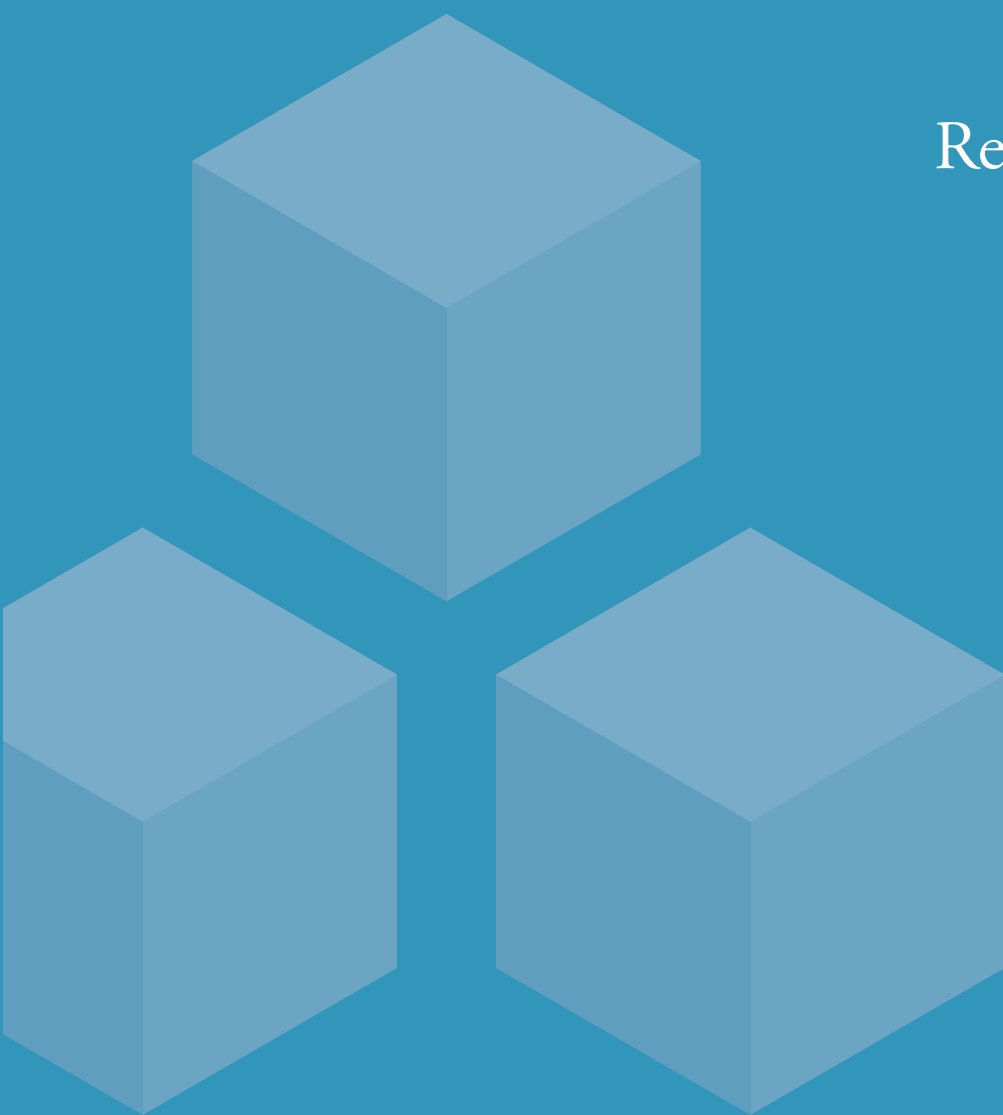


Review of Housing Supply

Delivering Stability: Securing our Future Housing Needs

Final Report -
Recommendations



Kate Barker
March 2004

Foreword

March 2004

Dear Chancellor and Deputy Prime Minister,

Housing is a basic human need, which is fundamental to our economic and social well-being. Yet housing provision is often controversial and provokes strong reactions. My Review of housing supply highlights the tensions that surface, when seeking to promote an adequate housing supply and a more responsive provision:

- A weak supply of housing contributes to macroeconomic instability and hinders labour market flexibility, constraining economic growth. These risks to stability are likely to be increased should the UK decide to join Economic and Monetary Union. The UK should have a more flexible housing market.
- For many people, housing has become increasingly unaffordable over time. The aspiration for home ownership is as strong as ever, yet the reality is that for many this aspiration will remain unfulfilled unless the trend in real house prices is reduced. This brings potential for an ever widening social and economic divide between those able to access market housing and those kept out. Rising numbers in temporary accommodation is evidence of the polarisation which exists today.
- Homes are more than shelter. They provide access to a range of services and to communities. Housing also plays a major role as an asset in household balance sheets and in household planning for their financial futures.
- The housing market indicates people's preferences for the types of housing, location and communities that they would like to live in, for example the preference for space as incomes increase.
- Increasing housing supply raises concerns about the environment and loss of open spaces.

These considerations pose a number of dilemmas for policy makers at all levels, (national, regional and local). There are issues around the relationship between the private sector as the main deliverer of housing and Government's objectives, which may not always accord with market pressures. There are no easy answers and no disguising that the choices we face are difficult. We inhabit a small island – land is a finite resource, which we must make best use of. But we also need to think about other outcomes that we wish to achieve:

- a more flexible housing market which adapts to and reflects the needs of the economy; and
- a more equitable distribution of housing wealth.

I do not believe that continuing at the current rate of housebuilding is a realistic option, unless we are prepared to accept increasing problems of homelessness, affordability and social division, decline in standards of public service delivery and increasing the costs of doing business in the UK – hampering our economic success. Indeed, the Government has already signalled the need for action through the Sustainable Communities Plan and the Planning Bill.

This Review sets out a series of policy recommendations to address the lack of supply and responsiveness of housing in the UK. The recommendations cover a broad spectrum of issues. It suggests that we need to integrate economic considerations into the planning system, that we need a better means of assessing the costs and benefits of development and land use and that we need to acknowledge market signals and use the information provided.

These recommendations will also require concerted action on the part of the housebuilding industry. In the past, quality of service to consumers and considerations of sustainability, design and innovation have been secondary to the desire to secure land. The signs are that the industry recognises these failings, which arise in part from the volatility of the housing market, and I believe there is a determination to do better.

I am grateful to the Government for giving me the opportunity to conduct this Review and I hope it will play a constructive part in what I am sure is going to be an active area of public policy over the coming years. I do not pretend that this Review provides all the answers at a detailed level. In some areas, I have sought to set out broad principles. Creating a more flexible housing market is a considerable challenge, which will take time and requires determination to engage in ongoing reforms. It will not happen overnight.

Ideas, facts and other inputs for the Review have come from a wide range of academics, professionals, policy makers, housebuilders and interested individuals. I am extremely grateful to them all. I have been struck by the desire among all those working in the housing field to secure change and to work together to promote a common goal of improving access to housing. There is clearly much common ground and a desire to elevate the policy debate. I hope that this Review will allow that debate to continue and develop.

I would like to express my thanks to all those who assisted me in producing this Report. Many individuals and organisations gave generously of their time and effort to propose ideas and support me in reaching these conclusions. These contributors are identified in Annex A. I would also like to thank warmly Jo-Anne Daniels and the team of very able people who have worked tirelessly and with good humour: Mark Aldridge, Tejinder Bassi, Rachael Clapson, Ben Dubow, Odette Fioroni, Kerry Higgins, Graham Kinshott, Adam Land, David Leam, Chris Nicholls and Bryn Welham.



Kate Barker

Executive summary

INTRODUCTION

1 The Chancellor and Deputy Prime Minister set up this Review on 9 April 2003 with the following Terms of Reference:

- Conduct a review of issues underlying the lack of supply and responsiveness of housing in the UK.
- In particular to consider:
 - the role of competition, capacity, technology and finance of the housebuilding industry; and
 - the interaction of these factors with the planning system and the Government's sustainable development objectives.

2 Demand for housing is increasing over time, driven primarily by demographic trends and rising incomes. Yet in 2001 the construction of new houses in the UK fell to its lowest level since the second world war. Over the ten years to 2002, output of new homes was 12½ per cent lower than for the previous ten years. This Review is concerned with the issues both of volatility and of long-run supply.

3 Volatility in the housing market, in the UK, combined with the strong association between house prices and private consumption (reflecting in part high levels of owner occupation) is striking. Consequently, the housing market has contributed to macroeconomic volatility, creating a more difficult environment for businesses and for economic policy makers.

4 A weak response of housing supply to demand changes has been one of the factors underlying this instability. In addition, there is growing evidence of a persistent inadequate supply. In the UK the trend rate of real house price growth over the last 30 years has been 2.4 per cent, considerably higher than the European average of 1.1 per cent. Latest evidence suggests that the trend rate of real UK house price growth has increased to 2.7 per cent over the last 20 years. The Review is fundamentally concerned with the longer-term issues of unresponsive and weak supply, rather than questions surrounding the current house price cycle.

5 The Interim Report argued that, in addition to the costs of volatility, there was a set of adverse consequences as a result of the long-run upward trend of house prices:

- Affordability has worsened between cycles. In 2002 only 37 per cent of new households could afford to buy a property compared to 46 per cent in the late 1980s.
- Wealth is re-distributed. Higher house prices result in a transfer of resources from those outside the housing market such as would be first time buyers to those inside the market, such as existing home owners. This also tends to favour older generations at the expense of younger. The wealth gap between home owners and others is widening.

- Labour mobility is restricted. Lower rates of house building can lead to significant regional house price differentials and regional price expectations, reducing labour mobility and constraining productivity.
- There is also an overall cost in terms of economic welfare from the restriction in supply.
- But against this, and the other costs identified above, have to be set important benefits from restricted supply – in particular reduced urban sprawl and the retention of open greenfield land.

6 Raising housing numbers is only part of the story. It also matters where houses are located and how much space they have. The nature of cities, towns and villages is also important, and the role of planning in shaping these as sustainable communities is recognised and valued. In considering policy recommendations, the varied nature of regional and local housing markets has been kept in mind, for example the different issues in terms of externalities and costs of development, which exist in low demand areas. The Review's recommendations in most cases aim to establish a broad framework, which is adaptable to differing regional circumstances, a one size fits all approach is not always possible or desirable.

7 New supply only accounts for 1 per cent of the housing stock, and so even measures which change new supply significantly would not have much effect on prices were it not for the role of expectations. If policy changes alter perceptions about the future course of prices, then the impact on today's prices is potentially much larger. This consideration has led to a cautious approach being taken to policy recommendations. A further reason for caution is that, with such a regulated market, it is very difficult to judge the supply response to any change.

8 Government has already taken important steps to address housing supply, (the Sustainable Communities Plan, proposals for four new growth areas, and recent reforms to the planning framework). This Review should be seen as part of that on-going process to reform housing supply, and indeed the housing market more generally. A further review of the housing market should be undertaken in three years time. This review would consider progress made towards delivering the Government's policy agenda and look at how the market is responding to the changes proposed in this Report.

OBJECTIVES

- 9 The overall objectives of the Review are:
- to achieve improvements in housing affordability in the market sector;
 - a more stable housing market;
 - location of housing supply which supports patterns of economic development; and
 - an adequate supply of publicly-funded housing for those who need it.

10 These objectives require a more flexible housing market, one in which supply responds more strongly to changes in price. But this raises difficult choices. Accommodating demographic projections for household numbers up to 2021 alone, will mean a higher rate of housebuilding than has been achieved recently. While the important recent steps taken by Government would address some of the problems of stability, affordability and housing those in need, more needs to be done if the present situation is to be improved.

11 Inevitably, this would bring adverse consequences for the environment and for public amenity. As Martin Wolf wrote recently: ‘We cannot have a rising population, spacious housing for each household and an unchanged quantity of undeveloped countryside’¹.

12 The Review sets out three scenarios, two of which would require policy changes beyond those already being implemented by Government. (The numbers in these scenarios relate to England alone.) The estimates in these scenarios for private and for social housing are rather different in nature.

13 Taking as the baseline the level of private sector build in 2002-03, 140,000 gross starts and 125,000 gross completions, it is estimated that:

- reducing the trend in real house prices to 1.8 per cent, would require an additional 70,000 private sector homes per annum; and
- more ambitiously, to reduce the trend in real house prices to 1.1 per cent, an additional 120,000 private sector homes per annum would be required.

14 These are in line with the estimates presented in the Interim Report², and subject to the same caveats. Going further, a zero trend in real house prices and the level of housebuilding this would imply is considered undesirable and unachievable. These estimates imply that large increases in the rate of new build would be required to achieve a reduction in the price trend, which is unsurprising given the fact that new build is only around 1 per cent of the existing stock. However, as highlighted previously, these estimates are highly dependent on how much price responds to additions to the stock. The recommendations in the Review, which should achieve a more responsive housing market, could be expected to increase the response of price, and therefore reduce the rate of housebuilding which is needed.

15 In the light of the issues raised above, it is clear that there would be significant benefits from a higher rate of housebuilding, and from the changes which aim to make the market more responsive. Even in the case of the less ambitious price trend, these benefits would include pricing an additional 5,000 new households each year into the market, and improving access for the backlog of those presently priced out. There would also be significant benefits as people would have access to housing which better meets their aspirations.

16 The scenarios for social housing are based on demographic projections. An increase in supply of social housing of 17,000 homes each year is believed to be required to meet the needs among the flow of new households. There is also a case for provision at up to 9,000 a year above this rate in order to make inroads into the backlog of need. Clearly, the scenarios for the private and social sectors for example, are to some extent independent of each other. It would be possible to take a more ambitious approach to social provision, irrespective of the approach to market provision. However, this would have implications for the level of investment needed.

¹ Martin Wolf FT 6.02.2004, England’s Great Housing Dilemma.

² Table 3.4, p.59, *Barker Review Interim Report*, (2003)

17 These scenarios set out the choices for Government, in the light of the trade-off which is believed to be appropriate between improving market affordability, meeting housing need and environmental considerations. In this context, it should be noted that, under the extreme assumption that all of the additional build were carried out in the South East, an additional 120,000 homes per year would take around 0.75 per cent of the total regional land area³.

18 The policy proposals listed below build up to a framework which should be more responsive, and in which incentives are aligned better with the wider costs and benefits of housing development. This greater flexibility is an important goal in itself, in light of the above discussion about the costs of housing market volatility. Generally, particular policies are not attached to each of the scenarios. Rather, the framework should be capable of delivering the rate of housing supply which Government, at national, regional and local level has concluded is best in light of the trade-off between housing market and environmental objectives.

19 Tackling issues of macroeconomic stability may also require measures to address the demand for housing alongside improvements to supply. Demand side measures, such as the reform of property taxation could help to mitigate house price cycles. In any reform of council tax, consideration should be given to having an element of this tax which is more closely related to property prices.

PLANNING FOR DEVELOPMENT

20 The Review makes a number of recommendations to improve the working of the planning system. At the centre of these recommendations is the principal objective that planning should take more account of, and use market information. That does not mean that planning should in all cases follow the market, in some cases decisions should contradict market signals. But there must be a clearer rationale for why this is necessary (for example, tackling market failures associated with housing abandonment in low demand areas) and a full understanding of all the consequences of these decisions, at local and national level.

21 Planning at regional and local levels needs to respond by:

- making better use of information about prices and preferences; and
- the process needs greater certainty and speed, though not at the expense of making bad decisions.

22 Central to achieving change is the recommendation to allocate more land for development. This certainly does not mean removing all restraints on land use, on the contrary the review advocates more attention be given to ensuring the most valuable land is preserved. But housebuilders would have greater choice as to which sites to develop, increasing competition. And it would also allow a quicker and more flexible response to changing market conditions on the upside.

23 A stronger role for regional planning bodies is recommended, with an independent Regional Planning Executive charged with setting out advice on market affordability targets, housing numbers, strategic growth areas and co-ordinating links between the key players (infrastructure providers, developers and English Partnerships).

³ This calculation assumes that 60% will be built on brownfield sites, and that dwellings will be built at a density of 30 per hectare. It also includes an allowance for related infrastructure.

24 At the local level, alternative routes to gaining planning permission are proposed which aim to speed up the process and increase certainty – while preserving opportunities for vital community involvement and the principles of sound design.

DELIVERING DEVELOPMENT

25 Land will only get developed if:

- the right incentives are in place for those making development decisions; and
- development is facilitated where market or government failures, particularly co-ordination failures, block permissioned development from occurring.

26 Reforms to local government finance are proposed, to align the incentives facing individual local authorities with the costs and benefits to society more widely. Funding flows need to be more forward-looking, and local authorities allowed to ‘keep’ for a period some or all of the council tax receipts generated by new housing.

27 Infrastructure providers need to be involved in developing regional and local plans from an early stage. They should then need to use their powers to direct refusal of planning permission, for development which accords with the plan only rarely.

28 English Partnerships should play a lead role in delivering development by assembling land and managing the issues around complex sites. Planning authorities should seek the best of the range of special purpose vehicles available to drive development where there are problems with land acquisition and infrastructure. A new Community Infrastructure Fund should be established to fund the up-front costs of infrastructure needs which are blocking development.

29 Section 106 needs reform to provide more certainty and simplicity. The Government is presently consulting on one way to achieve this. However, if the recommendation to introduce a Planning-gain Supplement is accepted, this would offer the opportunity to achieve this objective by scaling back Section 106 to cover the direct impact of development and contributions to social housing only.

CONTRIBUTING TO DEVELOPMENT

30 In principle taxation is often the best way to deal with externalities. However, using taxation as a means to increase the supply of land directly is unlikely to be successful, mainly because the role of the planning system in changing the value of sites reduces the effectiveness of price signals, and would create concerns about the fairness of the tax regime. In the context of land, tax may also be a blunt instrument, because of the individual nature of each site with regard to the balance between the social and private costs of development.

31 However, taxation can have other roles to play. In particular, windfall profits otherwise known as development gains often arise as a result of development decisions. The Government should actively pursue measures to share in these windfall gains, which accrue to landowners, so that these increases in land values can benefit the community more widely. The value captured can be used as a funding stream for a number of other policies.

32 Several options for capturing development gain have been considered, including development gains tax, changes to the VAT regime, and developer contributions paid on the grant of planning permission. It is proposed that the granting of planning permission would be a suitable point in the development process to levy a charge based on local land values. This Planning-gain Supplement would fall largely on landowners, with little impact on house prices.

33 In general, imposing a tax on an activity discourages its supply – but given the interaction of land supply with the planning system this effect could be expected to be small, provided that tax rate is not set at too high a level. More importantly, the proposed tax is part of a package of policies set out in this Review, which, taken together, aim to increase the supply of land and planning permissions.

ACCESSING HOUSING

34 The number of social houses built in the UK has fallen from around 42,700 per year in 1994-95 to around 21,000 in 2002-03. In recent years expenditure on social housing has increased, from £800 million in 2001-02 to over £1.4 billion in 2003-04, however the rate of new supply has continued to decline. This is due both to the strong rise in land prices (which has pushed up the cost of units) and the importance attached to improving the existing stock of social housing (bringing the proportion of social units falling below the decency threshold down from 46 per cent in 1996 to 33 per cent in 2002).

35 It is estimated that, over the next ten years, the number of social and affordable houses provided will need to be increased by at least 17,000 per year, requiring annual investment building up to around £1.2 billion, in order to meet the flow of new needy households. If the backlog of those whose need has not been met in the past is to be reduced, then up to 23,000 further houses would need to be supplied, at a cost building up to £1.6 billion. Not all of this cost would necessarily have to be met by Government – there may be further capacity among the Registered Social Landlord (RSL) sector, and some private suppliers are also developing models which seek opportunities to provide without public subsidy.

THE DEVELOPMENT INDUSTRY

36 The recommendations in the Review are intended to change the environment within which the housebuilding industry operates. Reduced house price volatility should lead the industry to be more willing to supply, and there should be less need to focus intensively on land. However, the industry needs to demonstrate a willingness and capability to respond to this changed environment.

37 The Review sets the industry challenging targets to improve service quality and consumer satisfaction ratings and to increase investment in skills and improved production techniques.

38 Local authorities should also consider the level of competition in the new build market when granting permissions. They should discuss the build out rates for large sites, and, where appropriate, encourage developers to split up these sites.

CONCLUSION

39 To improve the responsiveness of UK housing supply, many of the above recommendations are needed. Greater responsiveness could occur without there being a step change in the level of housebuilding – but this is also considered to be necessary at rate present time. Such a step change may mean more direct action by Government, for example through special purpose vehicles to drive forward delivery.

40 This Review was established with a UK remit, but given the devolved nature of housing and planning policies, many of the recommendations apply only to England. The devolved administrations will need to consider for themselves whether these recommendations are appropriate to their own circumstances, in the light of the policy changes the UK Government decides to adopt.

1

Objectives

Summary

The UK has experienced a long-term upward trend in real house prices. This has created problems of affordability. In addition, the volatility of the housing market has exacerbated problems of macroeconomic instability and had an adverse effect on economic growth.

Higher and more responsive levels of housebuilding, leading to a lower trend in real house prices, would benefit the UK in economic terms. But taking account of the environmental costs is also critical in determining the optimal level of housebuilding for the UK. The environmental costs of greater housing supply can be reduced, by increasing densities or through more efficient use of existing land and buildings: however, it is clear that more greenfield and brownfield land will be needed if an adequate supply of houses is to be delivered.

Household formation, based on the 2001 Census, has been estimated at 179,000¹ households per annum in England, yet only 134,000 extra houses were built in 2002. Rising demand for housing implies higher rates of housebuilding are necessary. A more responsive housing market would:

- help to reduce volatility in house prices thereby improving macroeconomic stability and supporting growth;
- improve flexibility and performance of the UK economy via greater labour mobility; and
- bring greater access to housing for many households, avoiding unwelcome distributional effects, and the ill-effects of poor housing.

Government has already recognised that doing nothing is not an option. The Sustainable Communities Plan sets out welcome proposals aimed at increasing provision in the South East. But more may be required. In particular to improve macroeconomic stability and deliver greater affordability for individuals a lower real trend in house prices is desirable:

- in order to deliver a trend in real house prices of 1.8 per cent an additional 70,000 private sector houses in England per annum might be required;
- to bring the real price trend in line with the EU average of 1.1 per cent an extra 120,000 private sector houses per annum might be required; and
- to improve access to housing for those who cannot afford market rates between 17,000 and 23,000 additional social houses may be required.

These estimates may overstate somewhat the actual level of housebuilding needed. They are particularly sensitive to the assumed responsiveness of house prices to changes in the housing stock. The effect of higher rates of housebuilding on expectations implies that a lower level of housebuilding might be necessary. However, they illustrate the potential scale of the challenge that Government and other players face.

Government should establish a market affordability target for the housing market.

Tackling volatility in house prices may also require measures to address the demand for housing, reforming council tax is one potential way of using taxation to stabilise the housing market.

¹ Shelter, *Building for the future – 2004 update*. A Report of the Shelter Housing Investment Project.

INTRODUCTION

1.1 Delivering an improved housing supply presents society, national and local government and communities with a set of difficult choices. It is necessary to strike a balance between the goals of:

- greater economic stability and economic growth;
- adequate and affordable housing for a growing population;
- meeting the aspirations of individuals as to the amount of space, the location and nature of housing to be provided;
- efficient allocation of resources, in particular land; and
- environmental and amenity considerations.

1.2 The strong trend in real house prices over the last 30 years (2.4 per cent per annum), is in part the result of past choices on these issues. The Interim Review² questioned whether the balance struck has been appropriate, and suggested that as a country a lower rate of house price increase would have brought significant benefits.

1.3 This Report sets out the changes needed to meet the challenge of creating a more flexible housing market. Delivering an adequate supply of housing requires action by all players: Government; the housebuilding industry; social housing providers; communities and local authorities.

1.4 This Review was established with a UK remit, but given the devolved nature of housing and planning policies, many of the recommendations apply only to England. The devolved administrations will need to consider for themselves whether these recommendations are appropriate to their own circumstances, in the light of the policy changes the UK Government decides to adopt.

1.5 This Review's Interim Report set out the evidence for the lack of responsiveness, and concluded that more housing may be needed in the UK. Inadequate housing means:

- constraining economic growth;
- greater risk of macroeconomic instability; and
- worsening affordability.

1.6 A key factor underlying the lack of supply and responsiveness is an inadequate supply of developable land. More land will need to be released or made viable for development, if housing supply is to increase. Better use of existing or previously developed land and buildings can be achieved through bringing derelict and contaminated land back into use. Many of the Review's recommendations aim to secure this objective.

² For reference the executive summary of the *Barker Review Interim Report* (2003) is reproduced at Annex A.

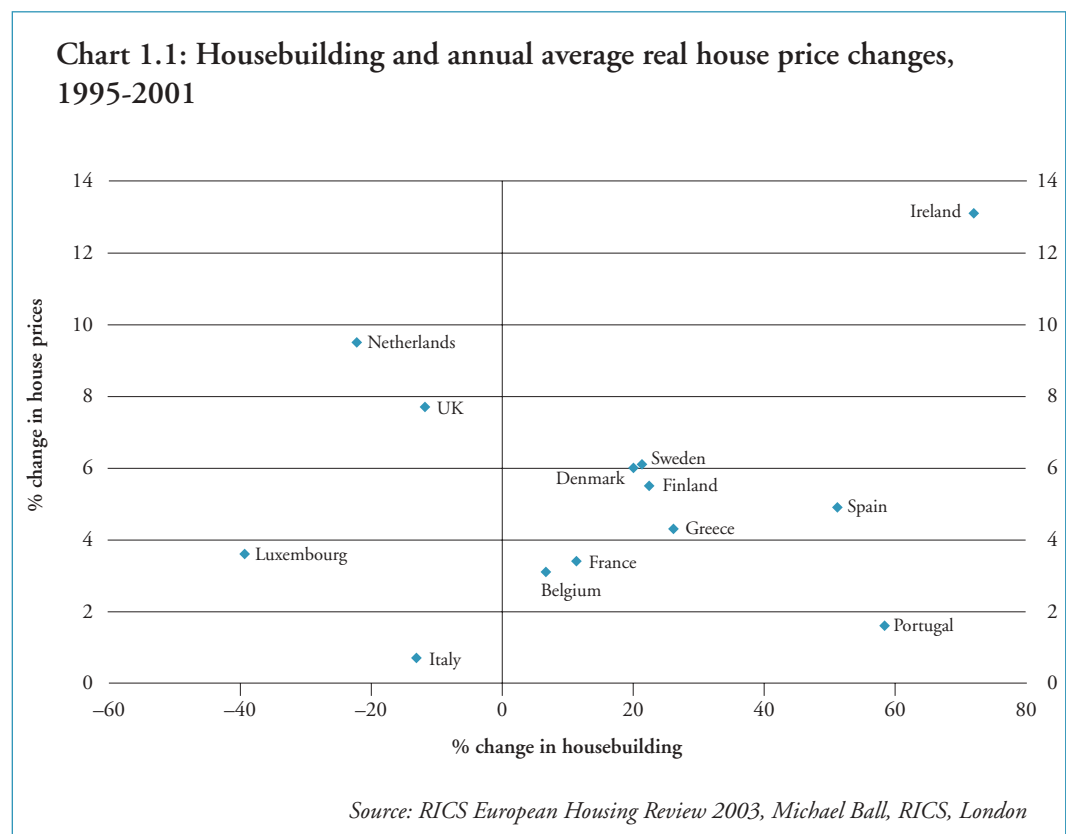
1.7 Land may also be used more efficiently through building at higher densities. Higher densities reduce land take, and make some services that are important for sustainable communities, such as transport, more viable. However, as incomes continue to increase it is likely that the demand for space will also increase; put simply, people tend to want to live in larger homes (often with larger gardens). This trend has been evident over a number of decades, partly as a result of the changing nature of the UK's economic and industrial base and supported by changes in the transport network.

CONSTRAINING SUPPLY: BENEFITS AND COSTS

1.8 Chart 1.1 illustrates recent symptoms of the problem that the Review is trying to address. Average house prices have risen over the last six years, however, housebuilding has not. Indeed, this chart shows that it has fallen in contrast to most EU countries. International comparisons show that this is not the norm. The nature of housebuilding means there are likely to be time lags between price signals and changes to the industry's output, but the lack of responsiveness in the UK is notable:

- international comparisons, set out in the Interim Report³, suggest that UK housebuilding is only half as responsive as the French, a third as responsive as the US and only a quarter as responsive as German housebuilding; and
- over the last 10-15 years, supply has become almost totally unresponsive, so as prices have risen, the supply of houses has not increased at all⁴.

1.9 The Interim Report set out the Review's understanding of why this is the case – that constraints on land supply prevent the market functioning “normally”.



³ Table 2.3, p. 44, *Barker Review Interim Report* (2003).

⁴ Table 2.2, p. 43, *ibid.*

1.10 This constrained housing supply has brought well-known benefits:

- Rising house prices benefit home owners and provide increases in wealth which can be accessed through equity withdrawal in order to increase consumption. It can also benefit future generations through intergenerational transfers. (However, this is clearly not of benefit to those outside the housing market and it is unclear if in the longer term it leaves the household sector as a whole better off.)
- Less land is developed. Land is a scarce resource, with costs of development including a loss of amenity, in particular the visual amenity of a more natural landscape.
- From a local perspective, congestion and infrastructure requirements may be reduced if fewer people lived in an area. Existing service users therefore receive greater levels of utility. However, nationally these additional demands will not be reduced. Concern over congestion and infrastructure would be better dealt with through direct policy measures. For example, a better route to tackle congestion is through road pricing, where there is a direct effect on road use.

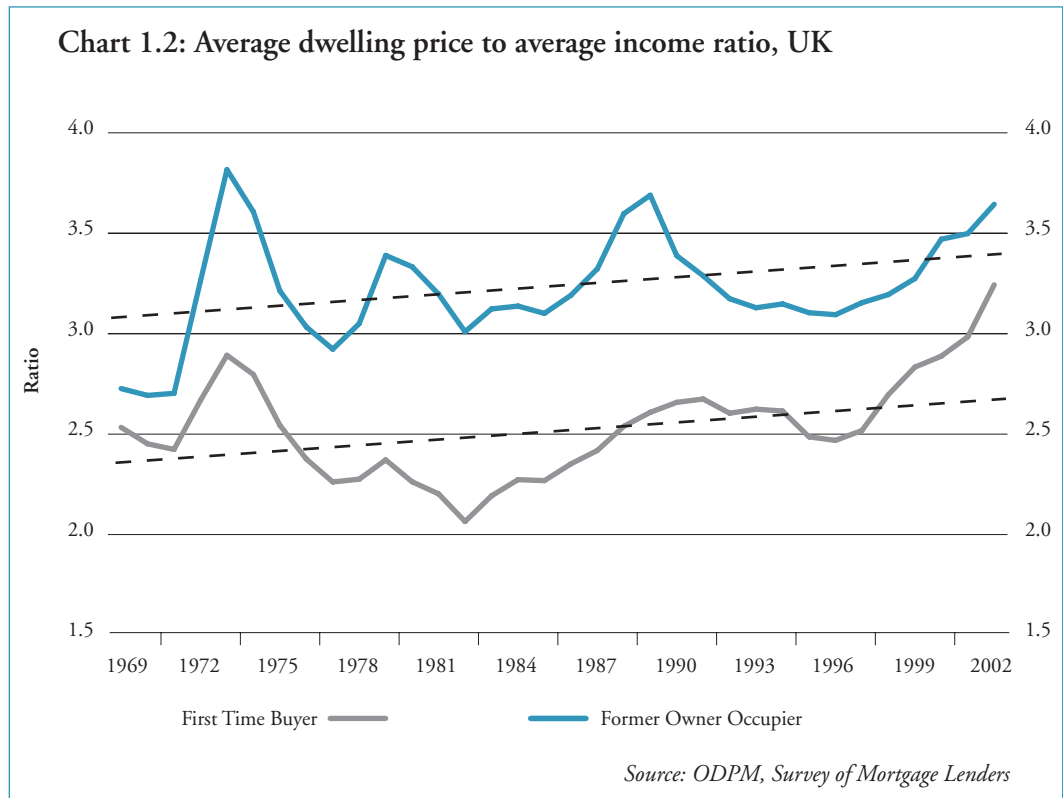
1.11 However, the costs of constraining supply include higher house prices and a lack of market affordability. Inadequate housing means:

- The UK will become an increasingly expensive place to do business, with high housing costs and reduced labour market mobility.
- Long-term trends in house prices mean that for many people housing is becoming less affordable over time, while the periods of sharply rising prices push owner-occupied housing out of reach for many more. Individuals' choices about where to live become unduly constrained, which can have a negative impact on their quality of life, for example, leading to overcrowding, longer commuting times and affecting family structures and friendship networks.
- Weak responsiveness of housing supply and the volatile behaviour of our housing market poses risks to economic stability and overall economic welfare. The risks to economic stability are likely to be amplified should the UK choose to enter EMU.

1.12 Prices act to ration demand, so it is inevitable that some people will get priced out of the market. The relationship between supply and affordability is not always recognised in debate: the lack of market affordable housing is bemoaned, while, at the same time, new housing developments are fiercely opposed. Evidence of declining affordability is clear:

- Only 37 per cent of new households could afford to buy in 2002, compared to 46 per cent of new households in the late 1980s⁵. The ability of first time buyers to enter the housing market, based upon income to house price ratios has worsened (see Chart 1.2). The upward trend would be even stronger if average house prices were compared to average incomes of all households.
- The number of households in England in temporary accommodation has more than doubled between 1995 and 2003, from 46,000 to over 93,000.

⁵ Bramley, G. *Barker Inquiry in Housing Supply – Affordability and the Intermediate Market*, Barker Review Commissioned Work, (2003).



IS THIS REALLY A PROBLEM?

1.13 One view might suggest that problems of affordability, constraints on economic growth and economic instability are the price that needs to be paid for protecting the countryside and addressing urban decline. The housing market is simply the outcome of the expression of preferences as to land use, and in the UK there is a preference for preserving land. After all, the UK is a relatively densely populated country (242 persons per sq. km), on a par with that in Germany (230 persons per sq. km) although significantly less dense than Belgium (337 per sq. km) or the Netherlands (390 per sq. km). England is more dense at 380 persons per sq. km⁶.

1.14 But is this really the case? For example, not all land is valued equally, so, as the Interim Report highlighted⁷, while development on accessible open land (such as urban parks and fields with rights of way) would result in a high cost to society, building on other types of land with a lower social value would not. Furthermore, this issue has the characteristics of an insider-outsider problem, where those inside the housing market have more power over any decisions than those outside and their decisions naturally reflect their own interests rather than those of the wider community.

1.15 Greater affordability for all cannot be achieved by increasing government subsidy to home ownership, although this can help address key worker housing issues. If demand increases as a result of higher subsidies and supply is held constant, then the result will be higher prices. A different group of households who do not receive a subsidy would be squeezed out of the market. Wider affordability can only be sustainable over the longer term by increasing the supply of housing, a point rightly recognised in the report of the Home Ownership Taskforce⁸.

⁶ On a regional basis the South East has a density of 734 persons per sq. km including London, and 419 persons per sq. km outside London. In other EU countries high density regions are West-Nederland at 860 persons per sq. km and Nordrhein-Westfalen at 529 persons per sq. km.

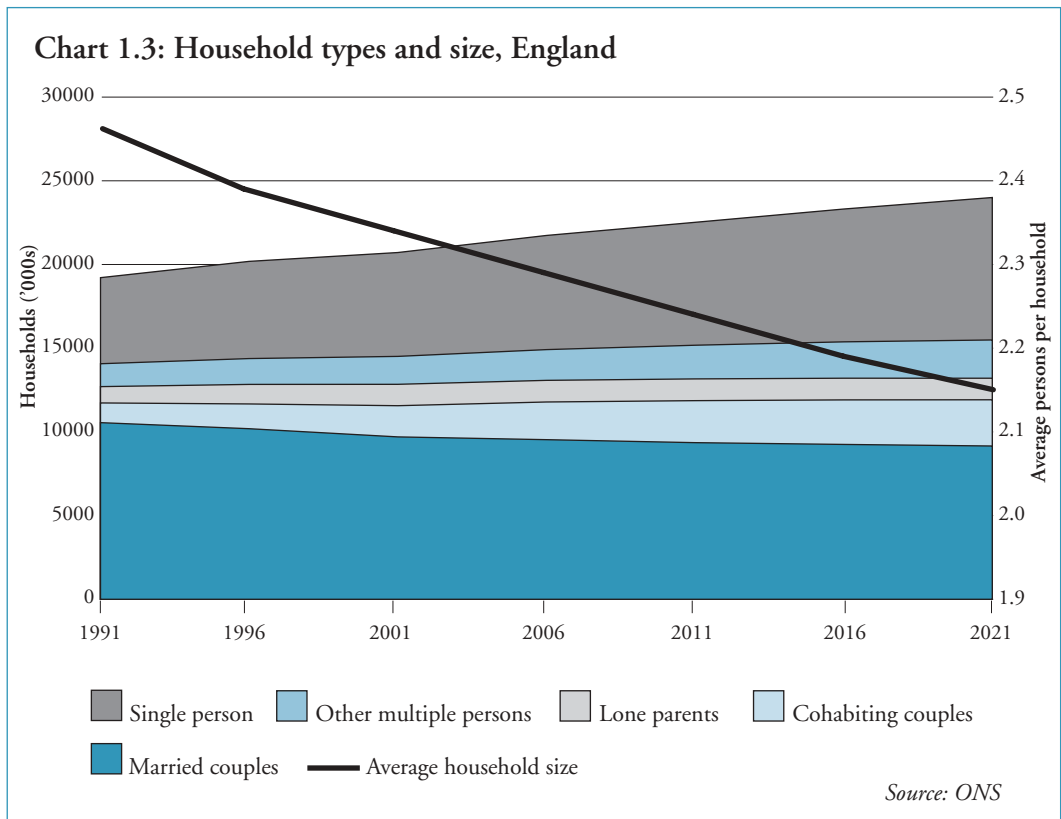
⁷ Table 1.6, p. 36, *Barker Review Interim Report*, (2003).

⁸ Home Ownership Task Force, *A Home of My Own*, (2003).

FUTURE DEMAND

1.16 In 2002 around 183,000 houses were built in the UK, 138,000 were built in England, though taking account of demolitions and conversions, net additions totalled 134,000, a 0.6 per cent increase in the stock. Official projections of household formation indicate that the number of households in England is expected to increase by an average of 155,000 a year over the 1996 to 2021 period, Chart 1.3 sets out these projections. Over the ten years to 2000 household formation is estimated to have been an average 196,000 households a year⁹. Increases in the number of households are in part the result of higher household formation rates, where people are less likely to be part of a couple. But with rising incomes there is no certainty that smaller households will necessarily demand smaller houses.

1.17 Official 2002-based household projections which will take account of the 2001 Census results are not due to be published until 2005. Alan Holmans’ estimates of household formation, based upon the Census, suggest households forming at a rate of 179,000 a year to 2011. Projections of household formation are not independent of housing supply. But this suggests that if supply is not increased lack of housing will drive decisions about formation in a way which may be unacceptable.



1.18 The outcome of this Review is not to provide a definitive answer to the question, what is the socially optimum level of housing supply? But the aim is to promote a more informed debate. The benefits of a less constrained supply are not just cold efficiency arguments. Access to decent housing, in a location which sustains social networks, adds to individual welfare. Improving stability in the market would bring important economic benefits to all.

⁹ These estimates have not been revised to reflect the 2001 Census of Population.

A BETTER FUNCTIONING HOUSING MARKET

1.19 In the same way that the UK has sought to create greater flexibility in capital and labour markets, creating a more “flexible” housing market is essential to promote the UK’s economic well-being and improve stability.

1.20 The Review’s objectives and vision for a better functioning housing market is one in which:

- trend real house price growth is lower, leading to greater market affordability, reducing regional house price differentials;
- greater stability of house prices is maintained, with fewer ‘bubbles’ based around expectations of weak supply, promoting macroeconomic stability;
- decent housing is available for those who cannot afford market housing;
- better use is made of the existing housing stock, with less over-consumption of housing due to its role purely as an asset; and
- the negative impacts often associated with housing are minimised by ensuring the most valuable land is preserved and housing growth contributes to sustainable communities.

1.21 A more flexible housing market should mean a greater role for the private rented sector and a better balance of housing tenures. Indeed, the Interim Report pointed to the desirability of increasing provision in the private rental sector through investment vehicles along the lines of US Real Estate Investment Trusts. However, given the focus on overall supply, the Review has not looked at measures specifically aimed at shifting tenure balance.

Economic growth

1.22 More responsive housing supply would benefit the UK economy by improving flexibility and performance:

- Improved regional mobility: house price differentials will never be eliminated between regions or localities. Such differentials reflect more than just housing demand, they reflect differences between areas, for example the quality and availability of services and local amenities. In addition, higher prices in some areas may reflect higher environmental costs. But if the differentials between regions over-compensate for the environmental costs, this unnecessarily hampers labour market mobility and reduces efficiency. Improved supply in parts of the country with high house prices would also reduce the cost and improve the quality of public service delivery.
- Competitiveness of the UK: costs to business (and to the public sector) are increased by higher house prices. The UK’s attractiveness as a business location could also be improved by higher rates of housebuilding, thereby enhancing economic growth and employment opportunities.

- Economic efficiency: constraining markets beyond adjustments for externalities such as environmental effects, distorts the allocation of resources within the economy. If housing supply is artificially constrained, this means resources that should be allocated to housing are used for other purposes which provides less welfare to consumers. Allowing increased levels of housebuilding would increase welfare for all, though at the cost of increased land take.

1.23 Some contributors to the Review have made the case for constraining housing growth in the South East in order to encourage growth in other regions, using planning as an implicit regional policy. However, as the Interim Report¹⁰ set out, the user cost of housing (i.e. the opportunity cost of investing in housing) implies that high levels of house price appreciation in the South, perversely, can make housing there a more attractive option than housing in other regions. Price signals, as measured by the user cost, can be misleading. They may not reflect the real price of housing, i.e. the environmental or infrastructure costs of that location. Similarly, falling house prices in low demand areas increase the user cost, raising the total cost of housing, reinforcing the undesirability of such locations.

1.24 Businesses are more mobile than people. Increasing integration with Europe and globalisation mean that businesses are also increasingly mobile internationally. It is just as likely that companies priced out of particular regions of the UK will move internationally. High UK housing costs risk becoming a disincentive to location here.

Economic stability

1.25 Better housing supply could also play a part in reducing economic volatility. Most major cycles in the UK economy over the past 30 years have been associated with instability in the housing market. Instability in the housing market is a problem because of the link between house prices, credit constraints and household consumption. As house prices rise, consumers are able to spend more; as house prices fall spending also contracts. Consumer expenditure in the UK is sensitive to house prices (more so than elsewhere in the EU), so volatility in house prices is transmitted into volatility in the wider economy, which policy may not be able to offset fully. This macroeconomic instability can have damaging effects on levels of business investment and long-term growth prospects.

1.26 There are factors other than supply that contribute to house price volatility:

- demand for housing and housing space is sensitive to changes in income, however, demand is less responsive to price. As a consequence demand will only fall off if house prices rise significantly;
- mortgage finance which is reliant chiefly on short term interest rates; and
- speculation and expectations play an important role in the housing market, expectations of future appreciation increases the willingness of households to pay a higher initial price.

1.27 The supply of housing is not the main factor driving house price volatility and indeed some level of volatility is inevitable owing to the inherent time lags involved in new construction. New housing supply may also have a limited effect on prices in the short term. Prices tend to be determined by the stock of houses. In any one year new houses only account for 10 per cent of transactions and add 1 per cent to the stock. In the short run, therefore, prices will inevitably be determined chiefly by demand.

¹⁰ Chart 1.4, p. 28, *Barker Review Interim Report* (2003).

1.28 However, a protracted supply response is largely responsible for the strong upward trend in house prices in the UK over the longer term. This works partly through expectations. Increases in house prices are reinforced through purchases motivated by expectations of future relatively high rates of return. If housing supply were more responsive, this might put some boundaries on people's expectations of future capital gains. A rise in demand for housing services, would therefore lead to lower expected capital gains and less over-consumption of housing with the expectation of financial returns. Similarly, the tendency to undersupply may limit house price falls during downturns.

1.29 Reducing volatility and improving the adequacy of housing provision is an important economic objective. It is also highly relevant to the issue of EMU membership. HM Treasury's assessment of the five economic tests for membership of Economic and Monetary Union concluded that "the housing market is a high risk factor to the achievement of settled and sustainable convergence"¹¹.

1.30 Housing plays an important part in the transmission mechanism, the means by which changes in interest rates affect the macroeconomy through their effects on real expenditure. Interest rates affect the cost of housing as a consumption good and also affect the cost of investing in housing relative to other assets. If interest rates fall, housing becomes more affordable, so demand increases. Given the lack of responsiveness of supply, the resulting rise in house prices and household expenditure means that deviations in UK interest rates inside the euro from their appropriate domestic level could lead to particularly large swings in the wider economy.

1.31 Increasing supply by itself will not necessarily prove a panacea. Improvements to the responsiveness of supply need to be seen alongside the analysis and recommendations presented by the Miles Review of the UK mortgage market. Taken together, these reforms have the potential to reduce the destabilising impact of the housing market on the macroeconomy.

Social merits

1.32 Increasing housing supply could also have benefits for individual and social well-being:

- Fairer distribution of housing services and wealth: housing wealth is a significant proportion of overall wealth. Restricting access to housing equity has the potential to further increase differentials in wealth between those inside and those outside the housing market. Along with improving affordability in the private housing market, adequate levels of housing need to be provided for those who cannot afford market rates. A flexible and fair housing market would be one in which these households were supported in gaining a decent level of accommodation.
- Improving individual well-being: individuals face costs as a result of constrained choices, for example, over crowding, longer commuting times and adverse impacts on health and education outcomes, particularly for children in inappropriate accommodation. Ultimately, Government bears part of this cost through a higher cost of each unit of social housing, plus health and education remediation.

¹¹ HM Treasury, *UK membership of the single currency: An assessment of the five economic tests*, (2003).

- A better balance of housing tenures: a housing market in which there is less pressure to buy and access the housing ladder early, on the basis of expectations of house price appreciation, might be desirable. This would help to ensure that people make the step into home ownership when they wish to ‘settle down’ and when purchasing a house may be more sustainable. This might mean that people are content to stay longer in the private rental sector, and will be more readily able to re-locate for employment reasons. One recent report suggests 36% of those planning to buy their first property this year are worried that pressure to buy may lead to a rash purchase¹².

IMPLICATIONS OF FLEXIBILITY

1.33 How would success in achieving flexibility be measured and what might this objective imply for the scale of housebuilding that might be necessary? It is possible to measure responsiveness, for example through measuring elasticities of supply. However, these measures are difficult to estimate and then only after a time lag, so the effectiveness of policy changes could not be determined in a timely manner. House prices are a good proxy for responsiveness, but also pick up demand-side effects. But, if combined with appropriate measures of affordability, house prices are a good proxy of the extent to which supply is responding to changes in demand.

1.34 The Review has set out illustrative scenarios in terms of the housing market for different rates of housebuilding. There is no attempt to estimate the overall cost for the environment or amenity. Indeed, without knowing the location and type of houses, it would be impossible to draw an overall conclusion about the net benefit or cost of achieving these scenarios. These alternatives are intended to inform the choice for the UK.

A HIGHER TREND?

1.35 The trend rate of real house price growth from 1970 to 2001, as estimated in HM Treasury’s euro assessment, was 2.4 per cent. However, there is evidence to suggest that the trend rate of house price growth has in fact increased over the second half of this period. Using the same methodology, the trend rate of real house price growth over the last 20 years has risen to 2.7 per cent.

1.36 Estimates of future housing requirements in England, in order to reduce the trend rate of house price growth from 2.7 per cent are set out in Table 1.1. The private sector numbers presented here are based upon econometric models and as such, are subject to a degree of uncertainty depending upon the modelling assumptions made. They are particularly sensitive to the assumed responsiveness of house prices to the size of the housing stock. This is discussed below. The baseline for these estimates is 2002-03 when there were 140,000 private sector gross starts and 125,000 gross completions in England.

¹² Alliance & Leicester press release 21.02.2004.

1.37 Increasing private housebuilding and reducing the trend in real house prices will lead to more people being able to afford to buy housing. However, it will remain the case that some individuals will not be able to afford market housing. Taking this improved market affordability into account Table 1.1 sets out scenarios for the additional social housing required to ensure a fairer distribution of housing services. These numbers are explained in more detail in Chapter 5. Clearly these scenarios are to some extent independent of each other, though there would be implications for the level of investment required.

Table 1.1: Housing requirements in England

Scenario	Real price trend	Additional private sector houses required per annum	Average no. of newly formed households priced into the market per annum (2002 baseline)		Additional social sector houses required to 2011 per annum
			2011	2021	
			Government plans	2.4%	
Reducing the long term trend	1.8%	70,000	nil	5,000	17,000
Improving the housing market	1.1%	120,000	5,000	15,000	21,000

Source: Barker Review

Government plans

1.38 Government has recognised that doing nothing is not an option, that housing supply needs to increase to meet the needs of a rising population and economic growth. Indeed in 2002-03 housing completions were nearly 8,000 higher than in 2001-02, and in London and the South East, new housing completions for the last year are broadly in line with annualised allocations. 200,000 extra homes are planned for the four growth areas identified in the Sustainable Communities Plan. This implies housebuilding rates increasing by approximately 20,000 extra houses in England from 2006 to 2016.

- Assuming all of these additional houses were for market sales implies that the price trend would be reduced to around 2.4 per cent per annum, taking us back to the longer term trend since 1971.
- Based upon estimates produced by Glen Bramley, a price trend of 2.4 per cent would mean 5,000 extra newly forming households per annum, on average, being priced out of market housing and unable to buy by 2011. Affordability worsens as household average incomes rise by less than average house prices.
- Social provision would be increased only if additional funds were made available. However, looking forward, if the unit costs of social housing provision continue to rise as they have done over the last few years, in part a result of increasing land costs, and with a shift in emphasis to high cost areas such as the South East, social housing provision is more likely to decline. Section 106 contributions are unlikely to offset this fully.

Reducing the long term trend

1.39 While this level of housebuilding would prevent the housing market from deteriorating, it is unlikely to be enough to deliver the better functioning housing market that this Review has advocated. As Table 1.1 points out higher rates of housebuilding would be needed to reduce the trend in real house prices below its longer-term level.

1.40 To reduce the real price trend to either 1.8 per cent or the EU average of 1.1 per cent would require between 70,000 and 120,000 additional houses to be built each year. Under these scenarios affordability is increasingly improved over time, by 2021 between an extra 5,000 and 15,000 newly forming households are able to afford to buy housing compared to a baseline in 2002. Going further still, zero house price inflation might require 200,000 extra private sector houses to be built per annum.

1.41 Addressing the newly arising need for social housing could mean an extra 17,000 homes. A more ambitious approach to tackling housing need, such that the backlog of unmet need was reduced over time, could mean an extra 21,000 houses being provided per annum assuming a price trend of 1.1 per cent. Eradicating the backlog of households without self contained accommodation over 25 years would mean an extra 35,000 sub-market houses per annum, although this need could be reduced to 23,000 if zero house price inflation was achieved, as other households would no longer need sub-market housing.

1.42 However, this Review is sceptical that zero house price inflation is desirable. Given that productivity growth tends to be lower in the construction sector than the economy as a whole, rising real house prices might be expected. International evidence also suggests that zero real inflation is not the norm. Even in the US, where there are fewer constraints on development, the trend is still upwards. Perhaps more importantly it is not at all clear that this situation would be desirable, as the environmental costs to the UK could be considerable. This level of housebuilding could also have a significant adverse impact on the UK economy by creating resource misallocation into housing. It is doubtful that the housebuilding industry, given capacity constraints, would prove able to build to these numbers in the foreseeable future.

TOO MANY HOUSES?

1.43 Some of these estimates of housing required may appear high, being in excess of projected rates of household formation. There are a number of important points to bear in mind:

- House prices are influenced by the stock of houses. The effect of changes in stock on house prices may be relatively small as currently new houses account for less than 1 per cent of the stock each year.
- The effect on house prices of increasing rates of housebuilding depends upon how sensitive house prices are to changes in the size of the housing stock (i.e. the price elasticity with respect to the stock). If house prices become more sensitive to changes in the size of the stock the increase in housebuilding required to reduce the price trend is likely to be much smaller. The figures presented above are based upon a central estimate of this sensitivity, and are highly dependent on it. The impact of additional housebuilding on house prices will also depend upon where and what type of houses are built.
- Expectations have a significant influence on house prices. A large increase in supply might alter households' expectations of future price increases. The opportunity cost (or user cost) of investing in housing would increase with a lower price trend. This in itself could reduce the price people are willing to pay for housing. Therefore a smaller increase in housing supply would be required to achieve any given trend in real house prices. Expectations are part of the model, but if the policy changes recommended by the Review are implemented, the role of these expectations could change.

- The estimates of affordability presented here measure affordability for newly forming households. The apparently small number of new households priced into the market increases over time so that by 2021 the impact is significant: one third of new households currently priced out of the market are priced in. However adjustments in people's expectations might increase the impact of additional supply on house prices more immediately. In addition, these figures do not capture those existing households priced out of the market who, with a lower price trend would be able to access home ownership.
- Higher rates of housebuilding could also lead to higher household formation rates. Household formation is affected in part by housing market constraints, including house prices and access to credit. If the current rate of household formation is 179,000, it could be somewhat higher at lower prices. Conversely, household formation could be constrained if house prices rise higher, with more couples living as concealed households.
- The numbers presented in Table 1.1 are gross additions to the stock. Net additions, which take account of demolitions and conversions, would be lower. The replacement rate of the existing stock is very low. For example, in the 1970s demolitions averaged over 62,000 per annum, compared to 2002-03 when only 22,000 demolitions occurred. Houses built today need to last approximately 1,200 years. With higher rates of housebuilding it is likely that replacement of the stock would be higher.
- Housebuilding in 2001 was at its lowest since the second world war. Consequently set against this baseline, these rates of housebuilding may look high, but they are not out of step with those achieved in the past. For example, housebuilding in Great Britain in the 1970s averaged between 200,000 and 350,000 per annum.
- On the other hand, these figures could be an underestimate, if the economy's long-run growth rate increases, this immediately pushes up demand for housing.

1.44 However, while there is uncertainty around these numbers, and on balance they should be regarded as top end estimates, the key point is that to achieve a better functioning housing market, significant increases in housing supply are likely to be required.

Environmental costs

1.45 Increasing levels of housebuilding could have environmental costs. Additional housebuilding is likely to mean using more undeveloped land, alongside making better use of previously developed land and existing buildings. At the present time in England 36 per cent of land is protected from development, in the South East this figure is even higher, nearly 60 per cent of land is protected either through greenbelt status, designation as an area of outstanding natural beauty or other designated conservation or protected areas. Across England 7.1 per cent of land is urbanised, in the South East 7.8 per cent of land is urbanised compared to 9.9 per cent in the North West.

1.46 To illustrate, suppose Government chose to allow an additional 120,000 houses per annum to be built over and above existing plans and that all this building were concentrated in the South East (an unlikely and undesirable event). Over the next 10 years, this would mean using an additional 0.75 per cent of the total land area of the South East, 1.92 per cent of developable land¹³. Extra housebuilding will have environmental consequences and this cannot be ignored, however, the impact can be reduced by ensuring that land which society values least is used and tackling issues of water usage and waste management.

CHOICE FOR GOVERNMENT

1.47 Assessing the right level of housing supply is ultimately a matter for Government. Setting out potential housing numbers informs this decision. But, given the uncertainties, fixing on a specific number is unlikely to be the right approach. It is the outcome, market affordability, that should matter.

1.48 One way for Government to express this choice is through establishing a goal for market affordability. Government presently has an objective, set out in PSA 5¹⁴, to balance the housing market. Included in this is an indicator of affordability, the ratio of lowest quartile house prices to lowest quartile earnings in the regions characterised by high demand, although there is no target attached. A market affordability target would aim to improve access to market housing over the housing market cycle. It might also aim to reduce the regional differentials in affordability.

1.49 There are detailed and practical questions as to the most appropriate means of measuring such a target. For example, one possible measure of market affordability is median house prices to median incomes but the emphasis on access to housing might suggest a case for focussing on lowest quartile house prices to lowest quartile incomes. It could be measured as a ceiling on mortgage payments (given certain assumptions) for lowest quartile earnings, which would take into account changes in interest rates. Affordability might also be measured by an index, using a basket of measures to assess access to housing, such as that adopted by the Neighbourhood Renewal Unit in its Index of Deprivation.

1.50 Measures of affordability could also be an important tool used to inform regional decisions as to housing requirements. This issue and recommendations are discussed in Chapter 2.

Recommendation 1

Government should establish a market affordability goal. This goal should be incorporated into the PSA framework to reflect housing as a national priority.

¹³ This calculation assumes that 60 per cent of homes will be built on brownfield sites, and that dwellings will be built at 30 dwellings per hectare. It also includes an allowance for related infrastructure. Developable land is estimated at 1m hectares. 'South East' is the ROSE area (Rest Of South East) – equivalent to the Government Office South East region plus Essex, Hertfordshire and Bedfordshire.

¹⁴ Public Service Agreement 5 – To achieve a better balance between housing availability and the demand for housing in all English regions while protecting valuable countryside around our towns, cities and in the greenbelt and the sustainability of existing towns and cities.

CAUSES OF UNDERSUPPLY

1.51 In most markets, when prices rise, supply also increases. Why is the same not true for housing, why don't housebuilders build more in times of greatest demand? Understanding this puzzle was central to the Review's Interim Report and underlies the Review's policy conclusions.

1.52 The conclusion of the Interim Report was that land supply is the key constraint to increasing housing supply, due to a number of factors:

- In some areas not enough land is allocated for development and/or the rate of land release is not responsive to market conditions and rising house prices. Housebuilding is often politically contentious and assessing both the costs and benefits of development is difficult, as the incentives facing decision makers do not reflect those costs and benefits. Local costs of development can be high and those already housed have a much stronger voice than those in need of housing. Many of the Review's recommendations aim to improve the framework within which development decisions are taken in this regard.
- There are also a number of barriers to the development of allocated land. For example the availability of infrastructure, the costs and complexities sometimes associated with developing previously used (brownfield) land, weak incentives to bring land forward for development and the difficulties of site assembly where land ownership is fragmented.
- The housebuilding industry faces a range of significant market and planning risks. This results in an industry which is reluctant to invest for the long term, to employ direct labour, and at times may hold back production rates

1.53 Addressing these difficult matters means addressing contentious subjects, the value placed on land use, the role of local democracy, the appropriate level of subsidies and the extent to which individual preferences for housing should be met. There are also other policy issues not specifically addressed by this Report that those responsible for delivering housing have to come to terms with:

- Higher incomes are associated with an increased demand for space. Increases in incomes might be expected to create strong pressure for developments of lower density along the urban periphery¹⁵. This raises the issue as to the type of housing required and how far policy should deliver what people want. Constraining individuals' preferences or aspirations carries costs, and it is not clear these are well understood.
- The location of new housing is crucial. High cost areas are often where additional housing brings the most benefits. But it is often easier to build houses in areas that have a lower benefit and a lower cost. It is not clear that any house without regard to its location is beneficial. The economic benefits of housing are likely to be maximised by building more houses in those areas of the highest demand, where people most want to live. But this not only brings costs in terms of potential congestion in high demand areas, it can also impact on decline in less popular towns and cities. New housing can potentially have a positive impact on deprived areas. Government has recognised this dilemma and housing market renewal

¹⁵ Cheshire, P. and Sheppard, S., 'Estimating the Demand for Housing, Land and Neighbourhood Characteristics', *Oxford Bulletin of Economics and Statistics*, 60, 357-382, (1998).

pathfinders are seeking to ameliorate the effects of housing market decline and abandonment. Assessing the costs and benefits of housing in different locations needs to be done more systematically.

1.54 These issues challenge policy makers to consider appropriate urban forms. Urban forms are not static. Cities and towns grow and decline, as economic structures alter. There is no reason to believe that in the future they should remain as now. Indeed, there are strong arguments that some of our cities should be encouraged to expand further. In other areas, this might mean taking a much more active approach to demolitions and clearing stock that is no longer required, regaining areas of open land.

ADDRESSING DEMAND

1.55 The remit of the Review is around housing supply. But it is clear that to tackle volatility effectively in the housing market will also require measures to address the demand for housing. As HM Treasury pointed out in its Fiscal Stabilisation and EMU paper “fiscal instruments impacting on the housing market could help reduce volatility in this sector of the economy”¹⁶.

1.56 Changing the nature of property taxation in the UK is one possible way of achieving this. There are strong reasons to believe that reform of property taxation, particularly council tax, could play a key role. A council tax system that was more closely linked to property values could have an automatic stabilising effect. As house prices rise, increased tax liability might help to dampen demand for houses. This would also encourage a more efficient use of the housing stock.

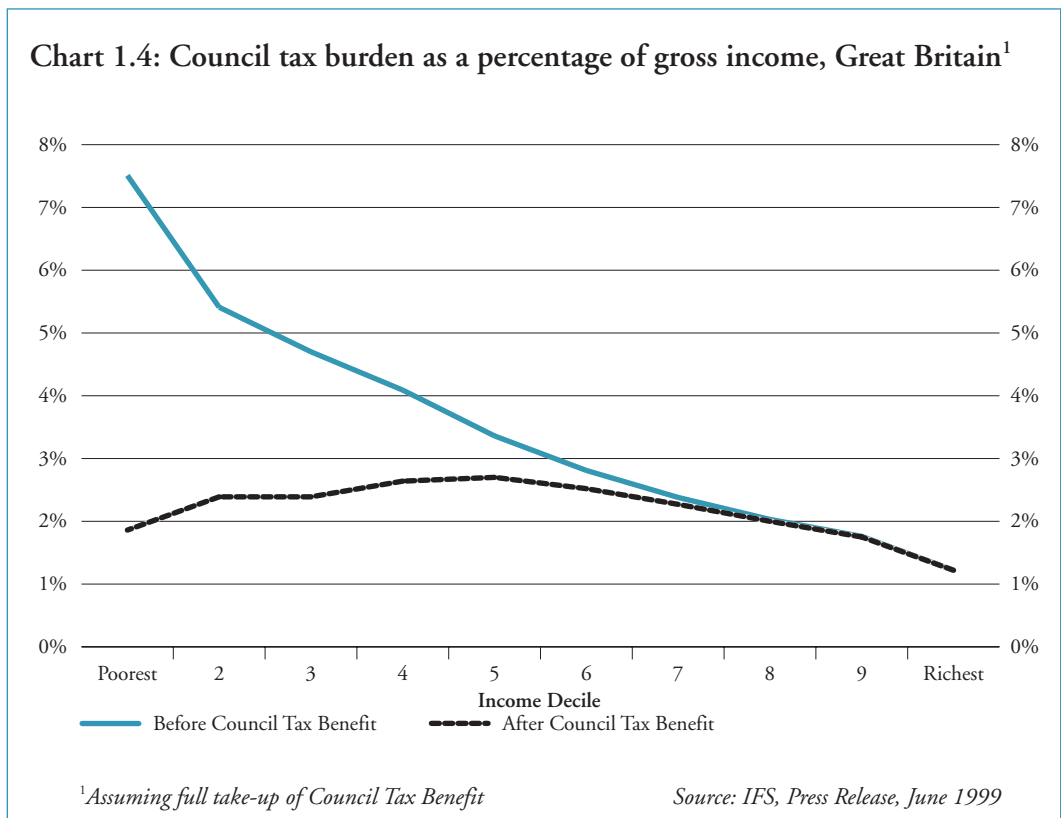
1.57 The present council tax is regressive in nature, that is, the marginal tax rates are much higher for those on the lowest incomes (this is illustrated in Chart 1.4). Infrequent re-valuations (council tax is currently based upon property values assessed in 1991) exacerbate these problems.

1.58 Council tax is also regressive with respect to the price of houses¹⁷, making it regionally regressive. Effective tax rates are higher in regions with lower property values. It also helps to incentivise the very houses that the planning system aims to discourage. Council tax is highest as a proportion of capital value on small houses and lowest on large houses, whilst the planning system seeks to encourage high density, often smaller, houses and discourages large houses using a lot of land. Nor does council tax encourage a more efficient use of the housing stock, although powers now exist to allow local authorities to levy between 50 and 90 per cent of the usual council tax charge on second homes. To encourage efficiency local authorities should use their powers to charge more for second homes¹⁸.

¹⁶ HM Treasury, ‘Fiscal Stabilisation and EMU’, *EMU study* (2003).

¹⁷ Chart 7.3, p. 124, *Barker Review Interim Report* (2003).

¹⁸ Data on second homes is uncertain, but may be around 200,000 in England. FPD Savills have published estimates recently putting the number at 206,000 in England.



1.59 Council tax has a number of functions, not least payment for services provided by the local authority. It is not currently designed to stabilise the housing market. This means that such reform raises difficult questions about how to structure local government finance. Nevertheless, in its current considerations as to possible council tax reforms, Government should consider ways in which property taxation, with proper discounts for the less well off and elderly, could help to stabilise the housing market. This type of reform would support the goal of achieving greater stability in the market.

Recommendation 2

Local authorities should use their powers to charge more for second homes to improve efficiency of the use of stock.

PRINCIPLES FOR RECOMMENDATIONS

1.60 A number of general principles have emerged during the course of this Review which have helped in shaping its recommendations. These are:

- Policies should reflect better both the positive and negative externalities associated with housing. This means the environmental costs of housing should be considered alongside the social and economic benefits, ensuring that land is used efficiently, that the most valuable undeveloped land is preserved and that development promotes sustainable communities.

- Market signals tell us a great deal not only about the level of demand for housing and the necessary supply, but about the desired nature of that supply. There may be very good reasons not to follow the market (owing to externalities) but, in principle, policies should not seek to impose a different market, without a clear regard to the costs of doing so.
- Policies should seek to re-focus the efforts of the industry towards improving the quality of its outputs. In the past, housebuilders have had few incentives to increase productivity, improve innovation and enhance performance. Their focus on land acquisition has arguably been to the detriment of good design and sustainability with consumers getting a less good deal as a consequence.
- A more responsive system with more timely decision making processes that are able to respond to changing market conditions is desirable. This will in part help to mitigate some of the risks, in particular the site-specific risks associated with housebuilding.

LOOKING AHEAD

1.61 Higher levels of housebuilding need to be combined with a stronger evidence base as to the location and distribution of housing growth and its impact on the surrounding areas, in particular the impact of housing supply policies on deprivation and economic growth. The Review has not been able to assess this complex area fully.

Recommendation 3

Further research should be undertaken to improve the evidence base for housing policies, for example on the relationship between housing, economic growth and deprivation at a micro level.

1.62 The Review recognises that reform of the housing market will not happen overnight. Indeed, it is desirable to avoid significant abrupt change as this risks disrupting the economic expectations and aspirations of existing and potential home owners. Achieving flexibility will require on-going review of the functioning of the housing market. Over time it may become clear that further reform is required. In order to assist in determining how far the housing market has improved, a review of progress should be established, possibly in three years time. The aim of this review would be two-fold.

- to assess progress towards implementing the recommendations set out in this Review; and
- to provide an independent assessment of progress towards achieving a more flexible housing market and assess any further or remaining obstacles, including the case for more radical supply measures or further measures to address demand side factors.

1.63 Given time lags in data it will be difficult for this review to assess changes in price trends. However, there are a number of success criteria that the review might consider:

- rate of housing completions;
- timescales in the planning system;
- market affordability; and
- social housing need.

1.64 To assist this future review it would be helpful if Government were to improve data in this area. The analysis conducted by the Review over the last year has shown up numerous shortcomings in the data. In particular, data on housing completions could be more timely, and preferably all parties would agree on its accuracy. It would be helpful to have better data on the private rental sector, on the age of the housing stock, its type and location, demolitions, conversions and second homes. Price data would usefully include the price per sq. metre. Improved data on land supply and ownership, and on the performance of local planning authorities, is also necessary to better understand the impact of policy and the effectiveness of delivery. Planning permissions could be tracked, to find out why they are not always built out. Data is also compiled on an inconsistent basis across the devolved administrations, making analysis at UK level much more difficult.

Recommendation 4

Government should establish a review of the housing market to report in no more than three years time. The purpose of this review would be:

- **to measure Government's progress in implementing the recommendations set out in this Report; and**
- **to assess progress towards achieving a more flexible housing market and to identify any further obstacles.**

This assessment might become a regular review of the UK housing market.

To assist any future reviews and to help improve the evidence base for assessing the effects of policy, Government should consider a range of data improvements to enhance understanding of the housing market, the effect of policy changes and planning processes.

REPORT STRUCTURE

1.65 The rest of this Report is structured in the following way:

- Chapter 2 considers the regulatory framework within which the housebuilding industry operates and looks at national, regional and local planning policies and processes;
- Chapter 3 looks at ways of overcoming barriers to development, focussing in particular on the incentives and constraints faced by those who can facilitate development;
- Chapter 4 examines the taxation of land and housing;
- Chapter 5 assesses the extent to which the market alone can deliver an adequate housing supply and the need for subsidised housing;
- Chapter 6 sets out the challenges that face the industry, the need to improve performance and increase capacity in order to deliver on the opportunities presented by a changed business environment.

2

Planning for development

Summary

- The Interim Report identified land supply as the main constraint on the delivery of housing. It argued that decisions about the scale, location and nature of development made through planning are not always optimal, and that the trade-offs associated with constraining development are not made explicit.
- This chapter sets out a number of recommendations for reforming planning policies and processes, with the objective of achieving a better balance between planning and the market. Planning at present tries to ‘make the market’ without consideration of the consequences, for example the effect on house prices and affordability.
- Regions should establish market affordability targets that make these trade-offs clear. To assist in this process a Regional Planning Executive should be established in each region. The Executive would be responsible for developing an independent evidence base, and for advising on the scale and distribution of housing required to meet the region’s market affordability target.
- Regional and local planning should be more responsive to market signals. Planning authorities should allocate a buffer of land for development to allow flexibility to meet market conditions. Land should be released for development in response to defined indicators of housing market disequilibrium. Decisions about land allocation should themselves be grounded in evidence about the value society attaches to different types of land use.
- Further flexibility could be achieved by acknowledging that different types of development should be treated differently by planning authorities. Government should introduce two alternative routes for developers seeking to achieve planning permission.
- There is an important role for democratic, community engagement in decisions about housing development. Community engagement should be front-loaded in the decision-making process to give people a voice over the principles of design and development.
- Reforms to planning should be considered together with the proposals to improve housing delivery set out in Chapter 3.

INTRODUCTION

2.1 The analysis presented in the Interim Report identified a number of factors contributing to constraints on land supply. These include the complexities of land ownership and of developing many brownfield sites, weak local incentives to develop land, and planning through its influence on the amount of land permissioned for development and made viable through supporting infrastructure. This chapter considers the role of planning in the allocation of land for development. Chapter 3 considers ways in which development can be facilitated through providing necessary infrastructure, addressing the complexities of developing brownfield land and promoting the right incentives for decision makers.

2.2 The amount of land given planning permission for development in a local area may be insufficient to achieve socially optimum levels of development:

- Political pressures may mean that housing numbers set at a regional level and cascaded to local authorities do not always represent the optimal level of house building.
- At a local level, insufficient land may be available to meet even these housing numbers. Land availability is constrained by a variety of factors – for example, the costs of land assembly and inadequate infrastructure can make a site unviable for development (these issues are explored in detail in Chapter 3).
- The release of land tends to be driven by annual or five yearly targets, rather than in response to changing demand, for example rising prices or declining affordability.

2.3 The Interim Report¹ identified two factors explaining this outcome:

- Assessing the costs and benefits of development is not straightforward. Many of the benefits of development relate to the wider regional or national level, and the tools available to take account of these factors are limited.
- Too often planning tries to create or constrain the market without taking full account of the information provided by price signals.

2.4 A more effective planning system would be characterised by:

- a system that responds to market signals;
- decision making procedures that take full account of the wider costs and benefits of housing development, including environmental and amenity costs;
- appropriate incentives for development at the local level;
- clear and timely mechanisms to provide the necessary infrastructure and services to support development and deliver sustainable communities; and
- sufficient resources to enable effective decision making.

LAND ALLOCATION

2.5 The planning system controls land use. Control over the amount of land available for housing lies with Regional Planning Bodies who determine regional housing targets² (although the Secretary of State ultimately owns these targets and can change them – as has previously happened in most regions). The importance of these numbers should not be under-estimated. Housing targets determine the amount of land that local planning authorities make available for development through their local plans. These housing targets also become an important benchmark for local authority performance in housing delivery.

¹ Chapter 8, *Barker Review Interim Report* (2003).

² Regional housing targets are net additional dwellings targets and include new build and conversions, minus demolitions.

2.6 However, a framework that determines housing targets with little regard to demand, and where adjustment of the projected targets is an infrequent and lengthy process, is unlikely to be inherently responsive. Indeed there are rigidities built into a system where these targets are annualised and become the objective against which performance is measured.

RESPONDING TO MARKET SIGNALS

2.7 An unrestrained housing market would lead to very significant negative externalities. Environmental degradation, congestion, substandard housing, abandonment and social exclusion are just some examples. Decisions made by individual players, without co-ordination, would not reflect the social optimum. The market price of land, for example, is unlikely to reflect the full social costs associated with its development. This provides a rationale for intervention through planning to influence the scale and nature of development.

2.8 The nature of that intervention is important, however. It is essential to ensure that market signals guide this intervention. Planning and the market should not always be in conflict.

2.9 Prices provide a wealth of information about the nature of demand. For example, price differentials indicate consumer preferences with respect to housing location and housing attributes. This does not imply that these preferences should always be satisfied. Prices are not a substitute for planning. However, using them as part of the decision making process can lend itself to better decision making, not just in high demand areas, but also in tackling problems associated with low demand and abandonment. While using prices can allow a better assessment of the costs and benefits of development, there is no presumption that society would then choose to increase the level of development.

INTEGRATING MARKET INFORMATION – HOUSING NUMBERS

2.10 Chapter 1 highlighted the choices and trade-offs that need to be considered when determining the right level of housing supply. At present, these choices and trade-offs are not addressed explicitly by Regional Planning Bodies in determining the level of housing provision.

2.11 The approach to setting housing numbers differs between Regional Planning Bodies. Factors such as household projections, migration, the needs of the regional economy, the capacity of urban areas and environmental considerations are all typically taken into account. However, the way in which these variables inform the outcome depends upon the weight attached to each one. This is frequently determined by political decisions, often reflecting negative local attitudes to development³. This is also less transparent than might be desirable, although the Examination in Public of Regional Spatial Strategies goes some way towards addressing this issue. But a clear sense of the housing market outcomes that regions are seeking to deliver when housing numbers are set is lacking. For example, few RPBs consider what impact additional housing is likely to have on the ability of people within their region to afford market housing.

³ See Chapter 8, *Barker Review Interim Report* (2003).

Market affordability target

2.12 In future, the first step for policy makers should be to determine the objectives for the housing market. This will give regions a clear rationale when determining housing allocations. The process should be led by Government setting out its goal for improved affordability of market housing, as outlined in Chapter 1. This would be an important step in changing attitudes to development by focussing communities and decision makers on housing market outcomes. These include whether key workers can afford to access the housing market, whether future generations will have the same access to housing as past and present generations, and whether people can afford to move between areas to access labour market opportunities, if supply is constrained.

2.13 Regions should similarly set out their own market affordability targets. These targets would be different for each region, although through discussions with the Secretary of State, they would need ultimately to be compatible with the national target. These targets would aim to improve affordability over the housing market cycle and narrow intra-regional differentials in affordability where appropriate.

2.14 There are a number of ways in which market affordability could be measured as set out in Chapter 1. These would be just as applicable at regional level. Regions would then seek to determine an estimate of housing numbers consistent with delivering this target. Naturally, there are large margins of uncertainty surrounding calculations such as these. Using this methodology would not lend itself to a hard target for housing supply, rather it would inform the likely level and distribution of housing required to achieve the target and would be subject to regular monitoring and adjustment. The Regional Spatial Strategy would set out the scale and distribution of these housing numbers, in order to achieve the region's affordability target.

2.15 Within regions there can be considerable differentials in market affordability (compare York and Hull for example). Regions should not be able to achieve their affordability target by trading off these sorts of imbalances. Therefore, regional targets would need to encompass both floors and ceilings in order to reduce differentials and to ensure that such a target would be relevant to regions characterised by both low and high demand. Such an approach would not undermine Government's work in housing market renewal pathfinder areas by allowing unconstrained development in surrounding popular housing markets. Rather, targets would be set to recognise that affordability might worsen in these high demand areas (by setting a high ceiling for these areas) but that this is a price worth paying for regeneration of less popular areas.

Recommendation 5

Each region, through the Regional Planning Body, should set its own target to improve market affordability. Taken together, the regional targets should be consistent with the Government target (Recommendation 1), although individual regions will differ. There is also merit in RPBs specifying sub-regional targets which may include floors and ceilings.

Indicative net housing targets for the region and local authorities should be produced, by the Regional Planning Executive (Recommendation 6), in order to aim to achieve this market affordability target. Government should provide regions with clear guidance on the methodology to achieve this. These targets would be set over a 5-10 year period as a trajectory. However, the targets and trajectory would not be fixed and would vary as a result of increased flexibility at the local authority level (Recommendation 9). They would also be revised in either direction if monitoring of the affordability target demonstrated that the region was not moving towards the desired outcome.

New institutional framework for housing

2.16 Within the current institutional framework at the regional level no organisation has overall ownership of the regional housing market. Regional Planning Bodies (RPBs) determine the scale and allocation of regional housing provision over a 15 year period in the Regional Spatial Strategy (RSS). The Regional Housing Boards (RHBs) advise on the allocation of funding for social and other sub-market housing for a 2-3 year period, private sector renewal and how to tackle low demand in a Regional Housing Strategy. The Regional Economic Strategies (RESs) produced by Regional Development Agencies (RDAs), have implications for housing demand and spatial planning to meet the needs of the regional economy. All these strategies should, of course, take account of each other but they often use a different evidence base and operate over different timescales.

2.17 Greater integration between the various regional strategies and the bodies that produce them would seem desirable:

- Housing need and demand has to be expressed spatially, which makes it difficult to consider housing market issues separate from the Regional Spatial Strategy and Regional Planning Body.
- There is a requirement to reconcile the needs of the housing market with other regional priorities through the RSS, but it is made more challenging by the lack of a shared evidence base between different regional organisations including the RPB, RDA and RHB, suggesting the need for a single evidence base.
- Given the range of interests, it might also be desirable for this evidence base to be compiled by an independent body.

2.18 The establishment of elected regional assemblies will allow various functions and strategies at the regional level to be brought together. However, even in the absence of elected regional assemblies, a streamlined institutional framework is possible and desirable.

2.19 The Regional Planning Bodies and Regional Housing Boards should be merged to create single Regional Planning and Housing Bodies (RPHBs), responsible for all aspects of managing the regional housing market. They should be supported by the establishment of Regional Planning Executives (RPEs) which would be responsible for providing evidence to inform the provision of market housing and investment in social housing in the region. There would be merit in extending the remit of the RPEs to provide the evidence base for the Regional Economic Strategy.

2.20 The Review envisages that the functions of the new Regional Planning Executives would include:

- advising the new Regional Planning and Housing Bodies on the number of additional houses required to achieve the region's market affordability target and the distribution of this housing within the region;
- advising on other aspects of the technical base for the RSS, including economic and transport considerations;
- identifying strategic growth areas within the region, if required, and proposing delivery vehicles with specific powers as necessary;
- establishing strong links with key stakeholders, such as infrastructure providers, the housebuilding industry and English Partnerships;
- monitoring the regional housing market and local authority performance on meeting indicative housing targets and responding to changes in local markets; and
- signalling that a review of regional housing targets was required if the housing market data indicated that the regional market affordability target was unlikely to be met, or if market affordability was improving with an associated risk of increasing vacancy.

2.21 RPEs could be formed in part from the existing secretariats that support the RHBs and RPBs, although it is likely that they will require a wider skill set and that new appointments would be required to guarantee that they have the required analytical skills. This would include a chief executive whose role would be to ensure the evidence for advice was robust, appointed by a public appointments process, rather than by the RPHB.

2.22 It is desirable for RPEs to be strong and independent organisations, providing public advice to the RPHBs. There are several benefits to this. Independent advice would bring greater transparency into the decision making process at regional level and would expose and challenge attitudes to development and housing supply. It would make explicit the trade-offs that were being made with respect to market affordability and land supply. It should also ensure that the evidence for regional housing numbers was not unduly influenced by political considerations and so the need for intervention from the Secretary of State would be limited. The Government should consider what the best reporting structures and governance arrangements should be for the RPEs, to minimise risks of undue political influence.

2.23 The risk associated with this independence is that advice becomes irrelevant. Politicians could distance themselves from and even ignore the technical advice, where they consider it unpalatable. However, on balance, independence is necessary. If politicians choose to ignore advice, that is their right, but the existence of the advice should expose the trade-offs and decision making process to desirable public scrutiny. It would also be more difficult to ignore the advice of the RPE once the market affordability target had been set. Politicians would need to adjust the affordability target in order to meet it.

Recommendation 6

The Regional Planning Bodies and Regional Housing Boards should be merged to create single bodies responsible for managing regional housing markets, delivering the region's affordability target and advising on distributing resources for social housing. These Regional Planning and Housing Bodies (RPHBs) would continue to be responsible for the Regional Spatial Strategy (RSS) and the integration of housing with other regional functions.

These merged bodies should be supported by strong and independent Regional Planning Executives in each region which would be the expert analytical body responsible for:

- providing public advice to the RPHB on housing numbers and allocation of housing within the region in order to achieve the region's market affordability target;
- advising on other technical aspects of the RSS and on investment in social and submarket housing;
- identifying strategic growth areas and the need for special purpose vehicles;
- creating strong links with key stakeholders;
- monitoring the regional housing market and local authority performance on both completions and responsiveness to the market; and
- signalling the need for a review of the RSS where the market was not functioning well and the affordability target was unlikely to be met.

In order to give RPEs sufficient expertise, new appointments would be necessary, including a chief executive appointed through an independent public appointments process.

Guidance to determine housing requirements

2.24 As noted previously approaches to determining the scale and allocation of housing required are inconsistent across regions, and Regional Planning Bodies themselves have expressed a desire for greater guidance. The present methodology is unsatisfactory, in particular, the failure in many cases to use market information and the limited use of economic analysis. A more prescriptive framework would still offer regions significant freedom and flexibility to determine what is right for their regional circumstances.

2.25 A more robust approach to determining housing numbers would mean:

- Setting out a vision and market affordability target for the region that aims to strike the appropriate balance between the social and economic need for housing and environmental considerations, produced by the Regional Planning and Housing Body in consultation with stakeholders and the public.
- Producing a baseline assessment of the regional and sub-regional housing markets produced by the Regional Planning Executive working with local authorities and Local Housing Assessments (LHAs)⁷
- Assessment of the scale of housing development required to meet the RPHBs affordability target for the region, produced by the RPE using an appropriate model to inform the number of houses and trajectory of house building required to achieve the target, but in the context of Local Housing Assessments.

⁷ Local authorities in England develop Local Housing Need Assessments. ODPM are currently working up a new approach to these assessments that will also take account of market indicators and the wider housing market.

- Housing targets should be set as indicative, with the expectation that the actual level of building achieved will vary from the planned target and year-on-year as a result of local land release policies.
- Development of a preferred allocation of housing targets by the RPE (cascaded to local authorities) based on achieving the affordability target.
- Regional Planning Body accepts, modifies or rejects the advice of the RPE and produces a draft RSS. The RPB also sets out the reasons for modifying or rejecting the advice of the RPE and what this means for housing outcomes in the region.

2.26 Government should set out technical guidance on the process and methodology that should be used to determine the scale and allocation of housing within regions, accompanying a revised Planning Policy Guidance for housing (PPG 3). Technical guidance should be based on the need to achieve transparency in the calculations used to determine the housing requirement and the need to achieve consistency in the methods used between regions, in particular, in the approach to translating the affordability target into indicative housing targets. Guidance should also set out the need to integrate market information to inform the distribution of housing requirements and to ensure that decisions about distribution are grounded in a strong evidence base – where the trade-offs agreed to achieve a policy are made explicit.

Recommendation 7

Government should set out technical guidance, accompanying a revised Planning Policy Guidance 3 (Housing), on determining the scale and allocation of housing provision at the regional level to ensure that methodologies reflect a full consideration of the economic, social and environmental costs and benefits of housing at the regional and local level. This guidance should be based on the following principles:

- Transparency over the calculations, assumptions and policies that determine the scale and distribution of housing provision, so that the trade-offs between different outcomes are made explicit.
- Consistency in the approach of different regions to the use of information and to the weight given to different variables, in particular, consistency in the method used to translate the region's affordability target into indicative housing targets across the region.
- Application of market information and signals, including house prices and market affordability in decisions made about the scale and distribution of housing targets.
- Decisions about the scale and distribution of housing numbers that over-ride market information, should be based on sound evidence and should set out the costs associated with the decision.
- Decisions about the scale and distribution of housing numbers should be informed by sub-regional and Local Housing Assessments (which should include analysis of house price growth and affordability, as well as local housing need).

Co-ordinated decision making

2.27 Acquiring the right information for plan-making requires involving the right organisations. The Interim Report⁸ found that organisations with direct responsibility for delivering infrastructure and services were not fully engaged in the planning process at the right time. Often these organisations, such as the Highways Agency, were only alerted to planned developments when a developer submitted an application and therefore any objections meant the development was delayed at a late stage. Had they been involved in the initial planning stages – when the land was allocated – then these problems might have been resolved before developers needed to bring the site forward. Joined-up Government and integrated land use planning is often cited as the solution to many of the difficulties with delivering development.

2.28 Government regulations specify that 70 per cent of the Regional Planning Body (as it currently stands) should be elected representatives. The remaining 30 per cent are other regional representatives (social and economic partners) – unspecified by Government. Important organisations and agencies such as the Highways Agency, Strategic Rail Authority, water and sewerage companies and the Environment Agency are often absent. Although they may be statutory consultees there is no guarantee that they are fully engaged in the regional planning process.

2.29 RPHB membership should include those agencies and organisations responsible for infrastructure and service delivery and investment in social housing. Although this would not be a guarantee that their strategies would adjust to the priorities of the RSS, it would ensure that the RSS is realistic in the transport and infrastructure priorities it identifies. Members of the RPHB should also receive training and skills development to enable them to operate better in a regional planning capacity, and, where necessary, to work in a supra-regional capacity with other RPHBs, for example in the Northern Growth Corridor.

Recommendation 8

Government should set out guidance on the composition of Regional Planning and Housing Bodies. This should include:

- Guidance on training and skills requirements for members of the Regional Planning and Housing Body to enable them to act in a regional (and supra-regional) capacity.
- Guidance on the optimal make up of the non-elected component. Although the ideal make up will differ from region to region, Government should specify the organisations and agencies that should be represented. The review recommends that organisations and agencies responsible for planning and funding infrastructure and services should be on the Regional Planning and Housing Bodies.

⁸ p. 160, *Barker Review Interim Report* (2003).

ALLOCATING LAND FOR DEVELOPMENT

2.30 So far this chapter has considered how the information provided by market signals can better inform decision-making at the regional level, through improved methodologies for setting housing targets and the introduction of mechanisms for analysing affordability. However, if real responsiveness is to be built into the planning system, changes must also take place to the decision-making processes governing the allocation and release of land at the local level.

2.31 One of the striking features of the local planning process is the lack of any reference to price signals. In spite of numerous modifications, the planning system retains many of the mechanisms originally set out in the 1947 Town & Country Planning Act. Indeed, one contribution to the Review described the current structure of land use planning in Britain as “almost certainly the least changed feature of the sweeping changes introduced by the 1945 Attlee government”⁹.

2.32 Box 2.1 outlines one possible means of incorporating price signals into planning decisions, proposed by Paul Cheshire. This model sets out a useful vision and identifies some important principles that have informed the Review’s recommendations. While there are a number of practical obstacles to introducing this particular model at the present time, considerations about land prices should be incorporated into planning decisions alongside the proposed new planning framework.

Box 2.1: Introducing price signals into land use planning decision making

Planning decisions attempt to balance the costs and benefits of development. In particular, they try to reflect the value attached to land and seek to preserve from development land which has a greater value to the wider community in its current state. However, these judgments and decisions are difficult to make. In part, this is because decisions are made without reference to prices. Paul Cheshire of the LSE has set out one way in which the information generated by price signals could be integrated into the planning system¹⁰.

Constraints on land supply have created considerable price differentials between land designated by the planning system for different uses. These ‘price premia’ provide information on the shortage of land for any particular use in a locality. Price premia could become a ‘material consideration’¹¹ and if they exceed a certain threshold there should be a presumption that permission to develop should be granted. The exception would be in cases where the existing amenity or community value of the land was sufficient to show that it is in the public interest to maintain the existing use and refuse development.

By levying impact fees on development which reflect the full costs to the community of any development – including congestion and wider infrastructure costs – the threshold above which a premium would trigger a presumption in favour of development could be set at zero. However, in view of short-run volatility in land markets, conservative practice might suggest such a triggering threshold should be set significantly above zero.

Using price signals in this way would help to distance land availability decisions from the political process.

⁹ Cheshire, P and Sheppard, S. ‘The Introduction of Price Signals into Land Use Planning Decision-making: A proposal’, *Research Papers in Environmental and Spatial Analysis*, No 89, (Department of Geography and Environment, LSE 2004).

¹⁰ Ibid.

2.33 Creating a more flexible housing market requires greater responsiveness at the local level in releasing land for development. More land should be released when market signals indicate that housing shortages and affordability problems are growing. Releasing more land by revisiting the whole plan-making process from scratch would not, however, result in timely outcomes. Instead, local plans should be more realistic in their initial allocation of land, and more flexible in bringing forward additional land for development.

2.34 In allocating land, local plans should be more realistic than at present about sites which are likely to become available and suitable for development. Experience on the ground indicates that an implementation gap opens up between planning and delivery, as not all land allocated for development actually gets developed, often as a result of site-specific problems. At present, some local planning authorities, particularly those in urban areas, under-allocate land as they anticipate windfall sites coming forward to make up the shortfall. However, few local authorities operate the reverse policy of over-allocating land to correct for the proportion of sites that prove undevelopable. As a consequence of this asymmetry, shortfalls occur. In drawing up their plan, individual local authorities should identify their own historic shortfall and allocate an equivalent amount of land to fill this implementation gap.

2.35 Local plans should also be more responsive to changes in demand, bringing forward additional land for development when there is evidence of local housing market disequilibrium. At present, local authorities phase the release of land to meet annual housing targets. Planning applications can be refused when these targets are met, even if there is evidence of strong demand for housing in an area, for example when house prices are rising steeply. By creating a buffer of additional land, areas of high demand would be able to respond to such pressures, and help manage them, by bringing forward land for development.

2.36 In future, the process of allocating land in the local plan would work as follows. As now, local planning authorities would be given a housing target through the regional plan. The local plan would allocate land sufficient to meet this target, including a proportion to correct for any implementation gap. The local plan would then allocate an additional buffer of land. It would be inappropriate to be unduly prescriptive at this stage about the appropriate size of this buffer, but it seems reasonable to assume that an additional 20-40 per cent of land sufficient to meet an authority's housing target would provide enough headroom to respond to signals of market disequilibrium. It is not envisaged that either of these mechanisms would be necessary in those parts of the country where low demand for housing is leading to problems of dereliction, namely the housing market renewal pathfinders.

2.37 The local plan should not distinguish between this buffer of land and the land that would be allocated ordinarily under the current system. Developers should be able to submit applications for any site identified in the plan, subject to the conditions of the revised sequential test being met. Once sufficient land is being developed to meet an authority's housing target, then an authority could, as now, refuse planning permission for further applications. However, if predefined indicators of local housing market disequilibrium were triggered, then authorities would not be able to refuse planning permission for additional applications on the grounds that their target had been met. This would make the planning system more responsive to market signals.

¹¹ A material consideration is a factor which has a significant bearing on the decision by local planning authorities as to whether permission should be granted.

2.38 Again, it would not be appropriate for this Review to be unduly prescriptive about the precise form these triggers should take, nor the level at which they should be set. Government should take forward further analysis in the context of both the market affordability goal outlined in Chapter 1, and the broader package of recommendations set out in this Review. However, there is merit in these triggers being based on the following indicators:

- worsening market affordability for newly-forming households and/or lowest quartile earners;
- local house price increases relative to the regional average;
- an increasing premium in land prices for residential use over other uses;
- employment growth significantly outstripping housing growth; and
- rising numbers of housing transactions.

2.39 Triggers should be sensitive to time lags and the differing circumstances of housing markets across the country. For example, the specific problems posed in those parts of the country where low demand for housing is leading to problems of dereliction could be addressed by setting higher thresholds at which the triggers would come into effect. The new Regional Planning Executives could play an important role in developing an evidence base to be used as a guide to the type of development required, and in advising on setting these triggers.

Recommendation 9

Local plans should be more realistic in their initial allocation of land, and more flexible at bringing forward additional land for development. When allocating land sufficient to meet their housing targets, local authorities should allow for the proportion of sites that prove undevelopable, often as a result of site-specific problems. In drawing up their plan, individual local authorities should identify their own historic shortfall and allocate an equivalent amount of land to fill this implementation gap.

Local authorities should allocate a further buffer of land to improve their plan's responsiveness to changes in demand. Additional land for development would be brought forward from this buffer when there was evidence of local housing market disequilibrium. It would be inappropriate to be unduly prescriptive at this stage about the appropriate size of this buffer, but it seems reasonable to assume that an additional 20-40 per cent of land sufficient to meet an authority's housing target would provide enough headroom to respond to signals of market disequilibrium.

Developers should be able to submit applications for any site allocated in the plan, subject to the conditions of the revised sequential test being met. Once sufficient land is being developed to meet an authority's housing target, then it could, as now, refuse additional applications. However, if predefined indicators of housing market disequilibrium were triggered then authorities would not be able to refuse additional applications on the grounds that their housing targets had been met. These triggers could include:

- worsening market affordability for newly-forming households and/or lowest quartile earners;
- local house price increases relative to the regional average;
- an increasing premium in land prices for residential use over other uses;
- employment growth significantly outstripping housing growth; and
- rising numbers of housing transactions.

The new Regional Planning Executives should play a central role in developing an evidence base and in advising on setting these triggers. Triggers should be sensitive to the differing circumstances of housing markets across the country, including those parts of the country where low demand for housing is leading to problems of dereliction.

Government should revise PPG3 to set out how this process would work.

IDENTIFYING SITES FOR DEVELOPMENT

2.40 Not only should the amount of land allocated be influenced by market signals, so too should its location. While the market price of land does not always reflect its full value to society, there are numerous methods by which such broader values can be revealed. Table 2.1 averages a number of academic studies of contingent valuations to indicate the external benefits that society gains from different land uses. Although the study did not cover all the external benefits or land types, it suggests that development on accessible open land (such as urban parks and land with rights of access) would impose a considerable cost on society. Conversely, building on intensively farmed land would result in far smaller costs. These alternative land values are part of the framework within which the costs and benefits of housebuilding should be assessed.

Table 2.1: Benefits from different land use¹

Land Type	Present benefit (per hectare per year, 2001)	Net present value of future benefits ²
Urban core public space (city park)	£54,000	£10,800,000
Urban fringe greenbelt	£889	£177,800
Urban fringe forested land	£2,700	£540,000
Rural forested land	£6,626	£1,325,200
Agricultural extensive	£3,150	£630,000
Agricultural intensive	£103	£20,600
Natural and semi-natural wetlands	£6,616	£1,323,200

Source: ODPM Appraisal Guidance, *Valuing the External Benefits of Undeveloped Land – A Review of the Economic Literature*.

¹ These values were assessed using contingent valuation methods. This asks a cross-section of people how much they would be willing to pay to maintain a piece of land in its existing use.

² This is the value today of the future benefits from land in different uses. It assumes a rate of return of 3.5 per cent (this is the rate at which future benefits are discounted over time). It also assumes an increase in willingness to pay of 3 per cent (this is the additional amount that people may value land's amenities over time).

2.41 Moving towards an alternative approach, whereby land for development is assessed according to its relative value to society, presents challenges, including the implication that some greenbelt land should be re-designated. The term greenbelt is often conflated with greenfield land. In fact, up to 11 per cent of brownfield land in the UK (over 4,000 hectares) is within greenbelt designations¹². Greenbelt policy was introduced in the 1940s, primarily to prevent urban sprawl; it is not, as often assumed, a designation solely to preserve beautiful and highly valued countryside.

2.42 The general principle of containing urban sprawl through greenbelt designation should be preserved. However, planning authorities should show greater flexibility in using their existing powers to change greenbelt designations where there are strong pressure points in a particular urban area, and where forcing development elsewhere would lead to perverse environmental impacts (through increasing infrastructure requirements, for example)¹³. Any change in the designation of greenbelt land should require a strong evidence base, taking full account of the value that society attaches to different types of land use in an area. The hurdle to overcome before greenbelt land can be re-designated and developed upon should remain a high one. Moreover, such an approach need not lead to an overall reduction in the volume of greenbelt land; any re-designation could be balanced by additional greenbelt designations elsewhere.

Recommendation 10

Planning guidance should be amended to advise regional and local planning authorities on assessing the value of land to society. This would enable planners to take account of the relative values that society places on different types of land use when allocating land in local development frameworks, recognising the inevitable difficulties with interpretation of this data.

The general principle of containing urban sprawl through greenbelt designation should be preserved. However, planning authorities should show greater flexibility in using their existing powers to change greenbelt designations where this would avoid perverse environmental impacts elsewhere. Any change in the designation of greenbelt land should require a strong evidence base, taking full account of the value that society attaches to different types of land use in an area.

¹² National Land Use Database, ODPM.

¹³ Authorities in some of the growth areas, such as Cambridge, Luton and in the Thames Gateway, are currently considering the scope for re-designating greenbelt land in certain defined areas

THE DEVELOPMENT CONTROL PROCESS

2.43 There is no point in the allocation of land being more responsive if the development control process (the process of giving planning permission to specific applications) is not responsive or timely. Development control decisions are often characterised by confrontation; they can also be slow and uncertain.

2.44 There is currently a clear presumption in favour of development which conforms to the local plan in the UK, though that presumption may be defeated if the planning authority consider there to be other material considerations which mean that the application should not be granted. A number of submissions to the Review suggested that the presumption in favour of development should be strengthened. Substantially strengthening the presumption in favour of development would require amending the Town and Country Planning Act 1990, so that local planning authorities must make their decisions in accordance with the development plan unless ‘exceptional’ circumstances indicate otherwise. This would move the UK closer to binding local plans.

Binding local plans

2.45 Binding local plans were suggested by the Government in Budget 2003 as one possible means of speeding up the development process. Binding local plans are used in a number of countries. Box 2.2 illustrates how they operate in the Netherlands. One advantage brought by binding local plans is greater certainty, as once land is allocated in the plan, development control decisions should be taken quickly by planning officers.

Box 2.2: Binding local plans

Most other European countries have legally binding local land use plans. In the Netherlands these are known as Bestemmingsplan and cover all or part of a municipality. All public and statutory consultation over land allocated in the plan is carried out before the plan is adopted. Once the plan is adopted it is legally binding on all parties.

Developers submit applications for land allocated within the plan and these are given a building permit as long as they comply with the plan – there are no material considerations. Building permits are administered by a technical officer (Burgomaster) rather than an elected politician.

Developers may submit applications for developments on land that is not allocated or covered by the plan, but in these cases the plan may have to be revised – which can take around 3 years.

The main advantage with binding local plans is that the principle of development is established once the plan is adopted, and so achieving planning permission is a more certain and quicker process. However, plans take much longer to adopt because of the level of consultation required and are relatively inflexible to changes in the market or other events. Bestemmingsplan are often very prescriptive – setting out the size, design and tenure of houses to be built on certain sites.

2.46 It is not necessarily clear that such a system is any more responsive; indeed the responsiveness of housing supply in the Netherlands appears currently to be lower even than in the UK. The introduction of binding local plans would also constrain flexibility and, consequently, this route is not recommended. It would however, be helpful if future revisions to PPG3 incorporated a clear presumption in favour of granting planning permission for development that conforms to the local plan, particularly where brownfield sites have been allocated.

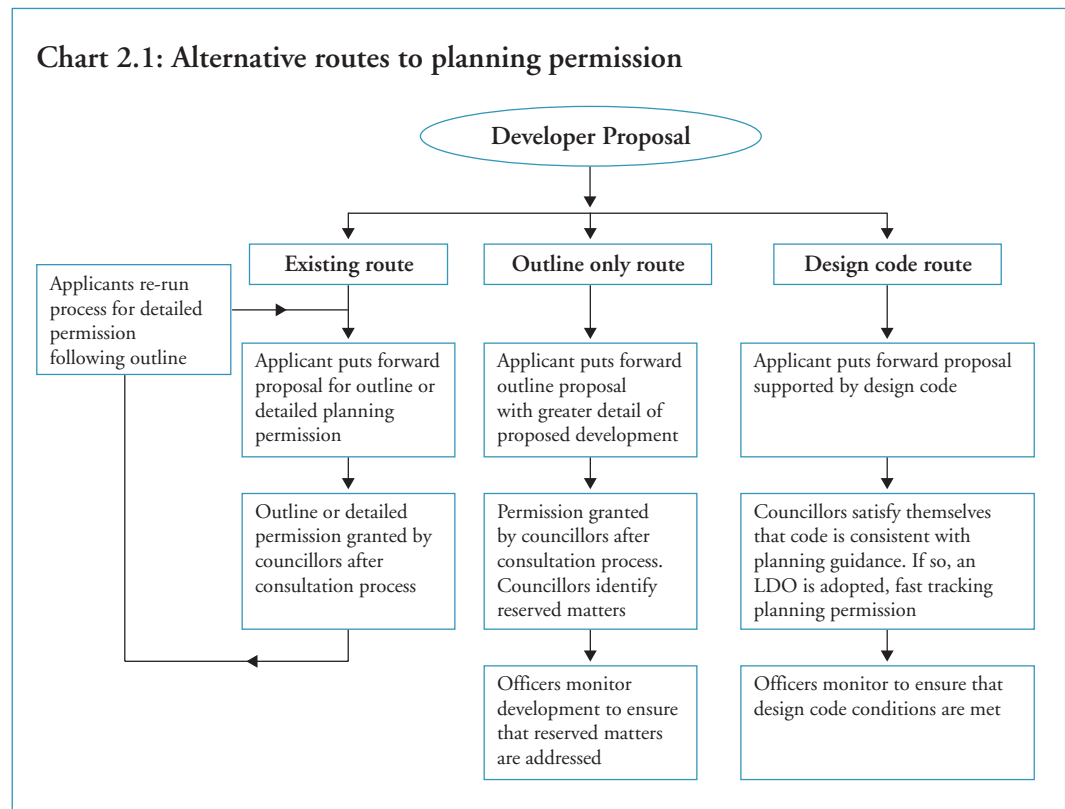
Flexibility in development control

2.47 However, one desirable feature of binding local plans is the front-loading of community consultation that occurs to establish the principle of development. Many of the reforms in the Planning Bill aim to increase community engagement in drawing up local plans. If more consultation and democratic engagement occurs up-front, this should allow individual development decisions to proceed with less dispute. Consultation cannot go on indefinitely and once widespread consultation has informed the Local Development Framework, development should be encouraged to proceed without further undue intervention.

2.48 There is considerable merit in providing alternative routes to the gaining of planning permission. These would:

- reflect the fact that developments differ in size, scope and scale;
- reduce the back-end requirements, thereby streamlining and speeding up the process;
- introduce greater certainty to the planning process by setting out clearly the demands made of developers, councillors, officials and the local community; and
- require housebuilders to take greater responsibility for the quality of development and for the way they engage with both consumers and local communities.

2.49 Chart 2.1 illustrates two alternative routes to planning permission, alongside the existing one.



- 2.50 To provide this choice of routes, planning policy guidance would need to be revised to:
- outline the choice of routes available to developers and the minimum requirements in each case;
 - recommend that councillors should delegate the discharge of certain functions to officers;
 - set out the principles which urban design codes should meet, including clear guidance on community consultation; and
 - provide a mechanism for the use of Local Development Orders to fast-track applications supported by a design code.

2.51 The reforms outlined here should not necessitate changes to primary legislation. However, should it emerge that, in practice, councillors were not delegating to officers as recommended above, legislative change would be necessary. This could be achieved through amending the Town and Country Planning Act 1990 to specify the respective roles of councillors and officers in granting planning permission.

2.52 The emergence of urban design coding offers one attractive mechanism for potentially improving the quality and acceptability of development. As Box 2.3 illustrates, urban design codes have already been used successfully in a number of countries and are beginning to be used in the UK, encouraged by ODPM. This approach and the reforms to the development control process outlined here would help make coding a more attractive prospect for developers, as well as to planning authorities and public development bodies.

Box 2.3: Urban design codes

Urban design codes have been used in the US, Australia and parts of Europe to allow landowners to establish the key features of the design of a new development up front and to then, through legal requirement, require developers looking to build in the area to abide by the code¹⁴.

A code is basically a form of detailed guidance comprising:

- a masterplan of the development area setting out the intended arrangement of spaces and buildings, including massing, orientation, distribution of uses, densities and building lines; and
- a supporting set of written requirements explaining the plan and addressing more detailed issues such as the use of material, landscaping and tenancy. The level of prescription can, naturally, vary from code to code.

In the UK, codes have recently been used by the Prince's Foundation at Poundbury in Dorchester and by English Partnerships at Upton in Northamptonshire, where a series of collaborative design workshops involved a wide range of local stakeholders plus professionals from the planning, property, environment, transport and design worlds.

2.53 By becoming actively involved in urban design coding, developers would send a clear signal that they were prepared to take greater responsibility for the quality of development and for gaining the trust and support of local communities for development in their area. This would pose a significant challenge to the industry, requiring them to demonstrate their commitment to the sustainable communities agenda.

¹⁴ For further information see Commission for Architecture and the Built Environment (CABE), *The use of urban design codes: Building sustainable communities*, (2003).

Recommendation 11

Housing developments differ in their nature. It is not appropriate to apply the same development control process to all developments. The Government should introduce two additional routes for developers to choose between, when applying for planning permission:

- Outline only route – applicants would put forward an outline application which contained more detail than is currently required. Local councillors would grant outline permission, but the granting of outline permission would mark the end of both the formal consultation process and of councillors' involvement. Any outstanding issues or reserved matters would be dealt with by planning officers.
- Design code route – applicants would put forward a proposal for development supported by a design code. Local councillors would satisfy themselves that the code had been drawn up in accordance with planning guidance on both design and community consultation and, if so, would adopt a Local Development Order (LDO) to cover the identified site. This would automatically waive the need for permission to be granted. Planning officers would then monitor to ensure that the conditions set out in the code were met.

To achieve these changes, PPG3 should be revised to:

- outline the choice of routes available to developers and the minimum requirements in each case;
- indicate that councillors should delegate the discharge of certain functions to officials;
- set out the principles which urban design codes should meet, including clear guidance on community consultation; and
- provide a mechanism for the use of LDOs to fast-track applications supported by a design code.

CHANGING PLANNING POLICY GUIDANCE

2.54 Planning policy guidance should encourage responsiveness and flexibility. The Government has already published selected updates to PPG3 for consultation¹⁵. Putting many of the recommendations outlined in this report into practice would require further changes to PPG3.

Recommendation 12

Government should take a rigorous approach to revising PPG3. Future revisions should be grounded in an evidence base and should be subject to scrutiny from a panel of housing and planning stakeholders, including the development industry. Restrictions on development should have an identifiable and evidenced benefit that outweighs their costs.

¹⁵ ODPM *Supporting the delivery of new housing – Proposed change to PPG3: Housing (Consultation paper)*, (2003); and ODPM *Influencing the size, type and affordability of housing – Proposed change to PPG3: Housing (Consultation paper)* (2003).

2.55 National planning policy guidance for housing, as set out in PPG3, lacks some flexibility in that it does not always suit the circumstances in all regions and localities. However, many of the policies set out in PPG3 are challenging and it would not be right to allow local authorities to deviate from these policies simply because it would make their work easier. However, there is a strong case for allowing regions to make applications to the Secretary of State to amend elements of PPG3 as applied to their region and to include this as policy within the Regional Spatial Strategy¹⁶. For example, in some regions the differential in price between 4-bedroom homes and other houses is high, relative to other regions – i.e. this type of housing is disproportionately expensive in some regions. This might support the case in some regions to allow development at lower densities than set out in PPG 3, in order to provide more spacious housing and greater choice and to support a wider labour market. Deviations from national PPG would need to be evidence based and set out in the draft RSS which would need to be agreed with the Secretary of State.

Recommendation 13

Government should allow Regional Spatial Strategies to deviate from PPG 3 where there is clear evidence to support a different approach within the region. While the agreement of the Secretary of State should be essential, it should only be possible for Government to reject an application to deviate on the grounds that the evidence is not strong enough.

2.56 The Interim Report¹⁷ highlighted housebuilder criticisms of Urban Capacity Studies, for identifying sites that were unviable for development, or at least very difficult to develop within a realistic timeframe. There are two ways of addressing this:

- There is substantial support for the re-introduction of Housing Land Availability Studies (the method used in Scotland and Wales) and housing land availability registers that took a wider view of sites available for housing and were produced in close co-operation with the housebuilding industry.
- Second, the sequential test, set out in PPG 3, that requires local authorities to release land for housing development in an order of preference, prioritising brownfield sites, could be refined. The Interim Report noted that whilst it was not the intention of the policy to restrict land supply, some local authorities were over-interpreting it to the detriment of housing being delivered¹⁸.

2.57 In applying the sequential test, local planning authorities should be realistic in considering whether sites are available, suitable and viable. Where it is argued that otherwise sequentially-preferable sites are not appropriate for the particular development proposed, applicants should provide clear evidence why they are not practicable alternatives in terms of:

- Availability: the site is unavailable now and is unlikely to become available for development within a reasonable period of time.
- Suitability: the site is not suitable for the type of development proposed.
- Viability: the site is not viable for the type of development proposed.

¹⁶ The Planning Green Paper (2001) set out Government's intentions for Regional Spatial Strategies including the need for them to reflect regional diversity and specific regional needs, but in practice these RPG/RSSs have tended to re-state national planning policy.

¹⁷ p. 153, *Barker Review Interim Report* (2003).

¹⁸ *Ibid*

2.58 Where a site fails the available, suitable, viable test, this should send a strong signal to local planning authorities that additional public intervention might be necessary to bring forward development on that site in future. Authorities should engage with English Partnerships, or the RDA, to examine the scope for developing public-private partnerships, joint ventures, or area-based special purpose vehicles to overcome the barriers to development. Chapter 3 covers these delivery mechanisms in some depth.

2.59 Amending the sequential test as proposed would mean that local authorities would need to take account of suitability, viability and availability in developing their Urban Capacity Studies. This would address some of the concerns outlined previously and implies that it may be unnecessary to return to Housing Land Availability studies. However, there is merit in local authorities involving, to a greater extent, local housebuilders in drawing up Urban Capacity Studies.

Recommendation 14

PPG3 should be revised to require local planning authorities to be realistic in considering whether sites are available, suitable and viable. Any site which is not available, suitable and viable should be disregarded for the purposes of the sequential test.

2.60 Developments can also be blocked on the basis of prematurity, where a local plan is being prepared or is under review, but has not yet been adopted. This creates an incentive for some local authorities to delay adopting a local plan. The Interim Report highlighted the significant number of local authorities that remain without a plan in place¹⁹. This is deeply unsatisfactory. Refusal on the grounds of prematurity is only appropriate where the proposal is so substantial or the effect so significant that it would predetermine issues being addressed by the plan. Moreover, the weight to be attached to emerging plans depends upon the stage of preparation or review, increasing as successive stages are reached. The revised draft of Planning Policy Statement 1, recently published by Government, clarifies this point.

RESOURCES FOR LOCAL PLANNING

2.61 If local planners are to perform their jobs effectively they must be resourced appropriately. The Government is injecting additional resources into local planning authorities through the Planning Delivery Grant (PDG). £350 million has been made available over three years from 2003 to reward those authorities that have achieved or made significant improvements in their performance in handling development control applications. Extra grant also goes to areas of high housing demand and the growth areas.

2.62 As the PDG has only just been introduced and is currently being evaluated, it would be premature for the Review to make any definitive recommendation as to whether local planning authorities are resourced adequately. Initial feedback from authorities and ODPM suggests that the grant has had a positive impact, with additional resources being used to improve staffing levels and IT capability in many authorities. There are also indications that the grant has had an incentivising effect, with those authorities that previously performed poorly now striving most to meet their targets. However, there remains considerable scope for local planning authorities to improve their performance radically on the speed of determining planning applications, without compromising the quality of their service.

¹⁹ p. 141, Chart 8.5, *Barker Review Interim Report* (2003).

2.63 ODPM is due to publish an evaluation of the PDG later in the spring, which should present a fuller picture. One issue that requires particular attention is the question of whether the grant has introduced a perverse incentive for local planning authorities to reject planning applications in order to meet their performance targets. The Interim Report quoted ODPM-commissioned research that concluded there existed a group of local authorities “whose short term response to this pressure has been to refuse applications and this has led to an increasing number of appeals”²⁰. ODPM indicates that its own initial statistical analysis has been unable to find convincing evidence of such a correlation. Government should assess whether the level of appeals could feed into the distribution of PDG. In any case, it is desirable that in future the PDG should take greater account of outcomes – the delivery of housing, not just the planning processes along the way.

Recommendation 15

Government should assess whether consideration of appeals levels in the distribution of Planning Delivery Grant could help correct the potential perverse incentive for local planning authorities to reject planning applications in order to meet their performance targets. In future, the PDG should take greater account of outcomes, as well as processes.

2.64 Despite additional resources it is clear that planners need to focus their time and resources on more strategic functions. It remains the case that local authorities spend a considerable proportion of their resources on dealing with relatively minor matters such as householder applications. In 2002/03, for example, householder developments accounted for 52 per cent of all decisions²¹.

2.65 There are a number of means by which local authority resources could be freed up to better concentrate on larger, more complex developments. Government should review the scope to increase the range of permitted development rights for householder applications, whereby certain types of development are allowed to proceed without planning permission. In the meantime, local authorities should bear in mind their power to vary these rights, once the Planning Bill has become law, through establishing Local Development Orders. Government should also consider increasing planning fees as a means of providing resources.

2.66 Local planning authorities can also learn from existing best practice in managing large-scale developments. Box 2.4 highlights how some local authorities have responded to the challenges posed by major developments, by forming dedicated project teams, mirroring the developers’ own project team, to bring together the range of public sector stakeholders involved in enabling housing development to go ahead. Similarly, planning authorities should ensure that they use junior technicians on householder applications, freeing up staff with more advanced planning skills for complex developments.

²⁰ ODPM, *Investigating the increasing volume of appeals in England by ARUP* (2003), cited in p. 151, *Barker Review Interim Report* (2003)

²¹ ODPM, *Development Control Statistics, England 2002/03*.

Box 2.4: Good practice – local authority project teams for large scale applications

Some local authorities have responded positively to applications for large scale developments by establishing multi-disciplinary project teams to work with the developer's own project team. The best results have been achieved when these project teams have agreed contracts with the applicant for managing the process – taking an holistic view of the issues involved, including Section 106 and Section 278 agreements, for example.

This approach allows the local authority project team to identify at an earlier stage the main barriers to the delivery of development and, where appropriate, assign responsibilities to organisations to unlock those barriers. The ideal make up of the project team will vary between local authorities and between different sites, however, it might include representatives from the Highways Agency, Environment Agency, housing officers from the local authority and Registered Social Landlords.

The British Property Federation has also launched an initiative (the training module 'Financing the Urban Renaissance') to help councils better understand the finances behind a development.

2.67 For some authorities, applications for large-scale developments are rare and so developing sufficient planning and legal capacity would be inefficient. Consultants may be used in some cases, but the Planning Advisory Service should help overcome capacity constraints by developing a team of "trouble-shooters" who could be called upon by needy local authorities. This may require a small increase in its resources.

Recommendation 16

In order to allow local planning authorities to focus on key development decisions, resources need to be released or strengthened. This could be achieved in a number of ways:

- Government should review the scope to increase the range of permitted development rights for householder applications, whereby certain types of development are allowed to proceed without planning permission.
- In the meantime, local authorities should bear in mind their power to vary these rights, once the Planning Bill has become law, through establishing Local Development Orders.
- Government should also consider increasing planning fees if additional resources are necessary.
- When dealing with large-scale developments, local planning authorities should follow existing best practice and form dedicated project teams, bringing together key public sector stakeholders.
- Where it is not practicable for authorities to develop the capacity necessary to manage large-scale developments, they should have access to additional planning and legal expertise or resources. This could be achieved through the Planning Advisory Service developing a team of 'trouble-shooters'.

3

Delivering development

Summary

- The distributional impact of the costs and benefits of housing growth can militate against sufficient development taking place. The costs of additional houses are typically felt locally, whereas benefits are often more diffuse.
- Reforms to local government financing would help rebalance the incentives facing local authorities, by reflecting better the true costs and benefits of development to society.
- Physical and social infrastructure shortcomings also constrain development, even when planning permission has been granted. Fears of unsustainable pressure on existing infrastructure and services can have a powerful disincentive effect for local authorities and communities.
- The numerous market failures affecting land assembly, land servicing and infrastructure provision make a compelling case for government intervention. Co-ordination between planning authorities and infrastructure providers should be improved, and the roles and powers of existing public bodies clarified. Government should make resources available for infrastructure provision to bring housing development forward.
- Government should be more strategic in its use of area-based special purpose vehicles to deliver housing development. Local and regional authorities should be provided with better guidance on mechanisms for delivering development.
- Section 106 agreements offer a useful mechanism for infrastructure delivery and, in some cases, can act as an incentive for development by allowing local authorities to extract development contributions for the benefit of the wider community.
- Reforming Section 106 would improve its effectiveness and offer greater certainty of operation for developers and local authorities, while retaining its contribution to social housing. However, Section 106 reform needs to be seen in the context of recommendations in the Review, to capture windfall development gains.

INTRODUCTION

3.1 The previous chapter considered the processes and policies by which regional and local plans are drawn up and planning decisions taken. This chapter examines the incentives upon local authorities to support housing growth and assesses policy responses to the market failures that hamper land assembly, land servicing and infrastructure provision. It then considers the role of Section 106 agreements in delivering infrastructure, providing social housing, and incentivising local authorities to support new residential development.

THE COSTS AND BENEFITS OF NEW HOUSING DEVELOPMENT

3.2 As noted in Chapter 1, any national assessment of the economic or welfare benefits of additional housing must necessarily take account of the associated infrastructure and environmental costs. Attempts to assess the merits of housing development at a sub-national level are complicated by the existence of significant mismatches in the associated costs and benefits. This point was discussed in more depth in the Interim Report¹, but in short:

- the pattern of costs and benefits of housing growth at a local level might look very different to that at a sub-regional or regional level;
- the scale and distribution of costs and benefits at a national level might differ substantially to that at either the local or regional level; and
- the impacts of costs and benefits can fall in different time periods in the same locality.

3.3 Put simply, the costs associated with new housing, such as increased pressure on local services and infrastructure, or temporary disruption during construction, are often experienced directly at a local level. For example, the Department for Transport estimate that a typical residential dwelling is likely to generate an additional 8-10 road trips per day². Wider benefits of housing growth, such as greater macroeconomic stability, are much more diffuse and difficult to assess or appreciate at a local level. Greater benefits may also accrue to incoming home owners rather than the existing community. Furthermore, all these costs and benefits can be felt in different periods of time.

3.4 In assessing housing development in their area, local authorities may not take account of the full social costs and benefits of their actions. Decisions as to whether to enable greater housing growth may, therefore, result in an overall under-investment in a desirable social good (in this case housing growth) because social costs are felt more directly than social benefits.

3.5 Local authorities that fail to deliver housing growth may, as a result, impose costs on other authorities, in the form of higher prices overall. This may lead to an increased need for social and affordable housing, or greater housing of families in temporary accommodation. This cost to the public finances is in addition to the loss of welfare for individual house buyers, who face higher prices – and may even be priced out of the market as a result.

Local authority incentive structures

3.6 Giving the regions a central role in planning for growth, as argued for in the previous chapter, is one means of internalising these spatial tensions. Another method is to ensure that the incentives facing local authorities better reflect the true costs and benefits of development, and correct for the externalities that exist, thereby delivering a more socially optimal outcome.

3.7 The Interim Report³ identified a number of shortcomings in the current incentive structures facing local authorities. One such issue relates to the funding relationship between central and local government, a matter currently being considered in the ongoing ‘Balance of Funding Review’⁴.

¹ pp. 137-140, *Barker Review Interim Report* (2003).

² TRICS data (Trip Rate Information Computer System). This is based on two people driving to work and back (4 trips), leisure trips, dropping children at school, going shopping, visitors etc.

³ p. 137, *Barker Review Interim Report* (2003).

⁴ The Government’s Balance of Funding Review is considering the funding relationship between central and local government and options for its reform.

Box 3.1: The effect of additional housing on local authority finances

The Interim Report noted that local government finance mechanisms broadly increase funding levels with population increases. However, this is not always done proportionately. In all local authorities, funding per head of population will decrease slightly as the number of households increase. In two different local authorities modelled by ODPM (A and B) funds decreased (by 0.89 per cent per person in A and 0.92 per cent per person in B) when 1000 extra households were added to local authority funding estimates.

This is not necessarily a problem, because the costs of providing services to people typically decline through economies of scale. However, additional households can create demand for new infrastructure and services that may not be covered by marginal increases in grant.

3.8 In distributing central funds to local authorities, the Government determines the relative spending needs of local authorities, and takes account of the relative ability of local authorities to raise council tax. Each year Government allocates available resources between local authorities by using various indicators of need. This becomes individual local authority Formula Spending Shares (FSS). The Government then assesses the number of houses in a local authority that are equivalent to a Band D property for council tax purposes, and assumes a council tax income on that basis. Local authorities then receive a uniform per capita allocation of business rates. The difference between an authority's FSS and the combined total of assumed council tax income and national business rates is made up through the Revenue Support Grant (RSG).

3.9 In calculating FSS (the relative spending need of local authorities), the government uses several sources, including demographic data from the Census, local education authority school-roll returns, and indices of deprivation to indicate both the size of the population in an area as well as its need for local services. Importantly, these data sources are typically backward-looking, in that they indicate the local situation as it was when data was collected. This inevitably creates a lag, as it takes a number of years for the input data to reflect the current state of the population and to be subsequently accounted for in a revised RSG.

3.10 Such an approach disadvantages local authorities that experience rapid housing growth. Within a relatively short space of time, homes may be built, new residents moved in and local services consumed, yet FSS (and the related changes to the RSG grant) will take longer to reflect these population changes. Such funding mismatches between the actual population in an area and the officially assumed population may be particularly acute where new households pose high demands on local services. For example, the construction of a large amount of sheltered housing for the elderly could have a significant effect on the level of service demand in a local authority area.

3.11 This issue can be compounded by the use of 'floors' and 'ceilings', in the local government finance system. Floors and ceilings are national minimum and maximum limits to how much the grant allocations for each local authority are allowed to change (in percentage terms) from one year to the next, and act to reduce the volatility of year-on-year grant levels for individual authorities. However, while fulfilling this important role, ceilings can act to hold back a proportion of the grant increases that would otherwise go to fast growing authorities.

3.12 Making local authority funding more responsive to expected population growth would go some way towards ensuring that new housing development does not constitute a potential financial burden for local authorities. The present incentive structure works to exacerbate externality problems, by making authorities experiencing rapid housing growth bear costs that do not relate to the benefits their extra housing brings to society. Changes to incentives structures should go some way to ameliorating these issues.

Recommendation 17

Central government funding settlements for local authorities should be made more forward-looking. The Government should include in its calculations of Formula Spending Shares a variable to reflect expected housing growth in an area, drawing on housing targets set by the reformed regional planning process.

Further incentives for growth

3.13 The Government has recently consulted on plans to introduce a Local Authority Business Growth Incentive scheme. This scheme aims to encourage local authorities to be proactive in creating a business-friendly environment in their locality, by rewarding them with a share of the local business rates they collect above a certain level. At present, revenue from business rates is distributed between local authorities in a uniform manner.

3.14 By varying the sum local authorities can receive, such a scheme changes the incentives they face when considering business growth strategies, and encourages efforts to deliver business rate growth. It also helps correct for an externality – local authorities may value business rate receipts at less than their true social value, as they receive little of the benefit from increased revenues.

3.15 Such a modification of incentives is also appropriate in relation to housing growth. Providing local authorities with a positive incentive to meet their regionally determined housing targets would help to change behaviour in local planning decision making. This approach would also help meet the transitional costs associated with new housing in a local authority, at least until the RSG settlement catches up to reflect population change.

Recommendation 18

Building on the broadly positive response to its Local Authority Business Growth Incentive proposal, the Government should consider ways of incentivising local authorities to meet housing growth targets.

One way would be to disregard, for a period of possibly up to three years, some or all of the council tax receipts generated by new housing from the calculation of a local authority's grant allocation. This additional revenue should not be ring-fenced.

INFRASTRUCTURE, LAND ASSEMBLY AND SERVICING

3.16 Physical and social infrastructure issues can have a significant impact on local authority and community attitudes to development. Fears of unsustainable pressure on existing infrastructure, or uncertainty that capacity will be expanded adequately in future, will act as a disincentive for development for local authorities. Efficient methods for ensuring that adequate infrastructure is in place will help overcome local authority disincentives for further housing growth.

3.17 However, attempts to assemble and service land so that development can go ahead can be affected by a range of market failures, even when planning permission has been gained. Correcting for these market failures necessitates government intervention in a number of forms, and at a number of spatial levels.

3.18 Significant market failures that constitute real barriers to development include:

- Externalities: sometimes the social costs and benefits of an action diverge from the private costs and benefits. If the social benefits of an investment are greater than the private benefits, the market will under-invest from society's point of view (for example, development of land which is contaminated or derelict might prove more costly than for alternative sites, but result in large positive spillover effects for surrounding areas). Conversely, some development can impose external costs on others, through traffic congestion, or the loss of amenity land.
- Co-ordination failures: individual private and public sector organisations may not be able to co-ordinate their actions effectively, giving rise to sub-optimal outcomes. For example, if housing developers are to make a return on their investment they need certainty that infrastructure and other local sites will be developed in a complementary way (that schooling provision will be expanded, for example). Similar issues are important in land assembly, where the systematic acquisition of connected sites can mean that a single landowner could hold a development to ransom.
- Information failure: housebuilders and landowners may have imperfect information on the quality or price of properties and land in the market. For example, some brownfield sites may represent a sound investment opportunity, while others may not, and the uncertainty surrounding some sites may affect market assessments of the viability of all sites. Accurate information may be prohibitively costly for potential developers and investors to acquire.

3.19 In addition to these market failures, there may also be cases where government intervention is justified by reference to social and/or equity objectives, such as the encouragement of jobs in deprived areas or the provision of affordable housing for poorer groups in high demand areas (see Chapter 5 in particular).

3.20 Market failures are often at their most apparent when developers and local authorities assess the difficulties associated with development on brownfield land. Box 3.2 highlights some of the barriers that exist.

Box 3.2: Challenges facing brownfield development

Residential development on greenfield sites is generally more straightforward than on brownfield. Greenfield land is usually in single ownership, does not require decontamination or remediation, and site logistics are usually straightforward.

In contrast, using previously developed land for residential build offers particular challenges. The Interim Report identified a number of barriers to brownfield development, including:

- higher costs of land assembly due to multiple ownership of sites;
- additional costs of decontamination and remediation, as well as increased construction costs due to on-site logistical constraints;
- high alternative or existing use values that may prevent land coming forward for residential development;
- the location of brownfield land may not be consistent with current patterns of housing demand; and
- regulatory constraints, such as greenbelt designations, which can prevent the release of brownfield land for development.

While the difficulties associated with land assembly and servicing may favour the development of greenfield land, society tends to place greater value on such land; Table 2.1 shows that certain types of greenfield land can command very high estimated values.

While greenfield land may be easier to build on, such sites can require greater infrastructure provision in comparison to brownfield, which can often utilise existing facilities. Consequently, when assessing the costs and benefits of greenfield versus brownfield development, there are also important infrastructure considerations to bear in mind.

3.21 More generally, the Review was presented with evidence of numerous sites where development was constrained by infrastructure shortcomings. The Interim Report presented a figure of some 40,000 housing completions being held up by infrastructure problems in the South East alone⁵, while the House Builders Federation has suggested that over 20,000 homes are similarly delayed in Wales. The challenges this poses for the public sector are typified in two site-specific examples presented to the Review and set out in Box 3.3 below.

Box 3.3: Overcoming infrastructure constraints

Imperial Wharf, London – planning permission for the second phase of Imperial Wharf, a mixed-use development with 1,665 homes, was delayed while the developer negotiated with the Strategic Rail Authority over the provision of a new station to address transport constraints faced by the site. Negotiations lasting five years were finally completed in 2003, with agreement that a new station, adjacent to the site on an existing West London rail line, would be funded by the developer.

Ashford, Kent – large housing sites identified in Ashford, one of the four growth areas in the Sustainable Communities Plan, have been delayed by the need to find a funding solution to carry out improvements to Junctions 10 and 10a on the M20, that are necessary to allow access to the sites and prevent congestion on existing roads. The efforts of public agencies to co-ordinate private developers, and partially to fund these improvements, have helped to ensure that the necessary road improvement work will go ahead, enabling residential development to take place. However, housing development cannot come forward until the works are completed, estimated to be 2010.

⁵ p. 160, *Barker Review Interim Report* (2003).

DELIVERING INFRASTRUCTURE MORE EFFECTIVELY

3.22 Building sufficient housing requires partnership and co-operation between a variety of public bodies and service providers. Agencies involved in infrastructure provision cover both public and private sectors, ranging from those dealing with physical infrastructure, such as the Highways Agency and utilities companies, to those agencies that provide equally important social infrastructure, such as local education authorities, primary care trusts and police authorities.

3.23 The Interim Report noted that at present many public service providers – and indeed some private sector infrastructure suppliers – concentrate their efforts and resources primarily on meeting the needs of the existing population, and do not necessarily plan for future population growth as a matter of course⁶. If the growth scenarios set out in this Review are to be met, the principle of planning for housing growth, as required, needs to be ingrained into the strategies of key public service delivery agencies.

Recommendation 19

All Government Departments and agencies should assess the demands implied by the Government's housing targets in their spatial planning and funding decisions. Departments' contributions to meeting ODPM's housing targets should be recognised within their own priorities, including Public Service Agreements.

The Ministerial Committee on housing and growth issues across the wider South East (MISC22), chaired by the Prime Minister, should be expanded to cover housing delivery in general, and be used to facilitate cross-Departmental co-operation.

Those Departments with responsibility for allocating funds for infrastructure development, such as the Department for Transport, the Department of Health and the Department for Education and Skills, should take account of planned housing and population growth in making spatial allocations.

3.24 As well as focusing service providers on the demands posed by housing growth, practical steps should be taken to involve from the outset, all relevant parties in strategic housing decision-making. This will help avoid unnecessary disputes and delays at later points in the development process, when time and money – both public and private – have already been committed to a project.

⁶ pp. 160-161, *Barker Review Interim Report* (2003).

Recommendation 20

To minimise delays to development, infrastructure providers, such as the Highways Agency and water companies, should be involved from an early stage in developing both the regional spatial strategy and the local development plan:

- As part of the work involved in drawing up the local and regional plan, providers should be as clear as possible about the sort of infrastructure improvements that would be required. Having been involved in the drawing up of the local and regional plan, providers should reflect the outcome in their operations as far as possible. They should not seek to block applications for planning permission compliant with local and regional plans, unless compelling changes in the situation – for example a failure to agree a Section 278 agreement – justify a different approach.
- An infrastructure provider's objection to a development should only be allowed to block the granting of planning permission if the benefits of the new development are clearly outweighed by the costs in infrastructure terms. Where infrastructure providers, such as the Highways Agency, have powers to direct refusal of planning permission, they should only exercise their powers in this way. Government should commit itself to only using these powers under the same restraint.
- To help mitigate the impact of infrastructure costs on developers' cash flow, the Highways Agency should allow developers to begin building houses in parallel to road construction, even where the implications for congestion are such as to rule out allowing occupation until construction is complete.
- Ofgem and Ofwat should develop and publish guidance on establishing a fair price for developer charges for extensions or alterations to energy, water and sewerage networks required for new housing development. Where feasible, this should be achieved through promoting competition. In the absence of effective competition, water and energy network providers should advertise and exhibit a development-servicing plan, describing the area covered and assets used, and describing the basis on which a developer charge has been calculated.

3.25 Given the scale of the challenges set out in the growth scenarios at the beginning of this report, there is clearly a leadership role for the public sector in enabling development on the ground. The following sections concentrate on:

- setting out the scope for the public sector to take the lead in land assembly and servicing;
- identifying how additional resources could be provided to overcome market failures in delivering housing development; and
- highlighting the potential for existing public and private delivery vehicles to be used to secure development.

The role of the public sector in enabling development

3.26 One way in which Government can intervene to tackle the problems posed by externalities, co-ordination failures and information failures is to task and empower public bodies to take a lead role in enabling development. English Partnerships (EP), the Government's regeneration agency for England, is playing an essential role in identifying brownfield sites suitable for development, and in working with public bodies, such as local authorities and Regional Development Agencies (RDAs), in assembling and masterplanning sites, remediating land, and then servicing it by putting in place the necessary infrastructure⁷.

3.27 Increasingly, EP is entering into joint ventures with the private sector to share expertise, experience and risk in developing brownfield land. EP is also helping solve co-ordination problems by linking with local authorities and using its compulsory purchase powers on large brownfield sites where land ownership is fragmented and complex. In these ways, EP can help make brownfield development more attractive to developers, while potentially capturing some of the uplift in value for the public sector. One such innovative joint venture is set out in Box 3.4.

Box 3.4: Barking Reach: an English Partnerships joint venture

EP and Bellway Homes have come together to form an innovative joint venture company for the development of Barking Reach, a 150 hectare brownfield site in the Thames Gateway. Proposals currently being drawn up by the Dutch project masterplanners, Maxwan, will create a sustainable community of over 10,000 new mixed tenure homes, to be developed over 15 years. In addition, major transport improvements, community facilities, new schools and employment opportunities will be created. EP and Bellway will share investment costs and jointly prepare the land for regeneration. Bellway will act as developer for many of the new homes on site and will act as project manager for the infrastructure works.

3.28 While the Review found widespread support for, and recognition of, EP's role in enabling brownfield development to take place, concern was expressed by a number of private sector developers about whether EP was going beyond its remit and taking on a lead role in developing sites where the private sector could itself deliver. One example cited was in Bracknell, where EP had acquired the site of a former Ministry of Defence staff college in the face of competition from private developers. The main justification used in this instance was that EP would deliver a more socially optimal solution than the market, with higher densities and more affordable housing.

3.29 In the interest of smoothly functioning land and property markets it would be desirable if there was greater certainty as to the principles by which EP would, or would not, intervene and on the ways in which EP would seek to engage with the private sector. While acknowledging EP's considerable achievements in regenerating difficult brownfield sites and in helping deliver the Sustainable Communities⁸ agenda, there are legitimate concerns about the potential for EP to crowd out private sector activity, and to stunt the development of new markets, such as for land intermediaries.

⁷ Broadly similar roles are played by the Welsh Development Agency, Scottish Enterprise, and Communities Scotland in supporting the work of the Welsh Assembly and Scottish Executive respectively.

⁸ Outlined in more detail in ODP, *Sustainable Communities: Building for the Future* (2003).

Box 3.5: Private sector land intermediaries

The Interim Report highlighted the relative absence of specialist private sector land intermediary companies in this country, compared to other countries such as the US. One company that is active in this field in the UK is the Midlands based Cofton Ltd., which provides serviced land for housebuilders and other end-users via the acquisition of larger, more complex development sites. The company does not build houses; instead it uses its land management and civil engineering expertise to decontaminate land and deliver a range of infrastructure needs and planning obligations – from roads and utilities through to community centres and schools.

3.30 Decisions about the appropriate boundaries of EP's role should be made in the context of the broader package of recommendations set out in this Review. Government's objectives in this area can also be achieved through reforms to planning, taxation, incentives for development, and public spending on social housing. In any outcome, there remains a central need for the public sector to access private sector capital and expertise, Government should promote this by tasking EP with encouraging greater private sector competition in delivering development, promoting initiatives such as urban design coding, and continuing to develop innovative partnership arrangements with private sector developers and RDAs.

Recommendation 21

English Partnerships (EP) should have a lead role in delivering development through partnering with public and private sector bodies in assembling complex sites, masterplanning, remediating land and developing supporting infrastructure. At the same time, Government should provide greater certainty as to the principles by which EP would, or would not, intervene, so as to avoid crowding out private sector activity, or stunting the development of new markets.

Devolved administrations may wish to assess the roles of their own housing and regeneration agencies in the context of this Review's recommendations.

Additional support for infrastructure

3.31 Greater co-ordination and partnership between public and private sector bodies will facilitate more effective development. However, some developments, such as those on large strategic sites with major infrastructure needs, may require additional forms of government intervention if development is to be brought forward. The Government has already committed some £2.7 billion in funding for major transport schemes in the growth areas for exactly these reasons.

3.32 As a condition for receiving planning permission, developers are usually required to pay an upfront contribution to fund infrastructure costs, under either Section 106 of the Town and Country Planning Act 1990, or Section 278 of the Highways Act 1980. This can help internalise some of the negative externalities associated with new housing development, such as increased congestion. However, this approach may create or exacerbate other market failures, and thereby serve as a barrier to new development. In particular:

- Infrastructure required to service one development can also benefit future housing developments, or indeed the existing community. Any developer making the first move faces the risk of subsequent developments free-riding on its efforts. In other words, there are positive externalities associated with some infrastructure.
- The costs of funding infrastructure can increase site-specific risk, by adding to negative cash flow early on in development. This prevents some sites from being developed, particularly if other risks and upfront costs are already a factor, as is often the case with brownfield sites.

3.33 In these circumstances, public sector intervention may take the form of ‘gap funding’, whereby a relatively small amount of up-front public money levers-in and facilitates substantially greater private investment, thereby allowing development to proceed. The public sector, whether in the shape of EP, the RDAs, or even local authorities, can play a role in co-ordinating development through paying for certain up-front costs, and then reclaiming these once developers begin to realise a return on their investment. One mechanism through which this might be done is outlined in Box 3.6.

Box 3.6: The ringmaster approach to gap funding

One gap funding mechanism that has recently been used to pay for improvements to the trunk road network is the ‘ringmaster’ approach. This involves a third party acquiring land for development – including any land needed for Highways Agency road improvements – then entering into a Section 278 agreement with the Highways Agency and providing the up-front funding. The costs are then recouped from developers as the land is sold off for development.

For example, Derbyshire County Council is acting as ringmaster for the Markham Employment Growth Zone (the former Markham Colliery site), which includes a new junction onto the M1 between junctions 29 and 30, together with local road improvements between the A632 and A619. The cost of the motorway junction and link road is estimated at £21.5 million and will act as the gateway to the site. The site is designed to provide local employment, recycle brownfield land and regenerate the area.

3.34 Government should make resources available to support public-private partnerships that help bring development forward through building essential infrastructure. Government should also do more to improve local and regional authorities’ awareness and understanding of the various forms of partnership that may be of benefit to them in delivering development.

Recommendation 22

A Community Infrastructure Fund (CIF) of £100-200 million should be established within ODPM. Regions should be encouraged to submit bids for support towards the up-front costs of medium-sized utilities and transport infrastructure schemes, which would bring forward otherwise unviable development. Bids for support towards gap funding schemes, such as the ringmaster approach for transport infrastructure, should be particularly welcome. In these instances, Government should seek to operate clawback mechanisms where this is practicable.

To enable local and regional authorities to maximise the impact of the CIF by leveraging in private sector capital, ODPM should publish a delivering development toolkit to provide guidance for local and regional authorities seeking to access the fund. Drawing on experience in the growth areas and elsewhere, this would provide practical guidance on:

- models for partnership between the public and private sector;
- ways in which the public sector input into new developments can be co-ordinated; and
- options for recovering the up-front costs of gap funding from subsequent developments.

Using special purpose vehicles to deliver development

3.35 In addition to the increased use of public-private partnerships and joint ventures to enable development, area-based special purpose *public* vehicles that concentrate planning powers, resources and expertise can also help overcome the co-ordination and information failures that hold back housing development.

3.36 A wide variety of area-based statutory and non-statutory partnerships can already be established under existing provisions, each with varying degrees of power over masterplanning, development control and land assembly. These include:

- New Town Development Corporations (NTDCs);
- Urban Development Corporations (UDCs);
- Urban Regeneration Companies (URCs); and
- Local Limited Liability Partnerships (LLLPs).

In addition, the Planning and Compulsory Purchase Bill contains provisions for Simplified Planning Zones (SPZs) and Local Development Orders (LDOs) to facilitate strategic growth points. Given this diversity, the Review does not seek to recommend the creation of additional delivery vehicles.

3.37 Rather, the challenge for government, whether central, regional or local, is to be smarter and more strategic in its use of special purpose vehicles to co-ordinate housing delivery. Where obstacles to development can be overcome straightforwardly through improved joint-working, LLLPs, URCs and LDOs have an important role to play and should be utilised. Alternatively, where large sites face multiple problems of viability, cross-authority development and land assembly, then UDCs are often the most appropriate and effective mechanism for ensuring that development takes place, and should be adopted, as has happened recently in the Thames Gateway.

3.38 There may also be a greater role for New Towns in delivering additional housing and the infrastructure necessary to support it. Forthcoming research for the Joseph Rowntree Foundation suggests that New Towns, used in combination with other development options, can command greater popular support. Survey data from the research indicates that the option of concentrating growth in New Towns of over 20,000 homes was the most preferred option for development, narrowly ahead of either densifying, or expanding, existing urban areas. Options that concentrated growth in existing villages or small new settlements of 2-4,000 homes met with strong dislike⁹.

3.39 People appear far more favourable to development when it is underpinned by supporting infrastructure, and one of the best ways of ensuring this is through large-scale planned development. If planners can engage with communities and convince them that lessons have been learned from the UK's variable experience of large planned development in the past, then New Towns could play a major role in delivering housing growth and building the sustainable communities of tomorrow.

3.40 Finally, local authorities and RDAs should show greater willingness to bring forward development by using either their own Compulsory Purchase Order (CPO) powers, or engaging with English Partnerships to use their CPO powers, where this is more appropriate. The new CPO provisions in the Planning and Compulsory Purchase Bill should assist in this respect, and their passage into law should be used to promote a wider understanding of the use of compulsory purchase powers.

Recommendation 23

Central and regional government should be more strategic in its use of area-based special purpose vehicles to deliver housing development. Where problems of land acquisition, servicing and infrastructure provision are identified through the regional planning process, Government should engage with English Partnerships to identify the most appropriate vehicle for delivering development. Greater use should be made of both UDCs and New Towns, taking advantage of their ability to deliver both additional housing and the infrastructure necessary to support it.

New guidance on the circumstances to which different vehicles are most suited, and on using compulsory purchase powers, should be included in the proposed delivering development toolkit.

3.41 If Government chooses to pursue the high growth scenarios set out in this Review, then the scale of development required would necessitate significantly greater use of those vehicles with strong planning and land assembly powers, such as UDCs and New Towns. This would pose additional cost implications for government that would need to be considered; for example, the annual running costs of Thurrock UDC are estimated at £2 million per annum.

⁹ Platt, S., Fawcett, W., and de Carteret, R., *Housing futures – informed public opinion* (Joseph Rowntree Foundation, 2004). The survey asked 1,428 people living in the South East how much they liked or disliked various planning options for development.

SECTION 106, INCENTIVES AND INFRASTRUCTURE

3.42 Section 106 offers opportunities for local authorities to obtain vital infrastructure necessary to enable developments to go ahead, as well as providing local authorities and communities with an incentive for development.

Section 106 and infrastructure

3.43 Section 106 agreements between developers and local authorities can be used to enable proposals which might otherwise be refused to go ahead and help ensure that local residents are no worse off following residential development, by requiring developers to contribute towards mitigating the impact of development.

3.44 This can mean the developer providing a range of facilities. The Interim Report noted that this might often include items such as highways contributions, community facilities, landscaping and open space¹⁰. In addition, and following guidance issued in 1998, Section 106 agreements now also typically involve a clause for the provision of affordable and/or social housing by the developer. These contributions have grown to be an important source of additions to the social and affordable housing stock.

Box 3.7: Planning obligation and sub-market and social housing

Circular 6/98 provides local authorities with supplementary guidance to Planning Policy Guidance 3 (Housing) on sub-market and social housing provision for residential developments that meet certain criteria, primarily related to size.

Where local authorities identify a need for sub-market or social housing in their area, they should set out in the local plan a policy for seeking sufficient sub-market housing on certain developments. Approximately 12,500 such units were constructed through this route in 2002/3, and sold at below market value to local authorities and Registered Social Landlords.

As well as national guidance, there also exists specific guidance for certain areas. For example, the Mayor of London has recently recommended that at least half of all new dwellings built in London should be sub-market.

Section 106 and local authority incentives

3.45 Over time, Section 106 has evolved through case law, so that the scope of development contributions has, in practice, been extended beyond strict 'necessity'. For major housing developments, Section 106, as it currently stands, offers the local authority the prospect of obtaining planning contributions over and above those strictly required to mitigate the impact of development.

3.46 Section 106 has, therefore, come to offer a possible method of allowing local authorities to share in development gain – that is, access some of the windfall gains that accrue to landowners from selling land for residential development. By changing the relative costs and benefits of development, this can have the effect of addressing the externalities facing local authorities when deciding on housing growth.

¹⁰ p. 141, *Barker Review Interim Report* (2003).

3.47 The proposition that Section 106 allows for development gain appropriation, is supported by evidence of the behaviour of land prices. Residential land values, as measured by the Valuation Office Agency, now usually include a ‘Section 106 charge’ typical for the area and are thus lower than they would otherwise be (see Chapter 4 for more information on land markets and their interaction with development costs). Therefore, although intended as a mitigation measure, Section 106 offers local authorities a mechanism for sharing development gain more widely.

3.48 However, the Interim Report noted the problems surrounding the incentivising and value capture effects of Section 106 in practice¹¹:

- the value of contributions achieved varies considerably between areas, and even between sites, in the same housing market locality;
- Section 106 agreements are mostly attached to major housing schemes and many authorities will deal with applications of this scale relatively infrequently;
- negotiations can take many months, occasionally years, and are costly in both local authority and developer time and resources;
- there may be asymmetries in negotiating expertise between the two parties, leading to unsatisfactory outcomes;
- local authorities are not always aware of the level of planning contributions that might reasonably be expected in a given development, due to the non-transparent nature of the system; and
- some local authorities may misuse Section 106 to delay or discourage development, by asking for unreasonably onerous levels of developer contributions.

3.49 All these factors will combine to reduce the potential infrastructure and incentive effect of Section 106, by making it more difficult and costly for local authorities to secure appropriate developer contributions.

Infrastructure, incentives and Section 106 reform

3.50 Local authority incentives for housing development, and the infrastructure necessary to facilitate it, are clearly essential if housing supply is to be increased. However, as discussed above, Section 106 in its current form does not offer the best method for achieving these aims.

3.51 Current Government policy, as outlined in the recent consultation on planning obligation reform and the proposed optional planning charge, is already moving in the direction of greater certainty and clarity. Proposals consulted upon would provide developers with the option of paying a set charge in place of entering a negotiated agreement.

3.52 However, the Review has considered an alternative which develops the principals behind the Government’s proposals. Section 106 should be scaled back to cover direct impacts and mitigation along with affordable and social housing requirements.

¹¹ p. 141, *Barker Review Interim Report* (2003).

3.53 Safeguarding social and affordable housing contributions is important given the useful additions to the stock that Section 106 provides, as noted above, and the need to deliver mixed communities. Section 106 sub-market (including social) housing contributions offer particular potential in areas of high demand and high land prices, where local authorities or Registered Social Landlords would find it hard to purchase land themselves on the open market.

3.54 Such reform is dependent upon Government accepting the recommendations on fiscal instruments to capture development gain set out in Chapter 4. These changes could increase incentives for housing growth for local authorities and provide a funding stream, allowing infrastructure blockages to be addressed.

Recommendation 24

Section 106 should be reformed to increase the certainty surrounding the process and to reduce negotiation costs for both local authorities and developers.

If the Government accepts the recommendations outlined in Chapter 4 concerning the capture of development gains:

- Section 106 should be 'scaled back' to the aim of direct impact mitigation and should not allow local authorities to extract development gain over and above this, except as indicated below. ODPM should issue guidance, or new legislation, to this end.
- Section 106 should retain its current affordable and/or social housing requirements as set out in Circular 6/98, and other specific regional guidance.
- Local authorities should receive a direct share of the development gain generated by the Planning-gain Supplement in their area, to compensate for a reduced Section 106. Local authorities should be free to spend this money as they see fit. This share should at least broadly equal estimates of the amount local authorities are currently able to extract from Section 106 agreements.

If the Government decides to maintain the current fiscal framework as it is, then it should press ahead with the Section 106 reforms, on which it has recently consulted, that aim to introduce an optional planning charge in place of a negotiated agreement. However, this would be second best and leaves open the possibility of prolonged and costly Section 106 negotiations for large developments.

4

Contributing to development

Summary

- The Review has considered various fiscal measures that might have an impact on housing supply.
- Taxing land values to raise the cost of not bringing land forward for development is unlikely to yield additional residential land supply given the effect of the planning system in both determining land values and restricting the use to which land can be put.
- Tax measures could be used to affect developer behaviour by altering the relative costs of certain development choices to better reflect the externalities, for example by encouraging brownfield development.
- However, given the low price elasticities of demand and supply in land markets, tax measures are unlikely to yield large behavioural effects and planning remains the best method of resolving externality problems and affecting developer behaviour.
- As noted in the Interim Report, land and housing markets involve the generation of (often substantial) economic rents. Given that tax measures are unlikely to affect behaviour in land markets, they can have a powerful role in capturing economic rents for the wider community with relatively little distortional impact.
- Government should actively pursue measures to share in windfall development gains accruing to landowners so that increases in land values can benefit the community more widely. Capturing part of these values will provide a funding stream for a number of other policies that will support increasing housing supply.
- There are several options for capturing such windfall development gains including: development gains taxes, changes to the VAT regime and a system of developer contributions levied at the granting of planning permission.
- The Review has considered these, and believes the Government should consider the granting of planning permission as a suitable point in the development chain in which to levy a charge based on local land prices that aims to capture part of the windfall development gain. Given the structure of the land and housing market, such a move would allow the cost of the contribution to fall largely on the landowner and avoid impacting on house prices.
- It is generally true that taxation of anything tends to reduce its supply – however in the case of land, it is the restrictions of the planning system that are the main constraints on land use for housing. The effect of the package of measures in the Review as a whole is expected to increase supply.

INTRODUCTION

4.1 The Interim Report considered the influence that various policy levers might have on the supply of houses, noting that a number of taxes impacted on housing and land market decision making. In the case of tax measures as an economic instrument, there are a number of possible objectives they might have in relation to housing:

- They can influence developer behaviour by altering the costs and benefits of particular choices. This could have the effect of promoting environmental goals, for example, by discouraging some types of development and encouraging others.
- Taxes can extract economic ‘rents’ – the unearned windfall that accrues to landowners when land is designated for residential use. This has primarily been the rationale for development and land taxes in the past. Capturing this ‘development gain’ could, in principle, allow it to be used to deliver the benefits of development to the wider community and support other housing policies.
- The supply of land could be stimulated by using tax to raise the ‘opportunity costs’ of holding land in order to compensate for the wider costs of not using suitable land for development, which are borne by society at large.

4.2 As the Interim Report noted, it is important to remember that government interventions in markets typically involve trade-offs between competing objectives. It is often the case that even the best designed market intervention will be unable to achieve all desirable outcomes. Similarly, with the tax measures considered by the Review, there is no one fiscal instrument that could achieve all the potentially desirable objectives described above.

4.3 It is rightly assumed that, in general, taxation of any activity, good or service tends to reduce its supply, all things being equal. Therefore, the use of tax measures in relation to the development of land and housing could reduce the supply of both.

4.4 That said, there are two justifications for the Review proposing tax measures in relation to housing supply:

- Tax policies are part of a package of reforms and should not be looked at in isolation. Combined with policies to promote the supply of land, planning permissions and affordable housing, the result should be an increase in the amount of new housing overall, compared to a situation with no tax. Indeed, many of these policies might not be possible without additional revenue to recycle.
- If Government is to reform the planning system to bring forward more land for development, it will increase the potential for unearned windfall development gains that can be made by landowners (including developers) from selling land for residential use. Consequently, there is a strong case for Government to consider the use of tax measures to allow the community to share in the increase in development gains its actions will create.

TAX AS AN ECONOMIC INSTRUMENT

4.5 As discussed in the Interim Report, policy instruments to correct market failures, such as subsidies, regulation or fiscal measures, can often be interchangeable. Following this, rather than use regulation to deal with externalities (the uncompensated costs or benefits of an action imposed by one person on another) it is often preferable to use the price mechanism. This can be for a number of reasons:

- Economic instruments affecting the price mechanism allow for the internalisation of external costs, in line with the ‘polluter pays’ principle. Price signals are changed so that business is encouraged to restructure away from producing more environmentally damaging products.

- It gives the polluter flexibility in how they respond to the changed incentive structure, with scope for innovation and/or greater technological development. Tax can, therefore, be an economically efficient way of achieving positive behavioural change.
- Regulation often applies uniform requirements across diverse industries and is rarely sensitive to individual circumstances.

4.6 Tax measures, and their interaction with the price mechanism and subsequent impact on market behaviour, merit careful consideration given their potential ability to facilitate more socially optimal market outcomes.

TAX, BEHAVIOUR AND INCENTIVES TO DEVELOP

4.7 The Review has identified land supply as the major constraint on housing growth. One possible source of land supply constraint could be an unwillingness of landowners to bring their land forward for residential development.

4.8 One option could be to use taxation as a method of incentivising land to be brought forward for development in the first place. Land could be taxed according to its market value and land that had a high value, and was therefore in greatest demand for use, would attract a higher tax liability to encourage its development, or its most efficient use. Since the most profitable of these possible uses would often be residential development, this could increase the amount of land that landowners wish to sell for housing development overall.

The scope of land value taxation

4.9 Several options for land value taxation have been submitted to the Review. For example, land value taxes could be levied on:

- all undeveloped or vacant land across the country;
- land allocated for development in local authority development plans;
- land with outline planning permission; or
- land with full planning permission.

National land value taxation

4.10 The impact on housing supply of national land value taxation at an acceptable rate would be limited. A large amount of land in the UK would never be suitable for development at all, and so taxing such land would not produce additional land supply for residential development, or indeed commercial or industrial activity. However, if low value land were to be excluded from the system this issue could be avoided.

4.11 Importantly, the ability of land to be used for housing supply is ultimately a function of the planning system, which explicitly aims to select only that land most suitable for residential development. It could be considered unfair to tax the value of land in order to create an incentive for residential development, but then to deny the possibility for such use, either permanently or for a number of years, through a restrictive planning system.

4.12 There would also be a question as to whether to tax land as a proportion of its non-residential (current) value, or whether to tax it at the assumed residential value it would attain following successful navigation of the planning system. This demonstrates the important fact that the planning system itself determines the value of land. On the one hand, taxing the land at current value would provide little incentive to sell, since the tax liability would likely be small; however taxing land at its assumed residential value would generate substantially larger liabilities, but no guarantee as to when – or indeed if – the land would eventually attain planning permission, again raising a concern about the fairness of the tax.

4.13 Significantly, as has been explored at length in this Review, landowners who sell their land for residential use are typically the recipients of large windfall development gains. Therefore, using a land value tax to further incentivise landowners to sell their land for residential use, and further encourage developers to build on it, may have little effect given the structure of cost and benefits that would exist anyway.

4.14 A national land value tax would also require additional administrative resources in order for a national land ownership and value register to be created. Given the volatility of land prices over recent years, regular valuations would be needed in order to tax accurately the underlying value of land assets. Such a system would not be impossible to envisage, however – the Interim Report noted that Denmark operates a system of nationwide land taxation¹. Indeed, given the information shortages concerning land ownership and land value in the UK, there are arguments for a more comprehensive land registry in any case.

Land value tax, allocations for development and planning permission

4.15 Land value taxation might be more appropriately levied on land already considered suitable and desirable for development, such as land allocated for development in the local plan, or land that has achieved some form of planning permission. In this case the tax would clearly reflect the social value placed on the development of that site. It would add to the incentives that would exist for landowners to bring the land forward for development in any case.

4.16 However, once again land value taxes levied on land allocated for development in a local authority development plan, or subject to planning permission, raise issues of fairness. The local authority decides which pieces of land are allocated for development, and, therefore, which are liable for a tax, and subsequently uses the sequential test to decide which pieces of land should be brought into the system first. Once land had formally entered the planning system, the local authority would also be able to influence the rate of progress of the application as it moves through the various stages of the planning process.

4.17 Landowners responding rationally to the tax, and attempting to facilitate building on their land to meet their tax liability, may therefore find that their application is delayed for a number of reasons beyond their control.

4.18 This problem might be overcome to a degree, since the tax liability could conceivably be ‘frozen’ at the point at which a planning application is made, in order to avoid penalising landowners for delays occurring within the planning system, over which they have no control. However, in practice, this could lead to a perverse outcome whereby landowners affected by the tax lodge numerous speculative – and possibly hopeless – planning applications in order to halt the build up of a tax liability. Such a situation would likely neither increase the supply of developable land, nor raise revenue, but instead end up weighing down local planning systems.

¹ p. 117, *Barker Review Interim Report* (2003).

4.19 Taxing land with only outline planning permission raises further possibilities for perverse effects. Given that a decision to lodge an application for outline planning permission rests with the developer, there would be scope to delay the application until the developer believed they had the best chance of having their application decided quickly, and thus their tax liability reduced. This may lead to more development control happening ‘off the record’ in informal discussions, since developers would not wish to have their land formally designated as ‘outlined’ for development before clearing up as many development issues as possible.

Vacant brownfield land and value taxation

4.20 One possible area where land value taxation may be useful relates to brownfield land allocated for development in local plans. Most land would typically not need incentivising for development through value taxes, given the potential gains available to landowners anyway – as discussed above. However, the Interim Report noted that brownfield land was more likely to require expenditure on remediation and decontamination². Depending on the cost of such remediation, this could make it more profitable to leave the land vacant.

4.21 Imposing a tax on brownfield land left vacant may have the effect of changing this decision and tilting the balance in favour of redevelopment. Government already has a number of policies designed to encourage the redevelopment of currently unused brownfield land, including the contaminated land tax credit and grant scheme, and the tasking of regeneration agencies, such as English Partnerships, with purchasing and assembling brownfield land. The Review recommends further reforms in this area, as outlined in Chapter 3, and once these reforms have had time to take effect there may be merit in considering whether they would benefit from being operated alongside a brownfield land value taxation scheme.

Land value taxation and the wider economy

4.22 Most land value taxes, therefore, appear to be of limited use in stimulating the supply of land for housing given the nature of the planning process. That is not to say that land value taxes could have no part to play in the wider economy. The combination of a potentially wide tax base and the fact that land is physically ‘fixed’, which makes avoidance and concealment of the asset and its tax liability very difficult, point to land value taxation as a good method for raising revenue without distorting behaviour; indeed, it could encourage better behaviour. Such taxes may also have a useful role in recapturing for the public purse part of the uplift in land values that can occur as a result of public investment. Furthermore, some advocates of a land value tax view such a method of taxation as increasing social justice. However, the broader merits of the greater use of land taxation lie beyond the scope of this Review.

² pp. 67-68, *Barker Review Interim Report* (2003).

Box 4.1: Current land taxation regimes

It is important to note that taxation of housing and land sits within an established fiscal framework which taxes expenditure, assets and income in varying ways to achieve numerous policy aims. New taxes aiming to affect the fiscal position of land and housing must be sensitive to the existing regime. Landowners will pay tax on the income arising from the use of land, either through corporation or income tax in the same way as any individual or corporation. In addition, land sales are subject to stamp duty and, following reforms to stamp duty rules, must now be recorded at the Land Registry. Where land is sold, owners are subject to capital gains tax (CGT), which aims to tax part of its increase in value. However, for a number of reasons CGT does not always capture the full extent of windfall gains associated with the selling of agricultural land for residential use. The availability of roll-over relief (which allows certain reinvested gains to be deferred) and taper relief (which can substantially reduce the effective tax rate applying to a capital gain) mean that many landowners who benefit from these reliefs face a low tax liability.

In addition to this, there are likely to be large capital losses, possibly totalling billions of pounds, in the agricultural sector, which could be offset against CGT liabilities, as well as yearly personal allowances (£7,900 for 2003/4) and an indexation allowance for periods of ownership from March 1982 to March 1998.

The cumulative impact of these features is that windfall development gains accruing to landowners are often not fully exposed to CGT. As such, the amount of revenue CGT raises from sales of agricultural land for residential development is small. Estimates suggest that the yield from all agricultural land and buildings disposal, following reliefs and offsets against previous losses, was approximately £50 million in 2000/1. This total would also include CGT revenue from sales of land not intended for subsequent residential use, and is therefore an overestimate of the actual CGT revenue resulting from sales of land for residential development.

4.23 Thus the taxation of land to bring forward additional residential land supply would yield limited results and may, in fact, only succeed at the cost of introducing elements of inequity. However, the price mechanism could be used in other ways to affect land use behaviour. For example, there may be possibilities for tax to have a greater role in affecting the market behaviour of landowners and housebuilders where development is already proposed.

TAXATION AND BEHAVIOURAL CHANGE

4.24 Prices could play a role similar to that of regulation – in this case the planning system – in changing market behaviour so as to address externalities and reach a more socially optimal outcome. For example, tax measures could affect the relative price of building on greenfield and brownfield land, so as to reflect society’s preferences for reusing previously developed land.

4.25 Economic theory suggests that taxation as a means of affecting land use behaviour will tend to be effective if there are high price elasticities of supply and demand for the land being taxed³. However, these elasticities are low in the market for housing in the UK⁴. Since land is a key factor of production in the housing market, price elasticities of demand and supply for housing are a good proxy for ascertaining the same elasticities for land.

³ Meaning that the demand for, and supply of, land is sensitive to a change in its price.

⁴ pp. 39-41, *Barker Review Interim Report* (2003).

4.26 This suggests that the behavioural impacts resulting from the imposition of a tax would not be sufficient to ensure that decisions about which land to bring forward for development reflected the value that society places on that land. For instance, taxation alone is too blunt an instrument to ensure that brownfield land is developed in preference to greenfield. Because of the individual nature of each site this function is best carried out by the planning system⁵. However, it is still worth designing tax measures which might yield useful, if limited, behavioural changes. Reforms to ensure the planning system is better able to perform the difficult balancing task of reconciling the social costs and benefits of residential development in particular locations are thus of great importance.

SUBSIDY, BROWNFIELD AND ECONOMIC BEHAVIOUR

4.27 Though tax is unlikely to have a significant effect on market behaviour, then other economic instruments – for example subsidies – could be used more extensively to influence landowner and developer behaviour, for example, in altering the relative attractiveness of greenfield and brownfield land.

4.28 To this end, the Government has already introduced a contaminated land tax credit and grant system designed to lower the effective cost to developers of building on contaminated brownfield land that would otherwise prove economically unviable to develop.

4.29 Brownfield land is typically more difficult and costly to assemble and build on than greenfield land built it typically offers greater positive externalities, for example through urban regeneration. Information from the National Land Use Database suggests that there currently exists over 60,000 hectares of brownfield land – much of which has lain derelict for long periods of time. Regenerating such land would offer opportunities for new housing development and thus increase supply.

Recommendation 25

Government should consider the extension of the contaminated land tax credit and grant scheme to land that has lain derelict for a certain period of time. This should be done on the basis that extra public money levered into the market through such a scheme would encourage genuine new investment in brownfield remediation, and not simply subsidise development that would take place in any case.

4.30 The use of subsidies to aid the regeneration of brownfield land that has been derelict for a number of years will bring positive benefits, as discussed. However, care must be taken in the design of such a scheme, that does not reflect the value that society places on that land to ensure this does not generate a perverse incentive for landowners to leave land derelict for longer than they otherwise would, in order to qualify for such tax credits and grants.

⁵ Although regulatory systems can themselves use information provided by prices to inform and enhance decision making.

TAXATION AND ECONOMIC RENTS

4.31 The above analysis suggests that in bringing forward land for development and influencing the use of land already proposed for development to deal with externalities, tax measures alone may not be able to generate the desired market outcomes, given the current structure of land and housing markets in the UK.

4.32 Tax measures by themselves are not likely to affect market behaviour, combining this with the existence of economic rents means that taxation could have an important role in capturing value without overly distorting behaviour – although, as mentioned, there is merit in trying to ensure that any such tax reflects externalities.

Development gain

4.33 The Interim Report discussed the nature of economic rents and their interaction with housebuilder residual values⁶. Rents are the extra amount paid by purchasers for a good over and above its next most profitable use. When considering land and housing markets in the context of taxation, these are a natural focus for attention and demand serious consideration.

4.34 Development rents are created as a result of a public agency, namely the decision by a local authority – acting on behalf of the wider community – to grant residential planning permission for a piece of land. They are not attributable to the efforts of landowners to improve their land assets and increase their value through private investment and improvement. This means that:

- since development rents are publicly created, it is right that the wider community appropriate a share of the value that their actions generate; and
- in the context of increasing housing supply, ensuring that a share of the development gain flows to the community can also have a vital role in providing funding for other policies which promote housing supply.

4.35 The following examples, using Valuation Office Agency data, indicate the scale of the potential development gains available to landowners from selling agricultural land for residential use. These values may, in fact, be an underestimate of the actual average price as they include a reduction in value for assumed Section 106 contributions, which are likely to apply only to larger developments.

Table 4.1: Agricultural and residential land values in selected regions of England, 2003

Region	Value of arable agricultural land per hectare (£)	Value of bulk land for residential use per hectare (£)	Ratio of agricultural to residential land price
North East	7,534	1,230,000	1:163
East Midlands	7,450	1,770,000	1:238
South East	9,122	2,760,000	1:303

Source: Valuation Office Agency Property Market Report, Autumn 2003

⁶ pp. 115-116, *Barker Review Interim Report* (2003).

4.36 The existence of economic rents is particularly evident in relation to greenfield development. Greenfield land is typically easier to build on in comparison to brownfield land. Brownfield land often carries costs of remediation, complexities relating to the multiple ownership of sites and greater logistical difficulties in construction which reduce its potential value. It also carries higher alternative use values than greenfield land, for example as commercial or industrial enterprise.

4.37 Therefore, while there will always be exceptions, it is fair to say that development gains are more obviously present on greenfield land in comparison to brownfield development. This would imply that greenfield economic rents could be taxed at a higher rate, since there is a larger and more certain development gain to be captured. Differentiating the capture of windfall gain between greenfield and brownfield also tilts the playing field in the right direction to promote environmentally desirable behavioural changes.

4.38 Land, like most other assets, is already taxed through the capital gains tax regime. However, the existing system, which aims to incentivise and promote the efficient use of productive capital, does not sufficiently capture windfall development gains. There is, therefore, a case for extending the taxation of development gains resulting from land sales through different methods.

4.39 The Review has considered a number of possible taxation policy options that can capture windfall development gain, and also go some way to changing economic behaviour so as to achieve a more socially optimal outcome. The taxes considered here include:

- development gains taxes, including their past operation and how they might work in the future;
- VAT on new houses built on greenfield land; and
- a development contribution payable upon the granting of planning permission.

4.40 The rest of this chapter reviews these taxes and analyses their potential impacts.

DEVELOPMENT GAINS TAX

4.41 A number of contributors to the Review have advocated the re-introduction of a development gains tax (DGT) as a method of capturing windfall development gain.

Previous development gains taxes

4.42 The Interim Report noted that past attempts at levying development gains taxes had failed. These taxes, introduced by both the main political parties at different times in the post-war period, suffered from a number of problems which hampered, to a greater or lesser degree, their ability to deliver on their objectives:

- Credibility: landowners did not necessarily believe that the tax would remain and held land back from development in the hope that incoming Governments would repeal the tax, and thus higher windfalls could be received in the future. Such a belief can, in part, be self-fulfilling, since by holding back land from development and campaigning against ‘ineffective development taxes’, landowners create the very situation that leads to the tax’s withdrawal.

- Complexity: an ideal DGT would seek to capture that proportion of the increase in land value attributable to a change of use to residential development. Such a process involves multiple valuations and was inevitably difficult to achieve in practice. Aside from the logistical and resource implications of such a task being undertaken on a national scale, it was frequently difficult to assess the true value of land at the various stages in the absence of a market transaction.
- Poor targeting: the taxes were often poorly targeted. In practice larger landowners and speculators could avoid the tax, leaving smaller landowners to form the majority of the tax base. This led to the perception that the tax was ‘unfair’ and disproportionately affected smaller landowners.
- High effective tax rates: some liabilities generated by these measures approached 100 per cent of land value. This hugely increased landowner incentives to hold back land and await a policy change, as well as further opening up accusations of unfairness.

Box 4.2: Previous development gains taxes

The Interim Report noted that previous Governments had introduced various DGTs in the past in an effort to share development gain more widely.

The 1947 ‘Development Charge’ was the first attempt to tax windfall gains from land development. The charge was levied at 100 per cent of the excess value attributable to the granting of planning permission, relative to the existing use value on the date the development began. However, the effect of the tax was to reduce land coming forward for development, and the revenue raised was substantially lower than expected.

The 1967 Betterment Levy aimed to capture value above 110 per cent of existing use value, so as to provide an incentive to sell by allowing some development gain to be made. The charge was introduced at 40 per cent with the stated intention of raising it higher. However, among other problems, the complexity of the legislation allowed many developers and landowners to avoid paying by ‘establishing’ that work had begun prior to the charge’s introduction and again, the measure raised far less money than was initially expected.

The 1973 Development Gains Tax aimed to extend the CGT regime by taxing as income gains accruing from disposals of land possessing development potential at rates of up to 82 per cent for individuals, and 52 per cent for companies. However, rapidly changing market conditions, and a change of Government to one with different development gain ideas soon after the tax’s introduction, meant that the measure had little time to exercise an influence on the land market.

The Development Land Tax was charged on each occasion of the realisation of development gain flowing from disposals of land after August 1976. The tax contained several different features to its predecessors. These include levying the charge not only on actual sales, but also on assumed disposals where development projects began on land without a preceding land sale. There were also numerous exemptions from the tax. However, the complexity of the tax led to a proliferation of avoidance regimes and resulted in the tax falling disproportionately on smaller landowners, leading to allegations of unfairness.

4.43 These are important lessons for policy makers. Any tax on the uplift in land values must have credibility, relative simplicity and be perceived as reasonable, or landowners may withhold land in the expectation of policy change, or engage in elaborate strategies to avoid paying.

4.44 These issues can be tackled, however, by a better designed tax operating within a stronger development framework. For example, on the credibility issue, a more proactive use of compulsory purchase powers to acquire developable land, alongside a DGT, might reduce landowner incentives to hold back land, given the possibility that it may be purchased compulsorily were it not to come forward for sale.

Taxing land sales directly

4.45 One of the most straightforward methods of capturing windfall gain would be to tax the vendor of land that is sold for residential use. Since the development gain is realised at the point of sale, this would intuitively be the rational stage at which to levy a new development gain capture measure.

4.46 The Review has undertaken analysis on the possible effect of such a land sales tax, were it to have been in existence over the period 1998-2002. This analysis concluded that the main advantages of such a tax, according to modelled results, would be that:

- substantial revenue could be raised, dependent on the level of the tax set; and
- in theory, it would lead to a very small drop-off in land coming forward for development (that is, a small number of sales where landowner profit is reduced to zero, providing no incentive to sell), even at very high marginal rates. This is because the tax charge would be directly proportional to the land sale price, and assuming it was levied at less than 100 per cent of the gain in land value, there would still be at least some profit for landowners in going ahead with such a sale. However, the experience of the behavioural changes of landowners in response to past DGTs suggests that at high rates, supply would be affected.

Value capture and incentives

4.47 While a land sales tax as a new form of DGT is attractive in theory, there are potentially significant implementation problems.

4.48 Such a charge would essentially resemble a ‘super stamp duty’ on the sale of land for residential development. This would increase the incentive to engage in complex tax planning to avoid paying the charge.

4.49 As well as this avoidance problem, there are more practical problems regarding the taxation of the sale of an asset based on its future use. While in many cases it will be clear that land is being sold for residential use, there will inevitably be other cases where the final use to which the land is put is unclear.

VAT AND THE HOUSING MARKET

4.50 The Interim Report considered the existing VAT regime and noted that it may act as an economic instrument by creating an incentive to build new homes, rather than renovate or improve existing housing. This is because new build housing is currently zero-rated, whereas repairs, maintenance and improvement (RMI) work is charged at 17.5 per cent VAT.

4.51 Applying VAT to new housing could correct the distortion between new build and RMI and create a more efficient market for housing resources. This has certainly been a feature of several submissions to the Review. Beyond this effect, it would also act to extract some development gain.

VAT and new build housing

4.52 House prices are primarily set by the second hand homes market, which accounts for around 90 per cent of transactions in any one year, and are VAT exempt. Furthermore, land prices are driven by residual values – the amount of money housebuilders have left over once the costs of construction are subtracted from the expected total value of a housing development.

4.53 These two factors mean that levying VAT on new build housing would:

- have little direct impact on house prices, since attempting to raise new build house prices by 17.5 per cent would render them uncompetitive in the wider housing market (bearing in mind that new housing already commands a price premium over second hand houses)⁷; and
- lead to a reduction in land prices, as developers are forced to factor in the cost of the tax in their overall construction expenses and, consequently, reduce the amount of money they have available to bid for land.

4.54 Therefore, while VAT would ostensibly be levied on new houses, it would be expected to fall overwhelmingly on landowners and have no material impact on house prices. VAT would therefore have the desired effect of extracting some of the development gain associated with land sales for housing development⁸.

New build VAT, economic instruments and behavioural effects

4.55 VAT could be levied only on houses built on greenfield land, while leaving brownfield housing development zero-rated. Such a policy would create a greater incentive for developers to undertake more brownfield development at the expense of greenfield, and move the private costs of greenfield and brownfield development closer to their social costs (albeit in a rather blunt way). Working in combination with the Government's contaminated land tax credit, and other urban regeneration policies, this could have a positive effect on the distribution of new build between greenfield and brownfield land.

⁷ p. 62, *Barker Review Interim Report* (2003), the price premium on new homes above comparable second hand homes primarily reflects, among other things, the higher value of fixtures and fittings, lower maintenance costs and location in more desirable surroundings.

⁸ This is certainly true for the short to medium-term. Economic theory would suggest, however, that the place at which any tax, including VAT and variants of DGTs, effectively falls might shift over time. Increasing price elasticities of supply typically allow for a greater proportion of any tax to be moved through the development chain, including onto the good itself, rather than be borne entirely by the producer – in this case the developer (who would pass the tax to the landowner). In theory, as the supply of land and housing becomes more flexible and responsive, some of the costs might be borne by consumers. However, the evidence presented by the Review – p. 41, *Barker Review Interim Report* (2003) – suggests price elasticities of supply in the UK are currently very low. Indeed, some academic estimates suggest that since 1990 the responsiveness of supply throughout England has fallen to zero in all regions – indicating that this would, at most, have a limited effect on house prices at some point in the long-term future.

Box 4.3: VAT and landowner rents

While VAT may be levied on the sale of new homes, it is unlikely that the actual cost of the tax would be borne by the consumer. The majority of house sales each year are of VAT exempt second hand homes, and new build houses must be priced proportionally, or risk being rendered uncompetitive. Thus the actual incidence of the tax will be factored into the housebuilders construction costs and result in a lower price bid for land and a reduction in landowner development gain.

Using data on average residential land values, house prices and densities it is possible to work out the regional average impact of VAT on landowner development gains.

In the North East for example, using Valuation Office Agency Autumn 2003 data to subtract agricultural land values from average residential land values, it is possible to estimate the potential average development gain a landowner would experience from selling their agricultural land for housing development:

Agricultural land value (arable land) per hectare: £7,534

Residential land value (bulk land) per hectare: £1,230,000

Thus the potential windfall gain for the landowner is £1,222,466

Using data on average house prices for the region in 2003 and average dwellings per hectare, it is possible to estimate the total average value of developments in the region. For the North East this would be £3,244,850 per hectare and therefore the VAT charge (at 17.5 per cent of value) would be around £483,276.

Assuming the VAT charge was passed back in full to the landowner, the average windfall gain would be reduced to £739,190 per hectare. Even in the presence of VAT, and in a region of relatively low land and house prices, there would remain substantial development gain for landowners selling land for residential use.

It should also be noted, however, that this is an average figure, and that while many landowners would stand to make even higher development gains from some land sales, a minority of landowners may see their development gain removed entirely, and as a result would not bring their land forward for sale.

In areas of the UK with higher house and land prices, such as the South East, development gains in a situation where VAT charges are passed back in full would be substantially higher, and could frequently be over £1 million per hectare.

4.56 Regarding the viability of land coming forward for development, analysis carried out in the course of the Review suggests that the introduction of VAT on greenfield housing would have a negative impact on the amount of greenfield building, with some small substitution from greenfield to brownfield development.

4.57 Nation-wide the model suggests that at least 12 per cent of greenfield development would have been affected by the tax over the period 1998-2002. This drop off in land coming forward for development represents situations where the cost of the VAT charge on new homes is greater than the expected landowner profit from a land sale (meaning there is no incentive for landowners to sell their land).

4.58 Applying that figure to today's greenfield output (around 40 per cent of development) means a potential reduction in housing supply of 4 per cent, or 6,000 houses, assuming no other policy or behavioural changes. This may, in fact, be an overestimate since some greenfield development would likely be substituted to brownfield land instead.

4.59 Within this broad estimate of overall greenfield land drop off, there lies considerable regional variation. It is important to note that VAT would pass a charge of 17.5 per cent of the value of new homes built on the land back to landowners, not a charge of 17.5 per cent charge of the land value (which would almost always leave profit to be made from the land sale). Evidence from the model suggests that, in fact, the effective average tax rates on land facing landowners in the presence of VAT would vary regionally across England and Wales between 43 and 173 per cent of land value. Higher effective tax rates would be levied in the North under VAT, and lower effective rates would be experienced in the South. For example, around 17 per cent of greenfield development in Wales would have faced effective tax rates of over 100 per cent of value between 1998-2002 whereas the corresponding figure is around 6 per cent in the South East, where land values are significantly higher.

4.60 While the impact of VAT nationwide may be relatively minor, and would likely be outweighed by the effects of other housing supply policies recommended by the Review, the impact of VAT on greenfield housebuilding in certain regions would be significant.

4.61 Bearing this in mind, it is important to remember that even under such a tax regime, there would still be a large amount of windfall gain accruing to the majority of landowners in the presence of such a tax. Therefore, the wider community would be able to use VAT to share in development gain without undermining the financial position of most landowners and their ability to prosper from land sales for residential use.

4.62 Estimates suggest that such a move could raise up to £1.8 billion per year, following adjustment and transition costs. This is clearly a substantial amount of money that could, in part, be used to benefit the local community. In the context of housing supply, the revenue might usefully be employed to fund other housing development policies at a national and regional level. These would have the effect of bringing forward additional residential construction, and thus increase the amount of housing delivered overall.

VAT options considered

4.63 At first glance, VAT on new build greenfield housing would seem an attractive option for both achieving environmental goals, and raising revenue for other housing policies:

- it has the advantage of commanding greater immediate credibility. Under European Union (EU) law, once VAT is imposed on a currently zero-rated good, it cannot be removed. As a result, landowners would have no reason to withhold profitable land sales in the presence of an irremovable tax;
- by differentiating between greenfield and brownfield, the tax can yield useful behavioural changes; and
- VAT is well understood and the collection and administrative procedures associated with it are well established.

4.64 However, the disadvantages of VAT on greenfield are potentially substantial, and require careful consideration:

- There is no reason why 17.5 per cent of the price of the homes built on a piece of land should be the 'correct' level at which to share development gains from land sales. Indeed, the regional differences in the correlation between land and house prices means that effective average tax rates on development gains as a result of VAT vary significantly between regions (and frequently exceed 100 per cent of value).

- The tax would introduce significant regional imbalances into the housing market through the differing effective regional tax rates on land. Greenfield developments in the North of England, where the proportion of land prices to house prices is lowest, would face noticeable drop offs in land coming forward (in the context, however, of most landowners still making significant profits). Although some areas in these regions would be suffering from low demand or population decline, overall there may still be a role for greenfield development in regenerating and revitalising these housing markets; a choice which VAT would effectively remove from local planners by preventing greenfield land from coming forward.
- The relevant EU VAT law also contains the requirement that VAT should be levied on the same goods at the same rates across the territories of individual Member States. There is the possibility that a legal question may arise concerning the legitimacy of differential VAT rates for greenfield and brownfield new build housing. A successful challenge to such differential rates would mean that VAT would have to be imposed on brownfield housing as well (although it could be set at a lower rate of 5 per cent). This would have serious implications for the viability of many brownfield housing developments.
- The implementation of the policy would require a lengthy transition period. As noted, the tax would operate by passing the charge back to landowners through a reduction in prices offered for land. However, many housebuilders are currently constructing houses, or applying for planning applications, where transactions have already been made, and thus no mechanism for passing through costs exists. In order to reduce the possibility of making certain developments economically unviable, there would need to be a transition period. Given that there can be a significant time period between land being purchased and houses finally being sold, this implies considerable delays until full implementation.

4.65 Though VAT has the attraction of credibility, for the reasons set out above, the Review does not consider VAT the best method of capturing part of the windfall gains accruing to landowners from selling land for residential development. Other methods can be envisaged which share many of the advantages of VAT on new build, but give Government greater flexibility and choice.

Box 4.4: VAT and repairs, maintenance and improvement

Some suggestions to the Review have recommended that new build and repairs, maintenance and improvement (RMI) be made more equal through a 'levelling down' of the VAT on RMI to a lower rate of 5 per cent rather than a 'levelling up' of VAT on new build. Equalising the rates as far as possible under EU law would encourage individuals to improve and maintain their existing homes – and would go some way to helping the Government meet its decent homes target.

While increased RMI work might be broadly helpful in promoting better care of the existing stock, a significant proportion of investment in housing in the UK is individuals upgrading their homes beyond that required to keep them in a decent and habitable condition. Reducing the cost of RMI across the board would act as an incentive to all home improvement, and consequently subsidise a great deal of work that would have happened anyway, generating a (possibly substantial) deadweight loss. Evidence suggests also that it is the relatively affluent who spend most on RMI, and thus an across-the-board RMI VAT cut would be broadly regressive.

DEVELOPMENT GAIN AND PLANNING PERMISSION

4.66 There is a choice for Government in deciding at which point in the development chain any tax might be levied. A DGT – or a direct tax on the sale of land for residential development – typically attempts to tax the estimated gain from the transaction in which the development gain is realised. VAT, on the other hand, taxes the sale of houses in the expectation that the charge would be passed back.

4.67 An alternative to levying taxes on the sale of land or the sale of housing would be to move the point at which the charge is levied to the point at which planning permission is granted.

Planning permission and taxation

4.68 All new housing development legally requires planning permission to go ahead. Only by obtaining planning permission can developers realise a gain, and only through this future gain can a landowner receive an enhanced price for their land. Thus the granting of planning permission could provide a useful point in the process at which to levy a tax, given its centrality to development gains.

4.69 Developers could be required to make a contribution based on a proportion of the residential value of land in each local authority. This could be calculated using actual values, and/or by using the existing twice-yearly land valuations undertaken by the Valuation Office Agency. This avoids excessive complexity – a downfall of some previous DGTs – since, by using such sources, this obviates the need to engage in a lengthy and costly administrative process to calculate accurately the exact part of the land value uplift that is attributable to a change of use.

Box 4.5: Land price valuations

The Valuation Office Agency (VOA), an agency of the Inland Revenue, is responsible for valuing property, including land and housing, throughout Great Britain. An equivalent agency operates in Northern Ireland.

District Valuers use sales data recorded at the Land Registry, historical land and house price trend information and their own estimates to value residential land ready for development. These values are collected twice yearly and published in an aggregated regional form in the VOA *Property Market Report*⁹.

4.70 All parties could know the rate and level of the tax in advance. Therefore when builders come to calculate the costs of construction, they will be able to pass the cost of this ‘Planning-gain Supplement’ back to the landowner through lower prices bid for land. Furthermore, given the pricing constraint of second hand homes discussed earlier, there would be little scope to pass the tax forward to the consumer in the form of higher house prices¹⁰.

⁹ These values estimate the value of ‘land ready for development’ – that is, land with no remediation or decontamination costs. This may therefore include some brownfield sites that have already received investment to make them fit for development. Given that such brownfield land is ready to be built on, it displays many of the salient characteristics of greenfield land in terms of the ease of starting development and the lack of additional costs required to make the land fit.

¹⁰ Although as noted, increasing elasticities of supply can allow the point at which the tax liability falls to shift over time, including onto the good itself.

4.71 Modelling of this proposal suggests that if such a contribution had operated as an average over the past five years it would have had a significantly smaller impact on land coming forward in comparison to VAT. This is because by calculating the required contribution using local authority level land data, the cost of the contribution will be more closely correlated to the actual value of land being sold. If applied at a sensible rate, landowners could still enjoy significant potential development gain and thus land sales can still profitably proceed. This is in contrast to both the tax rates of some previous DGTs, which were frequently punitively high, and to VAT, where the effective tax rate on land can often surpass 100 per cent of land value.

4.72 Drawing on the issues discussed in this chapter, linking charges to the granting of planning permission through a Planning-gain Supplement is a feasible way to proceed for several reasons:

- Reductions in land sales: analysis of the impact of VAT in England and Wales on greenfield, suggests that around 12 per cent of transactions would be made potentially unviable, as the effective tax rates on land from the VAT charge reached, or exceeded, 100 per cent of land value. Levies based on a proportion of average or actual land prices in a local area, and attached to planning permission, would directly reflect local variations in land values. Therefore the effective tax rates on land could be set much closer to the desired tax rate. This is modelled to result in a substantially lower reduction in land coming forward for development¹¹.
- Greenfield and brownfield: a contribution levied at the granting of planning permission could be sensitive to the distinction between greenfield and brownfield developments through a range of differential rates. VAT, however, may only be introduced at two rates – 17.5 or 5 per cent and must apply across the country as a whole. A contribution from developers at the planning permission stage has the added advantage of avoiding European VAT law obstacles (although care would be needed to ensure compatibility with the European state aid regime).
- Targeting: the Government is already promoting specific housing and development policies for both ‘growth areas’, where large housing development is expected, and also ‘pathfinder areas’, where housing demand is weak. A developer contribution at the point of planning permission, that is sensitive to both the greenfield and brownfield distinction, and to land prices, could be further refined so as to incentivise – or even disincentivise – development in particular areas. VAT must be levied at uniform rates on the same products across the whole territory of the Member State and is thus unable to be regionally or locally sensitive in the same way.

¹¹ However this is subject to behavioural assumptions, most importantly that landowners believe in the permanence and credibility of such a tax. As noted previously, the belief among landowners that development gains taxes would be repealed in the future have played an important role in the downfall of previous attempts to access and share development gain through fiscal measures.

4.73 As with any government intervention, there would remain difficulties and issues to consider. Government will need to give these particular attention in order to make the contribution regime a success:

- **Permanence:** Government would need to make – and win – the case for sharing development gains and build a national consensus on the merit of such a system. It is, however, worth noting that Section 106 has come to operate in a way similar to capturing development gain, and its core principles command widespread support.
- **Transitional measures:** contributions levied at the planning permission stage would need to involve some transitional measures (as noted, this is also the case with VAT). The expectation is that the cost of the tax would be passed on to the landowner in the form of lower prices bid for land. This naturally requires a transaction between developer and landowner. Given that developers typically hold some land already purchased, or subject to options contracts specifying a fixed price, there would need to be transitional measures so as to require the contribution only where there has been a chance to pass the charge through. Information presented in the Interim Report suggested major housebuilders held, on average, around 11 to 16 months supply of land that had already attained detailed planning permission out of a total average of three and a half years supply¹². Government would need to take this into account when looking in detail at the design and initial implementation of such taxes. In addition, and depending on the time period between announcement and implementation, the Government may also need to consider measures to prevent forestalling, or other temporary adverse behavioural reactions in response to the new regime, that may affect the smooth operation of the market.

¹² p. 85, *Barker Review Interim Report* (2003).

Recommendation 26

Government should use tax measures to extract some of the windfall gain that accrues to landowners from the sale of their land for residential development.

Government should impose a Planning-gain Supplement on the granting of planning permission so that landowner development gains form a larger part of the benefits of development.

The following principles might be considered:

- Information would need to be gathered as to the value of land proposed for development in each local authority. Sources of data could include actual transactions and/or Valuation Office Agency estimates as to the land prices in various local authority areas.
- Government would then set a tax rate on these values. This tax rate should not be set so high as to discourage development, but at a rate that at least covers the estimated local authority gain from Section 106 developer contributions and provides additional resources to boost housing supply.
- The granting of residential planning permission would be contingent on the payment of the supplementary planning contribution of the proposed development.
- Government may want to consider the operation of a (substantially) lower rate for housing development on brownfield land, and the possibility of varying rates in other circumstances, e.g. for areas where there are particular housing growth strategies, or where other social or environmental costs may arise.
- A proportion of the revenue generated from the granting of planning permissions in local authorities should be given directly to local authorities. Government should also amend the operation of Section 106 planning obligations, as set out in Chapter 3, to take account of this new charge.
- The Government may want to consider allowing developers to pay their contributions in instalments over reasonable time periods so as to ensure that housebuilder cash flow pressures are sufficiently accounted for.

The introduction of a tax would need to be accompanied by transitional measures to ameliorate the impact on developers already engaged in land sales contracts that were drawn up before this charge was introduced, or for those who hold large amounts of land already purchased, but where planning permission has yet to be secured.

TAXATION MEASURES AND OVERALL HOUSING SUPPLY

4.74 As discussed at the beginning of this chapter, taxation of any item tends to reduce its supply. The same logic can be applied to land sales, although the existence of significant development gains and low price elasticities of demand and supply will tend to reduce the behavioural effects of land taxation. Even in the presence of perfect credibility and complete price information for landowners and developers, it is likely that, holding all other factors equal, the amount of land coming forward for sale would decline in the presence of the tax.

4.75 Therefore, this only makes sense as part of the Review's package of policy changes. Changes to the regional and local planning systems, as well as measures to increase and enhance the delivery of housing infrastructure and affordable housing, will change and improve the land and housing markets. This will lead to a situation of greater housing supply overall and an increased share of development gain going to the wider community. The costs to landowners of a reduction in land price will be more than offset by increases in housing welfare, which the proceeds of tax measures will be able to deliver.

4.76 Given the size and windfall nature of these development gains, even if Government were to opt to continue with its existing housing supply policies, there would still be a case for capturing some of the development gain accruing to landowners and sharing this more widely with the community. If Government is to increase the number of opportunities for development gain by reforming the planning system, there is a strong case for the use of tax measures to share this increased gain more widely. Additionally, if Government were aiming to raise housing output more substantially, it will require a range of new policies, and it seems appropriate to fund these through economic rents.

5

Accessing housing

Summary

- Provision of social housing has not kept pace with need. The number of newly built social houses for rent has fallen from 42,700 in 1994/95 to around 21,000 in 2002/03. This is in part due to focussing on improvements to the existing stock, and increasing costs of provision especially in high demand areas.
- It is clear that more social housing is required. While there is scope for this to be funded to some extent from increased private investment or greater efficiency within the RSL sector, additional Government expenditure is likely to be necessary.
- Using household projections coupled with the package of measures suggested for the private sector, this Review suggests that between 17,000 and 23,000 additional social houses should be provided per annum. This would imply additional investment building up to £1.2 and £1.6 billion per annum to support this level of housebuilding, but not all of this should necessarily come from Government.

INTRODUCTION

5.1 The terms of reference for this Review were to consider the issues underlying the lack of supply of housing in the UK, and the Interim Report made clear that an important element in addressing the lack of supply was consideration of the adequacy of social housing provision. Building of sub-market or subsidised housing (which includes both social and low cost home ownership housing) has fallen steadily to historically low levels. One of the aims proposed by this Review is to make housing more accessible, which includes decent housing for those who cannot afford market housing.

5.2 However, it has not been possible in the context of this Review to do justice to the complexity and importance of all the issues raised in social provision. For example, the question as to whether the most efficient form of subsidy is through the supply of housing, or whether it would be better to subsidise individuals is touched upon here, but not fully discussed. Similarly, measures to improve the efficiency of the registered social landlord (RSL) sector are important, but require further investigation at a detailed level. The Review has focussed instead simply on considering the level of social housing need, and estimating the number of additional houses required to deliver a more adequate supply of housing.

BENEFITS OF HOUSING

5.3 Shelter is one of the most basic human needs. The provision of adequate accommodation also has important economic implications. Left to itself, the market would be unlikely to provide for all those who need housing, and it might also fail to provide sufficiently decent housing. Inadequate or insufficient housing is likely to lead to:

- Social problems: poor quality housing and social problems often go hand in hand. Crime, drug abuse and other social problems lead to those who can, moving out, leaving the most vulnerable living in increasingly undesirable areas.
- Poorer education: there is strong evidence¹ that poor housing, and particularly temporary housing, holds back educational attainment among children.
- Poorer health: poor housing and overcrowding leads to health problems. This is most clearly shown by the rapid rise in TB cases amongst rough sleepers – a disease that had almost disappeared in the UK. Other health problems result from poor housing, particularly those with poor heating, ventilation and dampness.
- Less labour mobility: the Interim Report highlighted the problem that a lack of labour mobility holds back the UK's economic potential, because people are less likely to move to where there are jobs².

5.4 There is a clear rationale for Government intervention to meet basic housing needs of the least well off. It is less clear how far Government should seek to subsidise people's housing aspirations, in particular their preferred choice of tenure.

5.5 Shared ownership schemes have developed in recent years to provide greater access to home ownership, as have key worker schemes to tackle issues of public service delivery and the barrier presented by high house prices. The public sector's national pay bargaining structure means that variations in local price conditions may not be adequately reflected in pay levels in most of the public sector, a constraint that most of the private sector does not face. Provision of housing may prove to be a more cost effective means of helping to solve a labour market problem in the short term. However, this may also have effects on the housing market, providing access for some but not others, and at the same time increasing overall demand.

5.6 Housing those in need will have an immediate impact on the potential output of the economy, as it allows the labour market to function better. For those who are in poverty, housing can have an even bigger impact in the longer term through improving social cohesion, and contributing to better health and education outcomes. Rightly, the Government has an objective that everyone should have the opportunity of a decent home.

HOUSEHOLD NUMBERS

5.7 The Interim Report³ presented provisional figures for the number of new households in England that are likely to need some form of subsidy to access housing over the years to 2011. Since then, revised population projections have increased the estimated number of households. The revised figures are presented in Table 5.1. They show that, based on past tenure trends and demographic movements, 179,000 new households per annum will form, 28,000 of whom will require subsidised housing.

¹ HM Inspector of Schools, *A Survey of the Education of Children Living in Temporary Accommodation*, (Department of Education and Science, 1990).

² p. 53, *Barker Review Interim Report* (2003).

³ pp. 30-31, *ibid.*

Table 5.1: Additional housing demand and need for housing, England, 2002-2011 (per annum)

	Market Sector	Sub-market Sector ¹	Total
Net increase in households	151,000	28,000	179,000
Increase in vacant dwellings (unchanged 2001 vacancy rate)	4,000	1,000	5,000
Loss of re-lets due to Right to Buy	-22,000	22,000	0
Reduction in private rental lettings to those on housing benefit	-10,000	10,000	0
Replacement of losses (mainly through demolition)	16,000	5,000	21,000
Total ²	139,000	67,000	206,000

¹ This is defined as 'social sector' in Shelter's report, but includes those in low cost home ownership, which is normally considered to be affordable, not social housing. All of these tenures are sub-market, however, as they require some form of subsidy.

² Discrepancy due to rounding.

Source: Shelter, *Building for the Future – 2004 Update: A Report of the Shelter Housing Investment Project, (2004)*.

5.8 Table 5.1 estimates the number of new households in need of sub-market housing each year by using relatively fixed shares within age groups. It assumes that the proportion of households in need of subsidised housing is driven by demographic trends and past trends in tenure movement, mainly from social to market housing. The table takes no account of changing levels of affordability or income distribution, which will in practice have a large impact on the future mix of market and sub-market housing.

5.9 Added to the demographic change is additional housing required to fill gaps left by structural changes to the sub-market housing stock. These include making up losses for properties entering the market sector through Right to Buy (RTB); losses of private rental properties to the market sector; and replacing demolitions and change of use. This means that 67,000⁴ additional sub-market houses would be required annually between now and 2011, assuming every new household needing subsidised housing is accommodated and losses from the stock are made up.

Backlog of need

5.10 Aside from this annual flow of households in need of subsidised housing, Table 5.2 sets out estimates of the backlog of households who, according to Holmans⁵, are likely to need help to access housing. It splits households up into three separate categories according to their current status:

- households without self contained accommodation;
- owner occupiers and private renters needing social rented housing; and
- social tenants in unsuitable accommodation.

⁴ Additional dwellings are required to plug the gap in a rising number of vacant properties (assuming vacancy rates do not fall) due to frictional vacancies; a RTB property reduces the available stock of social properties, because when it comes to the time for the occupier to vacate that dwelling it moves into the private sector, not back into the social sector; the number of private rental sector landlords willing to lease their properties to those in receipt of housing benefit has fallen steadily, so more housing is required to plug that gap; losses are mainly due to demolitions.

⁵ Holmans, A., *Housing Demand and Need in England – 1996-2016*, (National Housing Federation, 2001).

5.11 Within these categories, Holmans considers all those whose current housing situation could be considered to be unsuitable (such as overcrowding). Its coverage is very broad: it is not necessarily just a measure of housing undersupply for these households, but is jointly a measure of the efficiency of matching housing to households. For instance, just as there are households living in properties too small for their needs – the overcrowded households – there are those whose housing is larger than they need. These ‘under-occupiers’ do not feature in Table 5.2.

5.12 The table’s first column reproduces Holmans’ original figures highlighted in the Interim Report. The second column has updated some of these figures where available, up to 2002/03. It is very difficult to get an accurate new measure of this backlog figure, however, as most of the data have not been revised since Holmans’ original 1996 estimates.

5.13 Of the figures that have been updated, the backlog of those without self contained accommodation has increased since 1996 from 450,000 to 462,000 in 2001/02. Within that group, the number of households in temporary accommodation has more than doubled from 43,000 to 94,000. These are households who have applied to and been accepted by local authorities as unintentionally homeless and in priority need for accommodation (because they have dependent children or are vulnerable in some other way). They have been helped with a stop-gap until a settled home becomes available. The increase in numbers is an indication of the scarce supply of social housing.

5.14 The growth in the number of concealed households and would-be couples living apart is also symptomatic of a supply problem, as these households tend to be lower down the allocation waiting list compared to some of the other households in the backlog.

5.15 Households in shared dwellings have fallen significantly since 1996, due to a change in households’ willingness to share facilities. This has cut the recorded number of households in shared dwellings wanting self contained accommodation by more than half. Without this change, the total backlog has probably risen since 1996.

5.16 Whether all of these households should be categorised as equally needy is questionable. For example, it might be considered appropriate for those currently in owner occupancy who cannot afford their mortgage to move to cheaper market accommodation, where possible, as opposed to receiving subsidised housing. Assessing the level of housing need is subject to differences of opinion. Providing a definitive number is perhaps not the role of this Review. However, it seems clear that current provision is not enough to meet arising need and so the backlog is likely to worsen over time.

Table 5.2: Backlog of households in need of sub-market housing, England

	Holmans (1996)	Barker ¹
Households without self contained accommodation		
Households in temporary accommodation	43,000	94,000
Concealed families	125,000	154,000
Households in shared dwellings ²	130,000	53,000
Would-be couples living apart	65,000	74,000
Single homeless people; hostel residents etc.	110,000	110,000*
Adjustment for those saving to buy	-23,000	-23,000*
Sub Total	450,000	462,000
Owner occupiers and private sector tenants needing social rented sector homes		
Households applying for age or medical reasons	70,000	70,000*
Households who cannot afford mortgage payments	20,000	20,000*
Expiry of lease or inability to afford or rent	30,000	30,000*
Overcrowding	20,000	20,000*
Sub Total	140,000	140,000*
LA and RSL tenants in unsuitable housing		
Overcrowding	220,000	206,000
Households with children living above the ground floor	150,000	150,000*
Overlap in categories	-10,000	-10,000*
Sub Total	360,000	346,000
Total	950,000	948,000

¹ Holmans' figures have been updated using comparable tables from ODPM

² The reduction in the number of sharing households reflects strong preferences for not sharing. The number of houses in multiple occupation (HMOs) has fallen, and bedsits (non-self contained accommodation) have been replaced by studio flats (self contained) in many cases.

*No more recent information is available

Source: Holmans, A., *Housing Demand and Need in England – 1996-2016*, (National Housing Federation, 2001).

ODPM, *Housing Statistics Live Tables*, (2004) No. 623, *Housing Statistics: 2003*, (2003) Table 4.3, Table 8.6;

ODPM, *Housing in England 2001/02: Survey of English Housing*, (2003) Table A1.17, A1.68 (This uses the same proportion of those on the housing waiting list as that used by Holmans).

5.17 There will be households whose circumstances feature in the backlog categories above, but who then move on quickly to suitable housing. This is largely a frictional backlog, which could be reduced by a better use of the existing housing stock and more rapid administrative systems. For others, their circumstances result from a lack of suitable housing, and they are unlikely to be accommodated unless more housing is provided.

5.18 The size and persistency of this backlog is due to a number of factors, not only the total amount of housing provided. A steady fall in numbers of sub-market houses built each year – social rented down from 42,700 during 1994/95 to 21,248 during 2002/03 – along with a rising number of households and social trends towards smaller households, are all probable sources of upward pressure on the size of backlog.

5.19 As sub-market housebuilding has fallen steadily, the number of private sector houses built has remained relatively flat. This partly reflects a long term change in the nature of social housing provision. Once social housing was seen as a tenure for a sizeable proportion of the population, when after the second world war, social housebuilding outstripped private provision. Now, the mix of households in social housing includes a small proportion of those who are in employment, but a much larger proportion of economically inactive households, such as pensioners and those with long term disabilities. This is less by design, than by the fact that reducing the supply of social housing means that those most in need get housed ahead of those lower down the list. Low cost home ownership is a more recent innovation, which has gathered pace in areas of high demand.

Movement between tenures

5.20 Shelter's and Holmans' numbers of annual sub-market housing need and its backlog, are based on the assumption that there is currently little substitution between market and sub-market housing as relative prices change. Therefore, providing additional sub-market housing is unlikely to affect the demand for market housing significantly. Similarly, increasing the provision of market housing will not have a significant effect on those who are currently allocated sub-market housing.

5.21 This assumption is questionable. In reality, there will be some substitution between tenures when the amount of sub-market and market housing provision changes. Significant increases in the amount of market housing available will reduce price levels. Some households currently priced out of the market and in need of subsidised accommodation would be priced into the market. They include some public sector 'key workers' and others who benefit from low cost home ownership schemes, such as 'Homebuy', which gives households an opportunity to buy housing through various forms of subsidy.

5.22 The Review asked Glen Bramley⁶ to model this substitutability between tenures. He initially estimates the number of new households each year who are in need of sub-market housing in England⁷. From which he estimates the number who are 'priced in' to market housing under different future price scenarios.

5.23 Bramley's model shows that (after adjusting 2002's house prices back to their trend level) approximately 90,000 new households per annum are in need of sub-market housing⁸. A future house price trend of 2.4 per cent increases the number of households priced out of market housing by an average of 5,000 additional households per annum to 2018. Even though average incomes are likely to rise at a similar pace, the nature of household formation means that levels of income per household will fall behind house prices. Under lower house price trend assumptions, households do get priced in to housing. With a real house price trend of zero, an average of 12,000 additional new households each year get priced in to market housing in the years to 2011⁹ (see Table 5.3). This more than doubles over the following decade, as rising real incomes make significant inroads into the affordability problem.

⁶ Bramley, G. *Increasing Housing Supply: Achieving Increases And Estimating Their Impact On Price, Affordability And Need*, Barker Review commissioned work, (2004).

⁷ pp. 56-58, *Barker Review Interim Report* (2003).

⁸ Bramley's estimate is higher than Shelter's figure because it is based on affordability rather than historic trends of households in each tenure.

⁹ These figures take no account of those existing households who are currently priced out of the housing market, however. Of the 30 per cent of existing non-owner occupier households, approximately 120,000 households would be able to afford to buy market housing if price levels fall by around 1.5 per cent, which increases the overall impact of lower price trends. This is calculated by assuming prices fall by 1.5%, a price elasticity of demand of -0.5 and 17m owner occupier households.

Table 5.3: Additional new households reliant on affordable housing priced in to market housing per year, England (annual averages)

Forecast Period	Assumed future real house price trend			
	2.4%	1.8%	1.1%	0%
2002-11	-5,000	Nil	5,000	12,000
2002-21	-7,000	5,000	15,000	27,000

Source: G. Bramley, 2004

5.24 These figures can be used to adjust Shelter's projections for those new households needing sub-market housing. This means that, under a continued rise in house prices of 2.4 per cent per annum, an additional 5,000 households would require subsidised housing by being priced out of the market. On lower price trends, as more households are priced into the market, these numbers could reduce the annual subsidised housebuilding provision required.

ESTIMATING ADDITIONAL HOUSING NEED

5.25 Based upon these estimates, assessments of the level of housing need can be made. This section considers the additional number of housing units required once the overall package of measures introduced in this Review have fed through to prices and behavioural change.

Additional Units Required

5.26 Shelter's figures in Table 5.1 assume a contraction in the number of private rental properties accessible to those on housing benefit. This Review assumes that the private rental sector does not contract (for example the introduction of the UK version of US style REITs might be expected to expand the sector), so the 10,000 additional properties are not required to plug this gap.

5.27 As discussed above, not all households in the backlog would have as high a priority need for housing or re-housing. This is because need levels differ, and the ability for households who qualify for low cost home ownership programmes to acquire housing through independent means is much better than those other households classified in Shelter's estimates. As a result, the calculation of annual need for housing focuses on two thirds of newly arising households¹⁰. On this basis, 48,000 additional social houses are required per annum (see Table 5.4).

Table 5.4: Additional social housing required per annum, England, 2001-2011

	Number of units
Shelter's estimate (from Table 5.1)	67,000
<i>Less adjustment for improvement in PRS housing provision</i>	-10,000
<i>Less adjustment to accommodate priority new households (% of net household growth)</i>	-9,000
Total units required per annum	48,000

Source: Barker Review estimates

¹⁰ One way of assessing the level of need within Holmans' backlog is to consider the following as less needy than others: households in shared accommodation; would-be couples living apart; households who cannot afford mortgage payments; expiry of lease or inability to afford rent; and households with children living above the ground floor. This is approximately a third of the total backlog in Table 5.2.

5.28 Data on the current level of social housing provision is surprisingly difficult to obtain. Data in this area is uncertain because of the variety of different funding sources. Nevertheless, Table 5.5 shows the best estimates of social rental new build during 2002/03 and the number of units purchased by RSLs during the year – the gross addition to the stock.

Table 5.5: Social housing required to accommodate demographic change, England

	Number of units
Revised estimate (from Table 5.2)	48,000
<i>Less new build provision (2002/03)</i>	<i>-21,000</i>
<i>Less net number of units purchased (2002/03)¹</i>	<i>-10,000</i>
Total additional units required above current provision	17,000

¹ There were 11,530 units bought and 1,120 sold off during 2002/03.

Source: ODPM; Housing Corporation

5.29 According to these estimates, this means increasing the present level of new provision of subsidised housing to 48,000 units per annum – an increase of 17,000 in the current provision of 31,000 units – just to accommodate demographic expansion.

Addressing the backlog – four scenarios

5.30 Table 5.6 presents four scenarios where different assumptions have been made for both house price trends and social housebuilding. It relates to the scenarios in Chapter 1, which assume different levels of housebuilding as a result of this Review. The scenarios of additional social housebuilding and different price trends are not dependent on one another, and can be mixed according to different assumptions.

Table 5.6: Scenarios of additional social housing per annum to 2011, England

Scenario ¹	Accommodating demographic change	Addressing the backlog	Adjustment for new households priced into the housing market	Total additional social housebuilding per annum
Government plans	N/A	Nil	+5,000	N/A
Reducing the long term trend	17,000	Nil	Nil	17,000
Improving the housing market	17,000	9,000	-5,000	21,000
Zero house price inflation	17,000	18,000	-12,000	23,000

¹ See Chapter 1 for full details of the market housing scenarios that alter future price trends.

Source: ODPM; Housing Corporation; Barker Review estimates

5.31 The first scenario assumes Government continues to support current levels of social housebuilding over the future. Bramley’s estimates imply that the price trend associated with this scenario, 2.4 per cent, would price 5,000 additional new households per year out of market housing, which worsens the level of backlog.

5.32 The second scenario assumes a lower long run price trend of 1.8 per cent as a result of additional market housing. Alongside this is the additional 17,000 units (from Table 5.5) which accommodates most demographic expansion from those needing social housing. Bramley's figures assume there is little substitution between tenures from changing affordability levels, so the backlog is assumed to be static.

5.33 In order to address the backlog of need for social housing, higher levels of provision are needed. The third and fourth scenarios assume that a more ambitious social housebuilding programme would increase the level of provision to accommodate some of those already in need of social housing. Of those households estimated in the backlog, those in temporary accommodation are considered to be those most in need of housing. Assuming this is addressed over ten years, this means 9,000 additional dwellings¹¹ are required per annum. Increasing the extra provision to 18,000 per annum would halve the time to address the temporary accommodation backlog.

5.34 The third and fourth scenarios assume that the effect of reducing the price trend (to 1.1 per cent and 0 per cent, respectively) will alter the number of new households able to afford market housing, as discussed above. These lower price trends cut the projected numbers of additional social houses needed per annum from 21,000 and 23,000, respectively. This is because some new households who would qualify for low cost home ownership programmes will be priced in to the market. This reduces the gross flow of new households in need of low cost home ownership housing, which frees up housing to others who still require housing assistance.

5.35 Based upon projected Approved Development Programme (ADP) grant costs of social housing, this requires a subsidy of around £70,000 per dwelling. As a result, additional investment building up to £1.2 to £1.6 billion per annum would be needed to support this expansion of between 17,000 and 23,000 units, not all of which would necessarily be from Government.

5.36 However, new units and the investment required to deliver them, could not be delivered immediately due to capacity constraints and the need to identify where supply can best be located to meet demand. Increasing social housing provision should therefore be managed in a staged way to ensure capacity to deliver and value for money are maintained.

Recommendation 27

The provision of social housing should be increased. At least 17,000 additional houses are required each year compared with current provision to keep up with demographic trends. Addressing the backlog of housing need would raise this to 23,000 per annum (assuming substitution from sub-market to market housing, as market affordability improves).

Based upon current costs of provision, additional investment building up to £1.2 to £1.6 billion per annum would be needed to support this expansion, not all of which will be from Government.

¹¹ Approximately 10 per cent of the 94,000 households in temporary accommodation.

DELIVERING HOUSING – ENSURING EFFICIENCY

5.37 Additional investment in social housing could be achieved through a number of routes, for example:

- a higher volume of Section 106 contributions as a consequence of higher levels of private housebuilding;
- greater efficiency amongst RSLs;
- alternative funding streams; or
- better utilisation of RSL assets.

5.38 Increasing resources for new housebuilding could also arise from switching resources. In recent years expenditure on social housing has increased, from £800 million in 2001/02 to over £1.4 billion in 2003/04, however new build has continued to decline. Much of this funding has helped to improve the standard of existing social housing to meet the Government's decent homes standard¹². The backlog of repairs to local authorities' existing housing stock is estimated at some £19 billion. In 2001, 33 per cent of homes were deemed non-decent compared to 46 per cent in 1996. By 2010 Government aims to bring all social housing (and private sector housing for vulnerable groups) up to the decent homes standard.

5.39 The Government is on track to achieve its aim, but this target has switched the focus of local authorities' and RSLs' housing investment strategies towards repair and maintenance, and away from new build programmes. This is a more cost effective way of increasing the decent stock, but as most of the properties in the backlog are occupied, there is little net gain to the numbers available.

5.40 There is a potential of a trade-off between directing resources towards housebuilding and property rehabilitation programmes. This trade off may become more acute as Government approaches 100 per cent decency. The cost of bringing the very worst properties back to a decent standard may be significantly higher. It may also bring fewer net benefits than housebuilding.

Section 106

5.41 Planning obligations and Section 106 agreements specify how much of a site's housing should be sub-market – normally low cost home ownership and/or social rent. Approximately 12,500 sub-market units were built as a result of Section 106 agreements and other planning obligations during 2002/03. The larger this affordable housing quota, the less a housebuilder is able to pay for the land on which the housing is built. This price reduction is an implicit subsidy. As a result, it is unclear how much additional sub-market housing can be delivered through this route.

¹² ODPM Green Paper, *Quality and Choice – A decent home for all*, (2000), set a target that all social housing (and private sector housing for vulnerable groups) should meet its decent homes standard by 2010.

5.42 Affordable housing requirements are, for most projects, an efficient way of delivering additional sub-market housing and are worth pursuing. Importantly, they also promote mixed communities, and in most cases the amount of social housing delivered is higher as a result. But on-site affordable housing requirements can have the opposite impact, particularly for very up-market developments, as the subsidy required to provide affordable housing is so much higher than lower price developments. Overall, this delivers less housing. Allowing off-site affordable housing quotas for some very up-market schemes therefore, could deliver more sub-market housing, as well as a higher overall level. But unless there is land available nearby, this may be difficult to achieve in practice. And consideration of mixed communities should mean this is exceptional, or only applies to some of the units.

RSL efficiency and gearing

5.43 The Interim Report¹³ highlighted the contribution greater efficiency within the RSL sector could make to increase the supply of decent social housing. With a turnover of £6.6 billion¹⁴ in the sector, efficiency gains of just three per cent could release some £200 million per annum, for example, that could be reinvested to build more housing.

5.44 There is scope for the sector to achieve greater levels of efficiency across all of its activities, including procurement of new build housing, refurbishment of existing housing or its management and maintenance:

- A recent HM Treasury paper¹⁵ highlighted the significant three-fold variation in management costs found even amongst the largest RSLs. Such changes might have been explained by factors such as regional price variations. However, research undertaken by the Audit Commission has confirmed that there still appear to be significant variations in costs even after accounting for issues such as stock location and size.
- The Housing Corporation¹⁵ has also made clear its belief that there is scope for more efficient procurement and economies of scale, without sacrificing quality or customer satisfaction. It is now piloting a partnering approach with selected RSLs that aims to deliver such change.
- The end-to-end Review of the Housing Corporation and its interaction with RSLs is also expected to re-emphasise the Corporation's responsibilities for driving more efficient and effective delivery of the Government's policies and objectives within the sector.
- The Government has also established an independent review of efficiency in the public sector, led by Sir Peter Gershon, which is exploring options for radically reforming the Government's approach to public sector procurement. This review is currently working with Office of the Deputy Prime Minister to develop detailed efficiency proposals for inclusion in their 2004 Spending Review submission to the Treasury.

¹³ p. 170, *Barker Review Interim Report* (2003).

¹⁴ Housing Corporation and National Housing Federation, *2002 Global Accounts and Sector Analysis of Housing Associations*, (2003).

¹⁵ HM Treasury, *Public Services: Meeting the Productivity Challenge*, (2003).

5.45 Delivering efficiency gains will be beneficial, and could make a significant contribution towards delivering the additional investment needed within the sector. There is also scope for the sector itself to support increased borrowing and expansion, given its asset base.

5.46 The Interim Report¹⁶ also highlighted the favourable asset to debt ratio within the RSL sector of around three to one, which should provide scope for increased borrowing and expansion. This is not a uniform picture throughout the sector, however, as some are constrained by high debt levels, and some are unprofitable and have low credit ratings.

5.47 The issue of ADP liabilities hampering further borrowing was raised by some RSLs as a constraint to further borrowing. They felt that as ADP grant was never depreciated or written off, it restricted them from expanding. But discussions with financiers suggest that interest cover is a much bigger issue to a lender than whether or not an RSL has this subordinated debt. Any lender using property to secure debt will have a prior claim to that property it lends against, over and above any ADP liability, so it will not act as a constraint.

5.48 It would not be so much of an issue if those RSLs with low efficiency were those who had few expansion plans. But some of the less efficient do want to expand, and these factors are real constraints to their ability to grow. In addition, some of those who have already built up high levels of gearing, perhaps as a result of expansion, wish to expand further and are not able to do so.

Recommendation 28

Government should continue to explore the scope to achieve both greater RSL efficiency and higher funding through debt finance, to increase the level of housing through the most cost effective means.

Alternative funding streams

5.49 In addition to RSLs, the private sector has shown an increasing interest in providing or investing in sub-market housing. There are a number of different models that are being used, providing opportunities to tap in to funding streams not available through traditional funding models (see Box 5.1).

5.50 Most of the models highlighted in Box 5.1 are recent innovations and are unlikely to challenge the dominance of existing models of provision in the short term. However, as the lines between sub-market and market housing blur, the opportunities for greater private sector involvement in sub-market housing provision will rise.

¹⁶ Housing Corporation, *Re-inventing Investment*, (2003).

¹⁷ p. 171, *Barker Review Interim Report* (2003).

Box 5.1: Private finance

For local authorities and RSLs, alternative funding routes can be accessed:

- the private finance initiative (PFI) has been used for building a small quantity of social housing to date (but this still requires public spending for this option to be utilised);
- RSLs are also developing private sector arms, to cross subsidise their social housebuilding programmes; and
- Some private sector housebuilders will be able to access ADP subsidy to provide social housing.

Alternative funding models have also been explored elsewhere in the private sector. Access to more flexible financial instruments and different investment criteria has led some organisations to offer sub-market housing without direct grant subsidy. Asset Trust and North Country Homes are following this approach, albeit using very different models.

Better utilisation of assets

5.51 Increasing debt levels to finance housebuilding may not be an attractive option to most local authorities, as many will have difficulty raising their debt levels above existing levels, because of other budgetary constraints. Even so, most local authorities have a high level of equity in their housing stock compared to their level of debt. Releasing some of this equity enables them to finance housebuilding without increasing current borrowing levels.

5.52 The RTB established this principle of equity release¹⁸. For local authorities and RSLs, the RTB and Right to Acquire (RTA), respectively, release equity in their existing housing stock, and give tenants the opportunity to purchase their properties outright. But there are problems associated with these schemes, as the discounts given to the buyers reduce the amount of money available to replace those sold off. It also reduces the absolute stock of social housing. This is illustrated in Table 5.1, which shows that an additional 22,000 sub-market houses are required per annum to fill the gap left by those RTB properties that have moved previously into private ownership.

5.53 Introducing a scheme similar to ‘Homebuy’ (see Box 5.2) as an alternative to the RTB/RTA might raise significant amounts of additional revenue that could be channelled through to new housebuilding projects. Replacing the current schemes would have the greatest effect, as the level of subsidy required would probably be lower than the discounts offered through the RTB/RTA.

Recommendation 29

Government should explore moving to an alternative scheme to Right to Buy and Right to Acquire, which is provided at lower cost and enables greater recycling of revenues to increase the social housing stock.

¹⁸ Under current arrangements, 25 per cent of the equity released through RTB can be used at councils’ discretion, while the remaining 75 per cent must pay off debt.

Box 5.2: Social sector Homebuy

Homebuy is a scheme already open to households to buy private sector housing through shared ownership. It is open to social housing tenants and those on social housing waiting lists who would otherwise struggle to purchase a property in the private sector, which frees up tenancies for those in greater need. This offers tenants the opportunity to buy, say, up to 75 per cent of the equity of the property, while the social landlords retain the remaining equity balance. The households then have the opportunity to 'staircase' their ownership levels up to 100 per cent, when their circumstances allow.

Applying this scheme to the local authority and RSL properties the tenants already occupy, might enable them to enter home ownership without being forced to move home, and could encourage mixed communities. The landlords would release equity, while retaining some stake in the value of the housing they had sold off. This means that their present and future housing needs might be better matched, and offers them the means to add to the overall volume of their housing stock, provided that 100 per cent of the receipts are available for housing investment. This might enable the level of their equity investment to adjust better to reflect individual needs.

THE NATURE OF HOUSING SUBSIDY

5.54 Historically, the main way Government has taken responsibility for ensuring an adequate provision of dwellings for those who cannot afford housing has been by subsidising supply – known as 'bricks and mortar' subsidy. Originally this was through council housing, but more recently through RSLs.

5.55 In the case of most products or services, however, providing subsidies to individuals tends to be regarded as more efficient, as subsidising supply potentially creates distortions in the market. Providing subsidies to individuals creates competition between providers and provides greater choice for individuals. But bricks and mortar subsidies will normally secure a higher supply of housing, and can ensure other objectives such as ensuring decent standards of housing and providing security of tenure.

5.56 This is a very complex but important issue, full consideration of which is beyond the remit of this Review, but it is certainly worthy of further attention.

6

The development industry

Summary

- The recommendations set out in this Review, if implemented, should alter the policy environment within which the housebuilding industry operates. Reduced house price volatility and greater availability of land will enable the industry to increase supply, changing the relationship between housebuilders and land. This should allow the industry to re-direct its energies towards improving its product and delivering a better service to its consumers.
- This change to competitive dynamics may not be enough to guarantee that the industry responds, however. The track record of the industry, in areas such as consumer satisfaction, skills, innovation and local acceptance, is not sufficiently strong to inspire confidence in policy makers that it can deliver. The Review is therefore proposing a series of challenges for the housebuilding industry, to demonstrate success in delivering its part of the bargain, in return for Government delivering the reforms proposed.
- Low customer satisfaction levels have been underpinned, in the past, by a lack of adequate customer protection and, to some extent, the approach of housebuilders. The industry needs to work hard to restore its image with customers, developing a code of conduct for new house sales that delivers fair contracts and high levels of customer satisfaction. Levels of customer service must improve.
- The industry needs to address its weak record of innovation and remove barriers to the take-up of modern methods of construction and off-site manufacturing.
- Investment in skills needs to increase to produce higher levels of output in the future and to bring the take-up of apprenticeships towards the levels of leading international comparators. In the short-term, Government should consider increasing support for skills in the construction sector alongside any increases in the industry-funded training levy.
- The industry can do more to foster local acceptance of development. Houses should be designed to a high standard and in keeping with the surrounding area. Housebuilders should draw up a best practice guide for voluntary compensation schemes for those immediately affected by the transitional costs of development.

INTRODUCTION

6.1 The recommendations in this Review, if implemented, could significantly alter the policy environment within which the housebuilding industry operates. Reduced house price volatility will enable the industry to increase supply. Furthermore, the Review's recommendations aim to alter the relationship between housebuilders and land.

6.2 The housebuilding industry in the UK derives much of its profit from land. It is rational for businesses to focus their activities on those areas that yield most reward – where the returns to entrepreneurial endeavour are highest. At the present time, the greatest rewards accrue to those housebuilders who are best able to obtain good locations and who can effectively game the planning system to acquire permissions at lowest cost. This does not necessarily deliver good design or enhance the quality of the built environment. As a consequence, the quality of build suffers and customers get a raw deal.

6.3 Easier access to land and a simplified planning system should alter this dynamic, encouraging housebuilders to focus their efforts on meeting the needs of customers. The aim of the Review is to encourage the industry to improve its productivity and performance, to deliver consumers high quality homes within sustainable communities. Clearly there are considerable issues for the industry; including, to some extent, a legacy of mistrust that the industry must work to dispel.

6.4 If Government delivers the reforms set out in this report, what will this mean for the industry? Challenges will remain if UK housebuilding is to develop into a responsive, efficient industry, delivering a high quality product that reflects what consumers want. This chapter considers the capacity of the industry to respond to the changed policy environment and what further measures are necessary to deliver improved responsiveness.

HOUSEBUILDING AND RISK

6.5 The Interim Report set out the way in which risk influences the behaviour of the housebuilding industry¹. House prices are essentially asset prices, determined by the interaction between the supply and demand for all houses. Partly as a result, house prices are far more volatile than the prices of most other consumer goods and services. This market risk is further exacerbated by the risks specific to each site, such as the uncertainty in gaining planning permission, dealing with contamination and remediation as well as the potential construction delays that could be encountered.

6.6 Volatility in house prices makes timing the production of houses and their release for sale critically important to housebuilders. For a one per cent increase in house prices, gross development profit on some sites can increase by almost eight per cent. Predicting and catching the market at the right time is a critical skill for housebuilders seeking to maximise profits. The close correlation between housebuilders' profits and house prices highlights this relationship².

6.7 The industry's aversion to risk manifests itself in a reluctance to make long term fixed commitments through:

- low levels of investment in capital-intensive technologies, innovation and in the skills of the workforce, who are frequently employed on a sub-contracted basis;
- some reluctance to invest in brownfield development. If, as housebuilders have argued, brownfield becomes increasingly difficult to build on, as the easy brownfield sites are developed, this constraint may create greater problems; and
- increasing the value of adopting a wait-and-see approach to releasing houses, thereby reducing responsiveness.

¹ pp. 64-68, *Barker Review Interim Report* (2003).

² Chart 4.1, *ibid.*

Looking ahead

6.8 Changing the nature of risk should support changes in behaviour, creating incentives on the industry to increase investment levels and to take a longer-term view. The increases in output proposed in this Review are intended to reduce house price growth and house price volatility. As Chapter 1 pointed out, although increasing housing output alone may not necessarily reduce volatility, combined with other measures, it should contribute to a more stable housing market. In particular, since one of the factors affecting house price volatility is expectations of future house prices, the dampening effect on volatility from increasing supply could be enhanced. This, in itself, should create confidence and more stable expectations in the industry, supporting an increase in new build. The recommendations in this report will also reduce site-specific risks, by bringing greater certainty to planning and overcoming barriers such as lack of infrastructure.

6.9 Greater use should be made of the capital markets to extend the investment capacity of the sector. The Interim Report, while not finding any evidence that the supply of finance was constrained for housebuilders, suggested that risk sometimes resulted in capital being priced at a level that made certain developments unviable³. Addressing these uncertainties, through measures detailed elsewhere in this Report, should ensure that the availability of capital does not act as a constraint on development. At the same time, the Review anticipates a greater willingness of financial markets to invest in alternative construction techniques, with market risk being replaced by greater entrepreneurial innovation and risk-taking.

6.10 The Interim Report noted⁴ the limited role played by institutional investment funds in the residential property market in the UK. The Review noted further, that increased investment through a new bespoke vehicle (such as the Real Estate Investment Trusts, which operate in the US) has a number of possible attractions:

- Such vehicles could commission new build. This would directly increase the supply of new properties, if the supply of planning permissions also rises. However, if housebuilders were simply selling to property investment funds, rather than to individual purchasers, this would not, in itself, make an appreciable contribution to improving housing supply.
- Such vehicles have clear incentives, as well as the financial strength, to maintain their properties. This could lead to higher quality and a more professional private rental market, improving its attractiveness, and thereby helping to create a better balance of housing tenures.
- Long-term investment may promote greater stability in the market, as such vehicles would have greater access to equity finance, are therefore typically less reliant on debt financing and so less vulnerable to interest rate changes as well as being subject to greater market scrutiny.
- There is potential for institutional investment to play a greater role in managing subsidised housing.

6.11 The Review's Interim Report recommended that Government consider the introduction of a tax transparent property vehicle. It is therefore welcome that the Government has since announced its intention to consult on this proposal at Budget 2004.

³ pp. 68-69, *Barker Review Interim Report* (2003).

⁴ pp. 69-70, *ibid.*

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Government should deliver its proposals to promote greater interaction between institutional investors and the residential property market, through the introduction of tax transparent property investment vehicles.

6.12 If the recommendations set out elsewhere in this Report are implemented, many of the site-specific constraints should be addressed through greater certainty in planning and increased support to deliver infrastructure and tackle the challenges of brownfield. As a consequence, a significant increase in housing output should be possible over the next few years. This implies that the industry must take on more planning permissions. It must also be prepared to take the initiative, for example, with alternative forms of construction and innovative design, in order to play its role in meeting future housing needs.

COMPETITION IN HOUSEBUILDING

6.13 The Interim Report showed how land was the critical factor explaining competitive pressures in the housebuilding industry⁵. When land is in relatively scarce supply, fewer permissioned sites mean that there will be fewer competing housebuilders in any one area. This can reduce consumer choice. In such situations, competition focuses on land. Once land is secured, competitive pressures are reduced: to a large extent housebuilders can “sell anything”. There is therefore less need to compete on output, by offering a higher quality product or innovative design features, except in niche markets.

6.14 Housebuilders are often said to make their money from land, rather than from building houses. This is not entirely true. Housebuilders are not primarily land speculators and they often purchase “oven-ready” land⁶. However, where housebuilders have options on land, they will expect it to generate higher margins. This suggests that they expect to capture some of the uplift in value associated with gaining planning permission. Competition for options should limit the extent to which housebuilders are able to do this:

- developers will derive different residual values for the land, depending upon the value of the development they are proposing, their costs and their expected rate of return; and
- as long as there is effective competition, the developer with the highest value scheme and lowest costs should be able to offer the highest prices when bidding for land.

6.15 In principle, competition for land in these circumstances should ensure that housebuilders earn no more than normal profits. However, information shortfalls, such as those generated by uncertainty over the future of house prices or, in some cases, over decontamination costs, may allow a gap to emerge between the residual value paid by the housebuilder and the actual final value of the development. If house prices rise more than expected, housebuilders will capture the gain, though, conversely, they will also make losses if house prices decline. The longer the housebuilder holds on to land, the longer the gap between acquisition and development and, therefore, the greater the potential for housebuilders to make money from appreciation in house prices and land values. Of course this is also a very risky strategy, as housebuilders may face falling house prices and there is a cost to holding land.

⁵ Chapter 5, *Barker Review Interim Report* (2003).

⁶ Oven-ready land refers to land that is purchased outright, typically with outline planning permission already granted.

6.16 The Interim Report considered carefully whether housebuilders do in fact “hoard” land⁷ based on expectations of higher prices, or conversely, fears of building as the market moves downward. Evidence suggests that housebuilders’ land holdings are primarily operational. That is, they hold enough land with planning permission (and in some cases less) to deliver planned housing output over the next 11-16 months. The Interim Report did not consider this excessive, or indicative of significant land speculation.

Incentives

6.17 Even if developers did speculate, however, why should this matter? Speculation is, after all, a valid entrepreneurial activity that occurs in many areas of economic life. Speculation and speculative gains have significant implications for housebuilders’ financial incentives and the pressures they face to be more efficient, innovative and responsive to consumers:

- It implies that housebuilders may be rewarded far more for obtaining valuable, scarce housing land than for building a higher quality product in ever more efficient ways. By contrast, if land prices were more stable, the only way for housebuilders to improve profitability would be by improving efficiency and the quality of output. So, demand-side measures that reduced volatility would have a supply impact through this channel as well as reduced risk premia.
- Where speculative gains are, in part, a consequence of the regulatory system and its contribution to increasing house prices, housebuilders may compete to gain planning permission. This form of competition does not necessarily serve the interests of homebuyers or society as a whole.

6.18 Of greater concern is the possibility that housebuilders have an incentive to control production rates, in order to maintain house price increases. The Interim Report noted that housebuilders control their production rates on large sites in particular⁸. Two possible explanations were put forward for this:

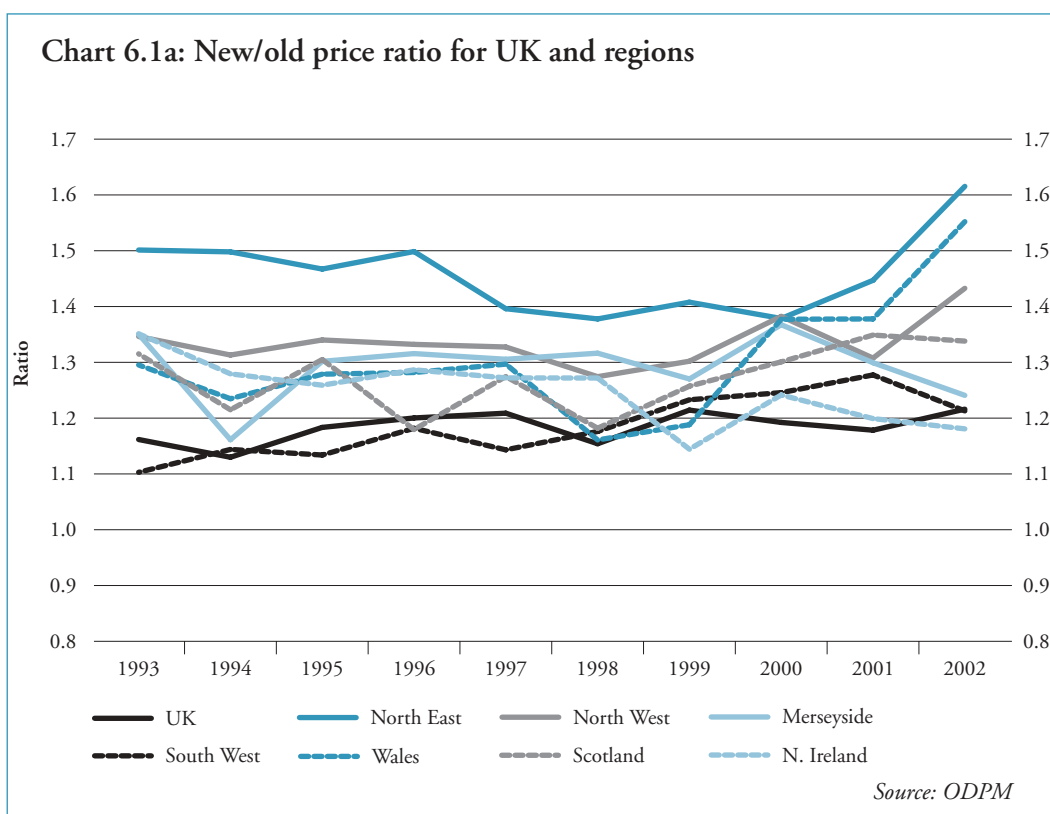
- Controlling rates of production may reduce the impact of house price volatility. Prices achieved in ongoing sales provide feedback about the state of local housing markets and can alert the housebuilder of the need to increase output when demand is strong, or to hold back build when sales are weaker. Without such feedback mechanisms, housebuilders could be exposed to greater losses, if prices declined.
- Where a housebuilder is building a high proportion of all units for sale in a particular locality they will be aware that producing too many at one time may reduce prices and hence profits.

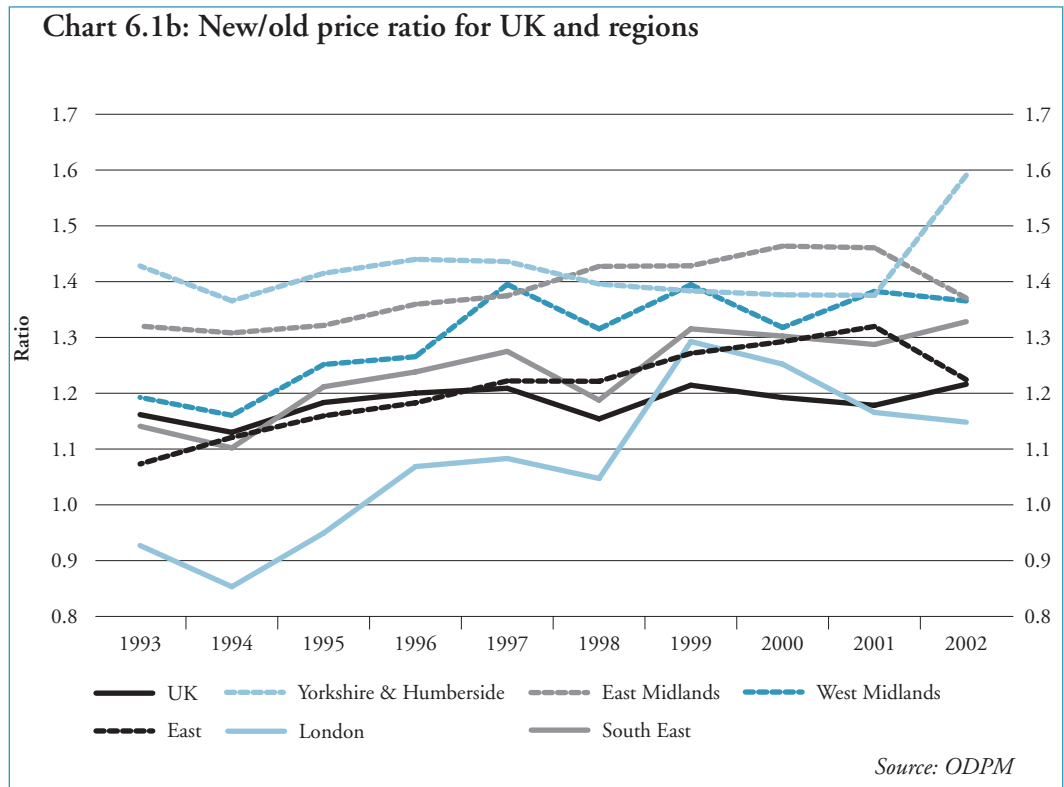
⁷ pp. 82-89, *Barker Review Interim Report* (2003).

⁸ pp. 87-89, *ibid*.

Market power

6.19 The extent to which housebuilders are able to influence house prices in a location, for example by slower production rates, is determined by their market power. The Interim Report pointed out that, in theory, the land market might encourage landowners to limit competition in the market for housing, as they benefit through a higher land value. At the same time, owning a single large site exposes the housebuilder to significantly greater market risk. As a result, many housebuilders choose to split sites and sell off parts to competitors, rather than exploiting the advantages of economies of scale and potential market power, which might result from retaining sole ownership. It is also important to bear in mind that any possible market power is limited by the fact that second-hand homes account for 90 per cent of transactions in any year. As charts 6.1a and 6.1b show, the price premia associated with new homes have, in general, remained broadly constant over time at a regional level.





6.20 The Interim Report also found little evidence to suggest the widespread existence of market power at local level⁹. Nevertheless, it is clearly desirable to ensure that competitive pressures are as strong as possible. If the Review’s recommendations succeed in increasing land supply, the industry’s relationship with land should change. In the future, greater house price stability should also mean more stable land prices. Along with increased availability of land, this should compel the industry to re-direct its energies towards improving its product and delivering a better service to its consumers. Profits should flow more from greater productive efficiency and less from speculative gains.

6.21 However, this may not be enough to guarantee that the industry responds. The track record of the industry over the past decade, in areas such as consumer satisfaction, skills, innovation and local acceptance, is not sufficiently strong to inspire confidence in policy makers that it can be guaranteed to deliver. The Review is therefore proposing a series of challenges for the housebuilding industry.

Controlling production rates

6.22 While the Review has found no compelling evidence of anti-competitive behaviour associated with build-out rates for large sites, it considers that it is desirable to ensure that sites are built out at a rate that is socially optimal as well as privately optimal for housebuilders. The Review has considered fiscal options to provide housebuilders with an incentive to develop land more quickly. This might work along similar lines to the land value tax outlined in Chapter 4, but with the tax levied after the granting of planning permission. For example, developers could be charged for every uncompleted house on a site.

⁹ pp. 89-90, *Barker Review Interim Report* (2003).

6.23 Attempting to increase build-out rates through a fiscal measure would potentially have the effect of changing builder behaviour by increasing the cost of holding land. However, such a measure could have a number of negative side effects:

- Housebuilders rely on phasing sites to ensure adequate cash flow, so that profits from previous sales fund future development. Reducing cash flow could prevent development.
- Some sites would not get developed, as the costs of development would be increased. This may be particularly true on complicated brownfield sites where land assembly and construction are typically more difficult to achieve. It could also impact on higher density development, particularly high-rise.
- Furthermore, housebuilders may become more risk averse under such a policy, as they will face higher penalties for getting a housing development decision ‘wrong’ and thus finding that it is necessary to build a site out more slowly or to postpone development. Increased risk aversion would lead, overall, to a drop off in development, as marginal projects become unviable.

6.24 As the Interim Report noted¹⁰, slow build-out rates and the exercise of market power are only likely to be of concern for large sites. Applying a fiscal measure of this sort to all sites could both increase administrative burdens on local authorities as they monitor output, and/or end up penalising those developments that run into unexpected problems following the granting of planning permission.

6.25 It is also questionable whether such a measure would be effective. If an extra cost were to be placed on housebuilders, it is likely that this would be factored into their calculations and ultimately capitalised back into land prices offered to landowners. By reducing residual values, some developments, particularly marginal brownfield sites, could be prevented.

6.26 Policy changes that result in more land coming forward for development overall would increase the amount of new housing coming onto the market, even if it was ‘trickled-out’ at present speeds, without distortions to developers’ business practices. To encourage increased build out rates, it may therefore be simpler instead for local authorities, faced with a large site awaiting development, to award a higher number of smaller permissions for the site and allow market competition to provide incentives for swift development.

6.27 Planning guidance should encourage local planners to allocate both large and small sites for development, where such a variety exists in their local areas, so as to increase the flow of new houses onto the market. Where only a few large sites exist in a local authority, planning departments should have regard to the impact on local competition and build-out rates in deciding whether or not to encourage applications from developers that split up large sites. To encourage faster build-out, planning authorities should use their discretion in setting time limits on planning permissions and seek to agree an expected build-out rate, as a condition of planning permission. If the rate of build-out has not increased appreciably by 2007, subject to conditions in the housing market, Government should review all available policy options to address this issue.

¹⁰ p. 88, *Barker Review Interim Report* (2003).

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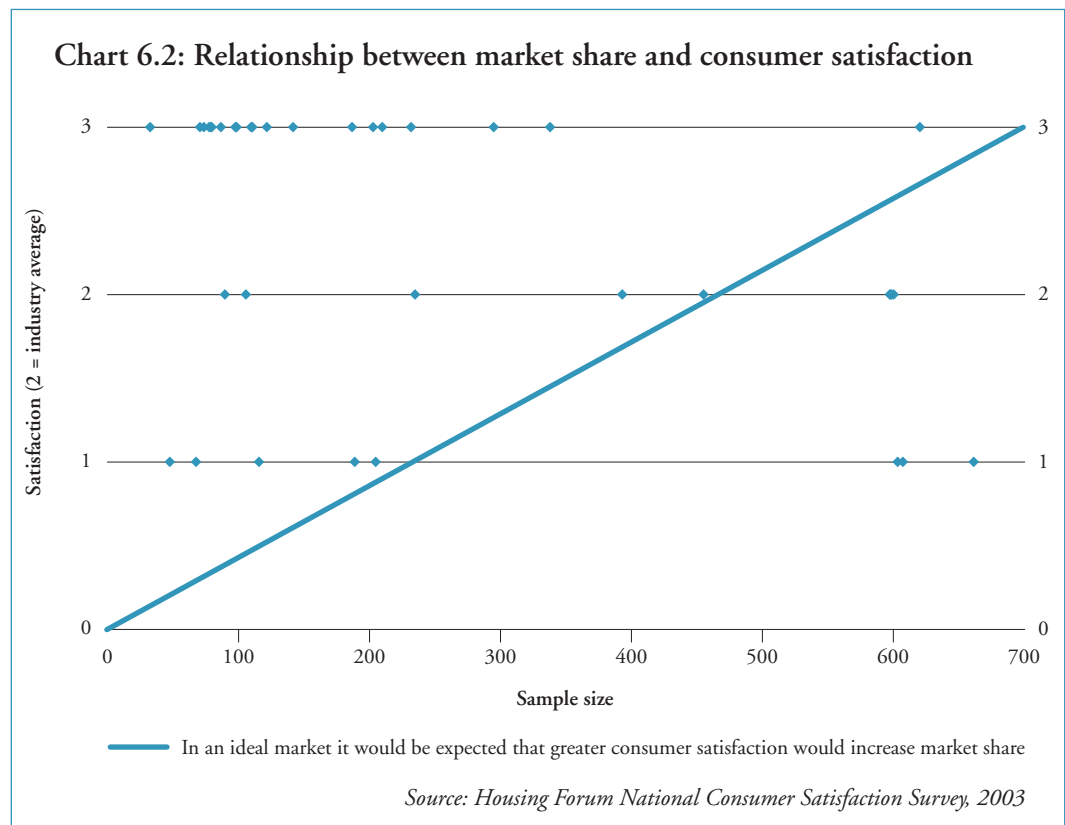
Planning Policy Guidance 3 (Housing) should require local planning authorities to have regard to the impact on competition when allocating sites in their Local Development Frameworks. For example, if there is a choice between allocating a number of small sites or a single large site for development, competition considerations would favour a larger number of smaller sites.

When granting planning permission on large sites, local planning authorities should discuss build out rates. To encourage faster build-out, planning authorities should use their discretion in setting time limits on planning permissions and seek to agree an expected build-out rate, as a condition of planning permission.

If the rate of build-out has not increased appreciably by 2007, subject to conditions in the housing market, Government should review all available policy options to address this issue.

CUSTOMER SATISFACTION

6.28 As noted earlier, housebuilders do not have to deliver a good product, or high levels of customer service, to win market share. Winning competition for land is key. Chart 6.2 shows that there is no correlation between a company’s market share and the extent to which consumers are satisfied, as measured by their willingness to recommend the housebuilder to others in future.



6.29 The industry must improve the quality of customer service. Customer satisfaction levels have fallen since 2000, with only 46 per cent of customers saying that they would recommend their housebuilder (see Box 6.1). The need to improve standards applies right across the industry: of the nine companies that performed worse than the industry average on this indicator, four – Persimmon, Barratt, Wilson Connolly and Westbury – were among the top ten housebuilders in 2002¹¹.

Box 6.1: National Consumer Satisfaction Survey

Since 2000, the Housing Forum has commissioned a regular consumer satisfaction survey¹². This survey of over 10,000 respondents measures a number of aspects of consumer satisfaction and dissatisfaction with new house purchases. Table 6.1 below shows lower levels of customer satisfaction compared with 2000 under all three main measurements.

Percentage of customers who are very satisfied or fairly satisfied with their house builder

	2000	2001	2003
Overall satisfaction with quality of home	87	87	83
Overall satisfaction with quality of service	69	70	65
Would you recommend your housebuilder	52	49	46

Source: Housing Forum National Satisfaction Survey, 2003

Although customers are mostly satisfied that new houses represent good value for money overall, a substantial proportion of customers express concerns about the quality of service and with the standard of construction and finishing. Satisfaction with the service provided by housebuilders tends to decline over successive stages of the purchase process, with dissatisfaction levels particularly high with after-sales service.

6.30 Low levels of consumer satisfaction have been underpinned in the past by a lack of adequate customer protection. Land contracts are partially exempt from the Unfair Contract Terms Act (1977). Until earlier this year, some in the industry questioned whether the Unfair Terms in Consumer Contract Regulations (1999) apply to consumers buying new homes. The Office of Fair Trading (OFT) intervened in a recent legal case on the issue of whether the Regulations apply to land contracts, and the recent Court of Appeal Judgment¹³ handed down in that case has resolved that these Regulations do indeed apply. The Regulations implement European Union law and therefore take precedence over the exemptions in the Act. However, the historic lack of protection means that contracts are often unclear and include wide ranging exclusions of liability, which can be detrimental to customers.

¹¹ The housebuilders that customers were least likely to recommend were Barratt Homes, David McLean Homes, Fairview New Homes, Morris Homes, North Country Homes, Persimmon Homes, Rialto Homes, Westbury Homes and Wilson Connolly.

¹² *Housing Forum, National Customer Satisfaction Survey* (2003). The survey has been carried out in 2000, 2001 and 2003.

¹³ *The London Borough of Newham v Khatun, Zeb and Iqbal*, 24 February 2004. Further details are available on the OFT website: oft.gov.uk/News/Press+releases/2004/29-04.htm

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The housebuilding industry must demonstrate increased levels of customer satisfaction:

- The House Builders Federation should develop a strategy to increase the proportion of house buyers who would recommend their housebuilder from 46 per cent to at least 75 per cent by 2007. Over the same period, levels of customer satisfaction with service quality should rise from 65 per cent to at least 85 per cent.
- The House Builders Federation should develop a code of conduct by the end of 2004 for new house sales in full compliance with the framework provided by the Office of Fair Trading's Consumer Codes Approval Scheme. This code of conduct should require fair contracts complying with the Unfair Terms in Consumer Contracts Regulations 1999.

If progress is unsatisfactory, or if consumer satisfaction levels do not rise substantially in the next three years, the Office of Fair Trading should conduct a wide-ranging review of whether the market for new housing is working well for consumers.

INNOVATION AND SKILLS

6.31 Innovation and skills are important factors in determining the industry's ability to increase housing supply. The impact of increasing land supply on output will be severely limited if innovation is low, or there is a shortage of skilled labour.

Innovation

6.32 At the present time, traditional brick and block methods of construction remain cheaper, in many cases, than modern methods of construction (MMC), including off-site manufacture (OSM). The time savings available do not currently provide a compelling financial reason to switch production. There are a number of further factors that exacerbate this cost disadvantage for OSM and MMC:

- the scale of production required to take advantage of reduced costs through economies of scale is not always available;
- the nature of the planning system may have operated against the introduction of OSM by increasing delays and uncertainty;
- new production methods require housebuilders, their subcontractors and employees to develop new skills and competencies;
- investors do not necessarily see the commercial benefits of switching from tried and tested methods of construction to approaches that are uncertain and where the reaction of consumers and mortgage lenders are also unknown; and
- the National House-Building Council (NHBC), who provide the vast majority of warranties for new houses, take a very cautious approach to new production techniques, particularly where houses are sold to private customers¹⁴.

¹⁴ For example, NHBC would not necessarily provide a warranty for private sale for some OSM schemes, even where these have been used in the social housing sector.

6.33 Despite the existence of barriers, improving production techniques is important: improved build quality, for example, is just one advantage of MMC and OSM (see Box 6.2 below). The Interim Report noted the increasing use of timber and steel frames¹⁵ and there have been a number of successful demonstration projects.

Box 6.2: Housing Forum demonstration projects

Since April 1999, the Housing Forum has run 140 new build, refurbishment and maintenance projects across the UK¹⁶. The majority of these projects have been in the social sector, with private housebuilding only accounting for five per cent of projects. These have been selected as demonstrating innovative approaches to construction, both in terms of the technology used (e.g. OSM) and the processes used to deliver (e.g. partnering and supply chain management). The examples below illustrate the range of projects undertaken in this programme.

- Millennium Plus at the Nightingale Estate in North London involved the tenants in both the design of the housing and the construction type. Tenant representatives were taken to Holland to examine and approve the tunnel form construction used on the project. Millennium Plus won the national Building Homes award for Best Options and Choices in 2001 against competition from both private and public sector developers.
- By using a specialist timber framing system, Prime Focus, in partnership with Kingfisher Building Contractor, on the Castle Vale project in Birmingham have developed houses that are calculated to perform 10-15 per cent better than the recommended level of energy measurement used by the Standard Assessment Procedure.

Although conducting such projects has not led directly to increased profitability, there have been a number of benefits, both to companies and their customers. Customers have benefited through better build quality (for example 40 per cent better performance on defects than the industry average) and greater involvement in the design process. There have been clear benefits to suppliers as well. These benefits include a greater willingness to innovate in future, expanding the competencies of the organisation, an improved focus on continuous improvement and enabling the organisation to keep up with its competitors.

6.34 Nevertheless, at the moment, most housebuilders do not see the commercial sense in a rapid expansion in OSM or MMC. Indeed, there may be risks, as well as opportunities, from going down this route. Dedicated technologies may require specifically skilled labour, implying tighter capacity constraints. When demand increases, production costs are likely to rise more steeply than with more flexible, but less sophisticated techniques. As Table 6.2 shows, on some measures, UK housebuilding costs have risen less steeply than a number of major competitors over the past decade¹⁷. This suggests to some observers that the organisation of the UK housebuilding industry may be relatively efficient in controlling construction costs and that growing skill shortages might be less of a threat to increasing output than has been feared.

¹⁵ pp. 107-108, *Barker Review Interim Report* (2003).

¹⁶ Housing Forum, *The Housing Forum Demonstration Project Reports: The Challenges Ahead*, (2002).

¹⁷ Michael Ball, UPE Consultancy Ltd, London. Real housing investment indices are estimated by calculating the implied deflator of housing investment in national accounts and adjusting them to real terms using the GDP deflator. Germany is negative because of the long collapse in demand since the peak of the 1990s building boom.

Table 6.1: Annual real increase in construction costs, 1991-2002

Country	Annual real increase in construction costs (%)
Netherlands	2.84*
USA	0.97
Denmark	0.86
UK	0.52
France	0.37
Germany	-0.37

* 1995-2002 real housing construction cost index

Source: Michael Ball, UPE Consultancy Ltd, London

6.35 UK housebuilders have avoided using proprietary OSM schemes. As a consequence many UK housebuilders adopting OSM have set up their own joint venture companies, in order to control the production process. This increases the problems of economies of scale, as each housebuilder must achieve sufficient scale to make their own processes commercially viable.

6.36 Increasing volumes, through the increase in housebuilding set out in the Report, may well make OSM or MMC more attractive propositions. Further consolidation in the industry, should this occur, and hence increasing scale, could make OSM viable for some housebuilders. Over time, it is likely that the commercial pressures will change and the economic rationale for MMC and OSM will become clearer. As a result, the Review does not consider that direct, ongoing financial incentives for MMC are warranted. But it is important that the industry is ready to take up this opportunity, as and when it arises.

6.37 The industry, therefore, should work with all of its stakeholders to ensure that any barriers to the adoption of OSM and MMC are removed. The Review supports the continuing funding of OSM and MMC demonstration projects by ODPM and the Department of Trade and Industry, which help to overcome informational market failures, by identifying the benefits of such techniques and establishing best practice. For example, it is Government policy that 25 per cent of new build in the RSL sector should use MMC/OSM, and often applications for projects using OSM or MMC are considered more favourably. It is also reasonable to expect, that with continuing improvements in efficiency and through developments in construction techniques, the industry should be able to reduce construction times and therefore speed up the release of completed homes.

Recommendation 33

The House Builders Federation, in conjunction with NHBC, ConstructionSkills¹⁸ and other interested parties, should develop a strategy to address barriers to modern methods of construction. This strategy should be developed to fit alongside existing initiatives, working closely with Government to identify further measures that can be taken. A range of approaches should be explored, in particular actions by industry, and changes to NHBC policy and practice, as well as representations to Government on areas such as changes to building regulations.

¹⁸ On 25th September 2003, the Secretary of State for Education signed a five-year licence for ConstructionSkills, a partnership between CITB Great Britain, CITB Northern Ireland and the Construction Industry Council, to become the Sectoral skills council for construction. ConstructionSkills will be responsible for representing employers' skills needs and tackling the skills and productivity issues of the industry.

Skills

6.38 The Interim Report noted that skill shortages currently exist in the housebuilding industry¹⁹. Of particular concern is the low level of training undertaken by the industry. Levels of training are low compared to other industries and by international standards. The housebuilding industry trains three apprentices for every hundred workers, as compared with 4.3 in the construction industry as a whole. International comparisons of apprenticeships within the key crafts of bricklaying and carpentry show that Germany trains nearly three times as many apprentices per hundred workers than the UK and that the Netherlands trains twice as many²⁰.

6.39 Market failures can exist in skills acquisition. Fear of poaching may make firms reluctant to invest in training, if, when employees leave, the benefits of the investment accrue to another employer. Individuals may fail to invest because of inability to access finance, or because they do not accurately perceive the benefits to training. There are also benefits to society from a better-trained, more productive workforce, over and above those enjoyed by either individuals or employers. For all of these reasons, underinvestment can occur.

6.40 These general problems with training provision are exacerbated in the housebuilding industry by the prevalence of sub-contracting, itself a response to the degree of risk and uncertainty faced by the industry. In recognition of the particular difficulties of skills provision in the sector, the industry operates a training levy through Construction Industry Training Board (CITB), the industrial training board. The levy raises over £90 million annually and is spent on improving training right across the sector. On top of this, the construction sector receives £56 million each year from Government through funding for Modern Apprenticeships, with further funding from other programmes.

6.41 The Review does not consider that separate Government programmes are needed to address skills shortages in this sector. A range of programmes and initiatives are already in place to promote skills acquisition, both for young people and for older workers:

- Modern Apprenticeships provide a UK wide, Government supported, training framework. Young people can participate in a full-time Modern Apprenticeship from age 16, and the Learning and Skills Council is currently raising the upper age limit of 25.
- The National Modern Apprenticeship Taskforce (MATF), chaired by Sir Roy Gardner, Chief Executive of Centrica, was established in February 2003 to increase further the number of apprenticeship opportunities, by generating increased and more broadly based employer engagement. The MATF has set up a Construction Sector Working Group to improve take-up of Modern Apprenticeships in the construction sector, which currently accounts for 12 per cent of Modern Apprenticeships.
- In August 2003 the Department for Education and Skills launched an Entry to Employment (E2E) programme throughout England to help develop more effective work-based learning, enabling more young people to progress to higher learning opportunities.
- In July 2003 the Government's skills strategy set out a new entitlement enabling any adult in the labour force without a full Level 2 qualification to have access to free learning for their first full level qualification.

¹⁹ pp. 98-104, *Barker Review Interim Report* (2003).

²⁰ Table 6.4, *ibid.*

6.42 Working with ConstructionSkills, the sectoral skills council, the industry could, and should, do more to take full advantage of these and other Government programmes. These programmes, in turn, require active employer participation, for example in developing a local skills base and actively managing up the supply chain, to maximise their effectiveness. Box 6.3 shows one example of good practice in the construction sector.

Box 6.3: Carillion Construction

Carillion operate a national network of 16 construction training centres. The centres were set up several years ago to train young apprentices to work with and eventually join the company's directly employed workforce. Over the last 25 years, most large construction firms moved away from direct employment to using sub-contractor supply chains and stopped training apprentices. As a response, the training centres switched their focus from exclusively training apprentices for their parent company to training on behalf of the industry as a whole.

This approach seems to suit construction firms, including Small and Medium-sized Enterprises (SMEs) who have an erratic workload or operate over a large geographical area. Working closely with CITB-ConstructionSkills, Carillion is able to offer apprenticeships to about 1,200 school leavers every year, many of whom would not otherwise be able to enter the industry as skilled workers. Apprentices can be rotated through a range of firms offering different types of work experience, enabling them to achieve their National Vocational Qualifications effectively.

Carillion help address local training supply and demand issues by opening new training centres and employing new apprentices. For example, a new centre has been set up near to Heathrow Airport with the support of the local Learning & Skills Council and British Airports Authority (BAA). The centre is offering employed Modern Apprenticeships to local young people who were not able to secure apprenticeships with local firms, or attend full-time college courses. These young apprentices will be placed for work experience with BAA supply chain contractors and local construction SMEs, until they complete their training and join the industry as skilled workers.

6.43 If further funding is deemed necessary, the first port of call should be to review the level of the training levy and its distribution. In the short term, Government should consider increasing support for skills in the construction sector, alongside any increases in the training levy needed to deliver increased housing output. In the longer-term, however, with greater certainty and higher overall volumes, there is no case for the sector to receive Government support over and above that available to all sectors of the economy, through initiatives such as Modern Apprenticeships. The industry should be challenged to raise its game and increase its investment in the skills needed to secure its own future prosperity. A number of factors would need to be addressed by industry and Government to make this happen:

- the absence of opportunities to undertake initial on-site training and the structure of apprenticeship training, which means that apprenticeships are insufficiently skilled to go on site and are therefore not always welcomed by employers;

- shortages of capacity and skilled instructors in Further Education colleges. Around 75 per cent of colleges expected their construction craft courses to be oversubscribed in the 2003/04 academic year²¹; and
- cultural attitudes, including both resistance to training within the industry and the ongoing difficulty in attracting new recruits from a diverse range of backgrounds.

Recommendation 34

CITB-ConstructionSkills and the House Builders Federation should work together to develop a strategy for substantially increasing the take-up of apprenticeships from the current level of three apprentices per 100 workers, to bring the UK to the levels of leading international comparators, such as the Netherlands and Germany. The development of this strategy should also explore whether the appropriate number and range of courses exist, and whether housebuilders are investing sufficiently in their own workforce training, as well as addressing the skills needed for modern methods of construction.

In the short term, Government should consider increasing support for skills in the construction sector, alongside any increases in the training levy.

If skills constraints are not adequately addressed by March 2007, Government should conduct a review of the effectiveness and impact of CITB-ConstructionSkills in the housebuilding industry.

LOCAL ACCEPTANCE OF DEVELOPMENT

6.44 The Review has highlighted the strength of opposition that often exists at local level to proposed development. The nature of such opposition is complex. Concerns may be environmental, related to preserving the character of the area, pressures on infrastructure, or even fear that property values will be eroded. The planning system is intended to address these concerns and balance the benefits of development through the democratic processes involved in granting planning permission. The Review has identified a number of recommendations that should improve this process.

6.45 However, the industry could do more to facilitate local acceptability of development. Urban coding, and the accompanying consultation process, is one way of achieving this. Improving the quality of design, ensuring that developments improve the built environment, that they are sustainable and enhance services available to the local community, is another.

6.46 Some commentators, sceptical of the industry's capacity to deliver good design, have suggested that the planning system should play a bigger role in determining design issues. The industry argues, on the other hand, that it is best placed to understand the needs of its customers. In order to compete and to command higher premiums, there is a clear incentive to improve the attractiveness of their product and to deliver what consumers want. However, in the recent past, this incentive has not been entirely self-evident and the industry needs to work with the Commission for Architecture and the Built Environment (CABE) to raise design standards across the board.

²¹ Source: ConstructionSkills, *Construction Skills Foresight Report*, 2003.

Recommendation 35

The industry should work together with CABE to agree a code of best practice in the external design of new houses. Where planners and housebuilders disagree on specific design issues, they should seek arbitration, possibly through CABE, to resolve these matters.

6.47 Even where new houses are designed to a high standard and in keeping with the surrounding area, development may inevitably result in a level of disamenity for some people affected. This can be true whether the development is for housing or any other purpose. For some developments this disamenity is dealt with through compensation payments, which are, in some instances, required by statute (Box 6.4 illustrates how statutory compensation schemes work). In other instances, voluntary compensation schemes are adopted. Box 6.5 illustrates how BAA is developing such a scheme, with regard to Stansted Airport.

Box 6.4: Statutory compensation schemes

The 1973 Compensation Act allows for residents to claim compensation for the impacts of public works carried out on, among other things, roads, rail and airport infrastructure.

Under the existing legislation, residents who believe that they are entitled to compensation can make a claim twelve months after the work is completed. District Valuers (DVs) from the Valuation Office Agency (VOA) measure quantitatively the decibel and/or vibration impacts of the public works against a threshold of acceptability. Using this, and hedonic pricing techniques, a level of compensation is awarded to the resident to account for the loss of value they experience to their property, as a result of the works. District Valuers' valuations and levels of compensations are then subject to appeal to the Land Tribunal, a division of the High Court.

6.48 Introducing a compulsory compensation scheme for housebuilding would not be appropriate. Aside from practical difficulties, when people buy a house, they do not necessarily buy the right to an unchanging level of housing provision in their local area or access to amenities. Indeed, it might be proposed that moving to a particular area, in itself, implies some level of tacit acceptance that inward migration should be allowed.

Box 6.5: Non-statutory compensation mechanisms

The Government's recent transport White Paper *The Future of Air Transport* laid out guidelines listing what it expects from airport operators in terms of non-statutory compensation for aircraft 'blight'.

The Government expects airport operators, amongst other things, to:

- operate voluntary compensation schemes according to a classification of levels of disruption based on decibel levels;
- assist households severely affected by airport expansion to move; and
- offer acoustic insulation to public service providers such as schools and hospitals.

With regard to the planned expansion of Stansted Airport, BAA is following this guidance and offering its own compensation scheme to residents affected by the planned development, including the guaranteed purchase of homes at a premium and money for insulation and sound proofing.

6.49 Secondly, and perhaps more significantly, such a scheme would be based on the assumption that more housing is always bad for the existing residents. Certainly, any large housing development will have some negative impacts on certain existing residents. However, benefits can also accrue to local residents from more housing growth. Furthermore, a larger population will support a more diversified economy, creating wider employment opportunities for all residents.

6.50 However, in some circumstances, compensation may assist in securing local acceptability of development. The Review therefore considers that it would be appropriate for housebuilders themselves to draw up a voluntary best practice guide to compensate people for the transitional effects of development.

Recommendation 36

The House Builders Federation, in consultation with its members, should draw up a best practice guide for voluntary compensation schemes to directly compensate those immediately affected by the transitional effects associated with development. This might include cash payments to individual households.



Summary of interim analysis

INTRODUCTION

A.1 Housing has a huge impact on individuals' quality of life. Being adequately housed, and living in a pleasant environment is fundamental to well-being. The housing market also has a major effect on the economy. An inadequate housing supply, or a poorly-functioning housing market, constrains economic growth. Demand for housing in the UK continues to grow. Population growth, changing patterns of household formation and rising incomes are all fuelling demand for homes, yet in 2001 the construction of new houses fell to its lowest level since the second world war. Over the ten years to 2002, output of new homes was 12½ per cent lower than for the previous ten years.

A.2 There is considerable evidence that a shortage of housing exists in the UK, but the nature of this shortage is complex. Simply comparing the number of households and the number of dwellings fails to capture mismatches between the location of supply and demand or between the type of housing desired and that which is available. In addition some existing stock fails to meet the needs and aspirations of today's households. Current housing output is insufficient to meet new demand. There is also a need to replace housing stock that has outlived its useful life.

A.3 The consequences of the way in which the housing market operates should be a concern for everyone. Over the last thirty years UK house prices have risen in real terms by around 2½ per cent a year. This stands in contrast to some other countries, such as France, Sweden and Germany, where real house prices have remained broadly constant or even declined. One reason for this trend is the weak response of housing supply to changes in demand. Higher demand therefore tends to be translated into higher house prices rather than increased output of houses. This poor supply responsiveness is also one of the factors which have resulted in marked volatility in UK house prices. In recent years house prices have risen sharply in almost all parts of the UK, fuelling concerns about affordability with consequent unwelcome effects on individuals and the economy.

A.4 Clearly, just providing additional houses is not enough. The Government's strong focus on building sustainable communities is also vital, and this Review recognises how important it is to promote that goal. Important reforms to deliver a faster, more transparent and more effective planning system are also underway. Other reviews, such as that being undertaken by Sir John Egan, are considering the requirements of sustainability. This Review is concerned with looking at how far the UK has fallen short of providing an adequate supply of housing, and the adverse effects an unresponsive housing supply can bring about. In reality there are many housing markets, operating primarily at local levels, but this Review is mainly focussed on the overall framework within which regional and local decisions about housing should be set. An analysis of possible sources of constraint on supply is presented, in the context of the existing policy framework.

WHY UK HOUSE PRICES MATTER

A.5 The UK housing market is unusual when set in an international context. Evidence in Table 1 shows that trend UK real house price inflation has been higher than the European average (1.1 per cent per annum) between 1971 and 2001. With the exception of Spain the UK had the highest real price inflation in Europe over the period at around 2½ per cent per annum. House prices have risen particularly sharply in recent years, up by an estimated 9 per cent per annum from 1996 to 2002¹. Although much of this rise is attributable to other factors, such as the effect of lower interest rates and expectations of greater economic stability, the weak supply response to these higher prices has also played a role. But the more fundamental issue is that a weak supply response has contributed to the UK's atypical long-term house price behaviour.

Table A.1: Real house price inflation, 1971-2001

	Average ¹	Trend ²	Volatility of house prices around trend ³	Correlation of private consumption and house price inflation
UK	3.3	2.4	15.1	0.85
Germany	0.1	0.0	11.1	0.33 ⁵
France	1.2	0.8	7.6	0.50
Italy	1.5	1.2	15.5	0.14
Spain ⁴	3.3	3.0	17.3	0.55
Netherlands	2.8	1.3	25.1	0.73
Belgium	2.1	1.7	14.3	0.38
Ireland	3.1	2.2	17.4	0.66
Sweden	0.0	-1.0	19.0	0.73
Finland	0.7	0.7	13.5	0.64
Denmark	1.3	0.2	13.4	0.64
Average	1.8	1.1	15.4	0.56

¹ Geometric mean.

² Based on a regression of (log) real house prices on a constant and a time trend.

³ Coefficient of variation.

⁴ Spain between 1972 and 2001 only.

⁵ Excludes former East Germany except private consumption growth 1992-2001.

Source: Bank for International Settlements HM Treasury's 'Housing, Consumption and EMU', EMU Study, 2003.

A.6 Volatility has also been a feature of the UK housing market over the longer term, with successive periods of strong house price growth in the early 1970s and the late 1980s being followed by periods of real house price decline. Table 1 also shows the close link between changes in house prices and spending. The sensitivity of household spending to housing wealth and house prices is higher in the UK than elsewhere in Europe, so house price volatility may have a greater impact on the UK economy. Expectations of house price growth also affect the user cost of housing (the cost of housing less the benefit of price appreciation). This will amplify the volatility of demand for housing because households' expectations of substantial future house price changes can alter their behaviour compared to a period of more stable prices. The expectations of housebuilders are also a key factor in determining their supply decisions. Time lags between the decision to build and completion can further exacerbate volatility. A lack of responsiveness of supply means that increases in demand will feed directly into higher house prices.

¹ ODPM mix-adjusted house price data.

A.7 Home owners often view rising house prices as a positive attribute of our housing market. Capital appreciation has increased individuals' wealth, and the scope for equity withdrawal has enabled them to realise additional spending power. But rising house prices also have unwelcome and unhelpful consequences for our economic well-being:

- Lower rates of housebuilding constrain economic growth, reducing standards of living for everyone in the UK. Reduced housing supply damages the flexibility and performance of the UK economy, having a negative impact on business location decisions and competitiveness. Regional price differentials reduce labour mobility and lead to increased national unemployment.
- Restricting supply leads to a loss of economic welfare. Constraining supply means that resources which would have been used for housing are instead used for other potentially less beneficial purpose or not used at all. This leads to an inefficient allocation of resources creating a deadweight loss. One counterfactual simulation suggests that if real house prices had risen in line with the European average since 1975, the UK would be £8 billion better off.
- The housing market also contributes to macroeconomic volatility. House price volatility feeds through into the wider economy, as changes in house prices and housing wealth are closely linked to private consumption. Household spending influences economic activity. In the past the combination of low levels of investment, high levels of owner occupation, high house price volatility and regional divergences together have created a more challenging environment for the conduct of economic policy.
- Higher house prices create affordability problems. An increasing number of people cannot afford to buy houses. In 2002, only 37 per cent of new households could afford to buy a property, compared to 46 per cent in the late 1980s. Declining affordability also has wider consequences, restricting labour market flexibility, hampering the delivery of public services and leading to longer commuting times affecting individuals' quality of life and environment.
- An undersupply of houses has distributional consequences that may be regarded as unwelcome. Higher house prices will result in a transfer of resources from those outside the housing market and those entering the housing market to existing home owners, landowners and, to some extent, housebuilders. The low rate of housebuilding in the UK over the last few years and the trend rate of house price increases suggests that the rate of home ownership (approximately 70 per cent at present) may only increase to around 72 per cent in 2016. For non-home owners the distribution of wealth will become increasingly unequal.

A.8 In the long term, the shortage of housing and related rising prices have a negative effect on all of us. In any time period, however, the most significant adverse effect of too few homes is on those who end up inadequately housed or homeless. The weakness of the present situation is all too real:

- for individual households: first time buyers in 2001 paid £27 billion more than if house prices had remained at 1975 levels in real terms. This is equivalent to each first time buyer paying an extra £48,000. First time buyers paid £18 billion more than if house prices had risen in line with those seen in other European countries with each first time buyer paying an extra £32,000; and
- for the homeless: the number of households in England in temporary accommodation has almost doubled between 1995 and 2003, from 46,000 to over 93,000 (the majority of which are in London and the South East). Housing supply is an important aspect, though not the only factor, behind this rise.

WHAT DRIVES UK HOUSE PRICES?

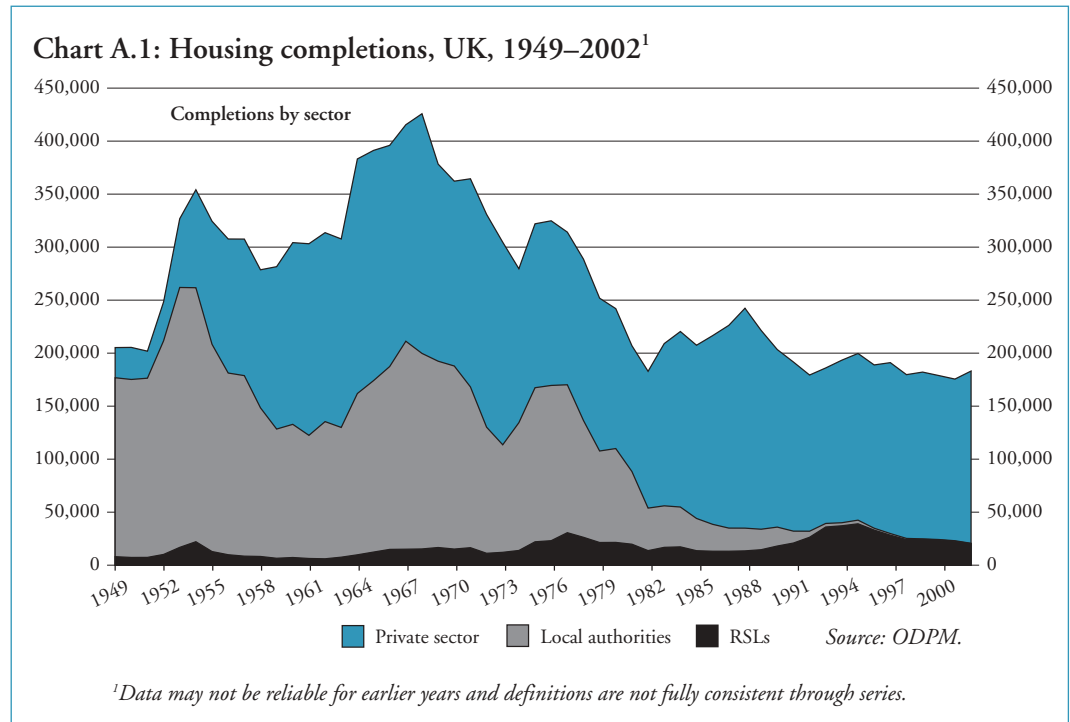
A.9 Strong house price growth in the UK stems in part from a high propensity to consume housing services, influenced by a number of factors such as:

- cultural preferences for home ownership, combined with policies that have encouraged home ownership such as the Right to Buy and Right to Acquire and, in the past, the relatively generous tax treatment of owner occupation;
- a more responsive and competitive lending market resulting from financial liberalisation; and
- the knowledge that housing is a good investment, given the price trends described above.

A.10 However, demand side factors alone cannot explain the high rate of house price growth seen in the UK, nor are they independent of supply. Chart 1 shows the decline in housebuilding over the past 50 years. The UK has had a relatively weak housing supply, having invested a low proportion of GDP in housing compared to other EU countries since 1960. Internationally, UK housing completions are also relatively low compared to the existing housing stock. At current rates of replacement a new house built today would need to last around 1,200 years.

A.11 Formal estimates of supply responsiveness suggest that housing output in the UK responds relatively weakly to changes in house prices. Against a background of rising demand, this will contribute to higher house prices than might otherwise be the case:

- international comparisons show that the supply of housing in the UK is less price responsive than in most other major economies. Our housing supply is only half as responsive as the French housing market, a third as responsive as the US market, and only a quarter as responsive as the German housing market;
- studies also show that supply has become less responsive over time. Before the war, it was up to four times as responsive as it was through most of the post-war period; and
- the responsiveness of housing supply has declined further in the 1990s, falling almost to zero, implying no change in housing output in response to the increases in price. Increasing demand has therefore fed directly into higher house prices.



HOW MANY HOUSES SHOULD WE BUILD?

A.12 The above discussion suggests that the UK housing market has not been delivering a socially optimum outcome. This optimum would need to strike the right balance between the environmental and other costs of housing and the macro and microeconomic benefits of satisfying demand more fully.

A.13 The socially optimum outcome is not just about overall numbers of houses, but also the type of housing and its location. Housing targets in England are determined by Regional Planning Bodies through Regional Planning Guidance (RPG). Regional Planning Bodies implicitly seek to establish a social optimum, though they might not use this term, in making decisions about the desired number of houses. Rates of housebuilding in the past have been below the rate required to meet these targets. RPG for England indicates that nearly 155,000 houses per annum should be built, but average annual completions between 1996 and 2001 were just over 140,000, suggesting a shortfall of nearly 15,000 units.

A.14 Looked at purely from the perspective of the UK economy, more housing would be beneficial. Different approaches to measuring the shortfall, produce a range of estimates:

- projections of population growth and changing patterns of household formation (a proxy for future demand), compared to current build rates implies there is a current shortfall of 39,000 homes in England per annum, of which 8,000 are private sector and 31,000 are affordable homes. In addition there is a backlog of around 450,000 households without self contained dwellings;
- keeping affordability for new households in line with that in the 1980s would imply a current shortfall of between 93,000 and 146,000 homes per annum in England, of which, 20,000 to 45,000 are owner occupied private sector homes and 73,000 to 101,000 are affordable; and

- reducing the long-term trend in house prices to zero real growth would imply an additional 240,000² homes per annum across the UK. To lower real trend price to 1.1 per cent³, 145,000⁴ more houses per annum might be needed, about double the current private sector housing output of 150,000 units⁵.

A.15 The Government has already acknowledged that more houses are needed. *Sustainable Communities: Building for the Future*⁶ sets out the Government's ambition to deliver an additional 200,000 homes by 2016, over and above those currently planned for through RPG. However, if the Government wishes to deliver a better functioning housing market, more houses may be required.

A.16 There are no obvious right answers as to how many more houses should be built. The number varies depending on the weight given to different policy objectives. Government has to consider a variety of possible objectives: improving economic performance and reducing housing market volatility; protecting the environment and open spaces; and ensuring that communities are sustainable. Determining housing numbers also requires consideration of regional and local housing markets and economies. Often supply and demand are spatially at odds, suggesting further problems which cannot be solved simply by building more houses regardless of location.

A.17 The UK is a relatively densely populated country, leading to concern that additional housebuilding will result in open spaces being concreted over. Actual land requirements will depend upon the density at which new homes are built and the extent to which previously developed land is utilised. In the South East⁷, over 60 per cent of land is protected (either greenbelt or designated conservation or protected area), 11.4 per cent is urbanised. Of the remaining land 1.5 per cent is required for future planned housebuilding between now and 2016. This requirement could be reduced further through even higher densities or better use of previously developed land.

CONSTRAINTS ON SUPPLY

A.18 Why are fewer houses built than might be desirable and why does output not respond to price signals? The Review has considered a range of factors that might constrain supply, arising from market failures and the underlying policy environment, including:

- industry constraints such as the competitiveness of housebuilders, capacity constraints relating to skills and innovation and the availability of finance; and
- the role of policy levers such as tax, regulation through the planning system and housing subsidies.

A.19 The underlying constraint on housing is the supply of land. This is constrained by a range of factors:

- the housebuilding industry, its response to risk and the speculative nature of land leading to a reluctance to build out large sites quickly;

² This is the central estimate of a range of housebuilding figures in Table 3.4.

³ This is the average trend rate of house price growth for the European countries in Table 1.

⁴ Ibid.

⁵ These figures are subject to a number of assumptions, set out in Chapter 3.

⁶ ODP, *Sustainable Communities: Building for the Future*, (2003).

⁷ South East is the ROSE area (Rest of South East) – equivalent to the Government Office South East region plus Essex, Hertfordshire and Bedfordshire.

- the increasingly complex nature of sites (especially brownfield), where significant remediation may be required;
- land ownership and the incentives to bring land forward for development along with the difficulties of site assembly, where ownership is fragmented;
- the planning system and its influence over the amount of land which is made available and whether development is viable through the delivery of necessary infrastructure; and
- land use is also politically contentious.

Policy levers

A.20 Government has a range of policy levers available to influence the supply of houses. Many of these are intended to reduce the negative externalities that can be associated with housing and promote positive externalities. Policy levers are potentially substitutable, so the same objective can often be achieved (and may be better achieved) by employing different instruments.

Tax

A.21 The tax regime interacts with land and housing in a number of ways at both the national and local level:

- The scarcity of land, combined with the operation of the planning system, results in significant windfall profits (known as economic rents) accruing to landowners. Previous attempts to capture this windfall gain through taxation have been largely unsuccessful.
- Previously, Government policies designed to encourage institutional investment in property through the tax regime have also had little success. However, there is merit in the Government considering a tax-transparent vehicle (based on the US Real Estate Investment Trust model) to encourage increased institutional investment.
- Aspects of the tax system favour home ownership above private renting. Tenants may be paying around 18 per cent more for a similar property after tax than an owner occupier. However, it is unlikely that this in itself has a significant impact on supply.
- The stamp duty regime is unlikely to be a significant constraint on housing supply. However, there may be particular distortions in behaviour near stamp duty thresholds.

The planning system

A.22 Housing development is often contentious and highly politicised. Local people often worry about:

- the possible loss of open space and the changing nature of their town or village;
- the potential impact on property values for those in close proximity to development, particularly if housing developments are poor quality, aimed purely at increasing numbers rather than creating communities in which people want to live; and
- the increased pressure on infrastructure and local services, which can lead to resources and services becoming more thinly stretched.

A.23 The present planning framework is not always able to balance appropriately the true social costs and benefits of development. In part this is because these costs and benefits are not accurately reflected in the incentives offered to and pressures faced by decision makers:

- local authorities face few sanctions if they fail to provide the housing numbers allocated by RPG;
- the local costs of development are considerable – as financial benefits to local authorities from increased population growth are slow to materialise; and
- those in need of housing are much less likely to have a strong voice in the political process compared to those who are already housed.

Many believe that housing numbers determined by Regional Planning Bodies are lower than they should be, reflecting what is politically feasible rather than what is socially optimal. At a local level the result is that less land is being made available for development than is required, given the price signals in regional or local housing markets. The release of land tends to be focussed on annual or five yearly targets, rather than on meeting demand and responding to market signals. The targets are often so contentious that there may be a reluctance to exceed them even if there is clear evidence of unmet demand.

A.24 Once housing numbers are agreed and land is allocated in local plans, delivery of housing can be constrained by a number of factors.

- Land availability may be constrained. 69 per cent of brownfield land may not be developable for the foreseeable future, owing to planning constraints or lack of demand in that locality. While there are often clear benefits to development on brownfield land, such as aiding regeneration, it is more complex and often more costly. Targets for brownfield development may also push up demand, and hence prices, for brownfield land.
- The planning system is complex, timescales are often unacceptably long and the requirements of planning can be used to prevent development. Refusals for planning permissions for major housing developments have gone up from 15 per cent in 1996-99 to 25 per cent in 2002.
- Specific infrastructure barriers, such as the delivery and funding of transport and water services also prevent or delay development. In the South East alone, over 40,000 dwellings have planning permission but are being held up by infrastructure shortcomings. Agencies responsible for transport and social infrastructure, such as schools and hospitals, are focussed on maintaining existing services rather than planning for growth.

Planning reforms being introduced by the Office of the Deputy Prime Minister, additional resources for local authority planning functions and a more proactive intervention strategy to deal with poorly performing local authorities, will all help to improve the effectiveness of the planning system.

Affordable housing

A.25 The level of affordable housing is largely determined by the extent to which government chooses to provide subsidy. If the amount of public subsidy allocated to social housing was increased and there were no constraints on land there would be more social housing delivered. Key constraints on the supply of affordable housing are the cost and availability of land. It is also important to ensure that Registered Social Landlords (RSLs) use their resources efficiently.

A.26 In the market for land, RSLs are likely to be frequently outbid by private housebuilders, particularly when land values are increasing. To help overcome land availability problems, private housebuilders are increasingly required to produce affordable housing through Section 106 agreements. However, the cost of such housing can be high, as private housebuilders tend to develop in higher value locations. In a less buoyant housing market there is likely to be much less scope to deliver affordable housing through Section 106.

The housebuilding industry

A.27 The housebuilding industry and its behaviour are, in part, a product of the policy environment. The industry faces two particular types of risk. Market risk arises from the volatility of house prices (a 1 per cent change in house prices can increase or reduce profits by up to 8 per cent). Site-specific risk covers those risks associated with land acquisition, gaining planning permission and the construction process.

A.28 These risks partly explain why the housebuilding industry is reluctant to make long term fixed commitments. The industry attempts to manage risk in a number of ways:

- by outsourcing many functions;
- by raising finance through retained profits rather than debt or equity; and
- by using option contracts to acquire land.

A.29 However, industry aversion to risk also manifests itself in:

- low levels of investment in brownfield development arising from housebuilders' reluctance to tackle complex brownfield or high rise developments (exacerbating the market failures typically associated with such developments);
- low levels of innovation, such as a reluctance to invest in off site manufacture and other innovative production techniques; and
- a lack of responsiveness, often arising from industry anxiety about being caught out by a period of housing market decline.

A.30 The Review has found little evidence, at least across the country as a whole, to substantiate concerns that option contracts and the practice of landbanking allow housebuilders to erect barriers to entry into the market. However, once land is acquired competitive pressure in the industry is reduced. In some localities a single housebuilder may have significant market power while the site is built out. Many housebuilders “trickle-out” houses, controlling production rates to protect themselves against price volatility and any adverse influence on prices in the local housing market, particularly when the development is large. This reduces responsiveness and while it may be rational behaviour for housebuilders, given that land is a scarce resource which society values, it is unlikely to be optimal for society as a whole. Faster rates of production may be more socially beneficial.

A.31 There may also be a more fundamental interaction between the existence of a housing shortage and the performance of the housebuilding industry:

- Limited land supply means that competition tends to be focussed on land acquisition rather than on consumers. Housebuilders' profitability depends on obtaining valuable land rather than building a higher quality product in ever more efficient ways.

- This might indicate a degree of regulatory complacency which has allowed the industry to settle into a low output equilibrium. Low output in the short run appears to suit many players – local authorities, home owners and arguably the industry. The only people it does not suit is the homeless, first time buyers and those inadequately housed. In the long-run, as argued above, there are negative impacts on the economy.

A.32 The industry does face some constraints:

- over 80 per cent of firms report skill shortages. These reports are supported by the fact that wages for skilled craftsmen are increasing faster than in the rest of the economy; and
- without changes in labour productivity, even modest growth in output could lead to a requirement for around 70,000 further employees in the housebuilding industry. A more substantial expansion of output would increase this still further, possibly up to 280,000 people.

A.33 Greater use of technology can lead to improved quality, and may also assist in dealing with skills constraints. English housebuilders are around 50 per cent more labour intensive than those in Denmark, and 25 per cent more than those in Scotland; labour intensity in England has been remarkably constant over the last 25 years. The industry has been relatively slow to adopt alternative manufacturing techniques – such as off site manufacture, and steel and timber frame construction. Reasons for the historic lack of innovation may include risk aversion, uncertainty caused by planning delays and the attitudes of consumers, lenders and warranty providers.

CONCLUSIONS & NEXT STEPS

A.34 UK economic well-being could be improved by increasing the supply of housing. Set against this, consideration needs to be given to the associated environmental costs. This gives rise to difficult choices, and the Government needs to weigh carefully its different policy objectives to determine its overall approach to housing. Making a real difference to housing supply may require a robust set of policies.

B

Summary of recommendations

Recommendation 1

Government should establish a market affordability goal. This goal should be incorporated into the Public Service Agreement framework to reflect housing as a national priority.

Recommendation 2

Local authorities should charge more for second homes to improve efficiency of the use of stock.

Recommendation 3

Further research should be undertaken to improve the evidence base for housing policies, for example on the relationship between housing, economic growth and deprivation at a micro level.

Recommendation 4

Government should establish a review of the housing market to report in no more than three years time. The purpose of this review would be:

- To measure Government's progress in implementing the recommendations set out in this Report; and
- To assess progress towards achieving a more flexible housing market and to identify any further obstacles.

This assessment might become a regular review of the UK housing market.

To assist any future reviews and to help improve the evidence base for assessing the effects of policy, Government should consider a range of data improvements to enhance understanding of the housing market, the effect of policy changes and planning processes.

Recommendation 5

Each region, through the Regional Planning Body (RPB) should set its own target to improve market affordability. Taken together, the regional targets should be consistent with the Government target (Recommendation 1), although individual regions will differ. There is also merit in RPBs specifying sub regional targets which may include floors and ceilings.

Indicative net housing targets for the region and local authorities should be produced, by the Regional Planning Executive (Recommendation 6), in order to aim to achieve this market affordability target. Government should provide regions with clear guidance on the methodology to achieve this. These housing targets would be set over a 5-10 year period as a trajectory. However, the targets and trajectory would not be fixed and would vary as a result of increased flexibility at the local authority level (Recommendation 9). They would also be revised in either direction if monitoring of the affordability target demonstrated that the region was not moving towards the desired outcome.

Recommendation 6

The Regional Planning Bodies and Regional Housing Boards should be merged to create a single body responsible for managing regional housing markets, delivering the region's affordability target and advising on distributing resources for social and sub market housing. The Regional Planning and Housing Bodies (RPHBs) would continue to be responsible for the Regional Spatial Strategy and the integration of housing with other regional functions.

These merged bodies should be supported by a strong and independent Regional Planning Executive in each region which would be the expert analytical body responsible for:

- providing public advice to the RPHB on housing numbers and allocation of housing within the region in order to aim to achieve the region's market affordability target;
- advising on other technical aspects of the Regional Spatial Strategy (RSS) and investment in social and sub market housing;
- identifying strategic growth areas and the need for special purpose vehicles;
- creating strong links with key stakeholders;
- monitoring the regional housing market and local authority performance on both completions and responsiveness to the market; and
- signalling the need for a review of the RSS where the market was not functioning well and the affordability target was unlikely to be met.

The regional planning executive would require new appointments, including a chief executive appointed through an independent public appointments process.

Recommendation 7

Government should set out guidance, accompanying a revised Planning Policy Guidance 3 (Housing) (PPG 3), for determining the scale and allocation of housing provision at the regional level to ensure that methodologies reflect a full consideration of the economic, social and environmental costs and benefits of housing at the regional and local level. This guidance should be based on the following principles:

- Transparency over the calculations, assumptions and policies that determine the scale and distribution of housing numbers, so that the trade offs between different outcomes are made explicit.
- Consistency in the approach of different regions to the use of information and to the weight given to different variables, in particular, consistency in the method used to translate the region's affordability target into indicative housing targets across the region.
- Application of market information and signals, including house prices and house price growth and market affordability in decisions made about the scale and distribution of housing targets.
- Decisions about the scale and distribution of housing numbers that over-ride market information, should be based on sound evidence and should set out the costs associated with the decision.

- Decisions about the scale and distribution of housing numbers should be informed by sub-regional and Local Housing Assessments (which should include analysis of house price growth and affordability, as well as local housing need).

Recommendation 8

Government should set out guidance on the composition of Regional Planning and Housing Bodies. This guidance should include the following:

- Guidance on training and skills requirements for members of the Regional Planning and Housing Body to enable them to act in a regional (and supra-regional) capacity.
- Guidance on the optimal make up of the non-elected component. Although the ideal make up will differ from region to region, Government should specify the organisations and agencies that should be represented. The Review recommends that organisations and agencies responsible for planning and funding infrastructure and services should be on the Regional Planning and Housing Bodies.

Recommendation 9

Local plans should be more realistic in their initial allocation of land, and more flexible at bringing forward additional land for development. When allocating land sufficient to meet their targets for additional dwellings, local authorities should allow for the proportion of sites that prove undevelopable, often as a result of site-specific problems. In drawing up their plans, local authorities should identify their own historic shortfall and allocate an equivalent amount of land to fill this implementation gap.

Local authorities should allocate a further buffer of land to improve their plan's responsiveness to changes in demand. Additional land for development would be brought forward from this buffer when there was evidence of local housing market disequilibrium. It would be inappropriate to be unduly prescriptive at this stage about the appropriate size of this buffer, but it seems reasonable to assume that an additional 20-40 per cent of land sufficient to meet an authority's housing target would provide enough headroom to respond to signals of market disequilibrium.

Developers should be able to submit applications for any site allocated in the plan, subject to the conditions of the revised sequential test being met. Once sufficient land is being developed to meet an authority's housing target, then it could, as now, refuse additional applications. However, if predefined indicators of housing market disequilibrium were triggered then authorities would not be able to refuse additional applications on the grounds that their housing targets had been met. These triggers should include:

- worsening market affordability for newly-forming households and/or lowest quartile earners;
- local house price increases relative to the regional average;
- an increasing premium in land prices for residential use over other uses;
- employment growth significantly outstripping housing growth; and
- rising numbers of housing transactions.

The new Regional Planning Executives should play a central role in developing an evidence base and in advising on setting these triggers. Triggers should be sensitive to the differing circumstances of housing markets across the country, including those parts of the country where low demand for housing is leading to problems of dereliction.

Government should revise PPG 3 to set out how this process would work.

Recommendation 10

Planning guidance should be amended to advise regional and local planning authorities on assessing the value of land to society. This would enable planners to take account of the relative values that society places on different types of land use when allocating land in local development frameworks, recognising the inevitable difficulties of interpretation of this data.

The general principle of containing urban sprawl through greenbelt designation should be preserved. However, planning authorities should show greater flexibility in using their existing powers to change greenbelt designations where this would avoid perverse environmental impacts elsewhere. Any change in the designation of greenbelt land should require a strong evidence base, taking full account of the value that society attaches to different types of land use in an area.

Recommendation 11

Housing developments differ in their nature. It is not appropriate to apply the same planning process to all developments. The Government should introduce two additional routes for developers to choose between, when applying for planning permission:

- Outline only route – applicants would put forward an outline application which contained more detail than is currently required. Local councillors would grant outline permission, but the granting of outline permission would mark the end of both the formal consultation process and of councillors’ involvement. Any outstanding issues or reserved matters would be dealt with by planning officers.
- Design code route – applicants would put forward a proposal for development supported by a design code. Local councillors would satisfy themselves that the code had been drawn up in accordance with planning guidance on both design and community consultation and, if so, would adopt a Local Development Order (LDO) to cover the identified site. This would automatically waive the need for permission to be granted. Planning officers would then monitor to ensure that the conditions set out in the code were met.

To achieve these changes, PPG3 should be revised to:

- outline the choice of routes available to developers and the minimum requirements in each case;
- indicate that councillors should delegate the discharge of certain functions to officials;
- set out the principles which urban design codes should meet, including clear guidance on community consultation; and
- provide a mechanism for the use of LDOs to fast-track applications supported by a design code.

Recommendation 12

Government should take a rigorous approach to revising PPG3. Future revisions should be grounded in an evidence base and should be subject to scrutiny from a panel of housing and planning stakeholders, including the development industry. Restrictions on development should have an identifiable and evidenced benefit that outweighs their costs.

Recommendation 13

Government should allow Regional Spatial Strategies to deviate from PPG3 where there is clear evidence to support a different approach within the region. While the agreement of the Secretary of State should be essential, it should only be possible for Government to reject an application to deviate on the grounds that the evidence is not strong enough.

Recommendation 14

PPG3 should be revised to require local planning authorities to be realistic in considering whether sites are available, suitable and viable. Any site which is not available, suitable and viable should be disregarded for the purposes of the sequential test.

Recommendation 15

Government should assess whether consideration of appeals levels in the distribution of Planning Delivery Grant (PDG) could help correct the potential perverse incentive for local planning authorities to reject planning applications in order to meet their performance targets. In future, the PDG should take greater account of outcomes, as well as processes.

Recommendation 16

In order to allow local planning authorities to focus on key development decisions, resources need to be released or strengthened. This could be achieved in a number of ways:

- Government should review the scope to increase the range of permitted development rights for householder applications, whereby certain types of development are allowed to proceed without planning permission.
- In the meantime, local authorities should bear in mind their power to vary these rights, once the Planning Bill has become law, through establishing Local Development Orders.
- Government should also consider increasing planning fees as an additional means of increasing resources.
- When dealing with large-scale developments, local planning authorities should follow existing best practice and form dedicated project teams, bringing together key public sector stakeholders.
- Where it is not practicable for authorities to develop the capacity necessary to manage large-scale developments, they should have access to additional planning and legal expertise or resources. This could be achieved through the Planning Advisory Service developing a team of ‘trouble-shooters’.

Recommendation 17

Central government funding settlements for local authorities should be made more forward-looking. The Government should include in its calculations of Formula Spending Shares a variable to reflect expected housing growth in an area, drawing on housing targets set by the reformed regional planning process.

Recommendation 18

Building on the broadly positive response to its Local Authority Business Growth Incentive proposal, the Government should consider ways of incentivising local authorities to meet housing growth targets.

One way would be to disregard, for a period of possibly up to three years, some or all of the council tax receipts generated by new housing from the calculation of a local authority's grant allocation. This additional revenue should not be ring-fenced.

Recommendation 19

All Government Departments and agencies should assess the demands implied by the Government's housing targets in their spatial planning and funding decisions. Departments' contributions to meeting ODPM's housing targets should be recognised within their own priorities, including Public Service Agreements.

The Ministerial Committee on housing and growth issues across the wider South East (MISC22), chaired by the Prime Minister, should be expanded to cover housing delivery in general, and be used to facilitate cross-Departmental co-operation.

Those Departments with responsibility for allocating funds for infrastructure development, such as the Department for Transport, the Department of Health and the Department for Education and Skills, should take account of planned housing and population growth in making spatial allocations.

Recommendation 20

To minimise delays to development, infrastructure providers, such as the Highways Agency and water companies, should be involved from an early stage in developing both the regional spatial strategy and the local development plan:

- As part of the work involved in drawing up the local and regional plan, providers should be as clear as possible about the sort of infrastructure improvements that would be required. Having been involved in the drawing up of the local and regional plan, providers should reflect the outcome in their operations as far as possible. They should not seek to block applications for planning permissions compliant with local and regional plans, unless compelling changes in the situation – for example, a failure to agree a Section 278 agreement – justify a different approach.
- An infrastructure provider's objection to a development should only be allowed to block the granting of planning permission if the benefits of the new development are clearly outweighed by the costs in infrastructure terms. Where infrastructure providers, such as the Highways Agency, have powers to direct refusal of planning permission, they should only exercise their powers in this way. Government should commit itself to only using these powers under the same restraint.

- To help mitigate the impact of infrastructure costs on developers' cashflow, the Highways Agency should allow developers to begin building houses in parallel to road construction, even where the implications for congestion are such as to rule out allowing occupation until construction is complete.
- Ofgem and Ofwat should develop and publish guidance on establishing a fair price for developer charges for extensions or alterations to energy, water and sewerage networks required for new housing development. Where feasible, this should be achieved through promoting competition. In the absence of effective competition, water and energy network providers should advertise and exhibit a development-servicing plan, describing the area covered and assets used, and describing the basis on which a developer charge has been calculated.

Recommendation 21

English Partnerships (EP) should have a lead role in delivering development through partnering with public and private sector bodies in assembling complex sites, masterplanning, remediating land and developing supporting infrastructure. At the same time, Government should provide greater certainty as to the principles by which EP would, or would not, intervene, so as to avoid crowding out private sector activity, or stunting the development of new markets.

Devolved administrations may wish to assess the roles of their own housing and regeneration agencies in the context of this Review's recommendations.

Recommendation 22

A Community Infrastructure Fund (CIF) of £100-200 million should be established within ODPM. Regions should be encouraged to submit bids for support towards the up-front costs of medium-sized utilities and transport infrastructure schemes, which would bring forward otherwise unviable development. Bids for support towards gap funding schemes, such as the ringmaster approach for transport infrastructure, should be particularly welcome. In these instances, Government should seek to operate clawback mechanisms where this is practicable.

To enable local and regional authorities to maximise the impact of the CIF by leveraging in private sector capital, ODPM should publish a delivering development toolkit to provide guidance for local and regional authorities seeking to access the fund. Drawing on experience in the growth areas and elsewhere, this would provide practical guidance on:

- models for partnership between the public and private sector;
- ways in which the public sector input into new developments can be co-ordinated; and
- options for recovering the up-front costs of gap funding from subsequent developments.

Recommendation 23

Central and regional government should be more strategic in its use of area-based special purpose vehicles to deliver housing development. Where problems of land acquisition, servicing and infrastructure provision are identified through the regional planning process, Government should engage with English Partnerships to identify the most appropriate vehicle for delivering development. Greater use should be made of both Urban Development Corporations and New Towns, taking advantage of their ability to deliver both additional housing and the infrastructure necessary to support it.

New guidance on the circumstances to which different vehicles are most suited, and on using compulsory purchase powers, should be included in the proposed delivering development toolkit.

Recommendation 24

Section 106 should be reformed to increase the certainty surrounding the process and to reduce negotiation costs for both local authorities and developers.

If the Government accepts the recommendations outlined in Chapter 4 concerning the capture of development gains:

- Section 106 should be ‘scaled back’ to the aim of direct impact mitigation and should not allow local authorities to extract development gain over and above this, except as indicated below. ODPM should issue guidance, or new legislation, to this end.
- Section 106 should retain its current affordable and/or social housing requirements as set out in Circular 6/98, and other specific regional guidance.
- Local authorities should receive a direct share of the development gain generated by the Planning-gain Supplement in their area, to compensate for a reduced Section 106. Local authorities should be free to spend this money as they see fit. This share should at least broadly equal estimates of the amount local authorities are currently able to extract from Section 106 agreements.

If the Government decides to maintain the current fiscal framework as it is, then it should press ahead with the Section 106 reforms, on which it has recently consulted, that aim to introduce an optional planning charge in place of a negotiated agreement. However, this would be second best and leaves open the possibility of prolonged and costly Section 106 negotiations for large developments.

Recommendation 25

Government should consider the extension of the contaminated land tax credit and grant scheme to land that has lain derelict for a certain period of time. This should be done on the basis that extra public money levered into the market through such a scheme would encourage genuine new investment in brownfield remediation and not simply subsidise development that would take place in any case.

Recommendation 26

Government should use tax measures to extract some of the windfall gain that accrues to landowners from the sale of their land for residential development.

Government should impose a Planning-gain Supplement on the granting of planning permission so that landowner development gains form a larger part of the benefits of development.

The following principles might be considered:

- Information would need to be gathered as to the value of land proposed for development in each local authority. Sources of data could include actual transactions and/or Valuation Office Agency estimates as to the land prices in various local authority areas.
- Government would then set a tax rate on these values. This tax should not be set so high as to discourage development, but at a rate that at least covers the estimated local authority gain from Section 106 developer contributions and provides additional resources to boost housing supply.
- The granting of residential planning permission would be contingent on the payment of the Planning-gain Supplement of the proposed development.
- Government may want to consider the operation of a (substantially) lower rate for housing development brownfield land, and the possibility of varying rates in other circumstances, e.g. for areas where there are particular housing growth strategies, or where other social or environmental costs may arise.
- A proportion of the revenue generated from the granting of planning permissions in local authorities should be given directly to local authorities. Government should also amend the operation of Section 106 planning obligations, as set out elsewhere in Chapter 3, to take account of this new charge.
- The Government may want to consider allowing developers to pay their Planning-gain Supplement in instalments over reasonable time periods so as to ensure that housebuilder cash flow pressures are sufficiently accounted for.

The introduction of a tax would need to be accompanied by transitional measures to ameliorate the impact on developers already engaged in land sales contracts that were drawn up before this charge was introduced, or for those who hold large amounts of land already purchased, but where planning permission has yet to be secured.

Recommendation 27

The provision of subsidised housing should be increased. At least 17,000 additional houses are required each year compared with current provision to keep up with demographic trends. Addressing the backlog of housing need would raise this to 23,000 per annum (assuming substitution from sub-market to market housing, as market affordability improves).

Based upon current costs of provision, additional investment building-up to £1.2 to £1.6 billion per annum would be needed to support this expansion, not all of which will be from Government.

Recommendation 28

Government should explore the scope to achieve both greater RSL efficiency and higher funding through debt finance, to increase the level of housing through the most cost effective means.

Recommendation 29

Government should explore moving to an alternative scheme to Right to Buy and Right to Acquire, which is provided at lower cost and enables greater recycling of revenues to increase the social housing stock.

Recommendation 30

Government should deliver its proposals to promote greater interaction between institutional investors and the residential property market, through the introduction of tax transparent property investment vehicles.

Recommendation 31

PPG 3 should require local planning authorities to have regard to the impact on competition when allocating sites in their Local Development Frameworks. For example, if there is a choice between allocating a number of small sites or a single large site for development, competition considerations would favour a larger number of smaller sites.

When granting planning permission on large sites, local planning authorities should discuss build-out rates. To encourage faster build-out, planning authorities should use their discretion in setting time limits on planning permissions and seek to agree an expected build-out rate, as a condition of planning permission.

If the rate of build-out has not increased appreciably by 2007, subject to conditions in the housing market, Government should review all available policy options to address this issue.

Recommendation 32

The housebuilding industry must demonstrate increased levels of customer satisfaction:

- The House Builders Federation should develop a strategy to increase the proportion of house buyers who would recommend their housebuilder from 46 per cent to at least 75 per cent by 2007. Over the same period, levels of customer satisfaction with service quality should rise from 65 per cent to at least 85 per cent.
- The House Builders Federation should develop a code of conduct by the end of 2004 for new house sales in full compliance with the framework provided by the Office of Fair Trading's Consumer Codes Approval Scheme. This code of conduct should require fair contracts complying with the Unfair Terms in Consumer Contracts Regulations 1999.

If progress is unsatisfactory, or if consumer satisfaction levels do not rise substantially in the next three years, the Office of Fair Trading should conduct a wide-ranging review of whether the market for new housing is working well for consumers.

Recommendation 33

The House Builders Federation, in conjunction with National House-Building Council (NHBC), ConstructionSkills and other interested parties, should develop a strategy to address barriers to modern methods of construction. This strategy should be developed to fit alongside existing initiatives, working closely with Government to identify further measures that can be taken. A range of approaches should be explored, in particular actions by industry and changes to NHBC policy and practice, as well as representations to Government on areas such as changes to Building Regulations.

Recommendation 34

The Construction Industry Training Board (CITB)-ConstructionSkills and the House Builders Federation should work together to develop a strategy for substantially increasing the take-up of apprenticeships from the current level of three apprentices per 100 workers, to bring the UK to the levels of leading international comparators, such as the Netherlands and Germany. The development of this strategy should also explore whether the appropriate number and range of courses exist, and whether housebuilders are investing sufficiently in their own workforce training, as well as addressing the skills needed for modern methods of constructions.

In the short term, Government should consider increasing support for skills in the construction sector, alongside any increases in the training levy.

If skills constraints are not adequately addressed by March 2007, Government should conduct a review of the effectiveness and impact of CITB-ConstructionSkills in the housebuilding industry.

Recommendation 35

The industry should work together with the Commission for Architecture and the Built Environment (CABE) to agree a code of best practice in the external design of new houses. Where planners and housebuilders disagree on specific design issues, they should seek arbitration, possibly through CABE, to resolve these matters.

Recommendation 36

The House Builders Federation, in consultation with its members, should draw up a best practice guide for voluntary compensation schemes to directly compensate those immediately affected by the transitional effects associated with development. This might include cash payments to individual households.

C

Consultation process

Following the publication of the Interim Report, Kate Barker and the Review team carried out further consultation with key stakeholders, through a series of regional roundtables, seminars and meetings. The Review is grateful to those individuals and organisations that offered written contributions in response to the issues identified in the Interim Report. Kate Barker is particularly grateful to Glen Bramley, Paul Cheshire, Alan Evans, Duncan Maclennan, Geoff Meen, John Muellbauer and Christine Whitehead who, working in a personal capacity undertook to review aspects of this study. All content, conclusions, errors and omissions in this report are, however, the Review's alone.

ROUNDTABLES

Six Roundtables were held to gather responses to the Review's Interim Report and to discuss possible policy solutions. At these roundtables, Kate Barker and the Review team met with:

National

Louis Armstrong: Royal Institution of Chartered Surveyors

Robert Ashmead: House Builders Federation

Lord Best: Joseph Rowntree Foundation

Sir Brian Briscoe: Local Government Association

David Butler: Chartered Institute of Housing

Jim Coulter: National Housing Federation

Imtiaz Farookhi: National House-Building Council

Oliver Foster: Royal Institution of Chartered Surveyors

David Higgins: English Partnerships

Nigel Kersey: Campaign to Protect Rural England

Elizabeth Peace: British Property Federation

Norman Perry: Housing Corporation

Adam Sampson: Shelter

Neil Sinden: Campaign to Protect Rural England

Robert Upton: Royal Town Planning Institute

Peter Williams: Council of Mortgage Lenders

Scotland

Keith Anderson: Edinburgh City Council
Bruce Black: Homes for Scotland
Cathy Cameron: Convention of Scottish Local Authorities
Peter Collins: East Lothian Council
Gavin Corbett: Shelter
Alan Ferguson: Chartered Institute of Housing
Andrew Holmes: City of Edinburgh Council
Allan Lundmark: Homes for Scotland
Margarita Morrison: Convention of Scottish Local Authorities
David Orr: Scottish Federation of Housing Associations
Mick Stewart: Stirling Council
David Thompson: Scottish Society of Directors of Planning
Graham Uren: Royal Town Planning Institute in Scotland

North

Stephen Barber: North East Regional Assembly
Gentle Berridge: House Builders Federation
Eammon Boylan: Manchester City Council
John Carleton: Housing Corporation
Carole Cozens: Yorkshire Forward
Paul Davis: Eden Housing Association
Geoff Dibb: Government Office for Yorkshire and The Humber
Steve Dunlop: Newcastle City Council
Mike Gallagher: North West Regional Assembly
Andy Groves: One NorthEast
Jolyon Harrison: House Builders Federation
Nigel Johnson: National Housing Federation North
Evelyn Kemp: North East Council of Tenants and Residents
John Kirkham: Taylor Woodrow Developments Ltd
Chris Martin: Yorkshire and Humber Assembly
Barry Miller: Bellway Homes
Eric Morgan: Sanderson Weatherall
Sue Powell: North West Housing Forum
Beverley Prevatt Goldstein: BECON
Tim Richards: Harrogate Borough Council
Wayne Shand: Northwest Development Agency

South

John Barker: Moat Housing Group
 Colin Byrne: Government Office for the South East
 Fiona Cruickshank: Housing Corporation
 Tony Curtis: Basingstoke and Deane Borough Council
 Mike Gwilliam: South East Regional Assembly
 Fiona Hearn: Government Office for the South West
 Keith House: Eastleigh Borough Council
 Tom King: Government Office for the South West
 Cllr Keith Mitchell: Oxfordshire County Council
 David Seaton: Midas Homes
 Thoss Shearer: Government Office for the South West
 Pat Tempany: South East England Development Agency
 David Trethewey: South West Regional Assembly
 Libby Wood: Business in the Community

Wales

Julian Anderson: Welsh Assembly Government
 Andrew Crompton: Persimmon Homes
 Keith Edwards: Chartered Institute of Housing Cymru
 Jon Fudge: Welsh Assembly Government
 Lynda Healy: House Builders Federation
 David Hedges: Welsh Federation of Housing
 Christopher Hobday: Welsh Assembly Government
 Phillip Johns: Royal Institution of Chartered Surveyors Wales
 Jim McKirdle: Bridgend County Borough Council
 Jon Price: Welsh Assembly Government
 John Puzey: Shelter Cymru
 Bob Smith: Cardiff University
 Julian Stedman: Cardiff Council
 Stephen Thomas: Welsh Development Agency

Midlands

John Acres: Redrow

Mary Beasley: East Midlands Regional Assembly

Matthew Berry: Northamptonshire County Council

Pam Brown: Warwickshire County Council

David Coates: Pye Homes

Richard Cooper: Nottinghamshire County Council

Steve Forrest: West Midlands Local Government Association

Matt Gregory: Nottingham City Council

Annie Grist: Manchester City Council

Peter Jones: Housing Corporation

Emma Kiteley: West Midlands Local Government Association

Clive Lloyd: Worcestershire County Council

Carol Muston: House Builders Federation

Rose Porter: West Midlands Local Government Association

Cllr Michael Rook: North Kesteven District Council

Louise Slocombe: East Midlands Development Agency

Dave Thew: West Midlands Local Government Association

Mike Thompson: Advantage West Midlands

Bill Warden: Hallam Land Management

Jackie Wellings: Advantage West Midlands

Ada Wells: Staffordshire County Council

Peter White: Derbyshire County Council

Martin Williams: Birmingham City Council

ACADEMICS

The Review team met with a number of academics to discuss policy options:

Michael Ball: University of Reading

Glen Bramley: Heriot-Watt University

Paul Cheshire: London School of Economics

Alan Evans: University of Reading

Alan Holmans: University of Cambridge

Duncan Maclennan: University of Glasgow

Geoff Meen: University of Reading

Sarah Monk: University of Cambridge

John Muellbauer: University of Oxford
 Gwilym Pryce: University of Glasgow
 Christine Whitehead: London School of Economics

OTHER MEETINGS WITH STAKEHOLDERS

Kate Barker and the Review team met a number of individuals and organisations, including:

Campaign to Protect Rural England
 Cofton Limited
 Council of Mortgage Lenders
 Environment Agency
 Robert Finch: The Lord Mayor of London
 Frontier Economics
 George Wimpey
 Green Issues Communications
 Highways Agency
 House Builders Federation
 Housing Corporation
 Local Government Association
 London First
 David Newbery: University of Cambridge
 Office of Fair Trading
 Royal Town Planning Institute
 Shelter
 St George Regeneration Ltd
 Town and Country Planning Association
 Scottish Executive
 South East Water
 Taylor Woodrow
 Wilson Bowden

Ireland

The Review team also visited Ireland. Individuals and organisations met include:

Diarmuid Collins: An Bord Pleanála
 David Duffy: Economic and Social Research Institute
 Hubert Fitzpatrick: Irish House Builders Association

Maria Graham: Department of Environment, Local Government and Heritage

Sheena MacCambly: Ballymun Regeneration Ltd

Pat McDonnell: Dublin City Planning and Development Department

Donald McManus: Irish Council for Social Housing

Rory O'Donnell: National Economic and Social Council

Kevin Ring: Department of Environment, Local Government and Heritage

INTERIM COMMENTS

Kate Barker and the Review team received numerous useful and interesting comments on the Interim Report published in December 2003. Individuals and organisations that submitted a response included:

John Acres: Redrow

Gideon Amos: Town and Country Planning Association

James Armstrong

Robert Ashmead: House Builders Federation

Thomas Aubrey

Harris Austin

John Barker: Consortium of Associations in the South East

Adrian Bell: Royal Bank of Canada Europe

Alan Benson: Greater London Authority

Lord Best: Joseph Rowntree Foundation

Bruce Black: Homes For Scotland

Conall Boyle: Action for Land Taxation & Economic Reform

Kevin Cahill

Campaign to Protect Rural England

David Cardde

Tony Carey: St George Plc

David Coates: J.A Pye (Oxford) Limited

Harvey Cole

Alice Coleman: Land Use Research Unit

Steven Cord: Indiana University of Pennsylvania

Philip J Davies: Linden Holdings Plc

Harry Deakin

CT Denninford Frics: Chester-Fanshaw Limited

Rupert Dickinson: Grainger Trust Plc

Richard Donnell: FPD Savills

Joe Dwek

John Edwards: Advantage West Midlands

Imtiaz Farookhi: National House-Building Council

Ian Fletcher: British Property Federation

Steve Forrest: West Midlands Regional Assembly

Danny Friedman: National Housing Federation

Robert Gillespie: RPS Group Plc

John Grooms: Housing Association

David Harner: Greater London Authority

Malcolm Harris: Bovis Homes

Martin Harrop: Croudace

John Hay: BuildStore

Brian H.Horsley: Civic Trust South East

Tim Hough: Miller Homes

Mark Hudson: Country Land & Business Association

Peter Hutchinson

Roger Hutton: Howard Hutton & Associates

Colin James: Heriot-Watt University

Neil Johnson: Royal Institution of Chartered Surveyors

Peter Johnson: George Wimpey

Colin Jones: Heriot-Watt University

Labour Land Campaign

Geoffrey Lee

Roger Lewis: London First

Kelvin MacDonald: Royal Town Planning Institute

John Macadie

Christopher Mahon: Property Truth

Manchester-Salford Housing Market Renewal Pathfinder

Nick Mansley: Morley Fund Management

Optimum Population Trust

The Opinion Research Business

Patrick McAuslan

Keith R Mitchell: South East England Regional Assembly

Andrew Nash: Andrew Nash Associates

Tony Newman: Association of London Government

John O'Donnell: Disability Action Yorkshire
Paul Pedley: Redrow
Ann Petheric: Living Over The Shop
Tony Pidgley: Berkeley Group Plc
Brian Pilkington
Rex Pointon
Sue Powell: Trafford Metropolitan Borough Council
David Rankin
David Rodgers: The Co-operative Development Society Ltd
Royal Institution of Chartered Surveyors
David Sawers: Forum of Arun District Amenity Groups
Steve Scrivens: Our World 2000
Peter Shadbolt: Surrey County Council
Merron Simpson: Chartered Institute of Housing
Francis Smith
John Stewart: House Builders Federation
David Sutherland
Bill Thompson: National Economic and Social Council
Leslie Turner: Maidstone West Branch Labour Party
Robert Upton: Royal Town Planning Institute
Tony Vickers
Allan Wilen: Construction Products Association
Peter Williams: Council of Mortgage Lenders
Philip Williamson: Nationwide Building Society
Piers Williamson: The Housing Finance Corporation Ltd
Rob Williamson: Office of Fair Trading
Wilson Bowden
Rob Wood: Bank of England
Dennis Woodman: The Kew Society
Charmaine Young: St George
Peter Young: John D Wood (Residential and Agricultural) Ltd

We have endeavoured to ensure that all individuals and organisations that have made representations to the Review are included here. However, if we have inadvertently left anyone or any organisation out of this list, please accept our apologies: it was not intentional.

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ISBN 1-84532-010-7



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