



CALLCUTT REVIEW OF HOUSEBUILDING DELIVERY

SUBMISSION BY HOME BUILDERS FEDERATION (HBF)

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KEY CONCLUSIONS

Achieving the Government's Targets: Barriers to Delivery

1. To achieve the Government's target of 200,000 quality, zero-carbon homes by 2016, the top priorities for the house building industry are:
 - sufficient sites with implementable residential planning permission, in the right locations, of the right sizes to fit local market demand;
 - adequate infrastructure to allow sufficient land to be made available for housing;
 - the ability to build homes which home purchasers want to buy – 85%+ of new homes are built by private developers for private buyers;
 - competitive returns for investors/shareholders;
 - residual land values which are sufficiently high to persuade land owners to sell their land for residential development and to compete with alternative land uses;
 - a reduction in the complexity of regulation and its cumulative cost on land values and house builders, especially smaller and medium sized firms – costs have risen substantially in the last seven years and are set to rise even more sharply over the next decade.
2. Other potential barriers, such as labour and skills, construction methods, materials/products and finance, are largely within the control of the house building, supply and finance industries, although Government may be able to play a supportive role.
3. Self regulation is the best route to higher quality (product, design, customer satisfaction).
4. The zero-carbon target and broader sustainability goals can only be achieved if the national timetable agreed between the industry and Government is adhered to, if local planning authorities are restrained from setting a multitude of independent policies, and if home buyer interests are fully protected.

Home Building Industry Business Models

5. There is a range of business models for developing housing in Britain, and no single 'right' model. The only way to ensure the best models emerge and prosper in a market economy is to allow investors and financial institutions to back different models which will, over time, adapt and evolve as economic and market conditions change. Some companies will be more successful than others, some models will be more successful in certain locations, markets or market conditions than

others. We do not believe the current range of business models is a significant barrier to achieving the Government's targets.

6. A driver for all models is profit growth. Investment capital competes for the best growth opportunities across the economy. If home building companies are unable to provide sufficient prospects for growth, they will lose out in securing capital. However, if the priority conditions listed above are met, the industry as a whole – across all models – would have a substantially enhanced ability to deliver the required increase in housing numbers, which would in turn meet shareholder and investor requirements for capital growth.
7. Consolidation has not increased the overall contribution of the larger home builders to housing delivery, nor have smaller and medium-sized companies diminished in importance. Competition is best served by increasing the supply of permissioned land across the widest possible range of local markets and site sizes. Larger home builders will have to deliver a large proportion of the required increase in housing output because they have the necessary capacity, resources and experience.

House Building Delivery: the Public Sector's Role

8. Central Government's role should not be to 'pick winners' or favour one model over another, but to ensure regulation and policy intervention (a) do not create barriers to achieving the housing target, (b) leave a level playing field on which the different models and companies can complete, and (c) do not erect barriers to entry or expansion.
9. The public sector has a very significant impact on the home building industry and housing delivery through the content and implementation of policy and regulation. If the industry is to meet the Government's ambitious numerical housing target, at the same time as it raises building, design and sustainability standards, there must be a properly structured framework for changes to all forms of regulation and proper regard for the cumulative impact of regulation on land values. Central government also needs to ensure that other stakeholders with a major influence on house building, including Government departments and agencies, as well as private sector providers such as the utilities, do not create barriers to meeting the Government's housing target.
10. The cost and complexity of policy and regulation is already constraining housing output through its impact on viability and land values. The cumulative cost burden, already on a rising trend, is set to increase even more rapidly as industry seeks to meet the zero-carbon target. Together with restricted land supply, the cost and complexity of regulation has created barriers to entry and expansion. Over the last seven years, the rising cost burden has been disguised by rising land values. However there is no guarantee land values will continue to rise at past rates, and weaker house prices and/or lower average densities would lower average land values.

INTRODUCTION

11. Before answering the specific questions posed by the Review, this submission addresses the broad issue of housing supply and possible barriers to achieving the Government's target of 200,000 zero-carbon quality homes in England by 2016. These barriers might usefully be categorised as external, including those created by regulation and policy, and barriers which are largely internal to the industry (skills, construction methods, finance, etc).

TOP PRIORITIES FOR ACHIEVING THE GOVERNMENT'S HOUSE BUILDING TARGET

Sufficient Sites with Residential Implementable Planning Permission

12. Without an adequate supply of land with implementable planning permission, in the right locations, it will be impossible for house builders to meet the Government's housing target, whatever is done to lower other potential barriers to housing delivery.
13. There is no shortage of land in England, only a shortage of implementable permissions to build. Only around 8% of England is urban, although a substantially larger area has some form of protection from development¹.
14. Official statistics for house building and density indicated the area of land developed for housing fell by 26% between 2000 (the year PPG3 was introduced) and 2005. Official statistics for the brownfield share of residential land indicated annual brownfield use fell by 10% between 2000 and 2005, while the annual greenfield area slumped by 43%. While these figures do not, of themselves, prove that there is a shortage of land with implementable planning permission, they certainly suggest there is a serious problem with land supply.
15. If there was no planning system, there can be little doubt that the supply of land would allow new housing to meet demand. However, because such free-market conditions would have many undesirable consequences, the planning system has a necessary and very important regulatory role to play. Whereas the planning system was originally designed to regulate the location of land for development, under the plan-led system of the 1990s it tended to become a mechanism for rationing the overall supply of land for housing. An unintended consequence was that housing supply was kept below demand and need, with damaging economic and social consequences (as examined by the first Barker Review).

¹ Green Belt (13%), AONB (16%), National Parks (7%) – though there will be some overlap between these areas.

16. Appendix 1 contains estimates of the additional planning permissions, and additional land area required to raising housing output from today's 160,000 per year to 200,000 per year. In order to raising housing output by 25% by 2016, the number of sites granted implementable residential planning permission will have to rise by somewhere in the region of 1,000-1,200 per year². The area of land granted residential planning permission will have to rise by at least 25% if the current average density is maintained, and substantially more if average densities are below the current average, which seems quite likely - by 35% if average densities were to fall to 38 units per ha from the current 41, and 50% if the average fell to 35 units per ha. (It is worth noting that the average density had kept very close to 25 units per ha for several decades before the sharp rise after 2000.)
17. If the total area of land developed in 2005 had been the same as the area developed in 2000 (approximately 5,600 hectares), at the average density in 2005 (40 units per hectare), there would have been over 220,000 completions instead of the actual 159,000.
18. The Government's 200,000 target for England was set when household growth was projected to be 209,000 per year from 2003-26. However the latest projections put growth at 223,000 per year from 2004-26, suggesting that even if the 200,000 target is met, housing supply will still be inadequate to meet need/demand. This will drive up house prices, worsen affordability, create yet more pressure for Affordable Housing on private housing sites through S106 agreements, which in turn will increase the risk that sites will not come forward for residential development, creating a vicious circle.
19. HBF and member companies fully recognise that the Government has implemented a raft of planning reforms, many accepting HBF's own recommendations for increasing the supply of permissioned land, and that further reforms will follow in the Planning White Paper. If these reforms are implemented as intended, they should bring an increase in the supply of permissioned land. However our concerns about land supply relate to the current situation and the likelihood that these reforms, even if successful, will take time to produce significant results.

In the Right Locations

20. These additional implementable planning permissions will have to be in the right market locations, and for sites of sizes appropriate to each market. Because 85%+ of new homes are built by private developers for private buyers, house builders must be sure they can sell homes in a particular market before they will build them.

² With around 350 local planning authorities in England, this implies an average of 3 permissions per authority per year.

21. The broad distribution of land for housing is relevant at the regional level. For example, the latest household projections indicate 45% of household growth from 2004-26 will be in London, the South East and East regions, whereas just over 25% will be in the three northern regions. The distribution of new housing will have to be broadly in line with these regional shares.
22. But the distribution of permissions is critically important at the local market level. As Kate Barker observed in the interim report of her Review of Housing Supply, there is limited substitution between markets. Allowing house building in one market and choking it off in another does not simply redistribute housing demand (i.e. people) from one area to another, with no other consequences. And house builders know from long experience that every market has only a limited capacity to absorb new housing per year, even in growth areas like Milton Keynes or Cambridge. For example, if a large housing site is attached to a large urban settlement, the sales pace (and therefore build rate) is likely to be faster than attaching a similar sized site to a small rural town. Simply allocating large tracts of land for housing will not automatically produce large numbers of homes.
23. A key variable in this discussion is the sales pace. A site that is too large for a local market catchment area will sell, eventually, but the sales pace will be slow. As the target is to lift housing completions by 25% within nine years, it would be unwise to swamp areas with more housing than their local markets can absorb. Put another way, the scale of land release from area to area must be broadly in line with potential market demand and household growth in each area.
24. A related factor is the distribution of sites by size in an area – i.e. whether land is released in a few large sites or many smaller sites. Given limits on the average sales per year per outlet/site (see Appendix 1), and given the capacity limit of each local market to absorb new homes, the size distribution of sites is an important influence on the potential annual output of each individual market area, and therefore of England.
25. The Government's brownfield land targets has had a number of adverse consequences. Local authorities need to adopt a more flexible approach to land supply.
26. The biggest limitation with the brownfield target is that it has been substantially exceeded primarily by drastically cutting the development of greenfield land, and at the expense of housing output. Official figures show that between 1997 and 2003 (the latest published land area data), the area of brownfield land developed annually rose by a modest 9%, while the annual greenfield area fell by 28%. (The total area fell 10%.) Official statistics for house building and density indicate that the area of land developed annually for housing fell by 26% between 2000 and 2005, with a 10% fall in brownfield land and 43% fall in greenfield.

Despite a dramatic rise in average densities since 2001, annual housing output did not grow nearly as much as would have been possible if the total area of land available annually had been at least maintained, or preferably increased.

27. Another problem with the brownfield target is that it implies a simplistic 'brownfield good, greenfield bad'. However this conflicts with the more sensible objective of seeking the most sustainable solutions. In some locations, greenfield land will provide a more sustainable solution than brownfield land.
28. The availability and distribution of brownfield land will be largely a function of the industrial and economic history of an area and current economic and business conditions. By contrast, the need for residential land in an area will be a function of housing market and economic conditions and household growth in the area. There is no reason why the supply of brownfield land which is viable for housing development in an area need match the need for such land in the area.
29. Of course the supply of brownfield land is not a fixed quantity. Whether previously developed sites are suitable for housing, are likely to come forward for residential development, or would be viable for such development, will constantly change as economic and business conditions change, and house and land prices change. A site may become viable for housing because house prices have risen (or may no longer be viable if prices fell), an owner may decide to close down or relocate a business, a change in local planning policies, or new infrastructure (e.g. a new road) may open up new opportunities, etc.
30. HBF argued in its submissions to the first Barker Review that a more sensible policy objective than any particular brownfield target would be to require local planning authorities to promote the most efficient use of land. Where market demand is strong and brownfield land plentiful, most residential development will take place on brownfield land. However where sufficient vacant and derelict brownfield land is not available, promoting the most efficient use of land would then shift attention to land which is currently in use, but which could generate a much higher land value were it redeveloped for housing. This might be low-grade industrial or commercial uses adjoining a residential area, or it might be relatively low-density, low-value older housing where redevelopment could lift land and sales values and produce much higher quality housing, probably at higher densities. The release of such 'potential' land value has the key benefit that it helps create a virtuous circle: land owners will benefit, and therefore be persuaded to sell their land; housing developers will find development profitable; and rising land values will help fund the physical infrastructure which is required to enable the development to go ahead, as well as the physical and social infrastructure which will help create a desirable, quality place where people will want to live, which in turn will raise house prices and land values; and so on.

31. In some settlements, where vacant or derelict land is in short supply and where there are no relatively low-value areas which could be realistically redeveloped, greenfield land will have to be released.
32. Therefore, given that achieving the Government's housing target is going to require a substantial increase in the supply of land for housing, unless we are much more successful at bringing forward previously or already developed land for housing, most of the increase will have to be on greenfield land. This suggests we need much more effective policies to promote the redevelopment of already or previously developed land.

With Adequate Infrastructure to Support Development

33. The Government has already recognised the need for adequate infrastructure to support future housing development. Although we believe the Planning-gain Supplement (PGS) would not be an effective way to raise money for infrastructure, and indeed may create further delays, an adequate funding regime must be found. On the infrastructure delivery side, we await the outcome of the Treasury's Cross-cutting Review for CSR07. Infrastructure needs to encompass both public sector provision (roads, schools, health, etc.), as well as services provided by private utilities (water, gas, electricity). At the individual site level, there may also be opportunities to use CPO powers to help with land assembly and infrastructure provision (e.g. ransom strips, drainage easements, etc.). We hope the Cross-cutting Review will require local planning authorities to set out clear and realistic strategies for development and infrastructure investment.

The Ability to Build Homes that Meet Purchaser Demand

34. Apart from numbers, location and infrastructure, it is essential that home builders are permitted to build the types³ of homes people are willing to buy, given that 85%+ of all new homes are built for private buyers. If people want to buy a home at a price which is profitable for the developer, and generates an adequate land value to persuade the land owner to sell, the home builder will build the dwelling.
35. There is growing concern within the industry that increasing numbers of local planning authorities are introducing prescriptive mix policies, specifying the proportions of different types of dwellings (e.g. by type or bedroom numbers) required on private residential schemes. It is difficult enough for house builders, with their extensive direct experience of building for local markets, to judge correctly the appropriate types, mix and prices of products for a housing scheme, given the long lead times and the fact that individual buyers are not

³ The term 'type' is used here as shorthand for house types, mix, density, parking, design, product features and specification, etc.

know in advance (housing development is 'speculative'). But a local planning authorities cannot possibly assess the correct market mix for a site with no direct experience selling in the local market, and without the financial discipline of having to get this decision right. Mix policies will not be based on market criteria – if they were, there would be no need for a prescriptive policy in the first place – but on some other objective, such as a theoretical and ultimately arbitrary notion of what is the most 'appropriate' mix of housing in an area.

36. By obliging house builders to build products which the local planning authority regards as 'appropriate', but which will quite likely not meet market demand, the authority is effectively pre-determining the types of people it will allow to live in the area, and by implication excluding others. That in turn must have sub-optimal consequences for the way the market works.
37. It is hoped that local planning authorities will be more flexible about density and parking under PPS3. Where authorities do have broad guidelines on mix, density and parking, these should be included within a DPD so that they are supported by a proper evidence base and subject to rigorous testing.
38. The best way to guarantee there is the broadest possible range of new home products and prices is to allow supply to match demand. Restricting the supply of land does not just drive up real house prices, but it restricts and distorts the range of products and prices house builders are able to offer. (If new car sales were artificially restrained, we would similarly expect the price and product range to be more restricted than in a free market.) If there were 25% more new homes on the market, competitive pressures would be a greater, and house builders would have to respond with much greater variety of products and prices, including an increased supply of products which were suitable and affordable for first-time buyers, whether at full market prices or using special products such as shared ownership or equity.
39. The zero-carbon target raises important issues in which the interests of home purchasers and occupiers must be a top priority. Achieving the target will require new products, new technologies, new designs, new forms of energy generation (on plot and on site). It is essential that zero-carbon homes obtain a warranty, that they are insurable and mortgageable. Homes owners must not be used as guinea pigs for new technologies. There must be consumer safeguards in the event of product failures beyond the warranty period or if the warranty does not cover certain new products. Where there is site-based renewable energy generation, issues such as ownership, reliability, maintenance and replacement must be resolved, and the cost-effectiveness of such energy for consumers must be properly assessed. We cannot afford to expose home owners to the systemic failures of post-war system building, or more recent examples of systemic failure in British Columbia and New Zealand.

A Competitive Return for Investors/Shareholders

40. An iron law of today's market economy is that capital is mobile. It will go where it earns the best return. If a company earns returns which are not competitive with other companies in the sector, or in other sectors, investors will disinvest and move their funds elsewhere.
41. Therefore whether they are large plcs, large unquoted companies, owned by private equity investors, or small family companies, house building companies must earn competitive returns for shareholders/investors to stay in business.
42. The notion that the impact of additional regulation can simply 'come out of developers' profits' is not realistic. If it does, the result will be lower housing output as investors will move their capital to more profitable sectors.

And Adequate Residual Land Prices to Persuade Land Owners to Sell Their Land for Residential Development

43. Most land owners do not have to sell. To persuade them to sell, whether they are public or private land owners, a house builder must generate a residual land price which the owner judges is acceptable, and which is competitive with other uses for the land.
44. What is 'acceptable' will vary from owner to owner, and is a judgement that will depend on the owner's circumstances, need to sell, the land's current use value and alternative use values, etc.
45. Land values cover a wide spectrum: from greenfield sites in high value areas with modest infrastructure requirements, where the land value may be extremely high, through greenfield sites requiring substantial infrastructure works with a relatively modest land value, through brownfield sites with high land values to contaminated brownfield sites where there may be no land value, or even a negative value. It is extremely misleading to assume that all land values conform to the first of these examples.
46. Apart from site-related costs beyond normal construction costs – decontamination, demolition, on and off-site infrastructure, etc. – land values are absorbing an increasing number of regulatory costs such as increasingly burdensome S106 on and off-site demands, Affordable Housing demands, contributions to infrastructure costs, local authority renewable energy requirements, higher building regulations costs that cannot be recovered through higher sales values, etc. Looking forward, the proposed PGS and scaled-back S106 and the zero-carbon challenge will add to these costs. These cost burdens can mean that even a greenfield site with a notionally high land value may in fact

generate quite a modest value after all these cost burdens are deducted.

47. With 74% of residential development on previously developed land in 2005, it is very important to take account of alternative use values. Land may already be in some form of residential or non-residential use, and it may have a potential use other than residential. Where there is a current use, the residential land value may have to cover the cost of relocating a business, so that there may be no surplus land value.
48. The usual defence for additional regulation is that “the cost will simply come out of land values”. In practice, the more cost burdens that are placed on land values, the greater the risk that land owners will not sell, or that potential housing sites that will no longer be financially viable. In other words, apart from the very few regulatory costs which create a compensating increase in sales values, it is difficult to see how increased policy and regulatory claims on land values can do anything other than reduce housing output.
49. The fact that higher densities since 2000, and sharply higher house prices since 1999 have pushed up land prices, and therefore hidden the impact of the growing policy and regulatory burden, provides a potentially very misleading guide to the future. It would be foolhardy to base future policies and regulation on the assumption that house prices and land values will rise rapidly over the next decade. As well as being highly implausible, given the current very high level of house prices relative to earnings, it is quite possible - indeed quite likely (see Appendix 1) that densities will fall back as output expands. This could result in lower average land values.

THE CUMULATIVE BURDEN OF REGULATION

The Cost Burden of Regulation and its Impact on Output

50. Regulation almost always imposes a cost on development. In some cases – probably a small minority – the regulation will generate additional sales value sufficient to cover the cost of the regulation, so there will be no impact on the developer’s profit margin or the land value. But in most cases, building regulations, planning policies, S106 demands, climate change policies, higher design standards, etc. will impose a cost that will have to be absorbed by profits or land values. As shown above, the former is unsustainable for any length of time, so in the longer-term such costs have to come out of land values.
51. The escalating cost burden of regulation has been disguised in recent years because rising land values, driven by higher house prices and higher densities, have been able to absorb these higher costs. However if land values were to stop rising as rapidly as in recent years, or indeed were they to stabilise or even decline, the rising cost of regulation could become a serious brake on residential development.

52. Central Government, regional assemblies, local planning authorities and other regulatory bodies should – though rarely do – take account of the impact of their policies on financial viability and land values, and ultimately on housing output. This impact comes not just through the direct cost of regulation, but also through the cost pressures created by constant changes to regulation which constrain production and have a negative impact on efficiency.
53. While we do not have comprehensive evidence of the cumulative cost burden of regulation, there is a growing feeling within the industry that we may be approaching the point where regulatory costs will have a serious impact on housing output. For example, Building Regulations have been revised with increasing frequency in recent years. The very large shift into brownfield land and regeneration sites will have increased the cost of development. S106 demands have been rising. The Government's own figures show that Affordable Housing contributions have already risen sharply in the last few years. This trend is likely to continue as local planning authorities push up their percentage demands and push down thresholds, as RSLs seek more family housing, and as more and more schemes do not receive grant funding from the Housing Corporation.
54. Looking forward, on top of all these existing cost burdens, the Code for Sustainable Homes and zero-carbon target will increase costs very considerably. A recent report for English Partnerships and the Housing Corporation⁴ suggested the additional cost of reaching Code level 5 for 'traditional' homes would cost between £26,000 and £36,000 per dwelling. At current average densities, this works out at £1.0 to £1.4 million per hectare (at the 2005 average density of 40 units per hectare). The cost of achieving Code level 6 could be substantially higher, although economies of scale, new products, etc. may help to bring down these costs. In addition, the Government has indicated the proposed Planning-gain Supplement (PGS) and scaled-back S106 would be expected to raise more money than the current S106 system.
55. And it must be stressed that these extra costs for the Code, zero-carbon and PGS will have to be absorbed out of land values in addition to all the other existing regulatory costs (S106, Affordable Housing, Building Regulations, brownfield, etc.) already coming out of land values, and which are themselves rising.

Regulation and Barriers to Entry

56. As well as the impact of regulation on existing companies, another big issue is the degree to which regulation erects barriers to entry or expansion. This impact cannot be quantified, but there can be no doubt

⁴ Cyril Sweett. A Cost Review of the Code for Sustainable Homes: Report for English Partnerships and the Housing Corporation, Final Report. February 2007

a range of factors have raised these barriers over the last decade or more. The scale and complexity of regulation seems to have risen exponentially in the seven years since PPG3 (March 2000).

57. The number and complexity of policies and regulations - planning, housing and general business - and the scale of changes the industry has had to cope with over the last seven years in particular, have made housing a much more complex and financially demanding business:

- Higher densities, and especially the dramatic switch into flats, have significantly increased the capital locked up in development;
- The big shift to brownfield land, now 74% of all housing land, and to major regeneration schemes, has almost certainly increased the complexity and cost of much development;
- Planning delays and greater uncertainty about the outcome of planning applications⁵ have increased the amount of land companies need to process through the planning system to achieve any given level of output;
- The overall shortage of land with planning permission has increased the risk and uncertainty of maintaining or expanding a company's output, which in turn has increased the average size of land banks companies feel they just hold to achieve any given level of output, and therefore increased land holding costs;
- Rising land values, in part driven by shortages of land with planning permission, have also significantly increased land holding costs;
- If implementable planning decisions were achieved more quickly, if there was greater certainty about the outcome of planning decisions, and if the planning system raised significantly the supply of land with planning permission so that house builders felt more certain about their ability to replace land as it was developed, the industry could shorten land banks, use its capital more efficiently and increase its return on capital;
- Negotiating complex S106 agreements requires a high level of expertise;
- Increased building regulation standards, health and safety regulation, legal and employment regulations have all added to the complexity of running a housing company.

⁵ In 2006, 34% of 'major' (10+ units) residential applications were refused, a proportion that hovered in the range 15-17% between 1992 and 1999, but then rose steadily between 2000 and 2006. While we might have expected a temporary rise in refusals following the introduction of PPG3 in March 2000, as the industry adjusted to the new planning rules, the fact that the refusal rate has continued to rise suggests other factors are at work.

58. One consequence of this complexity has been to increase the degree to which housing development is a highly specialised business. There are few, if any, larger companies involved in housing development for whom this is not their primary business.
59. Shortages of land with planning permission and the escalating regulatory burden, both cost and complexity, have undoubtedly made it more difficult for companies to enter housing development, and for smaller companies to expand. Most of the new entrants in the last few years have been large mixed-use developers, which already have extensive development expertise, or large RLS. There are very few examples over the last decade of relatively small house building companies expanding sufficiently to become major players.

Regulation, Land Supply and Consolidation

60. The Government has expressed concern that consolidation is reducing the industry's ability to raise output. However it is important to separate cause and effect. Planning restrictions on the supply of permissioned land have been a major cause of consolidation. All the Majors are committed publicly to expansion. However because this is so difficult to achieve organically, most large companies have had to rely at least in part on take-overs to achieve significant turnover and profit growth. It is very striking that consolidation has not in fact increased the market share of the largest house builders.
61. Taking the reported sales of the top 12 house builders each year, and expressing this as a percentage of total housing completions in Great Britain each year, shows that the top 12 raised their share from just under 25% in the late 1980s and early 1990s to 40% in 1999, but that this share then hovered in the range 42-44% between 2000 and 2005. The picture for the top 6 companies is similar. Their share expanded from about 17-18% in the late 1980s up to the mid 1990s, then expanded up to 2001 since when it has hovered in the range 31-43%. In other words, expansion and consolidation since 2000 have done no more than allow the top 6 and the 12 companies to expand their output in line with the expansion of total house building output in Great Britain.
62. It is also striking that, using NHBC data⁶, the shares of registrations by different size categories of companies show no clear evidence that the larger companies are gaining share or, conversely, that medium and smaller companies are losing share. The share of companies building 1-10 units per year has been static at 8% from 2000-2006. The shares of companies in the 11-30 and 31-100 unit categories both rose from 7-9% between 2000 and 2006. The share taken by the 101-500 unit category has moved somewhat erratically in the range 13-16% since the mid 1990s, with no clear upward or downward trend. Similarly the

⁶ NHBC New House-Building Statistics, 2006 Q4, Tables 13, 14 and 15.

share taken by the 501-2000 unit category has moved erratically – e.g. 18% in 2005, but only 13% in 2006 – but shows no clear trend either way. And most strikingly, the share of house builders in the 2000+ category, which has also moved erratically, shows no clear evidence of either gain or loss of market share. In addition, NHBC data for the top 25 companies show their share has actually fallen steadily over the last three years, from a peak of 59% in 2003 to 54% in 2006.

63. Similarly, NHBC data do not support the notion that a smaller and smaller number of very large companies are gaining dominance over the industry. The number of companies in the 1-10 category has, if anything, slightly increased in the last few years. There have been quite clear increases in the numbers of companies in the 11-10, 31-100 and 101-500 categories, with the number in the 501-2000 category has been fairly static (if somewhat erratic from year to year). The number of companies in the 2000+ category shows some evidence of decline because it fell from a peak of 15 in 2000 to a trough of 11 in 2005. However the number then rose again to 13 in 2006.

‘INTERNAL’ BARRIERS TO HOUSING DELIVERY

64. Issues such as skills, methods of construction, innovation, efficiency, etc. are addressed in the responses below to the questions posed in the Call for Evidence. As noted above, because these are largely within the control of industry – house builders, suppliers, financial institutions – they can be overcome by industry, given sufficient time, with some appropriate support and encouragement from central Government and other relevant bodies – for example, English Partnerships and ConstructionSkills. This is not to underestimate the importance of these issues, but they are qualitatively different from planning and other regulations which are largely outside industry’s control and, in effect, impose insurmountable barriers to housing output.

SUMMARY: MAJOR BARRIERS TO DELIVERY

65. The above discussion allows us to identify a set of major potential barriers to achieving the required increase in housing output by 2016:

- insufficient sites with residential implementable planning permission, in the right locations, of the right site sizes to fit with local market demand;
- inadequate infrastructure to allow sufficient land to be made available for housing;
- being obliged by local planning policies or other forms of regulation to build homes which home purchasers do not want to buy;
- regulatory costs which cannot be passed down into land values, and which therefore produce uncompetitive returns for investors/shareholders – an unsustainable position over any length of time;

- regulatory costs which produce residual land prices which are inadequate to persuade land owners to sell their land for residential development, or are uncompetitive against alternative land uses, and which raise barriers to entry and expansion.

HOUSE BUILDERS' BUSINESS MODELS

66. One of the hard policy lessons of Britain's post-war economic history is that Governments are very poor at picking industrial winners. The same logic must apply to trying to pick the best model (or models) for house building. The public sector should play an enabling role, not try to act as the industry's chief executive.
67. The only way to ensure the best models emerge in a market economy is to allow investors and financial institutions to back different models which will, over time, adapt and evolve as economic and market conditions change. Success requires imagination, innovation and, above all, taking risks. Neither the public sector nor private sector investors have sufficient foresight in 2007 to be able to pick the best model for 2016. To appreciate this, we only have to look back over the last two decades.
68. In the late 1980s, a number of major contracting companies invested their substantial cash flows in housing development. By the mid 1990s, following a disastrous recession, contractors had almost all withdrawn and housing development had become a specialised activity⁷. There was no cry for contractors or house builders to alter their business models in the late 1980s because no one could have foreseen future housing market and economic conditions, nor predicted their impact on house builders' business model.
69. Similarly, the house building consolidation of the last few years could not have been foreseen in, say, 1995. Of the top 10 house builders in 1995, only five still exist, and one of these is involved primarily in partnership affordable housing schemes.
70. There is a growing number of business operating models involved in house building: traditional specialist house builders - large and small, national, regional and local - RSLs, commercial mixed-use developers, urban regeneration specialists, a major supermarket company⁸, etc. In addition, some companies assemble land, obtain an implementable planning permission and in some cases prepare the land for residential development, but do not engage directly in building homes. Similarly, there are different models of ownership: listed public companies,

⁷ For example, George Wimpey and Tarmac, two of Britain's largest house builders in the late 1980s, swapped their housing and contracting businesses, so that Tarmac became a contractor and withdrew from house building, while George Wimpey withdrew from contracting and became a house builder.

⁸ Tesco

unlisted public companies, private companies, private equity investors, family businesses, small one-man operations.

71. Each model has its strengths and is appropriate to certain circumstances. For example, most commercial developers moving into housing appear to be concentrating on complex, mixed-use inner-city schemes. Some traditional home builders are highly skilled at brownfield and regeneration development, others cover a whole range of activities, from greenfield urban extensions through brownfield schemes to relatively small infill development. Some businesses limit their activities to a single region or a local market area.
72. No single business model has a monopoly of experience or wisdom. And we can be sure that over time, as market, economic and regulatory conditions change, new models will emerge and the relative importance of different models will change. The great benefit of a market system is that no one has to 'pick winners' in advance, and no one has to keep monitoring and intervening or guiding the market.
73. Investors pick what they hope will be winners, and some will be right and some may be wrong. The only guarantee of success is to let the market decide, to let different models emerge and be tested, and to let these evolve and adapt to changing economic, market and regulatory conditions. As long as the basic conditions outlined above are in place – sufficient land with planning permission, products which buyers wish to buy, adequate infrastructure provision, competitive returns, adequate land values, a regulatory burden which does not unduly damage viability and land values – investors in housing companies, and those operating these companies, will compete among themselves to produce the dwellings needed to meet demand. Some companies will grow and prosper, others will stagnate, some will disappear. But the industry as a whole, with all its different business models, will produce the number of homes required to meet demand without any Government involvement in these different models, apart from ensuring they all face a level playing field.
74. The Government has two key roles in relation to the industry's business models:
- to ensure the planning system delivers sufficient land with implementable residential planning permissions in the right locations;
 - to reduce regulatory costs and complexity which, on current trends, (a) already severely restrict the ability of existing companies to expand or new companies to enter housing development, and (b) risk reducing land prices to the point where housing output will fall, regardless of any increase in land supply through the planning system.

CALLCUTT REVIEW CALL FOR EVIDENCE: QUESTIONS

- **What published or private sources of information are used by housebuilders, suppliers, analysts and others to determine current and future demand for housing, in terms of volume, type, price and location, and over the near, medium and longer term?**

75. It is difficult for HBF to answer this question. It is best answered by house builders, suppliers and analysts themselves.

76. At the macro level, and over the longer term, the Government's official household projections provide a valuable guide to future trends, although it must be stressed that the links between household types and housing size are complex⁹.

77. At the site level, local market demand has to be assessed using local knowledge gained from the house builder's own experience in the local market, if available, estate agents and other house builders, possibly complimented by data from commercial providers such as Experian. The scale and sophistication of market research will, to some extent, depend on the size of site. The research needed for an infill site of 12 apartments will be quite different from that required for an urban extension of several thousand dwellings.

78. House building is 'speculative', in that the buyers of individual dwellings are not known in advance. Also, the industry's unit output is relatively small compared with most other industries¹⁰, this output is achieved via thousands of individual developments across very varied local markets, households move infrequently, repeat purchases are rare and each dwelling is almost unique¹¹, and demand can change dramatically over short periods from changes in interest rates or market and economic conditions. Therefore it is difficult to use market or econometric research to establish the regular demand patterns which can be observed in markets such as fast-moving consumer goods or cars where there are very large numbers of purchasers and unit sales, frequent repeat purchases, brand loyalty, and less volatile changes in demand. Direct front-line experience probably has greater important than external information in housing development than in many other industries.

⁹ These links were examined in research for HBF by Professor Dave King and in an accompanying HBF paper, *Room to Move? Reconciling Housing Consumption Aspirations and Land-use Planning* (2005). Put very simply, although around 70% of projected future household growth will be one-person households, England's future housing need will be primarily for larger dwellings.

¹⁰ For example, there were 2.34 million new cars registered in the UK in 2006, 14 times the approximately 168,000 private housing completions in GB.

¹¹ Even two identical house types on a development will have different shaped and sized plots, different orientations to roads, sun, neighbours.

- **Does the prevailing business model of the housebuilding industry constrain how it responds to demand? Is that model evolving or likely to evolve to meet changing patterns of demand? What would encourage a shift towards greater responsiveness?**

79. By far the most serious constraint on house builders' ability to respond to demand is the inadequate supply of land with implementable residential planning permission, not the industry's business models. (The industry's business models are discussed in more detail earlier in this paper.)

Diversity, Flexibility and Adaptability

80. The best guarantee of achieving the Government's housing target is a diversity of business models, allowing constant change and adaptation in response to to changing conditions. There is not, nor should there be, a single business model, whether operational model or in terms of business ownership.

81. Over the post-war period the house building industry has been remarkably adaptable. It has coped with sometimes violent fluctuations in demand, a growing burden of regulation, especially over the last 5-10 years, and since the early 1990s a rationed, under-supply of its most important raw material, residential land with implementable planning permission. Change and adaptation has been particularly marked over the last five to seven years. There is no reason to doubt this adaptation will continue in the future.

Alternative Business Models

82. For example, in the last five years the industry has managed to increase the number of housing completions, despite a sharp drop in the annual supply of land for housing, despite the restrictions imposed by PPG3 (e.g. on greenfield land, on density and parking) in March 2000, despite an accelerating rate of change to Building Regulations, and despite escalating S106 and Affordable Housing demands.

83. House builders have adapted at remarkable speed to the changing demand conditions of the last eight years – rapid house and land price growth and sharply declining affordability, the surge in demand from investors and buy-to-let purchasers, the rediscovery of inner-City apartment living. Only six years ago, over 50% of new private sector dwellings were detached houses and less than 20% apartments. In 2006, the detached house share had fallen to 23% and the apartment share had risen to 44%¹². Similarly, the brownfield share of new development has risen dramatically from around 53% of new dwellings in 1997 to 73% in 2005. Most of this product and land-type shift has

¹² Shares taken from NHBC private housing registrations in Great Britain.

been achieved by the traditional home building sector without fundamentally changing its business model.

84. The term 'models' is used deliberately in this paper because there are a number of alternative models. Indeed, it is important that there are different models and that different models emerge and adapt to meet changes in demand and the needs of different market segments and locations. Diversity, adaptability, experimentation, innovation and, above all, risking taking are the best guarantees of success.
85. A number of large commercial developers have recently identified a major new potential residential opportunity in mixed-use development in inner-city locations, especially in London. It is early days yet, and there is rather limited information available on these companies' housing operations, but the land holdings of some suggest they will make a significant contribution to some local markets in the future. This demonstrates how 'the industry' must be viewed from a very broad perspective. Even if some traditional pure housing developers have not identified these opportunities, or if they have decided such developments lie outside their expertise and therefore do not fit their business model, other developers have responded. One major home builder¹³ has evolved into a regeneration specialist, moving closer to the commercial mixed-use business model, in response to changing planning and market conditions. A number of traditional home builders are now involved in major regeneration and mixed-use projects.
86. Most of the major home builders are publicly committed to growth. The City expects quoted companies to achieve annual profit growth, which is primarily a function of turnover and output growth. The rise in consolidation in recent years has been driven primarily by the difficulty of expanding turnover and increasing profits against the background of a falling supply of land with implementable residential permission. In effect, companies initiating take overs have bought land and future growth.
87. Consolidation has led to the emergence of a number of very large companies aiming for 15-20,000 sales per year, double the size of the largest companies less than a decade ago. This adaptation has been a response both to the shortage of land with planning permission – leading to growth through acquisition rather than organic growth¹⁴ - and to the increasing complexity of development (regulation, higher density, brownfield, regeneration, the greater financial lock-up of apartment schemes, etc.). As with the other models, these very large majors may or may not become a permanent feature of traditional house building. The market and investor demands will determine the answer to this

¹³ Berkeley Group.

¹⁴ Even Barratt, which alone among the top 3 or 4 companies had achieved its position through organic growth, recently acquired Wilson Bowden, a smaller Major, its first significant acquisition for several decades.

question.

88. Some large companies which had, until the late 1990s, concentrated on building houses on greenfield sites have moved into predominantly brownfield development, including sometimes complex regeneration schemes¹⁵.
89. Over the last couple of years, a number of larger companies¹⁶ have introduced new highly affordable open-market products without public subsidy.
90. Some traditional house builders have withdrawn from pure market-sale housing to concentrate on partnership housing and urban renewal projects¹⁷.
91. Recently, private equity has acquired two major home builders¹⁸, again illustrating how the industry adapts and changes. This may set a new trend, or it may prove a short-term phenomenon. Either way, the outcome should be left to investors and those who run housing companies to decide. The Government cannot predict the outcome, and it should not try. Indeed, it should welcome market experimentation and change.
92. The question of industry models and structure should not be restricted to the consideration of company size and operational models. It should also consider the role of specialists, particular retirement home builders, and the extent to which the planning system adequately recognises the needs of an ageing population, reflects Ministerial concern about the need to provide housing choice for older people and to release family housing back into the market, and as a means of improving the quality of life of those of retirement age and over.
93. People of retirement age are a major, and growing, sector of the home owning community and have a major influence on housing provision. Research shows that they make a significant contribution to the re-use of existing housing stock by releasing larger family homes back onto the market. Any review of housing delivery and provision should make specific reference to the influence of older people on the market. The issue goes wider than the provision of Category 2 or specialised housing, extending to the way in which local planning authorities seek to influence the mix and type of housing. This will impact upon the propensity of older people to move home and, if priority is given to new "family" size homes, as some early indicators show, this may be counter productive in providing homes that meet the needs of older people and freeing up existing family homes.

¹⁵ David Wilson is a notable example.

¹⁶ E.g. Redrow, Barratt, Wimpey, David Wilson.

¹⁷ E.g. Lovell, Wates, Gleeson.

¹⁸ McCarthy and Stone, Crest.

94. It is the experience of the retirement housing industry that, despite Ministerial statements and the welcome advice in PPS3 that the needs of older people are a consideration to which local planning authorities should have regard in policy formation, generally this is a neglected area. Planners tend to focus on policies for Lifetime Homes as a one-size-fits-all solution. However this is a blunt, bricks-and-mortar solution which fails to take account of older people's need for care and companionship which is provided by specialist accommodation.
95. The planning system therefore impacts adversely on specialist provision, and thus on one of the potentially successful business models which is significantly different from the many other mainstream models. As stressed above, it is diversity of business models, and their ability to emerge through the market, that is critical to providing flexibility in output.
96. This process of adaptation and innovation will continue. One housing commentator has argued that the land development and house building roles, both of which are undertaken by traditional house builders, will tend to become separate functions in the future – i.e. there will be large companies assembling land with planning permission and then selling on parcels of serviced land to house builders who will construct and sell the dwellings. It is impossible to know whether this prediction will prove accurate, and it does not matter. If there is commercial benefit in such a separation, existing companies will adapt accordingly and new companies will enter the field or emerge out of the industry.
97. House building companies have particular expertise. Should a different business model become appropriate in the future in some locations, these companies will develop or buy in the required new expertise. The PFI companies provide a good parallel. Most are consortia, bringing together different expertise (e.g. finance, contracting, facilities management). If PFI had not been developed, these consortia would not have been formed. Similarly, as some RSLs have become involved in speculative development, they are having to buy in or develop expertise in market housing.
98. At the risk of repetition, the best way to encourage a shift to greater responsiveness is to ensure there is sufficient land with residential permission to meet demand, and that development can be undertaken profitably and with high enough land values to persuade land owners to sell for residential development. If these conditions are in place, 'the industry' – in its widest sense – will adapt and expand so that the required number of homes will be built and sold. In particular, a substantial increase in the supply of land with planning permission, across a range of sizes and markets, will help bring new entrants and support activity by smaller and medium-sized companies.

Business Models and the Government's Role

99. The Government has a limited role to play in this process of change and adaptation. It most certainly should not be attempting to 'pick winners', whether individual companies or business models. The public sector should make sure there is adequate land with implementable planning permission – which requires central Government not only to set out the policy framework, but also to make sure it is implemented at the regional and local levels. It must ensure that the policy and regulatory environment does not impose such a heavy cost on development that it restricts housing output. As argued above, this last point would be especially important if we were to enter a period of fairly stable, or even lower average land prices in which the increasing cost of regulation could no longer be absorbed, and effectively disguised, by rising land values. And it should ensure there is a level playing field and that regulation does not favour one model over another. Central government can play a positive role by helping businesses identify and explore the financial viability of potential new opportunities, most notably through the work of English Partnerships and EP's ability to absorb the cost of innovation through accepting sub-market land values.

- **What are the alternatives to the prevailing business model? What are the constraints on the development of those alternative models, and what advantages might accrue from the development of other models?**

100. The 'prevailing' business model, in terms of the largest share of output, is the traditional house building company which undertakes the whole process from land identification and assembly, through implementable planning permission, design, construction, sales and after-sales service. One key difference with some commercial mixed-use developers is that traditional house builders are rarely investors. They make a return on their investment by developing land and then moving on to a new development opportunity, but do not hold development as an investment.

101. Alternative models include pure land developers which do not undertake housing design, construction and sale, mixed-use commercial developers which may retain freehold ownership and management of a development, and RSLs which may also maintain ownership and management, or may build and sell like a traditional house builder.

102. It is not obvious that there are any major constraints on the development of a range of alternative models. Each has strengths in certain locations and types of development, so that each makes an important contribution to the sum total of housing output.

103. The biggest constraint would appear to be on the emergence and growth of relatively small home builders. As noted above, the shortage of land with planning permission and the increasing cost and complexity of development, particularly regulatory cost and complexity, appear to have limited the role for smaller developers and may have constrained their growth. But this is not really a function of any one business model. It is that large companies, whether traditional house builders or mixed-use commercial developers, are able to develop the expertise to cope with this complexity, to achieve economies of scale and to have sufficiently deep pockets to fund large development opportunities.

104. This is an unfortunate trend, but it is difficult to see how it could be reversed without major changes to land supply, planning and the overall regulation of home building. Because Government policies have had such a big impact on small and medium sized house builders, solving this problem is largely down to central and local Government. Any significant rolling back of regulation seems unlikely.

- **To what extent is the housebuilding industry exposed to competitive pressures? Are there barriers to competition, including to new entrants? If so, what might be done to reduce or remove these barriers?**

105. A key competitiveness indicator is the market share of key players in an industry. However in the house building sector, defining or measuring 'market share' is not straight forward:

- a. There are considerable data problems, not least the absence of up-to-date new and second-hand home sales statistics covering the whole of Great Britain;
- b. Because new homes account for only about 10% of total housing transactions, it is misleading simply to quote a house builders' share of new home sales;
- c. House building is a local business, in both the land and housing markets. Even the largest companies are effectively collections of many local and regional businesses
- d. Competition relates to two markets, the land market which is extremely competitive, and the housing market.

106. New homes account for about 10% of total housing market sales. The largest company¹⁹ in 2006 had around 8-10% of the new home sector, and only about 1% of the housing market.

107. As noted above, the top 12 home builders' share of total new home completions rose from just under 25% in the late 1980s and early 1990s to 40% in 1999, but this share then hovered in the range 42-44% between 2000 and 2005. Expansion and consolidation since 2000 have done no more than allow the top 12 companies to expand in line

¹⁹ Persimmon, with 16,701 sales.

with the expansion of total house building output in Great Britain.

108. There may be individual local markets where one house builder, through a major land holding, has a sizeable share of new housing supply, although the house builder would still have to compete with other house builders and with the second-hand market which is likely to be many times larger than new home supply. However this situation is not likely to be the case in most markets, and is certainly not the case at the regional or national level. To some extent the planning system can help avoid local market dominance by seeking to release a wide range of sites of varying sizes, and across as broad a range of local markets as possible, rather than restricting the location of development beyond a few local markets and restricting land release to a few large sites. But even where there is one house builder with a major land holding in a local market, companies frequently divide up large sites and either open more than one outlet, or sell parcels of land to competitors which then open up competitive outlets.
109. The barriers to entry, discussed above, appear to be erected largely by the complexity and cost of residential development, with land shortages and regulatory cost and complexity the most important influences. Also, these barriers appear to have most impact on entry or expansion by smaller companies. The fact that a number of large commercial mixed-use developers have built up sizeable residential land holdings in recent years, and begun to undertake residential development, suggests there are no barriers to entry by large companies, provided they have the required expertise. Smaller companies are much less likely to be able to take on very large sites, or large, complex regeneration schemes.
110. The fact that there have been no significant overseas entrants into the British housing market would also suggest that land shortages and regulatory complexity create barriers to entry. The only major example was the US house building giant Centex which acquired Fairclough Homes as part of a move into the European housing market. It eventually abandoned its attempts when it sold Fairclough to Edinburgh-based Miller Homes in 2005 and withdrew from the UK.
111. If the reformed planning system does eventually provide more residential land with planning permission, this will bring greater competition in local markets. However it is difficult to see how the regulatory cost and complexity of housing development will be lessened. Indeed, the zero-carbon target means development will become even more costly and complex.
- **To what extent is the volume and responsiveness of housebuilding constrained by limits in the supply of capital (including land), labour, skills or materials? Is this likely to change as a result of sustainability or other constraints? What steps might be taken to mitigate any effects?**

Land

112. As discussed above, the biggest constraint on housing volumes and responsiveness is the restricted supply of land with implementable residential planning permission.

113. The major home builders were able to reassure the Barker Review that they were not sitting on land with detailed permission. (Land with outline consent, or no permission, cannot be developed.) Also, the larger quoted companies have always argued that they have a strong incentive not to sit on excessive stocks of paid-for permissioned land because this would reduce their return on capital, a situation the City would not accept for any length of time.

114. Therefore if there are stocks of permissioned land – and, as far as HBF is aware, there are no official statistics to confirm or refute this assertion – there are three possible explanations:

- First, land is lumpy. A site of 200 plots may receive planning permission for the whole scheme on a single day, which then boosts the outstanding stock of permissioned land by 200 plots. However it will take perhaps four years or more to build and sell the scheme. The larger the average size of schemes, the larger the size of the outstanding stock of permissioned land in relation to annual output. Also, if the average size of sites has been increasing, we would expect the outstanding stock of permissioned plots to have been rising.
- Second, do measures of the outstanding stock include outline permissions as well as detailed? If so, this suggests there is considerable double counting. Also, because a developer cannot begin work on a site with only an outline consent, the stock of outline permissions should not be compared with output.
- Third, given that permissioned land is not being held by the plc house builders, if there is a large stock of outstanding permissions, then much of the land must be held by unquoted developers or non developers.

Research by London Development Research, published in the GLA Technical Report for the London Plan earlier this year, found that while ‘private’ developers owned around 40% of potential units of housing supply in London, ‘other’ land owners owned the majority (around 55%), while RSLs owned about 4%. There does not appear to be comparable evidence outside London, but it seems reasonable to assume we might find a high proportion of permissioned sites held by ‘other’ land owners.

In some cases these non-developer permissions will be for schemes which are not financially viable. If a developer were to buy the site, it would have to be on the basis of a revised, financially viable scheme which may appear to generate a lower land value than the high value

(falsely) generated by the initial permission. In other cases, the owner may simply not wish to sell to a developer. While there is a financial imperative for housing developers to develop their land holdings – that is why they are in business and is the primary source of their profits – there may be no such imperative for other land owners.

115. Large sites take a long time before the first dwellings are ready for sale because of the inevitable complexity of planning, site preparation and infrastructure provision. In normal market conditions, a developer of a large site has every incentive to achieve the first sales as soon as possible because the early stages of development require a massive cash outlay.

Capital

116. Capital does not appear to be a problem. The HBF Monthly Survey asks an additional quarterly question on production constraints. Respondents are given a series of factors (labour availability, materials availability, etc.) and asked whether each is a major constraint, minor constraint or not a constraint. At the request of the Bank of England, development finance was added to this list of potential production constraints in 1999 Q4. Throughout the last seven years, the proportion of companies across all business sizes indicating this is a major production constraint has varied from 1% to 4%²⁰. In other words, companies do not regard development finance as a serious constraint²¹.
117. Of course smaller companies are unlikely to take on very large development opportunities, especially complex regeneration and mixed-use schemes. However this reflects a lack of expertise and capacity rather than capital.
118. However finance may be a constraint in the sense that developers are not prepared to take the risks of borrowing more to expand production in an increasingly regulated market. In other words, it is not that the supply of finance is a constraint, but that the industry is not prepared fully to tap potential supply.
119. And as noted above, the shortage of land with implementable planning permission, and planning delays and uncertainty, lock up more capital than would be required in a less constrained planning environment. If house builders could achieve the same output with shorter land banks, existing capital would be freed up to expand output without any need for additional capital.

²⁰ 1% in the March 2007 HBF Survey.

²¹ For example, 3% of respondents said development finance was a 'major constraint' in December 2006.

Skills

120. The proportion of companies in the HBF Survey indicating labour availability is a major constraint has risen and fallen over the 15 years since the survey was introduced in 1992. In the recession of 1992, labour was an insignificant problem. As the market began to gather strength from 1997, the proportion indicating labour availability was a major constraint rose and remained at a fairly high level for a number of years, peaking at 70% in 2002 Q3. However this proportion has subsequently eased and in 2006 it was running at well below 20%.^{22 23}

121. Based on a study for HBF and CITB-ConstructionSkills, with input from a cross-section of different-sized companies representing around 30% of home building production, Professor Michael Ball²⁴ demonstrated that if other conditions allowed sufficient land with implementable planning permission to come forward, companies could collectively realise real and sustainable gains in labour productivity. On modest assumptions these might amount to 2% annually. In turn a UK increase of housing output of around 60,000 units would, on these assumptions, entail an increase in the workforce of only some 40,000 compared to an existing workforce of around 285,000 - perhaps half of which was likely to be met by people choosing a growth sector such as residential development as a career above other options, as well as skilled crafts and professionals entering the UK from other EU countries.

122. Professor Ball's overall conclusion was that:

"...while training issues are important in the expansion of housebuilding, it can be concluded at the same time that skills shortages are unlikely to represent a barrier to expansion of the housebuilding industry."

123. The findings of this study have would seem to be borne out already by the falling proportion of companies finding labour availability a major constraint on output. No doubt the inflow of migrant EU labour, which is generally good quality and benefits from training received in its home nations, has helped. The availability and contribution of new EU entrants to the UK home building workforce is in itself a testament to the flexibility with which the market can respond to the demands of increasing output.

124. The HBF and the industry have also been working to improve skills provision and to encourage new entrants from the indigenous

²² 16% quoted labour availability as a 'major constraint' on production in March 2007.

²³ There is some concern that labour may be a constraint in London and the South East in the run-up to the Olympic Games in 2012.

²⁴ Michael Ball. The Labour Needs of Extra Housing Output: Can the Housebuilding Industry Cope. 2005

population to enter the industry. HBF has also been working closely with ConstructionSkills to ensure that its wider work for the construction sector takes proper account of home building requirements. Building on Professor Ball's report, HBF launched a skills strategy - *Skills for Homes* - in February 2006 setting out how it proposed to develop existing initiatives and commence new areas of work to benefit future entry and skills in home building. Within the strategy, key areas include:

- the Qualifying the Workforce Initiative adopted by the Major Home Builders Group - this aims to have a fully CSCS (or equivalent) carded workforce on company sites by the end of 2007 and a fully qualified workforce by the end of 2010;
- increasing the number of apprentices and trainees entering the industry;
- developing new fit for purpose vocational qualifications for the key role of residential site management - we are on course for the new NVQs to be available from early 2008;
- ensuring that new qualifications such as the Specialised Diploma for Construction and the Built Environment take full account of home building requirements in the options they offer students.

125. Given the comparatively fragmented nature of the industry, ConstructionSkills continues to have an important role in working with a wide range of other professional and educational bodies to ensure there is adequate promotion of available career options and suitable provision at school, college and university for those wishing to enter home building and other construction careers. We would wish to see this role continue and to build further on recent efforts to ensure that ConstructionSkills provides increasing value for money for the industry - including via the return on the levy paid by the industry to help finance apprenticeships and other training schemes. It will be important to ensure that we can further enhance the ability of home builders to influence the design and implementation of schemes adopted by ConstructionSkills in line with the wider move to employer-led skills provision.

126. There is, however, another important dimension to skills provision that has been highlighted by the CABE housing audits and the current discussions on zero carbon homes. While home builders need to employ and access many different professional and craft skills in their work, the overall quality and success of the industry's output is also dependent on there being sufficient skills capacity in complementary areas in other bodies - most notably the local authorities who provide planning permissions.

127. The growing complexity of the issues involved in housing provision is a challenge for the industry - but it is also a major challenge for local authorities. The CABE audits have shown that local

authorities often do not have the skills capacity at officer or member level to ensure that good quality design can be positively promoted through the planning system. Equally, professional planners working with or in local government have expressed concerns about the skills available to effectively apply current thinking and proposals on the role of the planning system in tackling climate change. If such skills requirements cannot be met, the risk is that planning permissions will take longer to agree or that the results of new development will fall short in some way of what is sought - or both.

128. Our conclusion is that realisation of the Government's objectives on the quality, sustainability and volume of new residential development requires a fairly hard-headed assessment of the demands that can realistically be placed on other parties as well as home builders. This may in turn suggest that in some cases it should be other parties or mechanisms - for example, energy suppliers and energy regulation in the case of carbon reduction - that need to take on key roles rather than local authority planners assuming the full burden.

Materials and Methods

129. Apart from two minor blips in 1994 and 2002, materials availability has not been a serious constraint on production since the HBF survey began in 1992. The proportion of companies identifying materials as a major constraint has usually been below 10%, and in 2006 was in the range 2-5%. However, some parts of the materials industry may need to undertake substantial new investment if they are to expand capacity to meet a 25% increase in house building, along with the new material and product needs arising from the zero-carbon target. It is therefore critically important for the construction products industry that the 10-year plan for expanding housing output and achieving zero-carbon new homes is adhered to by central and local government.

130. The industry has steadily adopted modern methods of production and new products and materials. However change is likely to accelerate as the industry gears up for substantially higher output, and particularly as it adapts to the needs of zero-carbon homes. Following the report of the Barker 33 Cross-industry Group, HBF has recently set up a cross-industry Housing Production Barriers Group to identify key the key production barriers to achieving the Government's housing target and the actions necessary to lower these barriers.

Sustainability

131. As far as can be judged at this early stage, sustainability requirements will not pose serious problems as long as the house building and supply industries have to time carry out research, test new products, invest in new capacity, establish supply chains and acquire new skills. As already stated, this is why it is critically important that the

Government sticks to the 10 year zero-carbon timetable, and why central Government must control regional assemblies and local planning authorities which are increasingly introducing their own more demanding climate-change policies. Government support, encouragement and, in some cases, research funding, will also be required to achieve the zero-carbon target.

132. It is also important that the zero-carbon target is met in the most cost-effective way, with a sensible balance between (a) the degree to which energy use can be reduced cost effectively by the design and construction of dwellings, and (b) the cost-effective contribution of renewable low or zero-carbon energy generation. The energy supply industries, both conventional and renewable, have a major role to play alongside the house builders and their suppliers. Renewable energy and other climate-change policies by many local authorities, and now some regional assemblies, risk distorting decisions about the most cost-effective route to zero-carbon homes by imposing particular solutions without proper evidence, justification or even understanding of the consequences of their policies.

- **What constitutes good quality in housebuilding? To what extent is the housebuilding industry, as currently structured, well adapted to deliver well designed, good quality homes? What steps might be taken to improve quality?**

133. Quality can be divided into three key categories: product, design, customer service.

Product Quality

134. Product quality is ensure by the new home sector's unique warranty system operated by NHBC, Zurich and Premier, supported by the requirements of Building Regulations. NHBC's strategy to raise standards includes not only the new home warranty, but initiative such as training and support for HBF's Customer Satisfaction Survey. HBF's Survey suggests there is a high level of satisfaction with quality, with 76% of purchasers saying they are very or fairly satisfied with the overall quality of their home. The new home warranty schemes and HBF's customer satisfaction initiatives demonstrate the value of self-regulation, and suggest there is no imperative for the Government to get involved beyond Building Regulations.

Design Quality

135. Design quality falls into two areas, urban design and aesthetic quality. The Building for Life (BfL) criteria, developed jointly by HBF and CABE and directed at urban design quality, represent another example of self regulation. CABE's damning assessment of house building design quality in its three regional housing audits, using the BfL criteria, needs to be treated with considerable caution. For

example, in the Northern audit CABI decided arbitrarily that any scheme with a BfL score below 76% had 'failed'. After severe criticism from HBF, this was changed to schemes below 70% in the Midlands and South West audit, and the latest report made it clearer to readers that 70% was the cut-off score. However CABI's public reporting of its audits, whether press comment or conference presentations, has rarely made it clear that the industry appears to perform so poorly because CABI's cut-off point is so high. In the Northern audit, only 6% of schemes 'passed' the 76% cut-off. However the average score was 58%, and the 'pass' rate would have been 76% with a 50% cut-off, or 37% with a 60% cut-off. CABI's sensational earlier reporting of its audit results, and its failure to make clear the very high cut-off score for failure, has created unnecessary tension between CABI and the industry. However HBF is keen to help the industry work towards higher urban design standards.

136. CABI's research has shown very clearly that house builders are not solely responsible for poor urban design. Local planning authorities and Highways also have a major influence on urban design..
137. HBF has also been working with the Princes Foundation to help promote better understanding of the principles of sustainable urban development. This work includes a recognition scheme for exemplary schemes by the larger home builders.
138. Aesthetic design is highly subjective, as CABI is always at pains to stress, and must be largely a judgement for individual home buyers and local communities. The local context is a key influence. There are markets where traditional English village architecture is appropriate, such as the Princes Foundation scheme at Poundbury, Dorchester, just as there are markets where contemporary urban designs are appropriate.

Customer Service Quality

139. In response to Barker Review Recommendation 32, HBF initiated a customer satisfaction strategy. A large-scale customer satisfaction survey was launched, in association with NHBC, covering approximately 20 of the largest home builders. Two sets of results have now been published. The results show high levels of satisfaction. In the April 2007 survey, covering the 12 months October 2005 to September 2006, 76% of home purchasers were satisfied with the overall quality of their home and 77% would recommend their home builder to a friend. HBF also published a Customer Satisfaction Code of Conduct for its members in 2006 which a large number of members support. And in consultation with the OFT, HBF has developed model contract terms to help member companies ensure their contracts comply with the Unfair Terms in Consumer Contracts Regulations 1999.

140. House builders, especially since Barker 32, have made enormous efforts to improve customer satisfaction levels. The company star ratings in HBF's Customer Satisfaction Survey are a source of acute interest to individual companies. We know from reactions to the first two surveys that an unsatisfactory result triggers action at the most senior management levels. Many house builders include customer satisfaction ratings in their staff bonus schemes, so that procedures to ensure high levels of customer satisfaction are reinforced by strong staff commitment.

- **To what extent is sustainability, in any sense, a factor in the choices made either by housebuilders, suppliers and other providers, or by housebuyers? What impact is being achieved by the Code for Sustainable Homes and the agenda set out in the Government's consultation document "Building a Greener Future: Towards Zero Carbon Development"?**

141. Some home builders have made sustainability a central focus of their business. In other cases, companies have observed the standards required by Building Regulations.

142. The difficulty in going beyond Building Regulations is that unless the additional costs are matched by a corresponding increase in sales revenues, a company incurring these costs will either suffer an erosion of its profit margins, or it will be unable to compete effectively for land against companies which have not incurred such costs and will therefore generate a higher residual land value. Therefore the most effective way to achieve higher sustainability standards is to create a level playing field by making them part of Building Regulations. The Code for Sustainable Homes and zero-carbon target will bring a step-change in the industry's commitment to environmental sustainability. The case for proceeding on this basis is very clearly recognised in the sections of the Stern Report dealing with the construction industry.

143. Due to *Building a Greener Future* and the publicity generated around the HBF's zero carbon summit in January 2007, there is now a media and public awareness of the general objective of achieving a zero carbon homes standard. There is, however, little understanding at this stage of what this means in practice. This is a major issue for consumers as well as the industry and other parties. We will need to proceed with care to ensure that the solutions adopted are ones that have consumer confidence as well as technical validity. In this sense, sustainability cannot be seen as a purely objective and scientific matter. Rather it is a field where viable solutions must also fit in with public perceptions and aspirations. Ultimately it is the consumer vision of sustainability that will influence choices.

144. The Code and the agenda set out in *Building a Greener Future* have not yet had time to have any direct impact on housing production. However HBF, on behalf of the industry, supports the Government's

target of all new homes to be zero-carbon by 2016, provided local planning authorities are restrained from introducing a raft of different local climate-change policies. This is a major commitment by the industry and will, as time progresses, have an increasing impact. However, it is absolutely critical that the Government sticks to the 10-year timetable, and that central Government ensures there is not a policy free-for-all among regional and local planning authorities. We are extremely concerned that this is already happening, with local policies proliferating at an alarming rate. If this continues, the house building, construction products and energy supply industries will not be able to achieve the zero-carbon target by 2016, and there is a considerable risk that these policies will undermine the industry's ability to hit the 200,000 target.

145. The zero-carbon target, as already indicated, cannot be achieved by the house building industry on its own. The construction products industries have a critical role to play. The energy suppliers, traditional and renewable, will have to deliver solutions because the target cannot be achieved solely through the design and construction of dwellings. And most important, consumers will have to be at the forefront of everyone's minds. The stamp duty exemption is most welcome, and other incentives may be required to encourage home buyers to adopt the new products and technologies required to make homes zero carbon. The industry must also ensure that zero-carbon homes have a full warranty, and are insurable and mortgageable. On-site energy provision must have proper ownership, management, repair and replacement measures so that home buyers are protected. And attention must be given to who will carry the risk if there is product or technology failure in the future. It should not be automatically assumed this will be covered by building insurance or by the new home warranty. Warranties have a limited time period, they do not cover on-site renewables, and their cover for on-plot renewable energy generating products is not likely to insure again performance which falls below the manufacturer's claimed performance.

- **There is a clear public interest in the operation of a free market, in securing an adequate supply of new homes, and in sustainability. How, and how far, does the housebuilding industry respond to considerations of public interest? What public policy instruments are available to influence the performance of the industry, and how effective are they?**

146. This question can usefully be seen as having two dimensions: the wider public interest, and the interest of individual home buyers and occupiers.

The Wider Public Interest

147. Individual companies are ultimately responsible to their investors and share holders. While they must observe the laws and regulations

relevant to house building, if these regulations place too onerous a burden on individual companies, so that companies cannot earn a competitive return for shareholders, investors will disinvest and companies will, in the extreme, cease house building altogether. We have already seen several long-standing house builders withdraw from market housing in part because of the cost and complexity of regulation and shortages of land with planning permission.

148. It could be argued that the wider public interest is best served when the industry fulfils its primary function by producing new homes, given that shelter is one of the fundamental human needs. It is not therefore surprising that there is widespread concern that the industry is currently constrained from providing sufficient homes by public policy and regulation, particularly by an inadequate supply of land with implementable planning permission.
149. To the extent that other public interest considerations – i.e. those beyond providing homes - are part of the market as expressed through consumer preferences (and willingness to pay), or are reflected in regulations, individual companies – and the industry – will respond to these influences. However, as discussed in response to the previous question, competitive pressures in the land market make it difficult for companies to diverge markedly from the level playing field created by mandatory regulation and market demand. To do so is to risk being outbid for land by competitors and eventually going out of business. For example, were a company to try today to achieve Code levels 5 or 6, so as to meet wider public interest objectives, it would incur very significant additional construction costs and would find it impossible to buy land in the competitive market. (EP has a major role to play in sponsoring innovation and helping the industry meet higher public interest objectives by absorbing the additional costs of innovation and new products by accepting a land price below market value, effectively a public subsidy.)
150. The large house building companies all now publish CSR reports or commentaries. To some extent this is linked to investor pressure (e.g. the HBOS/WWF surveys), which indicates that investors may have public interest views as well as purely financial ones.
151. Although public policy and regulation has a very important role to play in ensuring companies, and the industry, meet public interest requirements, this must not be at the expense of housing output which is itself one of the industry's primary public interest objectives. As argued above, the cost and complexity of regulation, and shortages of land, are major brakes on house building activity. And escalating policy demands – S106, Affordable Housing, zero-carbon, higher Building Regulations, local authority policies, etc. – risk constraining the industry's ability to respond to demand even more than at present, even if there is a substantial increase in the supply of land with planning permission. At all levels of Government, specific public

interest concerns must not be pushed at the expense of viability and housing supply.

152. A long-standing problem with all regulation has been that each new policy or regulation is introduced in isolation. No one within Government considers the cumulative burden of regulation (cost and complexity) and its impact on viability and industry output.

The Public Interest of Home Buyers

153. The other key public interest concern is the interest of individual home buyers. As discussed in the above section on quality, in the last three years the industry has made a significant commitment to achieving higher levels of customer satisfaction, supported by HBF's strategy. Assisted by NHBC, Zurich and Premier and the system of Building Regulations, the industry is steadily raising building quality standards. And there is a new focus on urban design, especially now that PPS3 has made design a major planning objective. Almost all of these quality improvements are being achieved through self regulation. This must be a more effective route to improvement than direct Government intervention because it ensures the industry's full commitment and involvement and allows the industry to find the most cost-effective and operationally effective solutions.

APPENDIX 1. ESTIMATING THE NUMBER OF PLANNING PERMISSIONS AND THE AREA OF LAND REQUIRED TO DELIVER 200,000 HOMES PER YEAR

154. It is almost a law of house building that only so many homes can be built and sold from a single housing 'outlet'²⁵ in any year. Evidence collected weekly by HBF from larger home builders between 1993 and 2007, based on between 1,500-2,500 active sites at any one time, shows an average of 32 net reservations²⁶ per site per year. The number of sales per year on any individual site will vary according to site location, price and mix of dwellings, and broader economic and housing market conditions. However, when considering the Government's 200,000 target for England as a whole, we need to assume a sensible national average number of sales per outlet, putting aside the precise housing market conditions that might apply in 2016.

155. For mathematical simplicity, the following discussion has a central assumption of 35 private dwelling sales per outlet per year²⁷. We do not know if there is a comparable figure for RSL completions. Where dwellings are built under contract for social rent, the pace of construction may be somewhat faster than the pace for market sale units. Where affordable housing units are provided under S106 agreements (55% of all affordable housing in 2005-06²⁸), the pace of construction may be faster in cases where the affordable units are in a clearly defined area or block, or they will be at the same pace as the market units where they are pepper potted around the site, an increasing requirement of S106 agreements. In the absence of hard evidence, the following calculations take 40 social units per site per year as a working assumption.

156. According to official CLG statistics, last year's 160,000 completions split into 139,000 private and 21,000 social²⁹. Applying 35 sales per year to the private sector, and 40 dwellings per year to the social, would imply just under 4,500 outlets/sites were active during the year. Alternative assumptions for the private sector of 30 or 40 sales

²⁵ An 'outlet' is a sales term. A single housing site may have one outlet, or a larger site may have several outlets, either from the same house builder or from several competing builders.

²⁶ A dwelling is reserved when a modest reservation fee is put down. This allows the purchaser and developer to commence the legal purchase process which becomes binding only when there is an exchange of contracts. The term 'net reservations' refers to reservations less those which are cancelled. Although there is a timing difference between reservations and sales (legal completions), over a period as long as 1993-2007, this distinction is irrelevant, so that net 'reservations' can be regarded as synonymous with 'sales'.

²⁷ The HBF figure of 32 net reservations per outlet has been measured across the sites of larger home builders. As few larger companies build on small sites (below 25, and certainly below 10), the overall industry average, including all smaller companies, may be lower than 32, given the marketing skills of larger companies and the likely economies of scale of selling off larger sites. However we have no evidence other than the HBF figures.

²⁸ Source: Written Parliamentary Answer. Yvette Cooper, 22 January 2007

²⁹ It is not clear from official statistics whether the 21,000 social total includes all affordable units under S106 agreements, or whether some of these are counted in the private sector total.

per year, but maintaining the assumption of 40 completions per site per year for RSL completions, would imply 4,000 and 5,200 outlets/sites respectively³⁰.

157. Scaling up each of the two sectors by 25% to give an overall total of 200,000 dwellings per year, the Government's target, produces outlets/sites per year of approximately 5,000, 5,600 and 6,400 outlets/sites per year (at 30, 35 and 40 sales per year respectively in the private sector, with 40 completions per year assumed for RSL sites)³¹.

158. Taking the central point implies the industry and RSLs will need an extra 1,100 outlets/sites per year by 2016. The alternative estimates produce figures of 1,200 and just under 1,000 extra outlets/sites per year.

159. Although there will not be an exact match between outlets/sites and planning permissions, these numbers provide a good ballpark indication of the scale of the task faced by the planning system: assuming a constant average density, and assuming the distribution of site sizes remains broadly constant, it will need to grant permission for 1,000 to 1,200 additional sites per year in England to achieve a 25% increase in housing output.

160. The phrase "assuming a constant average density" is a very important consideration.

161. Housing completions have increased by nearly a quarter since the historic trough in 2001. However the picture behind this headline increase is more complicated:

- The number of 'major' (10+ units) residential permissions rose by 30% between 2001 (5,300) and 2006 (6,900), although there are no figures on the number of units covered by these permissions, nor do we know if the mix of outline, full and revised permissions altered over this period;
- According official land area estimates, the average area of land developed annually for housing fell by 6% between 2001 and 2003 (from 5,380 ha to 5,050 ha, the latest published land area statistics);
- Official housing completions and average density statistics imply the average land area developed annually for housing fell by 26% between 2000 (the year PPG3 was introduced) and 2005;
- The average residential density increased from 25 units per hectare in 2001 to 40 units per hectare in 2005.

³⁰ These estimates seem reasonable compared with figures from the CLG's own planning performance statistics. In 2006, 6,900 'major' (10+ units) residential permissions were granted. However there is considerable multiple counting as outline permissions, full planning permissions and revised permissions are all counted separately. The number of actual sites receiving permission must have been well below 6,900.

³¹ Assuming the average density for the 25% extra dwellings is the same as the average density for last year's 160,000.

162. In other words, housing output has risen solely because of rising densities, and in spite of falling land usage. The implication is that if the average density had remained constant at 2001 levels, annual housing output would have fallen quite sharply over the last five years as the annual land area declined.
163. There is a good case to be made that densities at the national level are nearing the maximum consistent with meeting consumer demand. Indeed, there is widespread concern that we are already building sufficient apartments overall, and too many in some locations. (NHBC registrations data showed a fall in both the number and proportion of private sector apartments in the second half of 2006 after a steady rise from 2000 Q1 to 2006 Q2. It is perhaps too early to judge, but these figures suggest we may have passed the peak average density.) It seems quite possible – indeed likely – that the average density of the additional 40,000 dwelling per year required to meet the Government’s 200,000 target might well be lower – and certainly not higher - than the average density for current output (primarily because there is likely to be a lower proportion of flats).
164. The constrained supply of land with implementable planning permission, coupled with the major shift into brownfield development and sharp cut in greenfield land, has placed competitive pressure on home builders to maximise site values. This in turn has helped push up densities, primarily through the switch out of detached houses into flats. With a better supply of land, we would expect such pressures to ease and that in turn may affect densities.
165. It is worth noting that, in addition to industry concerns about the current scale of apartment building, there is considerable pressure from central Government, some regional bodies and local authorities and RSLs to increase the output of houses, especially larger family houses.
166. To achieve a 25% increase in completions to 200,000, if the current average density is maintained across the additional 40,000 units, the increase in land area will have to be proportional to the required increase in completions (25%). If average densities for the additional 40,000 were to be lower than the current average, then a greater percentage increase in land area will be required. And if the average density for the existing 160,000 per year were to fall, the increase in land area would have to be even larger.
167. For example, were the average density across the 200,000 target to be 38 dwellings per hectare, rather than the current 41, the area of land required annually compared with today would have to rise by nearly 35%. An average density of 35 units per hectare would require a land area increase of nearly 50%.