)

Robust trajectory testing should identify areas of concern before preparation begins on the next iteration of a local plan (usually several years). This process should be a dynamic one involving assessment and action at regular intervals. A clear assessment of the delivery rate of each site assumed to meet the five-year supply of land for housing is essential to ensure that enough sites are allocated and granted planning permission to meet housing needs and prevent local plans being rendered technically unsound.

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*The five year land supply is in place but is not being delivered. The Local Authority is still saying that they're keeping up with the delivery. At the appeal we had last year the inspector relied upon a letter from another developer in the area, saying that, yes, all these sites would be coming forward, one of which has already taken 18 months with still no Section 106 signed. Another major site has not gone to planning yet and a windfall site for 800 that was in their control is going to planning now; well, it should have gone in about a year ago to start delivering homes. Lots of Local Authorities are in the same position. They've put in for these huge Sustainable Urban Extensions, which just are so complicated they're not getting off the ground, whereas we've got the land, we've got the resources to develop it, and we could actually crack on and do it, start building houses, but we're not being allowed to. Planning is standing in the way.'*

(Housebuilder interviewee, May 2016)

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### **Classification of garden land**

The motivation for the reclassification in land use planning terms of back gardens in 2010 was overwhelmingly based on politics and largely misrepresented the reality and the scale of back garden development. Hyperbolic rhetoric and dubious statistics overstated the issue. On signalling the changes, the minister declared it 'ridiculous that gardens have until now been classified in the same group as derelict factories and disused railway sidings', forcing councils and communities to sit by and watch their neighbourhoods get swallowed up in a concrete jungle'.<sup>12</sup> This vastly oversimplified the status of gardens in pre-existing planning policy. The definition of land as brownfield encompasses any site that has been previously developed. Alighting on railway sidings or unused industrial land provides a certain picture of brownfield but, of course, in addition to these unattractive or potentially contaminated uses, brownfield also incorporates existing residential buildings.

In addition to reclassifying gardens as greenfield from its previous brownfield definition, upon publication of the NPPF in 2012, planning authorities were instructed to:

'... consider the case for setting out policies to resist inappropriate development of residential gardens, for example where development would cause harm to the local area.'

(Paragraph 53, National Planning Policy Framework)

<sup>12</sup> Greg Clark, DCLG press release, 9 June 2010.



The reality of back garden development prior to these changes in policy and land use classification was rather different. DCLG statistics show that in 2010, garden development accounted for 1 in 15 new homes<sup>13</sup> and built at an average density around half that of developments on comparable sites.<sup>14</sup>

Building homes on residential garden land had long been the lifeblood for some small developers. Usually requiring good local knowledge and an appetite for smaller schemes, this was a niche through which SMEs could thrive unencumbered by competition from larger companies. It would often involve demolition of a single dilapidated dwelling, or a group of run-down properties and the construction of several more using land much more efficiently.

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*'Back gardens was another big negative: Reclassifying gardens as greenfield. I think around 80% of what we used to build was back garden-related. Sometimes it involved knocking the original house down, sometimes you would try not to, sometimes it meant relocating a garage or something so you could get the drive in. It was a sledgehammer to crack a nut on a problem much more south-east oriented and I think it has really hit delivery of new houses.'*

(Housebuilder interviewee, May 2016)

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The planning framework we have today should provide the appropriate level of protection from inappropriate development without an explicit reference to preventing housing coming forward on residential garden land be it classified as brownfield or greenfield. Decisions as to whether a scheme is sustainable should be made at a local level. In many cases a small development which incorporates some degree of garden development will be a sustainable option in helping to meet local housing demand. Sustainable development is a fundamental guiding principle of our planning system and should be able to apply to any site on which much-needed housing could be built, including what would broadly be classified as 'gardens'.

<sup>13</sup> 6.8% of new homes in 2010, DCLG Live Tables P221

<sup>14</sup> Garden development at an average of 22 dwellings per hectare compared with 'Urban land not previously developed' (46 per hectare) and 'Other non-previously developed' (45 per hectare), DCLG Live Table P223 (discontinued).



## Barriers for SMEs (cont...)

### **Phased planning application fees and other measures to improve planning authority resources**

Ministers have announced that local Government will retain more of the business rate receipts raised locally to reduce reliance on Whitehall. While moves towards self-sufficiency in the local Government sector are welcome, resources will continue to be stretched. Building capacity within planning departments is unlikely to be a popular choice for additional finances insofar as any are available. Realistically, therefore, we must consider alternative approaches to address this problem. Some commentators have pointed to 'cost recovery' for planning fees, usually with no clear explanation as to how this could maintain or improve efficiency and ensure positive outcomes. Another question frequently put to builders is whether they would accept higher fees for swifter outcomes. This hypothetical scenario is usually predicated on a reallocation of resources within the authority which would simply switch personnel from one planning application to another from a developer that has paid the premium. Eventually it is not difficult to foresee a time then when the premium rate effectively becomes the standard rate without any discernible improvement in the service on offer.

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*'There's obviously the initial planning fee for outline... Then there's the Reserved Matters and that's another fee. Then, of course, we had to apply to Highways to have the section 278 works vetted which cost £10,000. In addition to that there was £5,000 for the council's legal fees. We were then approached by the council to say they needed another £3,000 because the £5,000 hadn't covered it. And it's just constant seeking money from developers. What about the actual planning fee?!'*

(Housebuilder interviewee, June 2016)

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*'I think with what we've been caught out on are the timeframes involved in discharging planning conditions. Ticking all the boxes and dealing with all sorts of interference from third parties, who we've had everything from judicial review threats to Village Green designation attempts. Two separate Village Green applications to try and frustrate development. It is very hard to build all of that into your timeframes.'*

(Housebuilder interviewee, June 2016)

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*Broadly, there are several compelling options for improving the service received by home builders and speeding up the delivery of homes:*

- Phased planning application fee payments, potentially amounting to more in total than the current rates but spread over a period of time and linked to performance of the LPA in meeting timescales for decision-making and discharging of conditions etc.
- Ringfenced funding of planning and legal services.
- Competition in the planning service. Local Planning Authorities are examples of extremely strong geographical monopolies that regularly display monopolistic tendencies in their interactions with customers/clients. Government has announced long-term pilots for outsourcing of the non-democratic aspects of planning. The effectiveness will depend on the detail of how it is constructed. It is important that planning decisions made by politicians are not prejudiced by a developer's decision to use the external agency over the in-house team.
- Withdrawal of New Homes Bonus payments and other penalties if planning applications are approved only on appeal. The current process does little to discourage the sometimes whimsical politically motivated decisions of planning committees which are often designed merely to delay proceedings.
- Eliminate or significantly reduce the category exemptions in the current 'deemed discharge' procedure.

### **'Help to Plan'**

Government, possibly through the Homes and Communities Agency, could provide direct support for qualifying small home builders to plan new sites by providing the builder with access to an approved set of consultants to take forward the technical aspects of the planning application and approval process. By providing upfront technical and planning services for SMEs, companies would have additional equity to use on the development in question and on future schemes. Acting essentially as a loan for spending on planning and technical services, monies could be recovered upon the sale of each unit or at the very end of the scheme and could be particularly beneficial for start-ups.



# Finance

## Finance Problems



### Availability and terms

*'If you said to me, what is the single greatest issue affecting your ability to grow your business and make profits?, I'd have to say the availability of finance. The sites are there. If you've got to feed a machine of 12,000 houses, then the sites might not be there, but you can see from our size that if we were doing 200 units a year, we could, more or less double the size of the company. But we are likely to bid on three sites over the next two weeks where the total numbers, total something over 200 units. Now, if we're successful in bidding on them, we can't buy all of them because we haven't got the finance.'*

(Housebuilder interviewee, June 2016)

Financing a small housebuilding company's operations has become increasingly difficult over the past decade. As we have seen, constraints on the ability of small firms to obtain planning permission have affected the risk appetite of lenders, certainly in the field of providing Revolving Credit Facilities (RCF) that allow developers to use long-term finance to fund projects rather than individual loans for each scheme. Lenders' experiences through the Global Financial Crash have resulted in a drastic change in the terms that housebuilders receive when borrowing money to fund construction costs with a general perception amongst SMEs that traditional lenders assume the worst case scenario. Chiefly, this manifests itself via onerous conditions around the borrowing company's own equity, and the process through which the builder will see a return on the investment. This is very different to the way that larger builders will finance construction. The biggest home builders will often have very large capital bases which can support growth or cushion the company during fallow periods in the market. They will not be reliant on project specific finance, operating either with a revolving credit facility or with access to syndicated funds. The more established SMEs may have built a larger capital base over time.

*'Project finance is vastly different from an RCF where you manage the total facility and get on and run a proper cash flow business. Whereas the structure at the moment means that we can only ever draw down a maximum of about 45% of our total loan. And it's compounded by the fact that all of our sites start and finish at different times, which as I pointed out to the lenders, gives them much, much greater security. But they're not prepared to lend on any other basis than the rulebook as it were.'*

(Housebuilder interviewee, June 2016)

For most SMEs, development finance will typically be available on a project-by-project basis at a nominal 60% to 65% loan-to-cost from traditional lenders on reasonable terms (housebuilders report that higher LTCs can be obtained but only at very high cost) with the rest in the form of the housebuilding company's own equity. Prior to the 2008 crash, builders could obtain 70% to 80% and even as much as 90%. Furthermore, the 60-65% quoted by lenders will, in practice, amount to as little as 40-45% in some cases. This is because the developer will have invested the balance in the form of equity and the headline loan-to-cost level is based on total development value but the development is rarely in construction in its entirety unless it is a single phase apartment-led scheme.

Because costs are managed and spread, the full potential LTC is not usually drawn down at any one time and thus most loans operate at much lower levels with the housebuilder's own equity always forming a larger proportion of the Work in Progress (WIP) costs either for the entire loan period or at least the vast majority of the time. This reflects a fundamental misunderstanding of the way that the housebuilder business model works on the part of lenders, and in particular the relationship between build rate and sales rate.



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*'We've got to the stage now where it would be nice if a lender would give us a [revolving] facility. We're in year five now, the model works, the banks can see the model works. So we've asked the banks, would anyone like to give us a facility so we don't need to do it on an ad hoc, one by one basis? That received a luke warm reception to start off with, but we've been asking now for probably 18 months to two years, but they are looking for more scale in the business before considering a facility... We feel the lack of this additional flexibility/headroom is holding us back'*

(Housebuilder interviewee, June 2016)

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*'[Lenders] now want to see all our money in up front. When you buy the land... Let's say it's a scheme of a million pounds... So, we're putting in £400,000, and they're putting in £600,000. They want to have our £400,000 to fund the land. So you've got to engage all your equity from day one. Which makes it harder, because we've got fixed running costs of about £40,000 a month, and those go out no matter what. And the hardest thing for us is getting the continuity of sites. And that's down to two things: One is planning and the uncertainty of planning, and then, secondly the uncertainty of sales. So, quite often you're waiting for sales to come through, but really, you need to be starting another site so that you can pay your overheads and keep that site covered.'*

(Housebuilder interviewee, June 2016)

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The terms on which the housebuilder usually sees a return on its equity investment makes the expansion of businesses tricky to achieve. The developer's equity is commonly only returned once the lender has received all of its return so any withdrawal of the builder's equity and profit on the scheme is entirely back-loaded and only realistically achieved through the sale of the last units in the scheme. This has obvious consequences for the ability of small companies to recycle funding into future projects. Speeding up equity release through a more equal withdrawal from the scheme would allow for significant growth in the output of existing SMEs.



## Finance (cont...)

### Stylised example of how equity financing works for most SMEs

ABC Homes currently builds 20 homes per year with ambition to increase activity to 100 units within three years. The company holds equity worth £2 million, raised through previous profit and investment from individual backers. Just over half of this equity is used to purchase land (£1m) and secure planning permission (£50,000) over the course of a 6 month period entirely at the risk of ABC Homes and its investors. Total development costs (including land and planning) are estimated at £4m with a further £150,000 required for sales and marketing costs (All costs = £4.2m). It is expected that the development will be completed within 12 months of starting on site. A traditional lender agrees to provide £2.7m in finance at an interest rate of 6.0% (65% of total cost). In addition to the £1.05m invested in land and planning to date, the developer must use a further £420,000 of its equity to secure that loan from the bank (now £1.5m in total).

Construction begins and finance is drawn down on a monthly basis. After seven months most of the funding (£2.4m) has been drawn down to finance work in progress. At this point the bank finance is equivalent to around 55-60% of total scheme costs.

In month 8, the builder begins the sales process. Revenue from the first 10 sales (at £250k per home) simply goes towards repayment of the £2.4m financing provided in months one to seven and covering ongoing work in progress costs. At a sales rate of five per month, it is at the end of month 10 that the bank loan is repaid. From that point forward ABC Homes can begin to make a return, take back its equity and reinvest it into future projects.

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*'I was looking at a project which was two-year plus and I thought over half of the returns were going to go, in the end, to the bank, so there's no point doing it. It was just too onerous, because we're taking all the risk, we're getting less than a half return, if anything goes wrong in build or time or sales, we then will see our profit eroding further, so we just refused to do it.'*

(Housebuilder interviewee, June 2016)

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Some sites are available for purchase only 'subject to finance'. In these instances vendors will only accept an offer for land if the full amount is paid up front or the developer is able to provide a guarantee or proof of funds. However, as we have seen above, in many cases finance is only available when a builder has secured a viable planning permission. The reliance on project finance as opposed to revolving credit or existing capital puts SMEs at yet another disadvantage. It should be noted that the associated costs of individual project finance is an inefficient means of financing residential development schemes for both the borrower and the lender.

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*'We've got a reasonably good shareholder base to demonstrate our net worth, even though we haven't drawn on it, but we've had more land owners saying "If we exchange with you how do we know you've got money for completion?" So we've had to give them letters to demonstrate that we have funds for their guarantees. We've just given them confirmation of where our funds come from, so relevant questions, but they're all consistent with whatever the market was. Today, if I was a vendor I'd have various concerns. It's more about what has changed from 2007 to 2016 and there are some unreasonable clauses required by banks, which mean that SMEs need substantially more equity than they used to.'*

(Housebuilder interviewee, June 2016)

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## Costs

It should also be noted that there are often significant costs associated with the arrangement of finance followed by entry/arrangement fees and exit fees that, in aggregate, could amount to a total that effectively makes a nominal 6% interest rate more in the order of 7-8%. The costs of evaluations, legal involvement and reports will not change considerably in absolute terms between a site of 10 units and a site of 30 units leaving the smaller company at a further disadvantage.

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*'The average bank loan arrangement fee is £25,000 to £30,000, and then the same with the exit fee. They're big numbers. It's not necessarily the interest rate that causes the pain, it's the entry and exit fees, and the legal fees.'*

(Housebuilder interviewee, June 2016)

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*'What we've discovered in the last year or so is that the banks are more prepared to lend and they were prepared to lend but on terms you'd never have bothered to do it on. Not unless you were absolutely desperate. In the last six months or so, some of them are getting a little bit more sensible in terms of what they're prepared to offer you. So the biggest problem we find is that if you go along to any of the major banks, what they will say is, they will lend you 65% of your total development cost but you've got to put your 35% in first.'*

(Housebuilder interviewee, June 2016)

Mezzanine debt is generally available to builders but at understandably high costs; often in the region of 20% interest rates. There are also lenders emerging who offer equity as a form of debt but again this tends to squeeze the viability out of a site for the average SME.

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*'There are more possibilities for finance opening up. The secondary lender market is a little more active, and they seem to be lending more than they were and not on outrageous terms. Of course, some still offer outrageous terms, but will lend when no one else will. You're looking at 12% per annum, that sort of rate, and then maybe fees and costs even on top of that.'*

(Housebuilder interviewee, June 2016)



# Finance (cont...)

## Planning status

Funding for construction is extremely difficult for SMEs to obtain without a full, detailed and implementable planning permission. Without an implementable consent lenders are usually uneasy about making finance available without applying exorbitant fees and very high interest rates. Again, this reflects the perceived risk of delay and the potential for unforeseen blockages or costs. For this reason, SMEs are faced with a decision to either finance all pre-development costs themselves or only purchase land with a detailed consent.

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*'We're beginning to find some lenders who will lend on an outline [planning consent]. But not high street lenders. For the high street lenders it's got to be completely plain vanilla, risk free.'*

(Housebuilder interviewee, June 2016)

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*'Lenders are saying "if we lend on outline, we cannot be sure that you will develop the site" and therefore we're holding a piece of the land that we might have to trade when what we want to do is see a business process in which you buy land and build, but you're not capable of building because you haven't got detailed planning permission and we don't know how long that will take". That fits the theme that they want all your money up-front because they want to see you're capable of developing rather than having insufficient funds and only ever holding the land. That pushes the builder to a place where we can't compete to buy central sites that have outline planning permission which suit our business model very well.'*

(Housebuilder interviewee, June 2016)

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## Finance Solutions



### Government action to get lenders lending

Without access to development finance on competitive terms, it is unlikely that the structural decline in the number of SMEs will ever be arrested. The Home Building Fund, administered by the Homes and Communities Agency is still yet to have any impact and early indicators of its effect are mixed. Direct support from Government is welcomed but a healthier and more sustainable situation would be for the traditional lenders to return to realistic levels of support for small and relatively new companies. Government, either at ministerial level or through high level engagement at the HCA, should convene a regular roundtable of senior representatives to assess the true appetite of lending to SMEs in the sector and gauge the ongoing progress in helping companies to start and grow over a period of two years.

In the shorter-term there may be a role for lenders to get involved with the Home Building Fund, offering debt alongside the HCA. Previous attempts to do something similar have not been wholly successful but a concerted effort by Government to solve previous problems could help resolve the issues with competing objectives of the Agency and traditional lenders.

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*'To get debt down further, I want greater turnover. I've got a lot of sites so I've got a lot of costs structured in my business. To get more turnover, I need to get more sites. To get more sites, I need more debt. How do I get more debt if I can't syndicate and I'm not prepared to give up equity? And the bit about not giving up equity, I think, is actually fair: why should a business have to give up equity if it, particularly as an SME, wants to maintain its independence as a private company?'*

*So the only alternative open to me then is to do things like Builders Finance Fund, and we went off to the HCA to look at a series of sites in England where we were approved to get about £10 million of additional funding for projects that were started or just starting that we wanted to accelerate, and that would allow us to get some more sites coming in. We got the approval on that. What we couldn't get is an agreement between the HCA and our lender because both parties wanted to take first-ranking security over the sites, and that was never going to happen.'*

(Housebuilder interviewee, June 2016)

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## Finance (cont...)

### ***Lift barriers for SMEs to access Government support that other sectors enjoy***

The Enterprise Investment Scheme (EIS) provides tax incentives to investors making investments in small firms and has proven successful in opening up new sources of funding for small companies in a range of different sectors. However, home building SMEs are explicitly excluded from the scheme. An urgent review of this decision, and other similar exceptions made for builders, should be taken.

### ***'Help to Build': Government guarantees for bank to SME lending***

Mainstream lenders are unlikely in the foreseeable future to return to pre-2008 Loan-to-Cost ratios for residential development lending. As we have seen the usual format of bank lending to SME developers restricts the amount of homes that builders can deliver because of the inherently inefficient use of a developer's finite equity. This is characterised by a separate, specially arranged loan for each project, Loan-to-Cost ratios of around 60-65% and the requirement that the developer's equity must be invested at day one and retained in the project until the scheme eventually turns a profit on the sale of the final home(s). Ministers have demonstrated a desire to stimulate activity amongst existing SME builders and support the creation of new home building companies but this has tended to be with direct Government loans, supporting schemes that would otherwise not qualify for development finance at reasonable cost.

There is more that Government could do to encourage and support banks to lend without actually lending directly. A Government-backed guarantee – a 'Help to Build' programme – to a maximum proportion of the total costs could be used to secure more favourable, realistic terms for the developer. The Government risk would be dependent on the lender's own credit assessment of the company and act as a second charge over the project with the risk reducing over time as the developer's equity is injected over the early stages of the development (rather than at the very start). Ultimately the developer's total equity would not change over the course of the entire project but spreading it over a longer period increases the opportunities for the company to increase its development activity during any given period. Supported by the guarantee, at the beginning of the project a greater proportion of the costs will be borne by the lender and the Loan to Cost ratio will be closer to the nominal ratios reported by lenders at present. This is illustrated by a worked example included in Appendix A.



In this example, using a hypothetical scheme with land costs of £2m; build costs of £2m and sales of £5m, the builder's average equity investment over the 12 month build and sales cycle on an individual scheme is 35% less using the proposed 'Help to Build' guarantee than would typically be necessary in current conditions. This means that the average monthly equity balance for the builder averages 18% of total scheme costs rather than 27%. This equates to more than £400,000 on average across the life of the development which could help to support an additional scheme. This more efficient use of equity creates more flexibility, minimising dead money. This arrangement would lead to higher interest payments, as modelled in the example given. While this would have an impact on the scheme's overall profitability, the trade-off is being able to release equity from the scheme more quickly. Similarly, at the front-end the builder's equity would be inputted more gradually into the scheme.

The lower equity requirement overall, allied to a more gradual withdrawal of developer equity, could be transformational for SMEs. Continuing the scenario set out above and illustrated in Appendix A, a small builder currently building on average two 10 unit schemes per year would be enabled to purchase and begin development on a third site potentially increasing its output by 50% in a very short space of time.

The British Business Bank (BBB) has a programme through which this is theoretically already available to lenders to support their engagement with SMEs. The Enterprise Finance Guarantee, launched in 2009, provides accredited lenders with a guarantee for a proportion of the loan value. However, it would seem that no lenders have shown interest in utilising the guarantee to lend to small home building companies. This is perhaps reflective of the banking sector's risk appetite and its attitude to home building SMEs.



# Red tape

**Over the course of many years, successive Governments and ministers have done much to facilitate and accelerate housing supply by reducing the regulatory burden. This has, however, not prevented the creation of red tape in other areas or pre-existing regulation becoming more burdensome. Generally these are problematic for developers of all sizes and in both the public and private sector, limiting growth or affecting the speed of delivery. Larger firms are equipped to negotiate these hurdles and better spread the risk of damaging delays to individual sites. For small developers and especially start-ups, these are considerations that are critical to the ongoing existence, let alone growth, of the business.**

The HBF, on behalf of the industry, made a detailed contribution to the most recent in a long line of Government initiatives to address the ongoing burden of red tape on housebuilders, the Cutting Red Tape Review.

## Red tape Problems



### Highways

The provision of highways on new residential developments remains a concern for developers around the country. The principle methods of providing this infrastructure and supporting its ongoing maintenance are through Sections 38 and 278 of the Highways Act 1980. This decades old legislation is not wholly relevant in the context of housing delivery in 2016.

In relation to Section 38, the concerns relate to resource in the Highways Authorities, the point in the planning and development process at which Highways Authorities (HAs) properly engage, the lack of joined up working between Highways and Planning Departments more generally, the excessive charges levied on housebuilders by Highways Authorities and the variation of design standards between Highways Authorities which leads to additional costs and time delays for home builders.

Many Highways Authorities do not fulfil their consultation role at the planning stage. Very often HAs only comment on Highway geometry and design once planning consent is in place and a subsequent application for Section 38 highway adoption technical approval is made by the developer. In many instances the changes are such that a return to the planning process may be required.



Specific concerns, include:

- **Planning** - Highway departments are statutory consultees for planning applications yet they increasingly impose additional standards post-planning consent. We must find a way of agreeing final designs as early, and quickly, as possible to reduce delays and the potential need to consider late changes to scheme design.
- **Approval of designs** - in many cases it can take significant time to get designs approved by the LA. There should be a time limit for approving designs and it should be based around the planning submission.
- **Approval process for adoption** - in many instances the adoption process can take much longer than the date set out in the Section 38 agreement. There is currently no incentive for LAs to adopt roads in a timely manner, especially in today's economic climate when LA budgets are being cut. Until they are adopted LAs are not responsible for their maintenance. Such delays are compounded by the bonds provided by builders having to be kept in place for longer than is necessary, so adding to capital lock up and costs. These delays cost the developer with the bond provider apportioning overrun charges to the bonds.
- **Commuted sums** - Highway Authority demands for commuted sum payments for future maintenance, as part of the requirements of a Section 38 adoption agreement, are increasingly becoming excessive. Over the years the commuted sums demanded by LAs have increased significantly and are now often in excess of the cost of the road. As a result, the LA's inspection fees, which are a percentage of the commuted sum, have risen accordingly. The rationale for such payments has still not been fully tested in the Courts and it remains a moot point as to whether or not such payments are legal.

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*'Instead of having a facility with the NHBC of £100,000 we'd have one of £300,000, because at the present moment we've got £100,000 deposited with [our bank]. So both [the bank] and the NHBC can write us bonds. And, I don't have to do that. I can actually say to whoever finances the site, "take it as part of your debt", but all they'll do is reduce the amount they'll lend me by the same figure. So it actually doesn't get me anywhere. So I just took the view that we would have a nice discreet facility. I'll put £100,000 in a bank account and then [the bank] will write me the bonds out but that's £100,000 in capital that I can't use elsewhere.'*

(Housebuilder interviewee, June 2016)

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*'We had a site where we had the Highways Authority saying, "we don't really want to adopt it". I think that the state should be required to do so. And they said, "maybe we will for a commuted sum". So, I think they're almost ransoming us. Another example is on highways where you've got planning for a particular road width and the Highways say, "well, that doesn't suit it us". So you then have two statutory bodies and you're stuck in the middle, we cannot please them both.'*

(Housebuilder interviewee, June 2016)

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## Red tape (cont...)

With regard to the procedure for inspection and supervision fees and charging for inspections, due to the monopoly position that Highways Authorities effectively hold, developers can be asked to pay very large inspection fees without which a Highways inspector will not visit the site. Questioning of such fees necessarily leads to delay and can contribute to an overall level of frustration which can result in developers proceeding at risk that the road may not be adopted simply to avoid further delay to their scheme.

Highway Authorities apply their own design standards that vary from Authority to Authority across the country. This is clearly sub-optimal and adds to the time and costs involved with developers providing and agreeing design solutions.

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*'The other real headache is the question of supervision fees. If I go back 12 years we used to pay about 4% of the contract sum for Section 38 and 278 works. The price is never based on the winning tender now anyway. If the tender comes in at £3 million the council can just say that the figure is actually £3.5 million. And then supervision fees have increased massively. We're looking at paying 8% now. For the length of contract and the fees charged we could easily employ four or five engineers on a full-time basis.'*

(Housebuilder interviewee, June 2016)

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### Water

The principal legislation pertaining to the provision of water and sewerage infrastructure for residential developments is, once again, more than 25 years old. Section 104 procedures under the Water Industry Act 1991 for the adoption of sewers are a particular area of concern raised by HBF member companies. The issues are in broad terms the same as those relating to Highways. Companies complain of delay, excessive fees and charges, and of such adverse impacts being compounded and underpinned by the monopoly position of the regulatory authorities which prevents the industry using alternative and more competitive providers or developing solutions itself subject to meeting necessary statutory requirements in a smart regulatory form. The time taken to conclude processes to the point of an agreement are commonly reported as taking 3 to 6 months and in some cases a few months longer.

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*'We had the water company quote £2,000 to supply water to a site. We bought the site and they came back and said, "We made a mistake; it's actually going to be £160,000". So, we had a consultant look at it and said that they're using 1996 data. We now have to go and get a consultant on a no-win no-fee basis to go to Ofwat. He says it'll take up to a year but we're going to have to pay up front to get the water into the site. And I'll probably get half back in a year's time. We are finding that very difficult at the moment.'*

(Housebuilder interviewee, June 2016)

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There are a growing number of instances whereby Water and Sewerage Companies (WaSCs) are seeking to avoid their statutory obligations under the provisions of the Water Industry Act 1991, by pressurising the Local Planning Authority to impose planning conditions that:

- Demand developer funded network analysis for foul sewers, and;
- Seek developer funded off-site foul sewer and water supply network reinforcement. There is evidence of delays exceeding 6 months before the outcome of a network analysis is known. Similarly, of excessive cost demands for spurious network reinforcement (for example, as a result of using unrepresentative and disproportionate input parameters for assessments), or the imposition of planning conditions that restrict and/or delay development, pending completion of the off-site reinforcement – so called Grampian conditions. In several instances, the ability to complete the off-site infrastructure has no time limit and is often out of the developer's hands. On occasions, planning consents are at risk of lapsing before the required network capacity 'improvements' are likely to become operational.

Such demands from WaSCs are leading to pressure for local authorities to include the network reinforcement sought as part of Section 106 planning obligations agreements.

Assessment and "betterment" charges based on such over-conservative assessment assumptions are also arguably incompatible with the direct impact test that should apply to Section 106 obligations – if water infrastructure investment requirements are being enforced through this mechanism.

## Land registration issues

Interacting and transacting with the Land Registry is an unavoidable part of housebuilding which can create delays and frustrations, especially for smaller companies for whom such hindrances can have substantial impact on the company's development programme. One common source of delay comes from a lack of clarity provided at an early stage in the process of establishing the title of land. A lack of resources is often cited as a cause of these problems.

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*'We have a lot of problems with the Land Registry. Perhaps we've just been unlucky but they are incredibly uncommercial. Whenever we buy a site we send a copy of what we think is the title plan i.e. a proper topographical red line, off to the Land Registry and ask them to confirm it fits with the title. And there's one particular site where yes, they said that fits within title number XYZ. That title plan got attached to the contract and we bought the land.*

*We then send back to the Land Registry the plot deed files which are merely the original red outline carved up. And on this particular site they came back and said "sorry, this plot goes outside your title". They would not change their view. Now that is absolutely nonsense. Either they were wrong the first time or they were wrong the second time, but the problem is there is no way of actually sorting it out except going through an incredibly long winded process that actually no small developer is going to have the time to do.'*

(Housebuilder interviewee, June 2016)

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## Red tape Solutions



### Seizing the opportunity of Brexit

In the context of the UK's exiting of the European Union we would like to see a clear focus on how a refreshed regulatory framework could be shaped to help SME housebuilders thrive in a way that helps to expand overall housing delivery, and will continue to work closely with Government to identify opportunities to ease the burden on the home building industry generally and specifically SMEs.

### Highways

- Highways Authorities should be encouraged if not instructed to participate more effectively in pre-planning application discussions and to sign-off highway layouts as part of the planning process. This would make for smarter regulatory approval and reduce both cost and delay.
- A wholesale overhaul of the Highways Act 1980 is now required. As part of this legislative review, there is a strong case for competition in the provision of inspection and other services to create incentives for Highway Authorities to discharge their responsibilities with full efficiency and with a clear focus on timely delivery. In the present context the incentives can clearly be perverse with HAs seeing the scope to raise revenue from unwarranted fee levels and to offset their normal risks and future responsibilities through seeking unduly onerous commuted sums.
- An alternative approach, within the confines of existing legislation could be an attractive proposition in the shorter-term. The provision of appropriate roads on developments is a technical matter that could be dealt with similarly to Building Regulations where the previous monopolistic position of local authorities was tackled when competition was introduced several decades ago. Approved building inspectors could be encouraged to broaden their activities to include the inspection and approval of highways. Following a suitable period of supervision by the approved inspector, application could then be made under Section 37 of the Highways Act 1980 for the Highways Authority to adopt the road.
- A Government-backed guarantee for bonds used to secure the terms of Section 38 agreements and support adoption of highways.
- We advocate moving to an agreed single national set of design standards to be used by Highways Authorities, with the potential for the sign-off of designs and roads to be outsourced to qualified specialists and technicians.
- Section 38 and Section 278 conditions should have a deemed discharge approval mechanism built in to prevent delays caused by under-resourced or inefficient Highways departments.

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*'If the highways departments ever go the same route as water infrastructure provision then we're in trouble, because the section 38 on one site took us nine months and we got three or four legal completions before we got there. And doesn't matter now whether it's section 38, section 278 or section 104, they all need tightening up. You know what the Government has done with discharging planning conditions? They should have some sort of mechanism like that. If it is not dealt with within two months then there is an alternative system you can just go and get it fast tracked.'*

(Housebuilder interviewee, June 2016)

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## Water

Despite the present difficulties experienced with Water and Sewerage Companies (WaSCs), albeit in the main specific to foul drainage, there is a growing body of opinion in the development community (and amongst several WaSCs) that WaSCs should become the sole body responsible for surface water drainage in general, including SuDS infrastructure. (The concept of a single body responsible for this function was identified in the 2008 Pitt Report). This may require changes in legislation but the Infrastructure Act 2015 and/or the Water Act 2014 may provide an appropriate way to introduce smarter, and more responsive secondary legislation that deals more effectively with surface water management. Indeed, Section 21 of the Water Act 2014 empowers WaSCs to design, construct, manage and maintain SuDS infrastructure in the discharge of their statutory duties under S94 of the Water Industry Act 1991.

If this approach was adopted it would clearly be vital that a consistent use of agreed assessment criteria for network investment in respect of new development was agreed and stuck to.

The recent proposals put forward by Ofwat would have amounted effectively to handing water companies total discretion over the charges and fees levied for reinforcing the utility company's infrastructure, rendering many schemes unviable while providing no incentives at all for the water company to invest to maintain its own assets. The industry vehemently opposed this change and would not like to see this re-tabled by the regulator. Instead, the HBF has put forward a proposal for charges and fees that would create strong incentives for brownfield development and the effective integration of ever more innovative forms of Sustainable Drainage Systems (SuDS) on new sites.

In addition, we would advocate that there should either be a single infrastructure charge and no other obligation on developers, **or**, that developers should have the choice of arranging for the delivery of the assessed infrastructure requirement themselves and then hand this over to the WaSCs. This would both avoid the levying of unwarranted fees on developers and introduce competitive pressure into these processes.



# Appendix A: 'Help to Build'

We have created a worked cashflow analysis, comparing current standard terms and the way that equity could be inputted and withdrawn more dynamically using a 'Help to Build' model based on a Government guarantee to lenders. For this exercise we have made the following assumptions:

## Assumptions

- Units: 20
- Average sales price: £250,000
- Land cost: £2m
- Build cost: £2m
- Sales and other costs: £200,000
- First completion in month 8 of the scheme, one sale per week thereafter

## Lending terms

	Current	Help to Build
Loan-to-Value (Cost)	70%	70%
Initial equity	100%	50%
Pro-rata equity	N/A	50%
Repay rate	100%	80%
Interest rate	4.00%	4.00%
Initial equity input	£1.29m	£645,000

## Cashflow: Modelled 'Help to Build' terms

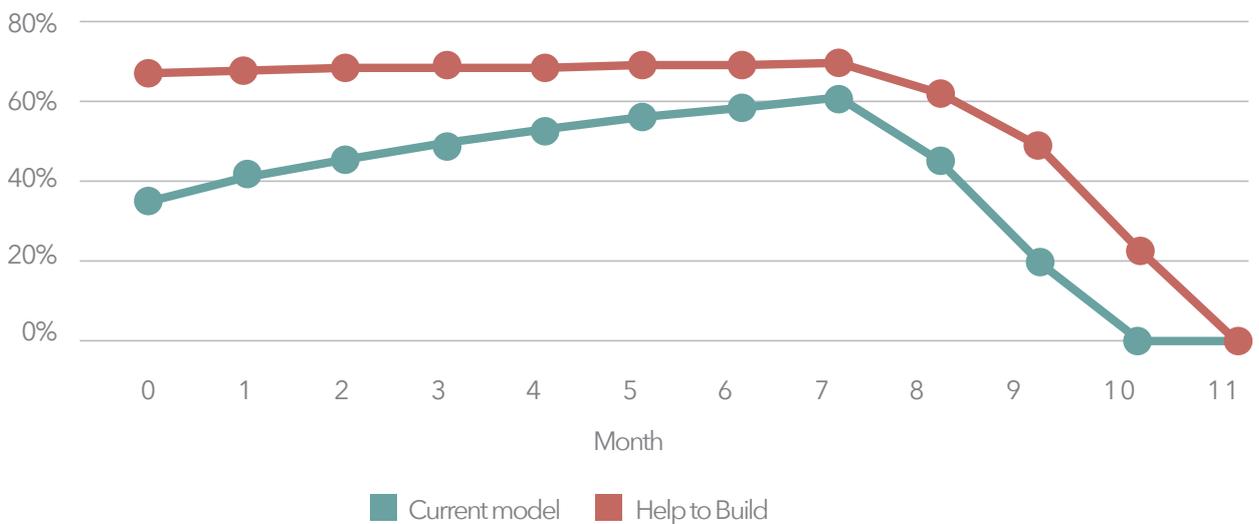
As shown in the charts and tables below, using the Help to Build model discussed in the report's main text, would see a housebuilder spread its equity input more evenly than is currently the standard practice. Rather than a single slug of equity inputted in month 0 and eventually withdrawn in months 10, 11 and 12, a Help to Build guarantee would help to create an environment in which the builder injects a large amount of its equity at the outset followed by additional equity in the early months of the development with withdrawal beginning earlier, in month 8 but at a slower rate. This helps to smooth the cashflow for the development and on average, the developer would have around £400,000 additional resource with which to support future schemes.



## Dynamic modelling of effects of Help to Build Scheme for 20 unit scheme with £4.2m costs



## Actual Loan-to-Cost ratios on stylised 20 unit scheme delivered over 12 months



## Appendix A: 'Help to Build' (cont...)

### Monthly equity input from small housebuilder (stylised example) under current model and 'Help to Build' for 20 unit scheme



#### Current standard practice

Month	Costs	Sales	Bank funding	Interest	Bank loan balance	Equity required	Equity balance	Work in progress	LTV
0	2,000,000		710,000		710,000	1,290,000	1,290,000	2,000,000	36%
1	183,333		183,333	2,367	895,700	-	1,290,000	2,183,333	41%
2	183,333		183,333	2,986	1,082,019	-	1,290,000	2,366,667	46%
3	183,333		183,333	3,607	1,268,959	-	1,290,000	2,550,000	50%
4	183,333		183,333	4,230	1,456,522	-	1,290,000	2,733,333	53%
5	183,333		183,333	4,855	1,644,711	-	1,290,000	2,916,667	56%
6	183,333		183,333	5,482	1,833,526	-	1,290,000	3,100,000	59%
7	183,333		183,333	6,112	2,022,971	-	1,290,000	3,283,333	62%
8	183,333	1,000,000	- 816,667	6,743	1,213,048	-	1,290,000	2,626,667	46%
9	183,333	1,000,000	- 816,667	4,043	400,425	-	1,290,000	1,970,000	20%
10	183,333	1,000,000	- 401,760	1,335	-	- 414,907	875,093	1,313,333	0%
11	183,333	1,000,000	-	-	-	- 816,667	58,426	656,667	0%
12	183,333	1,000,000	-	-	-	- 816,667	- 758,240	-	0%
	<b>4,200,000</b>	<b>5,000,000</b>		<b>41,760</b>		<b>- 758,240</b>	<b>1,152,793</b>	<b>Average mths 0-11</b>	

## Help to Build

Month	Costs	Sales	Bank funding	Interest	Balance	Equity required	Equity balance	Work in progress	LTV
0	2,000,000		1,355,000		1,355,00	645,000	645,000	2,000,000	68%
1	183,333		128,333	4,517	1,487,850	55,000	700,000	2,183,333	68%
2	183,333		128,333	4,960	1,621,143	55,000	755,000	2,366,667	68%
3	183,333		128,333	5,404	1,754,880	55,000	810,000	2,550,000	69%
4	183,333		128,333	5,850	1,889,063	55,000	865,000	2,733,333	69%
5	183,333		128,333	6,297	2,023,693	55,000	920,000	2,916,667	69%
6	183,333		128,333	6,746	2,158,772	55,000	975,000	3,100,000	70%
7	183,333		128,333	7,196	2,294,301	55,000	1,030,000	3,283,333	70%
8	183,333	1,000,000	- 671,667	7,648	1,630,282	- 145,000	885,000	2,626,667	62%
9	183,333	1,000,000	- 671,667	5,434	964,050	- 145,000	740,000	1,970,000	49%
10	183,333	1,000,000	- 671,667	3,213	295,597	- 145,000	595,000	1,313,333	23%
11	183,333	1,000,000	- 296,582	985	-	520,085	74,915	656,667	0%
12	183,333	1,000,000	-	-		- 816,667	- 741,751	-	
	<b>4,200,000</b>	<b>5,000,000</b>		<b>58,249</b>		<b>- 741,751</b>	<b>749,576</b>	<b>Average mths 0-11</b>	





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