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THE BARKER REVIEW OF HOUSING SUPPLY

A submission to the Review

By

THE ROYAL INSTITUTION OF CHARTERED SURVEYORS

1. This submission has been prepared in response to a review which the Chancellor and Deputy Prime Minister have asked Kate Barker to undertake into the lack of supply and responsiveness of housing in the UK.
2. The Royal Institution of Chartered Surveyors (RICS) has over 100 000 members around the world many of whom have expertise in all areas relevant to the Review including housing, planning, regeneration and construction.

KEY MESSAGES

- There is a major problem of under-supply of housing in the UK. Whilst housebuilding overall is at its lowest level for many decades, private housebuilding has remained at a very steady rate of around 150 000 per year over the last 30 years. The rapid decline in housebuilding levels is primarily due to the collapse of the social and affordable housing programme.
- If increased housing provision is to have any impact on house prices and hence affordability there would have to be a sharp increase in supply over at least a decade or more. To push the UK housing stock to the average level prevailing in Germany, France and Italy (taking account of population levels) would require an extra 2.5 million homes – an addition of some 10% to the stock. There is a need for output targets (including affordable output targets) to help meet the projected shortfall.
- House prices have increased most rapidly in areas of high demand but large increases have been seen too in many areas of relatively low demand.
- The key issue is affordability. The market provides for those who can afford to buy at current price levels but in many areas there is little alternative for those who cannot.

- There are many ways in which the planning system can be improved but we do not see planning constraints as a decisive factor over the longer term in stifling housing provision.
- The key problem is that housing associations cannot afford to buy land in areas of high demand. Their grants have been reduced and they are increasingly dependent on raising funds from the private sector. As a result they are becoming ever-more dependent on housing provided by s106 agreements in which private developers provide a proportion of affordable housing on a site in return for planning consent for market housing. However, s106 provision will never be sufficient to meet the need for affordable housing.
- The major growth areas in the South East such as Thames Gateway are likely to do little to ease affordability problems in London. Moreover, they will only work if major new infrastructure is provided and better understanding is gained about how to create new housing markets and sustainable communities.
- Greater integration of housing, land use planning, transport and economic development strategies are needed particularly at sub-regional and city region level. We recognise that Government policy is moving in this direction.
- In areas of high demand local planning authorities should be required to assess the residential potential of unused and underused commercial and industrial property and to produce strategies for its conversion to sustainable residential uses.
- The housebuilding industry tends to be very cautious, suffers from capital and skills constraints and operates in an environment where competitive pressures have reduced. It can deliver market housing but has little interest in providing affordable or social housing. It is currently a very profitable sector but has been reluctant to increase output even at a time of rapid house price inflation.
- Much of the taxation structure around the sector merits review. There are currently few incentives for investors to invest in residential property and so the level of institutional investment in areas such as the private rented sector is very low. There is a need for new types of investment vehicles, for reappraisal of the taxation treatment of residential property investment to bring it more into line with commercial investment and for consideration of new incentives to unlock land for affordable housing in high value areas.
- Provision by means such as shared ownership designed to help those who cannot afford to buy outright but do not qualify for social housing has proved disappointing and needs to be thoroughly reviewed.

INTRODUCTION

3. A close look at the issue of housing supply reveals that the commonly held view that the planning system is the main force constraining land supply for housing does not stand up to scrutiny. This argument, upheld as a shibboleth by the housebuilding industry, is frequently cited as the reason why housebuilding levels

are at their lowest for decades. Whilst the planning system can be slow to respond to housing needs over short timescales we do not see it as a decisive influence over the longer term.

4. In fact figures compiled by the RICS show that housebuilding levels in the private sector have remained relatively constant over the last twenty years. By contrast figures for social and affordable housebuilding have fallen dramatically and are responsible for the sharp decline in overall figures.
5. However, despite this it must be noted that the house price boom over the last few years has not been accompanied by a significant upsurge in new building, as was the case during the late 1980s and during previous booms. Recent research in London by London Residential Research bears this out. According to their Red Book analysis of development in London the number of planning permissions granted in the last seven years has almost doubled, from 17 000 in 1996 to 30 000 in 2002. Yet the number of buildings starts actually fell, from 6 800 in 1996 to 6500 in 2002.
6. The argument is therefore gaining ground that it is housebuilders rather than the planning system who are controlling supply and releasing new homes at the level that suits them best, in line with their obligations to shareholders. Despite their low rating – considered a dull and risky stock subject to downturns – housebuilders' profits and share prices have doubled over the last five years.
7. Both analysts' forecasts and anecdotal evidence indicate that this trend is set to continue. Analysts' forecasts reveal that the larger housebuilders are pulling back their volume forecasts but not their price forecasts. Meanwhile anecdotal evidence reveals that there are housebuilders in London choosing not to complete developments, preferring instead to finish the first phase and lock the site.
8. Given the well documented crisis in obtaining accommodation for key workers and the intermediate market more broadly, it is quite clear that supply, as determined by housebuilders, is not responding to demand for housing. This is not to say that the housing market is necessarily malfunctioning but rather that the affordable and intermediate sectors are unable to play a role in a market which is geared to providing housing for those who can afford to pay for it.
9. In their UK Economic Outlook (February 2003), Pricewaterhouse Coopers suggest that the dominant driver for house prices in the medium to long term is the level of personal disposable income. Low interest rates and easy access to mortgage finance are also seen as critical in enhancing affordability. They conclude that the market is therefore responding to demand and providing homes at prices some people are able to pay. The critical problem, however, is that this excludes those in the affordable and intermediate house price bracket.
10. RICS agrees that the issue of spiralling house prices and affordable housing are the key areas for review. We recognise that the level of personal disposable income is a key influence on house price levels. However, as can be seen in Germany and elsewhere, high income levels do not automatically lead to spiralling house prices. The other key factor influencing prices and hence affordability over the long term is the overall level of housing supply.

11. It must be emphasised, however, that supply has to increase appreciably over a long period of time before a significant impact is seen. This is because the housing market is primarily a secondary market with new housing adding just 0.7% extra to the stock each year. This means that even programmes as large as those proposed by the Communities Plan are unlikely to impact significantly on prices and the key workers crisis in areas such as London.
12. Furthermore, the least affordable areas of London, to the west and south west and the north east will benefit little from the Communities Plan which envisages residential growth to the east and south east of London as well as in the Milton Keynes and Stansted areas. Increasing overall supply in London and its environs may have some knock-on effects in less affordable areas but this may be marginal (particularly as the overall population of the capital is set to increase by 700,000 over the next 10 – 15 years). As has been pointed out, building in Thames Gateway is unlikely to solve the teacher recruitment problems in the areas such as Kingston-upon-Thames.
13. Policies aimed at relaxing constraints on greenfield development will be welcomed by housebuilders who find it much more profitable to build on greenfield rather than brownfield land for reasons which will be outlined below. Indeed housebuilders may be willing to release such developments onto the market much more quickly than they do currently in London. The question for the government in this instance is whether it wishes to pursue the current policy of curtailing greenfield development in favour of brownfield development. The RICS believes that the continuance of this policy is socially, economically and environmentally valuable.

THE UK'S HOUSING SHORTFALL

14. The UK housing market has traditionally been more volatile than the major countries of the euro area. This is in part due to the fact that the liberalisation of mortgage finance has raised the responsiveness of housing demand to changes in the economic climate. Also, the housebuilding industry has been quite sluggish in responding to changes in demand. Together, these factors have meant that housing cycles in the UK are particularly exaggerated.
15. As we have already emphasised, in any one year housebuilding has very little impact on overall market conditions. Demand for housing is closely related to the health of the economy and the level of interest rates. As such the UK's history of a volatile economy and inflation have led to periodic bouts of boom and bust in the housing market.
16. However, the smoother economic cycle that has followed the UK's exit from the European Exchange Rate Mechanism has benefited the housing market to the extent that it has not yet encountered a serious downturn. However, reduced economic volatility has not stemmed the rising trend in house prices. Even without marked volatility, rising prices still pose a problem for the UK, encouraging greater household consumption through equity withdrawal and hampering convergence with the rest of the euro area. Lower and middle income households are also priced out of the market, making it difficult for key workers to be located close to areas of work.

17. Rising house prices over the past 5-6 years have not been surprising as demand conditions have been strengthened by ongoing job creation and falling interest rates. At the same time the overall rate of new housing supply has been woeful. Housing output has fallen sharply over the past 30 years. In the 1990s 1.8 million new homes were built, compared to 2.1 million in the 1980s and 3.0 million in the 1970s. On the other hand, growth in new households has accelerated, rising from 1.4 million in the decade since 1971, to an estimated 2.2 million for the decade since 1991 (based on pre-2001 census data). Growth in the number of households is now outstripping that of new homes built. Without a strong rise in housebuilding from the current level of 170 000 per annum, the shortfall is likely to be sustained, maintaining upward pressure on real house prices in the decades to come.
18. The starkest evidence of the impact of both supply and demand is evident at a regional level. On the basis of pre-census data, those regions which experienced the largest relative rise in households compared to housing stock growth in the 1990s, also showed the largest house price rise. Not surprisingly all the southern regions, including London, showed the largest supply shortfall and the biggest price rises. A comparison of household growth alone with price changes produces a much weaker relationship, suggesting that housing supply is an important determinant of house price pressures over the medium to longer-term (i.e. for a period of around 10 years or more).
19. Regional analysis of housing supply provides an explanation for variations in price movements across the country. However, it does not explain why prices in the UK overall have doubled since 1995, with regions in the North of England also experiencing rapid price rises (up more than 80% in Yorkshire and Humberside and the North West). A look at housing supply on a pan-European basis shows that the UK as a whole suffers from a major under supply of homes relative to the population, even though the problem is most acute in particular regions. For the purposes of our analysis we have looked at 13 European countries, taking latest available data on the housing stock per 1000 of population.
20. Strong real price growth is most apparent for countries with relatively low levels of housing stock, with for example Ireland having the lowest supply and highest house price inflation in the EU. Whilst the accuracy of data in many European countries on house prices can be questioned and we have made no allowance for differences in demand factors such as income and employment, it is nevertheless clear that a fairly strong correlation exists between housing supply and price trends over the long-term. If the UK is to dampen housing market fluctuations, which is desirable whether it is inside or outside of the euro zone, then a significant uplift in housing stock is required.
21. Compared to Germany, France and Italy, the UK housing stock is respectively 5%, 8% and 15% less relative to population levels. As a result, France, Germany and Italy all experienced much weaker rises in house prices than in the UK in the 1990s, thereby helping to keep their stock at more affordable levels. To push the UK housing stock to the average level prevailing in the three largest euro area countries would require a 10% increase in the housing stock i.e. 2.5 million extra

homes. Such a steep rise in housing supply is very unlikely to occur over the near or even medium term.

22. As we have already mentioned, the government has responded to consistent demand pressures by announcing a plan for 200 000 new homes in the South East, which are additional to current building plans. We calculate that on the basis of the current trend of building 170 000 homes per year in the UK, the additional homes over a 20 year period may be enough to match projected growth in new households. But the modest rise in housing supply will be insufficient to improve the current unsatisfactory position and to prevent future episodes of sharp house price rises.
23. The announcement of the new homes does not, however, address the key issue of whether the housebuilding industry will be able to respond more readily to changes in demand conditions. Most research in this area has concluded that the structure of the housebuilding industry mitigates against a substantial rise in housing output in the medium term, without a fundamental change in market structure or substantial government intervention. We discuss this in more detail below.

ISSUE 1: LAND CONSTRAINTS IS THE SUPPLY OF LAND OVERLY CONSTRAINED AND IF SO, HOW, AND BY WHAT?

Shortages of land/landowners willingness to sell.

24. Current government policy enshrined in PPG3 (Planning Policy Guidance note 3) puts constraints on the development of greenfield land in favour of brownfield development, according to the 'sequential test'. Under this a planning authority can only grant permission for development on a greenfield site if there are not brownfield options available. The Government has also set a target of achieving at least 60% of housing development on brownfield land. RICS believes that development must be carried out in accordance with fundamental principles of sustainability and strongly supports these broad objectives.
25. Given the policy context in which housebuilders are currently operating it is therefore particularly important to ask whether the supply of brownfield land is overly constrained.
26. In so doing it is important to differentiate between the supply of land available to housebuilders and the supply of developed land released onto the market. As outlined above, securities analysts believe that it makes sense for housebuilders to release developments slowly onto the market to maintain price levels.
27. Land owners will generally only sell at a time when they think they are getting a good price for their land. If prices are low either for market reasons or because of restrictions that have been placed on the land, they may decide to hang onto the land until the market changes, or in the hope that any restrictions may be lifted. For example, if demand for affordable housing is high, the land owner may wait for a change of government direction. A landowner may also be aware of something happening locally which is likely to produce an increase in the value of his/her land

and may be keen to wait until that increase in value is realised. Very often landowners do not have to sell at a particular point in time, and are happy to wait until conditions are more profitable.

28. If landowners are reluctant to sell, particularly in areas where new housing is badly needed, then a possible option is to give greater incentives to landowners to increase their willingness to sell. This is backed up by findings from London Residential Research (LRR) which reveal that, contrary to popular opinion, most potential sites in London are not derelict but income producing. Of 200 possible development sites in Islington LRR found that only six were non-income producing. After the cost of capital gains tax is taken into account, combined with the loss of income stream, incentives must inevitably be reduced. The consequent recommendation from LRR is that capital gains tax breaks should be given to people who sell land.

Land Assembly

29. Considerable problems are associated with land assembly for brownfield sites and these do increase costs substantially for housebuilders which are in any case higher on brownfield than Greenfield sites. A major problem in land assembly has been the reluctance of local authorities to use their CPO powers to assemble land for regeneration purposes. RICS has pressed for changes to allow the greater use of CPO powers and proposed changes in the Planning and Compulsory Purchase Bill should help.
30. The main reason why housebuilders prefer building on greenfield land is that estates of executive homes tend to provide better returns than high density apartments in urban areas. This is particularly the case during a downturn in the market as greenfield homes can be sold individually as they are built. By contrast more investment is tied into apartment blocks which must be completed before anybody can move in. In addition they are often sold off-plan and, not surprisingly, during a downturn it is more difficult to get consumers to commit to buying on the basis of plans. Both of these factors can cause difficulty for the housebuilders' cash flow.
31. Moreover, standardisation in building techniques and materials prevalent on a greenfield estate reduce costs while there is also an argument that local planners in urban areas tend to be more design conscious, applying greater scrutiny to housebuilding techniques and design.
32. Contamination and dereliction issues can be severe on individual sites, and may increase as pressures mount to develop more difficult brownfield sites. However, on many sites such issues are fairly minor considerations. Issues with utilities (monopoly charges for extra capacity or unwillingness to provide underground high voltage cables for example) are often much more significant and organisations like Ofwat seem to place a very low priority on resolving them.
33. As for mechanisms for land assembly of brownfield sites most agree that there are significant problems in this regard in the UK. In France, for example, 'Lotisseur' is an organisation whose sole purpose is the assembling of land for development.

34. The success of the Urban Development Corporations in assembling brownfield land for development has now been recognised and it is welcomed that similar bodies are being set up in areas such as the Thames Gateway. However, the new UDCs will not have the same wide-ranging powers and degree of independence as their predecessors in areas such as London Docklands and Tyneside. They may struggle, therefore, to make the same impact.
35. English Partnerships will also continue to play a critical role. In conjunction with the Housing Corporation they could make a vital contribution in enabling the assembly and supply of publicly owned land for affordable housing. However, they continue to be constrained by Treasury rules which demand that public sector bodies receive best consideration when disposing of surplus land. The key priority in such circumstances should be to ensure that the land is used to bring the greatest public benefit, not simply the highest price. Whilst a certain latitude is currently possible it is all too easy, given Audit Commission scrutiny, for authorities to play safe and simply get the best price. A prerequisite for any comprehensive policy in this area must be information about the extent of surplus public land. We therefore look forward to the publication of the first national register of surplus public land.

Optioning

36. Deputy Prime Minister John Prescott said earlier this year that he is considering starting a register of who owns options on land. It appears that this is because housebuilders tend to wait for infrastructure improvements/investment before they seek to gain actual planning permission on their optioned land. The implication is that options can hold up the release of land by housebuilders, with options forming part of the housebuilders' landbank. Once investment/infrastructure is announced in the area the land soars in value ensuring that the subsequent development will also be sold at a much higher price.

Is the land allocated for housing in local development plans sufficient to meet housing needs?

37. We do not believe that allocations are sufficient. It is important that allocations in plans are soundly based on housing needs surveys but this often does not happen at present. Even where they are based on surveys, plans often fail to specify the type of housing that is needed, whether in terms of size of units required or the type of tenure needed. With regard to affordable housing there is often a presumption in favour of general needs rented housing, which is the lowest value of all affordable housing, and is therefore offputting to private developers. We recognise the need for a healthy supply of general needs housing. However, high demands for general needs rented housing can prevent some schemes from going ahead – schemes which may be viable if higher value alternatives such as shared ownership or keyworker accommodation were required. The proposed changes to PPG3 to allocate land to affordable housing, and specify in development plans how much will be required and where, should make the system more workable. We particularly welcome the Government's intention to require local planning authorities to undertake housing capacity studies.

38. It has historically been hard to get a change of use away from employment use, even where a commercial/industrial property lies empty. This should improve with the proposed changes to PPG3. The Deputy Prime Minister has indicated that he will expect authorities to allow land allocated for industrial or commercial use to be used for housing or mixed use development unless there is a compelling reason not to do so.

Building at Higher Density

39. A paradox exists in that there is an acute housing shortage in London despite the fact that London has one of the lowest housing densities of any comparable city in Europe. Paris, in fact, has densities some four times those of London. Higher density housing is, unfortunately, tarnished by many of the poor quality schemes built in the post-war decades. However, higher densities can be achieved without adversely affecting the quality of homes provided or the overall quality of the urban environment. The logical place for higher densities is around transport nodes and comprehensive guidance on achieving high quality development around such nodes has been published by RICS (Transport Development Areas: Guide to Good Practice) and is now being incorporated into regional and local plans.

The Growth Areas

40. The Government is focusing much of its hopes for increasing housing supply on the four growth areas – Thames Gateway, Ashford, Milton Keynes and Stansted. There are, however, formidable obstacles to overcome, particularly in the Thames Gateway. RICS is concerned that there is already considerable supply of mid-price stock available in the less sought after parts of London but people in the intermediate and above market do not want to live there, raising questions about whether they will want to live in the proposed growth areas.
41. Without major investment in transport infrastructure in the growth areas, lack of accessibility will undermine development both of housing and of the commercial/industrial development needed to support it. It seems clear that the expenditure required will not be found entirely from general taxation and that private sector sources will be expected to raise much of the shortfall. In the case of Crossrail the private sector contribution is likely to be at least £5 billion. When funding on this scale is required contributions from devices such as planning obligations, congestion charging, Business Improvement Districts or tax increment financing pale into insignificance. It is clear that new ways of funding such schemes have to be devised. In its recent report, 'Funding London's Transport Needs', RICS set out a comprehensive list of the possible alternatives, spelling out their respective advantages and disadvantages.
42. Equally, ways have to be found of creating housing markets where none currently exist. This, in turn, begs the question of how to create balanced communities. Little attention has been focused on these key issues but the need to do so is vital if many of the mistakes associated with many of the post-war new towns are to be avoided. RICS would like to see the emphasis maintained on the creation of balanced communities which contain a tenure mix and avoid the creation of 'cold spots'. The concern with the Communities Plan is that it fails to tackle the existing problems of the hot spot/cold spot pattern in the south east which can only be

addressed by encouraging greater tenure mix throughout each district. Instead the plan is focusing on creating new communities which are unlikely to solve the current housing supply crisis. As mentioned before the teacher recruitment problems as a result of a lack of affordable housing in hot spots such as Kingston-upon-Thames cannot be solved by building extensions around Ashford and Milton Keynes.

ISSUE 2: INDUSTRY CONSTRAINTS

43. As outlined above RICS agrees with the contention in the preamble to Issue Two that the returns are such that housebuilders/developers have little incentive to develop land at a faster rate than is currently the case, particularly with regard to brownfield sites.

Access to finance

44. Despite its profitability over the last five years the housebuilding sector remains unloved by investors. Although housebuilders have consistently outperformed the market the stock, is seen as both dull and risky with memories of past recessions still in investors minds. As a result it is rare for housebuilders – who trade off a low price earnings multiple of around 6 – to raise finance from the market.
45. Instead they are reliant on finance from banks who can be cautious lenders. Anecdotal evidence reveals that some banks only provide housebuilders with funding for schemes once a certain percentage is sold off-plan – a system which does little to help the housebuilder's cashflow.
46. On the other hand housebuilders have retained substantial proportions of their recent profits to finance growth in their businesses, while the increase in off-plan sales means that the cost of finance to developers is reduced.

Market volatility and risk aversion

47. The historic volatility of the UK housing market seems to have led private builders to take a very cautious output approach, to avoid being caught out by a down cycle. This is arguably a factor behind the housebuilders current reluctance to release land for housing, preferring instead to increase the size of their landbanks. During a downturn – or the threat of a downturn – this is a preferable policy as it means the housebuilder can release only his cheapest land in the hope that prices will pick up. In boom time by contrast it makes sense to have smaller landbanks and release more valuable land faster to maximise returns on capital.

Capital and skill constraints

48. Professor Michael Ball has pointed out (Housing and Construction: A Troubled Relationship, 1996) that rising demand pressures are unlikely to yield a rise in new output in the near term, as training lead times are long. As such, short-term demand pressures have to be met from existing capacity. However, in times of rising economic prosperity, construction resources are likely to be attracted into more profitable commercial projects, thus restricting housing output growth. It is significant, therefore, that RICS analysis shows that construction output in the

commercial sector expanded rapidly in the 1990s, rising some 62%. However, the rise in the capital value of commercial property in the 1990s has been only one-quarter of that for residential property. The commercial property sector has responded to the volatility of the economy and the property crash of the early 1990s by building predominantly on a pre-let basis (i.e. securing tenants in advance of construction). For the housing sector, selling off-plan is more difficult, leading to more cautious development activity.

49. Professor Ball also points out that the housebuilding industry is dominated by sub-contracting, rather than direct employment by firms. Whilst this gives the industry greater flexibility in dealing with changes in the demand cycle, such an approach has led to a standardisation of building design to keep costs down and an erosion of worker training and skills upgrading. Any specific skills imparted by one housebuilder to a sub-contracted worker, are transferable to competitors' companies, leading to a 'free-rider' problem. Moreover, given the volatility of the industry, the incentives for sub-contractors to train are also low, as a downturn will make new skills redundant as they are not easily transferred into other sectors of the economy.

Reduced competition

50. Perhaps the biggest concern for the industry is the loss of many medium size builders. Mid-sized firms have disappeared as public sector housebuilding provision has fallen from more than 1.4 million homes in the 1970s to just above 300 000 homes in the 1990s. The loss of a very dominant public sector player, has led to a dramatic contraction of the industry, with wider consequences for the industry's ability as a whole to train workers and accommodate short-term changes in housing demand. The hollowing out of the industry, with the number of small and medium sized firms falling by between a third and a half since 1990, has been to the detriment of the industry overall, and at a local and regional level may have reduced competitive pressures. By contrast, the proportion of homes built by the 25 largest housebuilders has risen from less than 40% in the late 1980s to close to 60% now (NHBC figures).

Alternative manufacturing methods

51. Such methods are used extensively in commercial development and are being transported into dense urban residential use. However this is in the context of small improvements to traditional methods rather than, for example, tunnel form or modular construction.
52. We note that the Government is setting a target of 25% of new Housing Corporation-funded homes to be provided by off-site manufacture. However, the chief obstacle to the development of innovative factory produced housing is the attitude of lenders who are as yet to be persuaded that these structures have a mortgageable life. At present lenders are not convinced that borrowers will be able to sell on such properties, owing to the properties' lifespan and durability among other factors, and therefore will not provide mortgage finance for such products.

53. Generally, off-site manufacture (OSM) homes are faster to put up and require less input initially from skilled tradesmen. However, it is not yet clear whether over the longer term OSM homes will need less maintenance than traditionally built homes as the life of components is improved. There also appear to be production constraints in the OSM sector at the moment and some planning departments continue to view them with suspicion.
54. Against this background it is unlikely that OSM will provide the houses needed in the short term. However, there are good prospects for such an approach in the medium to long term, particularly if further work is carried out to allay the concerns that currently exist.

ISSUE 3: POLICY ENVIRONMENT

55. Housebuilders complaints about the planning system can sometimes boil down to the fact that they paid too much for the land or that planning policies with great social and economic benefits (e.g. Green Belt, Conservation areas, sequential testing) are stopping them building housing when and where they want to. However they do have more legitimate grounds for complaint, particularly the lack of local authority planners which means that the processing of applications takes longer than it should.
56. Undoubtedly there can be problems over short-run periods if housebuilders wish to capitalise upon strong housing market conditions to build more homes. For this reason delays in the planning system may contribute to the problem of under-supply. However, over the medium and long-term we see no convincing evidence that planning has played a significant role in the decline of housebuilding, as development plans can change to accommodate new areas of demand over time and significant amounts of housing are supplied as windfall gains.
57. We would point out that private sector, housing completions in 2002 stood at 150 000, only a fraction below the long-run average level since 1970. The government's focus on the use of previously developed land (brownfield sites) may have constrained housing output to a limited extent in the short-run, as site assembly has become more complex. Moreover, section 106 agreements may have further eroded profit-margins, as builders must provide affordable housing on new private sites. However, in the medium and long-run, any reduced profitability experienced by housebuilders should be incorporated into the future purchase price of land, thus reducing input costs.
58. Whilst the planning system is not the primary cause of the current crisis in housing and land supply, the system is far from perfect and there are some key areas which emerge as points of concern. These are set out below.

Interpretation of planning guidance

59. A major problem is the extent to which the interpretation of planning guidance by local authorities can vary, as a result both of political pressures and the abilities of local planning councillors and officers. In many local authorities there are significant pressures on local councillors to oppose new development, particularly on greenfield land and particularly developments containing a significant level of

social and affordable housing. Better training of planning officers and councillors regarding new and often challenging policy areas such as the sequential test and the Section 106 agreements would be helpful.

Resources

60. A shortage of planners means that processing applications in some areas, central London in particular, takes longer than it should. It is imperative to find ways of persuading more people to choose planning as a career and to retain existing staff in local authorities. It will be essential to ensure that the additional £300 million that the Government has said it will put into alleviating the current chronic under-funding of the system is actually spent on planning.

The sequential test

61. The application of the sequential test on the basis of existing local authority boundaries is a major flaw in the operation of the test. The problem is that a brownfield site in one authority may lie abandoned while the neighbouring authority is free to develop on greenfield sites. RICS therefore suggests that the sequential test should be applied within housing market areas and at city region level as opposed to conforming with local authority boundaries.

Section 106

62. Housebuilders argue that raising the level of affordable housing required under s106 agreements not only creates perverse incentives but amounts to a land tax for them. Others, on the other hand, claim that it is perfectly possible for housebuilders to stick within current thresholds and still make healthy profits. This area of policy is riddled with controversy and seems to lack clarity for both planners and developers. In a recent RICS/Housing Corporation (Delivering Affordable Housing through the Planning System, 2003), a range of changes were suggested aimed at injecting greater clarity and consistency into the system.
63. Despite the level of misunderstanding of the economics of s106 among planners and developers, the land market tends to function fairly efficiently and opportunities for development are generally picked up as soon as the residual development value exceeds existing use value. As a result there is rarely any 'surplus' land value to pay for s106 except in cases where there has been a change in planning use which significantly increases values, for example from industrial to retail or agricultural to residential.
64. In these cases s106 agreements are entirely valid and should be based on an 'open book' approach where the developer agrees an appropriate return for risk and reward with the local planning authority and shares any profits in excess of this with the authority. This is how the grant system operates very successfully and we note that English Partnerships is about to undertake research in this area.
65. Housebuilders argue that raising the level of affordable housing required under s106 agreements not only creates perverse incentives but amounts to a land tax for them. Others, on the other hand, claim that it is perfectly possible for

housebuilders to stick within current thresholds and still make healthy profits. This issue will be looked at further in the next section.

The Planning and Compulsory Purchase Bill

66. Many of the changes in the Bill, currently before Parliament, will improve the overall operation of the planning system. However, it is unlikely that by themselves they will improve the supply of land for housing. Indeed, delays to the Bill are preventing local authorities from carrying forward their development plans and therefore compounding the very delays the Bill is seeking to overcome.
67. In terms of the content of the Bill the implicit threat to abolish outline planning permissions and replace them with vaguer statements of development principles could lead to greater uncertainty and bring an end to the sale of land with planning consents. This could make raising finance for development more difficult, particularly for large schemes, and pose major problems for both private and social developers.
68. Another important change is the reduction in the validity of planning permissions from 5 to 3 years. This may bring advantages in that it will force landowners with consents to bring their sites forward for development more quickly than they do at present. However, it could be a problem on large and complex schemes which could easily take more than 3 years to get started fully on site, especially where development is phased.

National Planning Policy

69. RICS set out a range of policy recommendations in its recent Housing Manifesto which we believe remain entirely valid:
 - Government should set output targets (including affordable housing output targets) to help meet the projected shortfall of homes and to monitor the provision of net additions to the housing stock against the growth in households, including concealed households
 - Government should seek to achieve better integration of housing, land use planning, transport and economic development strategies particularly in sub-regions, city-regions and other travel-to-work-areas
 - There should be a requirement on local planning authorities to assess the residential potential of unused and under-used commercial and industrial property and to produce strategies for its conversion to sustainable residential uses
 - New housing development in rural areas should be allowed to meet chronic shortages, particularly of affordable housing, where this does not jeopardise the distinctive nature of rural settlements and the countryside

- Government in partnership with local authorities and others, should ensure that all local authorities develop policies and practices to deliver affordable housing through the land use planning system in ways that match the best standards now in use.

Taxation

70. A number of taxation issues are relevant to the debate

- Housebuilders are traders who are taxed on profits with no incentive to sell to any particular type of buyer. Whether they sell to a Housing Association or an individual they will be taxed at 30% on their accounting profit.
- Investors who are taxpayers are worse off if they invest in residential property as they do not get tax relief for capital expenditure. For example, if investors put a heating system in a commercial property they will get tax relief for their expenditure but a residential landlord would not. The only relief for residential landlords is wear and tear which is 10% of the rent of a furnished property. Tax relief is only available for improvements when the property is sold. Consequently there is a disincentive for residential landlords to improve existing properties.
- Both commercial and residential landlords are taxed on gains realised from the sale of property. Neither can claim rollover relief (ie a deferral of the tax on the gain if the proceeds are reinvested in replacement property) unlike an occupier who is using property for a commercial business.
- Stamp duty is also a potential barrier. If rates increase still further that could make investment in property less attractive.
- The zero rate of VAT on new build and the full rate on repair and refurbishment is anomalous. A reduced rate on repair/refurbishment would bring the treatment of such property more into line with new build as well as encouraging better maintenance of the stock and deterring resort to the black economy. It would also better support the broader objective of maximising the use of brownfield land.
- The use of tax reliefs can make marginal areas more attractive but only if it is seen as one part of a broader tool-kit.
- Certain types of development can lead to large windfall gains for landowners, particularly when land is converted from greenfield use. Proposals have been put forward at various times to tax the uplift in value that can occur when land is granted consent for housing development. There is an argument for such an approach. However, if a greenfield tax were to be set at a punitive level it would reduce the flow of land for development. If it were set at a modest level it would probably have little adverse impact on land supply but could generate some modest funds for use in tackling problems associated with brownfield sites. There would, however, be a good deal of complexity in say, defining what is a greenfield site.

- Other changes in the tax regime to encourage greater institutional investment in the private rented sector are set out below.

Empty Homes

71. Tackling the problem of empty homes is another means of helping to maximise supply. Given that some 730 000 are currently empty in England and Wales. The Government has already taken a series of measures to encourage reuse by reducing the VAT rate on repair and refurbishment of long-term empty homes, increasing council tax liabilities on owners of empty properties and prioritising the development of existing land and buildings in preference to Greenfield land. It has also just issued a very comprehensive guide for local authorities and property owners on unlocking the potential of empty properties. More recently it has launched a consultation paper on the concept of compulsory leasing.
72. Action on empty homes is working. The number of such homes has fallen by 30 000 over the last year. Getting the number of empty homes down to still lower levels would require a range of new measures:
 - RICS supports the streamlining of compulsory purchase order structures, in particular the adoption of the American concept of quick-take – essentially fast track CPO following non-payment of property taxes.
 - We would also like to see an extension of the Public Request to Order Disposal provisions known as PROD. Under the PROD scheme any member of the public can ask for the disposal of publicly-owned property that is unused or underused. We would like to see this extended to the private sector. If a private individual, perhaps acting through the local authority, could apply to acquire a redundant property or derelict brownfield site, the financial burden would then not apply to the public body. Faced with such an application a property owner would have the option of applying for planning consent on the property; placing the property on the market; using it himself; or accepting the offer made by the person requesting disposal.
 - We would also like to see the Government setting targets for reducing the number of empty homes and establishing benchmarks against which Government agencies and local authorities should be required to act. In areas where empty homes is a significant problem there is a case for requiring mandatory empty homes strategies. The current requirement under PPG3 on housing for local authorities “to adopt positive policies to identify and bring into use empty housing” is just too vague.
 - There is also a need for flexibility in the planning sphere – flexibility to allow conversions of redundant commercial property for property use and flexibility in the nature of the conversion permitted, sometimes allowing a higher density than would generally be allowed.

ISSUE 4: SOCIAL HOUSING AND THE RENTAL SECTOR

73. As we have pointed out, the most cursory examination of housebuilding figures shows that the rapid fall in overall supply is due principally to the dramatic reduction in the supply of social and affordable housing. Quite simply affordable housing numbers have dropped as the subsidy for it has dropped. The industry produces much affordable housing outside desirable areas with high land values. In those areas of high land values affordable housing has always been achieved by public subsidy or regulation or charitable funding. In recent years, however, housing associations have become increasingly reliant on private finance. As a result housing associations cannot afford to bid for sites in high demand areas and are increasingly reliant on housing provided by s106 agreements. Unless a greater degree of public subsidy is provided the supply of housing for those unable to buy or rent privately will continue to diminish.
74. Given that 700 000 homes have been sold under the Right to Buy with little replacement provision we believe that further restrictions on Right to Buy in areas of high demand are essential to maintain the limited stock of social housing that remains in such areas.
75. We would also point out that the principal means by which Government envisages that social housing will be provided in future – section 106 agreements – will never be able to meet the demand for social housing provision. Professor Christine Whitehead has estimated that the maximum number of homes that could be provided by such means is 15 000 – a far cry from the level of provision in previous decades. Moreover, it means that the supply of affordable houses is almost totally dependent on how much the private sector is developing.
76. The main reason for the private sector's failure to embrace affordable housebuilding is that it does not see it as profitable. One consultant to the private sector described affordable housing to us as: 'Built at a loss, run at a loss and occupied by losers'. The housebuilding industry is ultimately accountable to shareholders and it is hardly surprising that it does not prioritise what it views as building for the public good.

The intermediate market

77. This section of the market is perceived as potentially profitable and is therefore viewed differently, particularly by the growing number of Registered Social Landlords (housing associations) who are undertaking low-cost home ownership and shared ownership schemes. In many cases RSLs are now working with housebuilders to develop these schemes, often taking on the task of managing the affordable section of new developments.
78. It is important that the definition of affordable housing is explained clearly here. Social housing, which has traditionally provided the core client base for housing associations, is targeted at low income people who are unlikely to get a foot onto the housing ladder. Affordable housing, sometimes confused with social housing, has increasingly come to mean housing for key workers, such as nurses and teachers and those in the intermediate earnings bracket, who now find themselves priced out of the private market.

79. During the last few years a number of lower-cost products, such as Homebuy and the Starter Home Initiative, have been developed for this market. However, there is some confusion about the policy with a number of commentators claiming that the ODPM and the Housing Corporation have been unclear what they wish to achieve.
80. There appear to be two central problems. The first is that an influx of too many of these schemes onto the market could inflate house price levels. The second is that there are considerable question marks over the extent to which these schemes are actually affordable. For example, the going rate for a one bedroom shared ownership flat in central London is £250 000 which breaks down at £900 a month in rent paid to the housing association combined with mortgage repayments on the portion purchased. For a single key worker this is financially out of reach and is likely to be tight for a couple as well.
81. RICS suggests that an interesting avenue to explore is the possible tie-in between employers looking at shared ownership/low cost schemes for their staff. It is widely recognised that past accommodation disposal policies in the public sector – for the police and nurses for example – have contributed significantly to the key workers crisis.
82. A further concern is that as more and more housing associations begin to emphasise the needs of the intermediate market housing association grant funds for the social housing client base may be diverted.
83. The intermediate sector has a potentially crucial role in providing housing not simply for so-called “key workers” such as teachers but for many others who contribute to the working of society. However, its potential has not been properly explored and a full review of current and potential schemes in this sector is badly needed.

Private rental sector

84. There has been a significant expansion in the private rental sector, particularly in the buy-to-let market, since rules regarding rent control were relaxed in 1988. Today the buy-to-let market alone is worth £28bn and is used by some as an alternative pension strategy, because of the collapse in the equity market.
85. Yet despite this the sector has not expanded as much as had been predicted, with institutions failing to enter the market, leaving the bulk of it to small private investors. There are several main problems deterring investors. Although total returns including capital growth have been high, many other factors make this market unappealing to institutional investors. Unlike other investments the asset has to be managed which can prove time-consuming, costly and problematic, particularly as a portfolio of properties is likely to be spread over a wide geographical area. Moreover, investors have to accept short leases on assured shorthold tenancies compared with longer term institutional leases in the commercial property sector. In addition, constructing a large enough portfolio can be difficult, particularly as there is a shortage of good products. Despite all these problems, a number of institutions have moved into the private rented market (e.g.

Alsop Chaco), often in conjunction with a housing association which absorbs some of the costs and risks.

86. There are many reasons why expansion of the private rented market is desirable. A supply of such property brings a better balance to the housing sector, it expedites labour mobility and is particularly suited to the needs of certain sections of the community, particularly the young and mobile. However, given that to expand the sector by just one percent requires an investment of some £10 billion, significant and sustained expansion requires greater interest from institutional investors.
87. A number of the taxation problems which we have identified could be resolved if investors were able to invest in residential property through a tax transparent vehicle. This would enable institutions to invest without suffering tax on gains or income. Taxpayers would still pay tax on distributions from the vehicle and also tax would be due on gains realised from the sale of their shareholding in that vehicle. Such a structure is likely to maintain stock in the private rented sector because investors could sell their shares if they wanted to invest elsewhere rather than selling the underlying stock into the owner-occupied market (which is the current case with much buy to let property). There would also be additional social benefits including more professional management (unlike the current position where landlords may lack experience or have only one or two properties to let).
88. Both the previous and the current Government have expressed interest in the use of new types of investment vehicles that might attract such investors. The previous Government promoted the setting up of special Housing Investment Trusts. However, the HIT structure was introduced without proper consideration of the range of factors needed to make them work and were also subject to tight constraints that made them unattractive. RICS strongly believes that Government should seek to learn from this experience and actively explore the possibility of facilitating new vehicles. Renewed interest by Government in exploring the case for facilitating the introduction of Real Estate Investment Trusts into the UK may provide an opportunity to address this issue again.

PRINCIPAL RECOMMENDATIONS

1. Greater use should be made of compulsory purchase powers by local authorities to assemble land for regeneration purposes (para 29).
2. Whilst contamination and dereliction can be problems, there is an even greater need to tackle issues associated with the services provided by utilities (para 32).
3. UDCs have an important role to play in land assembly but must have the requisite powers and independence if they are to make a difference (para 34).
4. English Partnerships and the Housing Corporation have a pivotal role to play in the supply of publicly owned land for affordable housing (para 35).
5. The key priority in disposing of surplus public land should be use it to bring the greatest public benefit, not simply the highest price (para 35).

6. Local authority plans should always be based on housing need surveys and should specify the type of housing that is needed (para 37).
7. Local authorities often equate affordable housing with general needs rented housing. There is, of course, a need for such housing but higher value alternatives such as shared ownership should not be neglected (para 37).
8. We support moves to allow land allocated for industrial or commercial use to be used for housing or mixed use unless there is a compelling reason not to do so (para 38).
9. Higher density housing options must be explored. They should be located around transport nodes as outlined in the RICS Guidance on Transport Development Areas (para 39).
10. Major infrastructure investment will be needed to improve accessibility both to and within the four growth areas in the South East. Ways need to be found, too, of creating housing markets in areas where none currently exist (para 40 et seq).
11. Off-site manufacture of homes offers good prospects in the medium to long term but further work is needed to allay the concerns that houseowners, lenders and planning authorities have about them (para 51 et seq).
12. Differing interpretations of planning guidance by local authorities pose problems but these can be eased by better training of planning officers and councillors (para 59).
13. The additional resources earmarked by Government for the planning system must be spent on improving planning services (para 60).
14. The sequential test should operate in the context of housing market areas rather than local authority boundaries (para 61).
15. Greater clarity and consistency is needed in the operation of s106 agreements (para 62).
16. Section 106 agreements should be based on an open book approach where the developer agrees an appropriate return for risk and reward with the local planning authority sharing any excess profit with the authority (para 63).
17. The system of outline planning consents which are particularly important in larger scale developments should be retained (para 67).
18. Government should set housing output targets including affordable housing output targets (para 69).
19. Government should seek to achieve better integration of housing, land use, planning, transport and economic development strategies, particularly at sub-regional and city region level (para 69).

20. There should be a requirement on local authorities to assess the residential potential of unused and under-used commercial and industrial property and to produce strategies for its conversion to residential uses (para 69).
21. Chronic shortages of affordable housing in some rural areas should be eased by allowing more new housing development in such areas as long as it does not jeopardise the distinctive nature of rural settlements (para 69).
22. Current tax arrangements discourage investment in housing and should be reviewed (para 70).
23. The contrast between the zero rate of VAT on new build and the full rate of VAT on refurbishment and repair is anomalous, discouraging maintenance of the stock and regeneration initiatives. The VAT rate on repair/refurbishment should be brought more into line with that on new build (para 70).
24. A range of new measures should be considered to reduce the number of empty homes still further (para 72).
25. Increased housing provision in the social and intermediate housing sectors will require higher levels of public subsidy (para 73).
26. The right to Buy should be restricted in areas of high demand (para 74)
27. The intermediate housing sector has a potentially crucial role to play in helping those who cannot afford to buy outright and those who cannot access social housing. So far the sector has proved a disappointment and a fundamental review of its potential is needed (para 77 et seq).
28. An expansion of the private rented sector would help improve housing choice, particularly for the young and mobile. In order to attract institutional investment there is a need to introduce new tax transparent vehicles (para 84 et seq).

FURTHER COMMENTS

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