

# 7

## Policy levers

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### Overview

Government has a range of policy levers at its disposal to influence the supply of housing. These include economic instruments, regulation and subsidy. Regulation and subsidy are considered further in subsequent chapters.

These policy levers can be used to differing degrees and in differing combinations to balance the social costs and benefits associated with housing and to tackle market failures.

Government failures can occur if intervention has unforeseen consequences or distorts behaviour in such a way that it creates additional costs.

One economic instrument available to government is taxation. The tax regime can impact on housing supply in the UK in a number of ways:

- 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 a tax have been largely unsuccessful;
- the differential VAT treatment of new build housing in comparison with repairs and maintenance of existing housing is likely to have an impact on the allocation of resources within the housing market;
- earlier Government policies designed to encourage institutional investment in property through taxation have 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 - indeed, UK transaction taxes are relatively low compared to other European countries. However, there may be particular distortions in behaviour near stamp duty thresholds; and
- council tax may also have little impact on housing decisions of individuals. There is evidence to suggest that the distributional impact of council tax is somewhat regressive.

Experience from abroad shows that some countries use tax much more actively than the UK to manage housing supply and demand.

## INTRODUCTION

7.1 The previous three chapters considered factors within the housebuilding industry that might explain the low levels of housing output and the lack of responsiveness to price changes that were examined in Chapter 2. In particular the existence of possible market failures, such as the role of competition and availability of skills, were examined. Given the Government's role in determining the balance between the social costs and benefits of housing, the policy environment in which the housebuilding operates is likely to have a significant impact on the level of housing output and the degree of responsiveness. This and subsequent chapters will examine the influence of Government interventions on housing supply and its responsiveness to demand.

## INFLUENCING MARKET BEHAVIOUR

**Government intervention** 7.2 Governments intervene in many different markets, for a variety of reasons. Typically, by intervening, governments aim to tackle the failure of markets, left to themselves, to deliver the most efficient allocation of resources. Governments may also intervene to ensure resources are distributed in an equitable manner.

**Market failures** 7.3 The provision of housing is subject to a number of market failures. On the one hand, as set out in Chapter 1, housing has positive consequences for the economic well being of the UK, and generates wider social benefits in terms of health and education outcomes. On the other hand Chapter 1 also explored the costs associated with development, such as environmental damage and loss of the amenity value of open land. Government intervention aims to balance these costs and benefits on the basis that the market left to itself would deliver a sub-optimal outcome. Chapter 1 also suggested that at the present time this balance has not been struck correctly, and that the UK economy might be better off with an increased supply of housing.

7.4 Governments have a range of instruments at their disposal that can affect the behaviour of markets. These influence market behaviour by altering the availability, or the relative attractiveness, of various choices. Government intervention in the housing market can take a number of forms, including:

- economic instruments, such as taxation, which will influence choices by changing incentive structures in the housing market;
- regulation, through the operation of the planning system, which determines the amount of housing that can be supplied, its location and nature; and
- subsidies, in the form of the provision of social or affordable housing, which primarily address issues of equity but can also improve efficiency.

7.5 These policy instruments are, to a degree, substitutable: Government can often achieve the same desired outcome through tax, regulation or subsidy. There may also be trade offs between interventions and choices for Government, for example increased market regulation might reduce the need for Government subsidy. The relative costs and benefits of different methods will vary; and different markets will require different interventions.

7.6 Importantly, no method of intervention will be ‘cost free’ since they will all involve some form of compliance, transition and/or monitoring cost. Furthermore, changes to Government intervention may have a negative impact on individual welfare by potentially disrupting the economic expectations and aspirations of existing and potential home owners. Choosing the correct method of market intervention is vital if Government is to ensure optimal market outcomes at an acceptable cost. Indeed, government failures can occur if intervention distorts behaviour in such a way that it creates additional costs.

7.7 This chapter provides an overview of the regulatory and subsidy related interventions used by government before going on to consider the role of taxation and other economic instruments in more detail. Chapters 8 and 9 consider the wider policy environment and the regulatory framework in particular, while Chapter 10 considers the impact of the government provision of subsidised or affordable housing.

## REGULATION: THE ROLE OF THE PLANNING SYSTEM

7.8 The role of the planning system is to balance the costs and benefits of development and to arrive at a decision which in some sense equates with a social optimum - the optimum balance between economic, social and environmental objectives. Governments use the planning system to influence the nature of developments in order to reduce, or alter the distribution of, any possible negative spillovers they generate.

7.9 Government Planning Policy Guidance 1<sup>1</sup> sets out the comprehensive list of objectives for the planning system. This illustrates the importance of viewing planning policies as a whole, recognising that achieving housing goals is only one of the many competing objectives which planning is charged with delivering:

“A successful planning system will promote economic prosperity by delivering land for development in the right place and at the right time. It will encourage urban regeneration by ensuring that new development is channelled towards existing town centres rather than adding to urban sprawl. It will help to conserve greenfield land and re-use urban brownfield land. It will value the countryside and our heritage while recognising that times move on. It has a critical part to play in achieving the Government’s commitment to sustainable development.”<sup>2</sup>

7.10 With specific regard to housing development, the planning system aims to balance competing land use demands at many levels. As examined in Chapter 8 and in Annex A, at a regional level Regional Planning Guidance translates expected housing demand into target housing construction numbers. The distribution of these targets between local authorities is then agreed and local planning authorities produce Local Development Plans to allocate specific sites for housing development. One key aim of these plans, at both the regional and local level, is to ensure that the impacts of housing – economic, social and environmental – are taken into account. Applications for housing developments are then assessed in accordance with the Local Development Plan and other ‘material considerations’. It is through this process that the use of government regulatory power to intervene in local housing markets is seen most clearly.

<sup>1</sup> ODPM Planning Policy Guidance 1: General Policy and Principles. Note: ODPM will be issuing revised PPG 1 (Planning Policy Statement 1) for consultation shortly.

<sup>2</sup> DTLR *Planning Green Paper – Delivering a Fundamental Change*, (2001).

7.11 The Government has recognised weaknesses in the planning system and has introduced a range of reforms to make planning faster, more transparent and more effective; particularly in delivering the infrastructure needed to support sustainable growth. The role of the planning system, as an instrument of regulatory intervention, in delivering housing supply and the reforms to planning are discussed in greater detail in Chapters 8 and 9.

### SUBSIDY: AFFORDABLE AND SOCIAL HOUSING

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7.12 Governments frequently intervene in markets to ensure an equitable allocation of goods and services among society. Furthermore, there are certain goods that society believes everyone should have, regardless of ability to pay. Housing is typically seen as such a ‘merit good’ because adequate housing is associated with improved educational and health outcomes. Therefore many government interventions in the housing market use policy levers to ensure that an adequate basic supply of housing is within everyone’s reach.

7.13 One policy lever available to governments for market intervention is the direct provision of housing to certain households through local authorities, or other social landlords. These organisations own and let housing at below market prices. The Government has other policy levers to exercise influence over the socially rented sector, for example the Housing Corporation contributes funds towards new housebuilding by Registered Social Landlords (RSLs) and is responsible for the regulation of RSLs. Another subsidy lever used by government is Housing Benefit, which subsidises an individual’s housing costs through a grant towards rent payments. Given Housing Benefit’s primary role in increasing *access* to housing rather than increasing the *amount* of housing itself, the Review will focus on Government subsidy delivered through the direct provision of housing to social tenants. The impact of social housing subsidy on overall supply is discussed in Chapter 10.

7.14 Social housing also illustrates how policy levers can be used in conjunction with each other to achieve certain aims. For example, as discussed in Chapter 9, through Section 106 planning obligations, many developers agree to provide a number of affordable dwellings (e.g. social housing, or sub-market lets to key workers) as a condition of permission to develop private market housing. In some cases these affordable units are transferred to, and managed by, social landlords. In this way, they operate as a subsidy for those renting the homes but are delivered through the regulatory planning framework. Thus different forms of Government intervention can work together in order to achieve a desired outcome.

### ECONOMIC INSTRUMENTS: TAXATION

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7.15 Taxes can be effective in ensuring that the overall costs to society of certain actions are imposed on the appropriate private actors - and ensure that these costs are distributed correctly. Through taxation, governments can more closely align those that cause, and those that bear, positive and negative impacts on the wider economy and society. Given this, the remainder of this chapter will examine the role of the tax system in affecting housing supply.

### Taxation as a policy lever

7.16 Many of the current taxes affecting property and land reflect the gradual evolution of the tax system and the legacy of a process of nearly continuous reform. As a result, they may not necessarily promote a consistent pattern of housing behaviour, or behaviour that makes best use of available land and housing supply. Changes to taxation need to be approached with caution as the interactions with individual decision making and the housing market could lead to unintended consequences.

### TAXATION OF LAND

**Alternative uses of land** 7.17 Land is one of the primary factors of production in the house building process. It also has alternative uses, such as for agriculture, commercial or industrial enterprise. In the absence of externalities, whether land is allocated efficiently will depend in large part on the planning system, but also on the efficiency of the pricing mechanism in expressing the interaction between supply and demand. Tax is a possible distortion in the efficiency of this pricing process, particularly when decisions are marginal.

**Tax and brownfield development** 7.18 Tax measures may particularly influence the redevelopment of brownfield land at the margin. The level of risk and uncertainty attached to development is higher on brownfield land, and the corresponding development gain lower. Taxes may therefore affect the development of brownfield more powerfully compared with greenfield. The introduction of tax credits and grants in 2001 for the remediation of contaminated land demonstrates one method of using economic instruments to affect development decisions in the presence of market failures that hamper optimal land use.

### Economic rent

7.19 Land is a scarce good; beyond this, each piece of land is characterised by differing attributes, relating to its location and quality (in terms of, for example, contamination or dereliction) which will influence its value. The value of land is also heavily dependent on the use to which it can be put; and this is in part a result of regulatory planning decisions. This can generate large differences in land value depending on the type of development permission granted.

**Table 7.1: Value of land by use in North East England, 2003<sup>1</sup>**

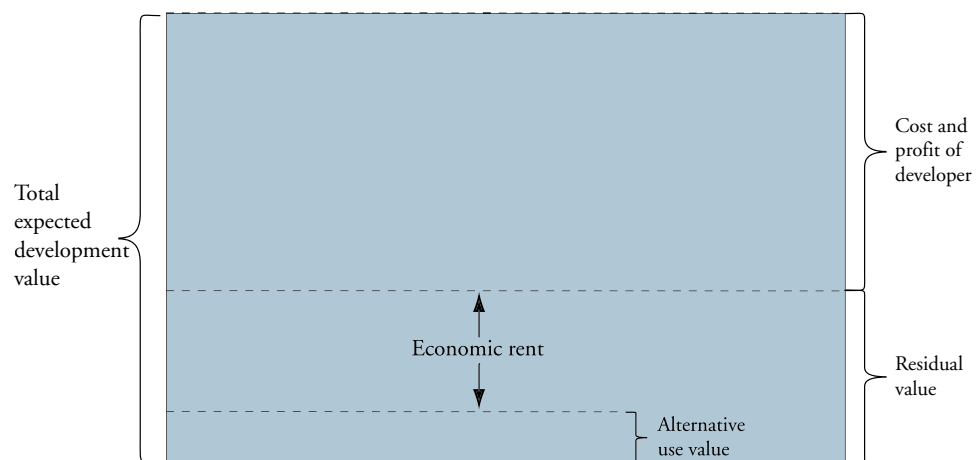
Use	Value per hectare
Residential land	£1.15 million–£1.26 million
Agricultural land	£865–£7,534
Industrial land	£80,000–£200,000

Source: Valuation Office Agency Property Market Report, Spring 2003

<sup>1</sup>Values refer to land typical for the area and may include a mix of greenfield and brownfield.

7.20 As discussed in Chapter 5, land prices tend to be driven by residual values, meaning the willingness of housebuilders to pay for land is determined by the final development value minus development costs. This can be much higher than the price landowners might be willing to sell at (the land’s alternative use value). Landowners therefore receive a higher income over and above that required to induce them to sell, and this windfall is known as economic rent. The concept of economic rent is illustrated in Chart 7.1. The actual size of the economic rent for a given development will vary significantly depending on, among other things, regional land prices and whether the land in question is greenfield or brownfield. In some cases, the economic rent accruing to the landowner will be a much higher proportion of the total expected development value than indicated in Chart 7.1.

Chart 7.1: Economic rent illustrated



7.21 Economic rents can also arise as the result of investment in infrastructure as well as from planning changes. For example, land in Stratford, East London, increased in value following the completion of the London Underground Jubilee line extension. This has important distributional implications, as it is possible for landowners to benefit from expenditure made by others, including from the public purse.

**Box 7.1: Landowners and economic rents**

“Roads are made, streets are made, services are improved, electric light turns night into day, water is brought from reservoirs a hundred miles off in the mountains — and all the while the landlord sits still. Every one of those improvements is effected by the labour and cost of other people and the taxpayers. To not one of those improvements does the land monopolist, as a land monopolist, contribute, and yet by every one of them the value of his land is enhanced. He renders no service to the community, he contributes nothing to the general welfare, he contributes nothing to the process from which his own enrichment is derived.”

Winston Churchill’s speech made to the House of Commons, May 4 1909.

## Vacant land and development taxes

**Vacant land suitable for development** 7.22 As discussed in Chapter 5, landbanking can result in housebuilders and other organisations owning large amounts of land with planning permission, but holding off development. Some submissions to the Review have advocated the use of taxes to encourage the development of permitted land and raise the costs of keeping the potential residential use of the land unrealised.

**Land taxation in other countries** 7.23 Other countries operate tax systems that are sensitive, to a degree, to demand for land, often through a variation of a wealth tax. These can have the effect of ensuring that the costs associated with holding onto vacant land that could be more efficiently utilised for residential development are borne by the landowner (and thus go some way to internalising some of the negative impacts resulting from not bringing forward developable land). Denmark, for example, has a locally levied land value tax that increases in line with land prices, and thus rises as development pressure grows. This provides landowners with a direct financial incentive to release suitable land for development when the market demands it most, or to build out land that has already secured planning permission.

### Box 7.2 Danish land taxation

Since 1924 Denmark has levied a land value tax based on the market price of land, revalued every two years.

Land tax is payable to the local authority and county based on a per thousandth share of the value of the land. Local councils set the amount for their area, varying the per thousandth share according to different types of land use. This is subject to a minimum of six and a maximum of 24 thousandths of the value of the land, giving an effective tax rate of 0.6 - 2.4 per cent of the land's estimated market value.

Such a tax raises the cost of holding developable land when demand, as expressed through rising market prices, increases. This should, absent other factors, make holding valuable land more expensive as development pressure increases, encouraging land release for development.

7.24 Submissions to the Review have suggested similar taxation systems:

- the Liberal Democrat land value tax advocacy group 'Action for Land Taxation and Economic Reform' (ALTER)<sup>3</sup> argue that a land value tax would serve to make housebuilders concentrate on producing more plentiful and better quality housing suited to today's needs, rather than seeking to profit from speculative land value appreciation; and
- John Muellbauer<sup>4</sup> considers a system whereby a land value tax is levied on all land that is not occupied for residential use or publicly owned, as part of a wider reform to property taxation. Such a system would he argues, generate efficiency and stabilisation gains for the economy as a whole and, drawing on experience from the Danish system, could improve the functioning of the land use planning system.

<sup>3</sup> ALTER submission to the Barker Review Consultation (2003).

<sup>4</sup> John Muellbauer submission to the Barker Review Consultation (2003).

**Box 7.3 Previous development taxes**

In the past fifty years there have been four attempts to tax the gains resulting from the development of land from agriculture to another use.

The Town and Country Planning Act of 1947 nationalised development rights: in the UK there is no presumption in favour of development where land is privately owned, except when planning permission is granted. The right to development was purchased from land owners for £300 million in 1947, the equivalent of over £10 billion now. At the same time a Development Land Tax was introduced; designed to go hand in hand with these reforms in order to recoup the increase in value associated with development. This was charged at 100 per cent of the value of land price increases attributable to planning permission. It was assumed that this would not reduce the incentive to sell land, but would rather encourage land to be brought to the market by removing any future hope value that landowners might attach to the land.

Following a change of Government, the tax was abolished in 1953. However various taxes aiming to capture some of the development gain were introduced in subsequent years, such as the 1967 Betterment Levy, the 1974 Development Gains Tax, and finally the Development Land Tax, which ended in 1985.

These taxes aimed to capture the windfall gains arising from planning permission and free up more land for development. However, all of them were widely seen as failures in meeting their policy objectives. Far from freeing up land, they contributed to reductions in supply as landowners held onto land in the expectation of policy reversal following a change of Government. Consequently, on average, these taxes also raised far less revenue than they were initially expected to.

The taxes failed for a number of reasons, some specific to the particular circumstances of the time. However, common features that contributed to the ineffectiveness of these taxes include strong opposition, widespread avoidance and the difficulty and complexity of their operation, often aggravated by poor design.

**Development taxes** 7.25 As Box 7.3 illustrates previous Governments have attempted to use development taxes to capture some or all of the economic rent accruing to landowners. However, for a variety of reasons none of these taxes have been particularly successful in achieving their aims.

**VAT AND HOUSING**

**New build and repairs, maintenance and improvement**

**New build and RMI** 7.26 The differential treatment of new housing (which does not incur VAT) compared with the repairs, maintenance and improvement (RMI) of the existing housing stock (subject to full VAT) has been highlighted in many submissions to the Review. This VAT difference distorts the allocation of resources within the housing market since, to compete in the same market, the cost of acquisition plus refurbishment must be around 17.5 per cent less than the cost of land acquisition and new build.

7.27 It is worth noting that new housing is currently zero-rated under VAT rules, not merely exempt. This means that not only is the sale of a completed house not subject to VAT, but also that housebuilders can claim back VAT on the goods and services used to build the property.

7.28 Harmonising the tax treatment of new build and RMI would therefore move towards a more efficient allocation of resources – an idea supported both by submissions to the Review, and by the 1999 Urban Task Force, headed by Lord Rogers of Riverside. One suggested way of doing this would be to impose VAT on new build, and equalise it to the same level as RMI. Were this to be done, it is likely that the cost of the tax would be factored into housebuilders' residual values and thus exercise a downward pressure on land prices. It would be unlikely to feed into higher new build house prices, since second hand homes constitute the vast majority of sales each year and, to stay competitive, housebuilders must price their new homes in light of this. As well as removing distortions in the allocation of resources between new build and RMI, such a system would also go some way to capturing part of the economic rent generated by the planning system currently accruing to landowners – albeit through the indirect route of passing tax costs through the housebuilder. These issues will be considered further in the next stage of the Review.

#### VAT, greenfield and brownfield

7.29 As noted above, the VAT treatment of housing currently distinguishes between new build and repair and maintenance to existing property. The tax system does not, however, differentiate between greenfield and new brownfield development. Submissions to the Review, such as the contribution from the Greater London Authority<sup>5</sup>, have suggested that the tax system should be reformed to be more sensitive to this distinction through a tax advantage to encourage the development of previously utilised land. Such a sensitivity would help promote positive spillovers associated with brownfield development such as urban renewal and regeneration.

#### VAT and conversions

7.30 As well as VAT advantages for new build, there are tax measures to encourage the conversion of existing buildings into residential dwellings. The VAT regime provides for a reduced rate of 5 per cent on the conversion of residential property, a similarly reduced rate for converting a non-residential building into residential use, and a zero rate for selling a residential building that has been converted from non-residential use.

7.31 This kind of tax advantaged RMI activity is particularly likely to generate positive spillovers. The measures above will encourage the development of under-utilised urban space and the more efficient use of existing buildings. This, in turn, contributes to revitalising urban neighbourhoods and promotes more environmentally friendly higher density living. However, welcome though these additions are, they only have a small impact on supply, and represented only 2 per cent of new housing completions in 2002/3. A similarly small increase in housing supply could result from a reduction in VAT for all RMI work by slightly lowering the cost of keeping existing houses in good repair. However, such a VAT reduction would also generate a substantial deadweight loss to the Exchequer (i.e. subsidise RMI work that would have happened anyway).

### INSTITUTIONAL INVESTMENT IN UK RESIDENTIAL PROPERTY

#### Institutional investment

7.32 Despite the strong performance of property compared with other assets in recent years direct institutional investment in residential property is very low in the UK. The rental market mostly comprises a large socially rented sector, provided by local authorities and Registered Social Landlords, and a smaller private rented sector run by often part-time and predominantly small-scale landlords.

<sup>5</sup> Greater London Authority submission to the Barker Review Consultation (2003).

7.33 In other countries institutional investors play a larger role in private rental housing, with social housing and owner occupation contributing smaller proportions of the total tenure mix (see Annex A for a more detailed breakdown of tenure type across countries). Institutional investors in other countries typically invest money in property through specifically tax-transparent property investment vehicles, for example Real Estate Investment Trusts (REITs) in the USA.

7.34 Governments in the UK have attempted to encourage such institutional investment in property in the past. For example:

- in 1996 legislation was introduced permitting the establishment of Housing Investment Trusts (HITs), which, among other features, had a reduced tax liability compared with normal property companies; and
- the Business Expansion Scheme (BES) of the 1980s represented an earlier attempt to interest venture capital investors into property.

However, like development taxes, these were not a success: BES was widely seen as a costly deadweight loss to the Exchequer that achieved few of its original aims; and to date no HITs have been created.

7.35 Several submissions to the Review have indicated a continued desire on the part of institutional investors to increase their exposure to property and highlighted the difficulties of doing so, including those difficulties related to the tax treatment of property investment companies. These submissions have argued that changes to the tax system would encourage greater institutional investment in property which might have positive benefits for housing supply:

- the quality of private rented stock may improve through greater investment in the physical fabric of dwellings, which would extend the usable life of the properties, and thus increase housing supply overall. Such quality improvements might also generate increased demand for the tenure type;
- given a guaranteed institutional buyer, housebuilders may be more willing to increase supply of the specific type of housing units desired by investors; and
- long-term investment may promote greater stability in the market, as institutional investors are typically less reliant on debt financing, and thus less vulnerable to interest rate changes than small individual private landlords, as well as being subject to greater market scrutiny.

7.36 Given the benefits that may result from greater institutional investment, and the role REITs play in other countries' housing economies, there may be merit in the Government looking at ways to promote greater interaction between institutional investors and the residential property market.

### TAXATION AND TENURE CHOICE

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7.37 Tax rules, as discussed, can have an impact on the amount of institutional involvement in the residential property market. In addition to this, tax rules - both past and present - can impact on the tenure decisions of individuals.

7.38 Historically, governments in the UK and in other countries have instituted tax regimes that have favoured home ownership over private renting. Most notably in the UK, mortgage interest tax relief, until its final abolition in 2001, provided a clear tax advantage for home owners in paying for housing services when compared with the treatment of private renters. This is not an unusual practice: across Europe and the rest of the world, many countries provide some form of tax relief for mortgage interest payments.

7.39 While mortgage interest relief no longer operates in the UK, its effects may continue to impact upon the current housing market. By previously making owner occupation more attractive, house prices may now be higher than they otherwise would be had interest deductibility not affected housing and tenure decisions over the preceding years - although these effects are likely to unwind over time. Such a system may also have engendered a legacy of consumer preference for owner occupation that continues to be expressed today.

**Continuing impacts** 7.40 As well as these 'hang-over' effects from the recent past, other current aspects of the tax system continue to favour home ownership above private renting. Examples include the non-taxation of the imputed rent of owner occupiers and the many tax rules applying to private landlords that grow out of the general treatment of rented property as an investment rather than a trading business.

**The effect on housing tenure** 7.41 The cumulative cost of these tax disadvantages may be passed on to the tenant in the form of higher rents, making renting a less attractive financial option compared with owner occupation. Analysis suggests that, on average, a tenant bears costs around 18 per cent higher after tax than they would as an owner occupier of a property with the same rental value in respect of the taxation on imputed rents<sup>6</sup>.

7.42 The effect of these historical tax related advantages suggests that current tenure mixes are not at the proportions a tenure neutral market would produce, implying an inefficient allocation of tenure overall. Aspects of the tax system favour home ownership above private renting, however, this may have a small impact on demand for certain types of housing and a correspondingly small impact on supply. However, tenure choice, and thus the efficiency of tenure allocation, is not solely decided by the intricacies of the tax system. Non-tax factors, such as general cultural attachment to home ownership, have an important role in shaping housing preferences.

## TRANSACTION COSTS

**Stamp duty** 7.43 The buying and selling of houses, as with many other assets, is subject to transaction costs such as stamp duty.

7.44 Unlike trade in shares, where stamp duty is fixed at approximately 0.5 per cent, the transaction costs of trade in houses comprises a 'slab' structure, with tiered rates of duty applied according to the value of the transaction. Table 7.2 details the current rate structure. In addition to the general system there are specific stamp duty reliefs for certain property transactions.

<sup>6</sup> Such a result is sensitive to certain assumptions. According to National Statistics, imputed rents of owner occupiers total £62 billion, net of certain costs allowable against tax such as repairs. Regarding mortgage interest deductions, working from Bank of England figures for mortgage borrowing on which interest would be deductible and assuming an average interest rate of 5.75 per cent results in an estimate of £24 billion of interest deductions. Taken away from the £62 billion total on imputed rents, this leaves £38 billion of taxable income. The average income tax rate on this additional income is assumed to be around 28 or 30 per cent. As a result, the additional tax on imputed rents, less interest deductions, represents around 18 per cent of the imputed rent total.

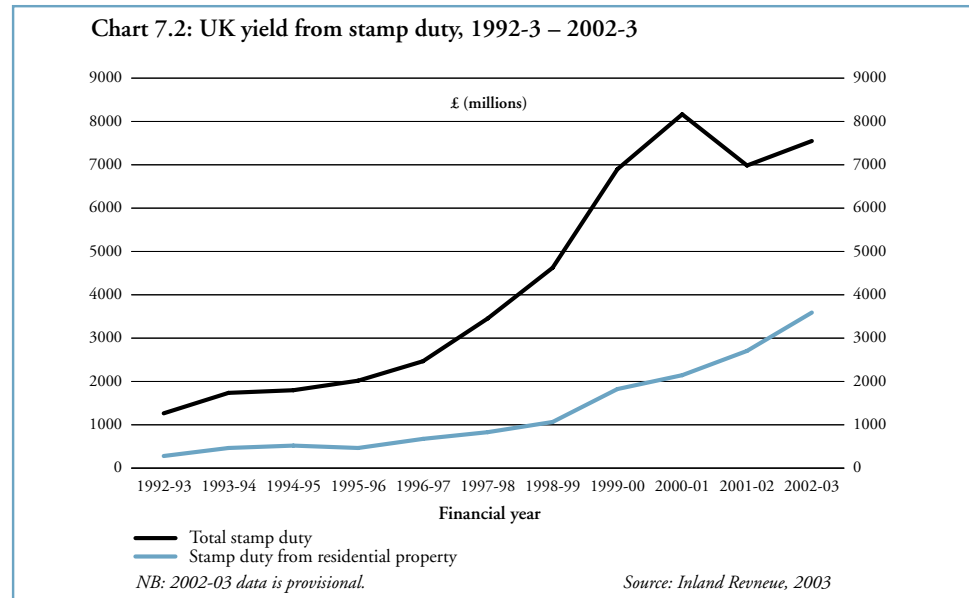
Table 7.2: UK rates of stamp duty

Consideration (£)	Rate of stamp duty (Per cent)
0–60,000	0
60,001–250,000	1
250,001–500,000	3
500,001+	4

Source: Inland Revenue

Stamp duty and rising house prices

7.45 As submissions to the Review have pointed out, the stamp duty thresholds have not been indexed upwards in line with general house price growth in recent years, and thus ‘fiscal drag’ has ensured that more and more properties are being drawn into the higher stamp duty bands. As a result of this effect, and in light of a general increase in the number of transactions - up from 1,327,000 to 1,450,000 between 2000 and 2002 alone - the revenue yield from residential stamp duty rose substantially during the property boom of the 1990s and now totals over £3.5 billion, compared with around £800 million five years ago.



7.46 The current stamp duty system is frequently criticised for distorting the housing market, although the overall effect of stamp duty is difficult to assess:

- the system could, in theory, create bottlenecks in supply as householders stay in dwellings for longer than they wish because of the transaction cost. This will reduce allocative efficiency and lower labour mobility; and
- the price signals at the boundaries of stamp duty thresholds show evidence of distortion, which will further reduce the efficient allocation of houses. This may, at the margin, prevent some households from freeing up properties by moving up, or finally moving ‘off’ the housing ladder through trading down or moving in with family, and thus prevent new entrants coming into the housing market at the first time buyer stage.

7.47 However, given the fact that stamp duty has operated for centuries, it is likely that the market may simply price in the one-off cost of stamp duty into the value of property. Thus any change to the duty will simply be reflected in lower (or higher) house prices as values adjust to the reforms.

7.48 Certainly, the financial decision to buy or sell a house is much more sensitive to the size of the expected capital gain (or loss) derived from price changes than to the cost of stamp duty. Consequently, alterations to the stamp duty regime, unless exceptionally dramatic, may have little effect on property demand (and thus an impact on supply) in the presence of an expected significant capital gain.

**Possible improvements to stamp duty**

7.49 Certain reforms to stamp duty may alleviate some of these allocative inefficiencies. The current slab system – whereby crossing a threshold results in the higher level of duty applying to the *whole* value of the transaction – creates a significant marginal cost when entering higher duty bands. As discussed above, this creates incentives to distort prices to avoid the higher rate being levied on the entire property value.

7.50 Respondents to the Review, such as the Council of Mortgage Lenders, have argued for a reformed regime that makes use of a more progressive ‘slice’ system - whereby crossing a stamp duty threshold results in only the proportion of value lying over the threshold being taxed at the higher rate. This would reduce the problems discussed above by decreasing the marginal cost of being drawn into higher bands. Such a system may be worth further investigation as it could reduce price distortion, and thus increase the marginal allocative efficiency of the housing stock. However, if reform to the stamp duty regime was contingent on fiscal neutrality, a greater number of bands and/or higher rates of duty at certain levels would be required.

**Box 7.4 Stamp duty in other countries**

UK stamp duty currently raises over £3.5 billion in revenue, with varying rates of duty charged at between 0 and 5 per cent of the property value. Other nations levy different rates of stamp duty, as illustrated in the table below.

**Main rate(s) of stamp duty in other European countries:**

Country	Main rate(s) of stamp duty (percent of property value)
Ireland	0-9
The Netherlands	6
Germany	3.5
France	4.8
Belgium	10 or 12.5
UK	0-4

In analysing the above figures it must be borne in mind that these rates are the main, or predominant, levels of duty paid in transacting property. Each national system will naturally have its own exemptions, loopholes and thresholds that serve to vary the level of duty paid in particular transactions.

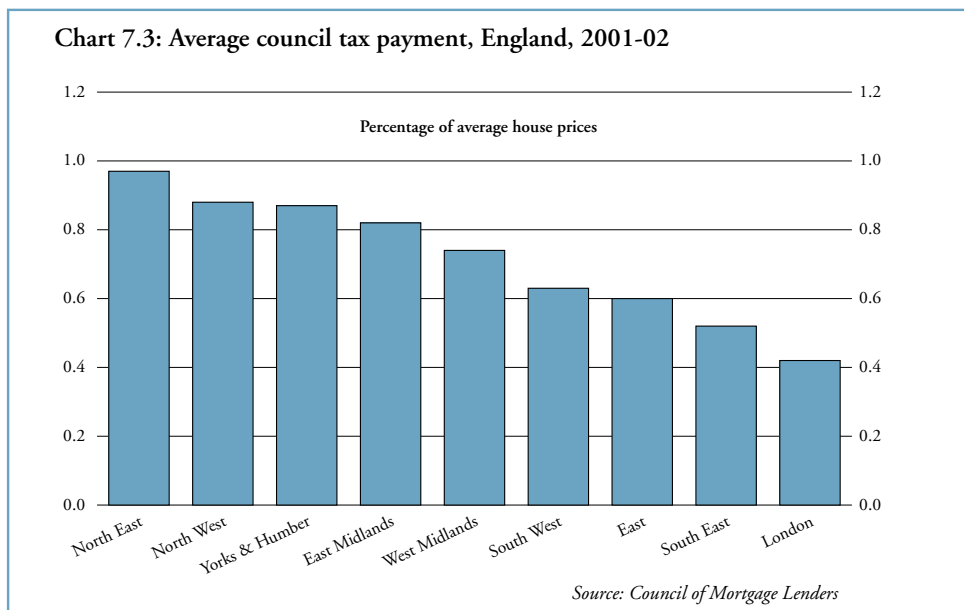
**LOCAL PROPERTY TAXATION**

**Local property taxation** 7.51 In common with many countries, the UK levies taxes on residential and commercial property to fund, in part, the activities of local authorities. Under the current system, local authorities classify residential property into 8 nationally determined bands based on the estimated price of the property, as valued in 1991. Billing authorities decide the council tax levy for Band ‘D’ properties, and the liability for other bands is set by a national formula as a percentage of the Band D charge.

7.52 The annual council tax bill for each household is thus related to the past value of the property, with exemptions and deductions for particular groups such as people living alone and students. Second homes also receive a discounted level of council tax compared to first homes of the same value. From 2004, this discount can be varied by local authorities to amount to between 50 and 10 per cent of the usual council tax liability.

7.53 The effect of regional variations in house values can be to generate large differences in the distribution of properties between bands. For example in 2003 over two thirds of properties in Derwentside local authority were in Band A, whereas around 1 per cent of properties in Westminster were similarly classified. Properties and bands are due to be revalued in 2005, with bills being affected from 2007.

7.54 Overall, the interaction of the nationally determined council tax banding system with regional variations in property prices means that council tax receipts make up a varying proportion of local authority revenue. Local authorities covering areas of higher relative house prices, such as in London and the South East, generate more of their revenue from council tax than authorities in other areas. As well as this, data from the Council of Mortgage Lenders also indicates that, as a proportion of property value, council tax is highest in the North of England, as illustrated in Chart 7.3. Council tax also has a distributional effect as it is a broadly regressive measure since council tax liability does not rise proportionately to account for the increased value of the property<sup>7</sup>.



<sup>7</sup> A similar picture would be likely to emerge if average council tax payments were compared with average incomes.

7.55 However, as with stamp duty, council tax is unlikely to have a dramatic effect on housing behaviour. It is relatively small compared to other relevant factors impacting on housing decision making, such as interest rates, house price inflation (or deflation) and real income growth. Some marginal housing decisions in large urban areas may be influenced by sizeable differences in council tax rates in neighbouring local authorities, but this will most likely have a very small effect on the allocation of households within the existing stock, with little impact on actual housing supply.

7.56 In his submission to the Review, as discussed earlier, John Muellbauer suggests ideas for reform of the local taxation framework to promote more effective, and fairer, use of the housing and land available and to increase macroeconomic stability. He mentions that taxes on imputed rents, or on the market value of properties, can be effective in encouraging households to make more efficient use of the existing housing stock, reducing the regressivity of local taxation and contributing to greater stability in the housing market and wider economy.

#### **Box 7.5 Property taxation in the Netherlands and Denmark**

The Netherlands and Denmark have a different approach to local property taxation compared to the UK, and rely, to a degree, on tax rates set at a fixed proportion of property value.

In 1998, the Danish government instituted a series of reforms aimed at moderating consumer expenditure and house price growth by diverting expenditure to savings. The 'Whitsun' package of economic reforms replaced a system a taxation of imputed rents for owner occupiers with a local government tax of 1 per cent of property value, with a 3 per cent charge for the proportion of the property's value exceeding a particular threshold. The reforms simultaneously allowed for the reduction of mortgage interest payment deductibility.

While property price growth did not slow as a result of these measures, commentators have suggested that price rises were moderated by the move, promoting affordability and stability in the market. However, the percentage-based property tax is politically unpopular, and has spurred the formation of political parties intending to abolish it.

Similarly, the Netherlands has a system of local taxation based on the value of property. Taxes based on imputed rents are levied on the principal private residence of owner-occupiers at 0.8 per cent of the property value, subject to a €8,200 maximum. These taxes are then added to an individual's income tax bill. The Dutch system also levies a local tax split between owners and occupiers, revalued every four years.

However, this tax in the Netherlands is coupled with a relatively generous and politically popular mortgage interest tax deduction policy. Dutch home owners are able to offset mortgage interest against income tax liabilities. Although this tax advantage has been reduced recently, it remains a strong incentive for investing in home ownership.



# 8

## Attitudes to development

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### Overview

Housing development is often contentious and highly politicised. Local people are often worried about:

- the loss of amenity – for example arising from greenfield development and the loss of open spaces. This could also reduce property values;
- pressure on local services – increased population may not be matched by additional funding, leaving services stretched more thinly;
- pressure on infrastructure – especially roads and public transport; and
- poor quality housing developments – aimed at just increasing the number of dwellings rather than creating communities in which people want to live.

While there are significant benefits from housing developments, these are much more diffuse – and are unlikely to accrue to the same individuals who are concerned about costs.

Regional Planning Bodies decide how many houses should be built in coming years in their regions – and the allocation between different local areas. In doing so, they aim to balance the social costs and benefits of development. However, many believe that the target housing numbers are lower than they should be – reflecting what is politically feasible rather than what is socially optimal.

Once the numbers have been adopted, local authorities often fail to ensure that the houses are built out:

- local authorities face few sanctions if they fail to meet their numbers;
- the local costs of development are considerable – with financial benefits from increased population growth slow to materialise; and
- those in need of housing are much less likely to have a strong voice in the political process than those who are already housed.

Major housing applications are also processed more slowly. Planning reforms presently underway, including the introduction of Local Development Frameworks will address some of these problems.

### INTRODUCTION

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8.1 The previous chapter explained how and why Government might want to intervene in the housing market. This chapter looks in greater detail at the role of the planning system as a means of intervention. However, this chapter also recognises that development is influenced by the wider policy environment within which planning operates. Development is often contentious and highly politicised. The actual and perceived costs of new housing development are often easy to identify and are usually concentrated within a local area while the benefits can be more diffuse. Individuals are directly aware of the impacts that a new housing development might have, commonly:

- loss of amenity; as when open space or greenfield land is developed, which may as a consequence lead to a reduction in property values. Box 8.2 looks at the extent to which land is taken up by development;
- pressure on services; new developments mean more people and the perception (as well as the reality in some cases) that services will be stretched more thinly;
- pressure on infrastructure; with greater demands placed on public transport and roads, leading to congestion, pollution and concerns over road safety; and
- housing developments in the past have often focussed on delivering housing numbers rather than creating communities in which people wanted to live, sometimes with adverse consequences. These include social consequences but poor design may have economic and environmental consequences as well, such as a reduction in property values and poor energy efficiency.

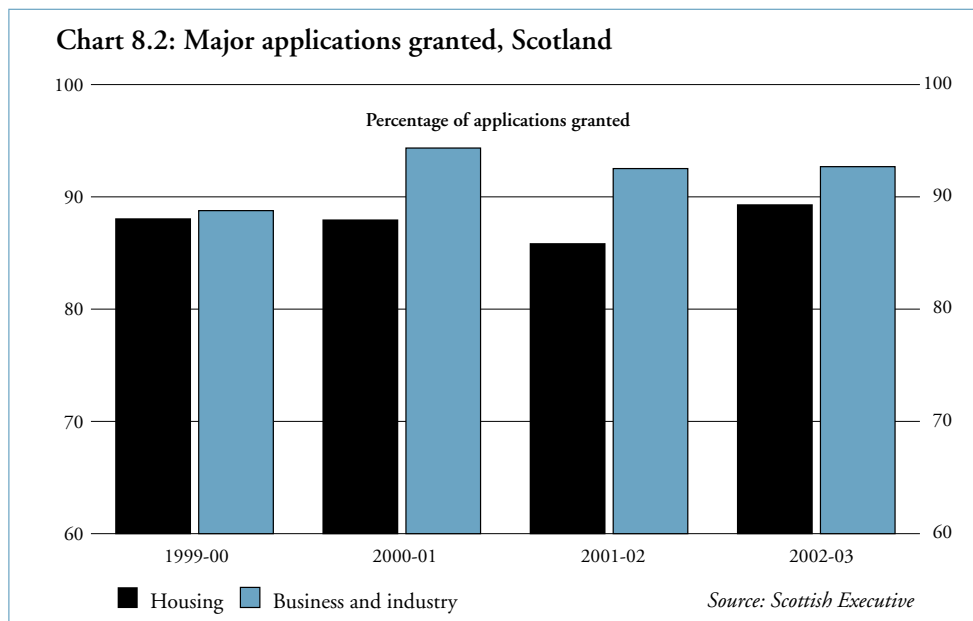
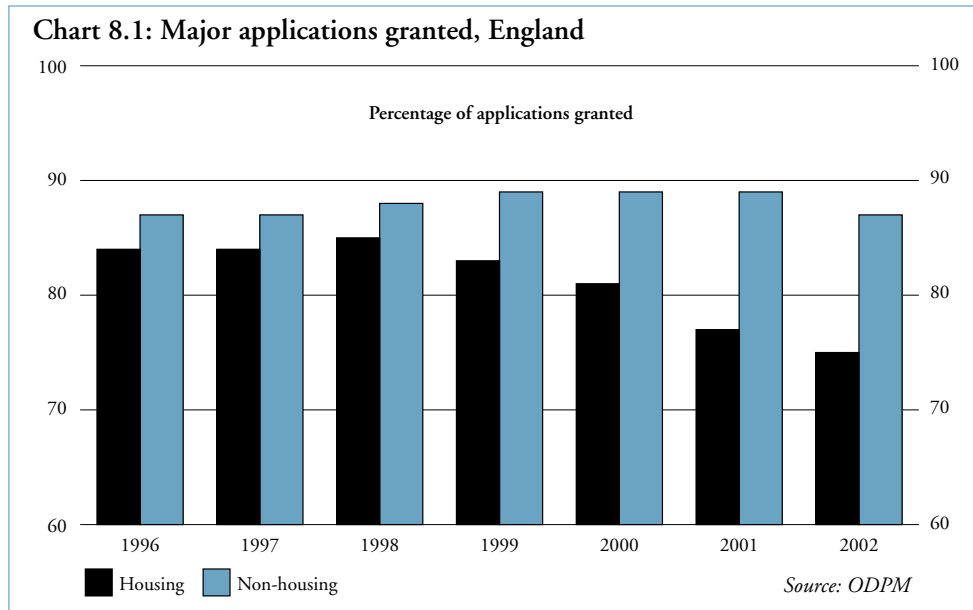
8.2 There may also be some direct and localised benefits associated with housing development, for example property values may increase following the delivery of supporting infrastructure or a well designed development. However, overall, the benefits of development can be more difficult to discern, particularly where national economic benefits are concerned. They may be harder to quantify and may not accrue to the same individuals who bear the costs. The benefits of development tend to accumulate over time, while many of the costs will be more immediately visible. One benefit may be increased affordability of housing. The Joseph Rowntree Foundation study 'Housing Futures' indicated that many people do not make the link between increasing housing supply and greater affordability - 'people believe the main problem is affordability, not housing shortage<sup>1</sup>.'

8.3 These arguments are true of all development, but housing development appears to be more contentious than many other types of development of similar scale and potential impact. Chart 8.1 shows that major housing developments (developments of more than ten houses) are more likely to be refused planning permission than other major developments<sup>2</sup>. This is not only true of England, Chart 8.2 shows the acceptance rate for major housing development is also lower in Scotland as a whole.

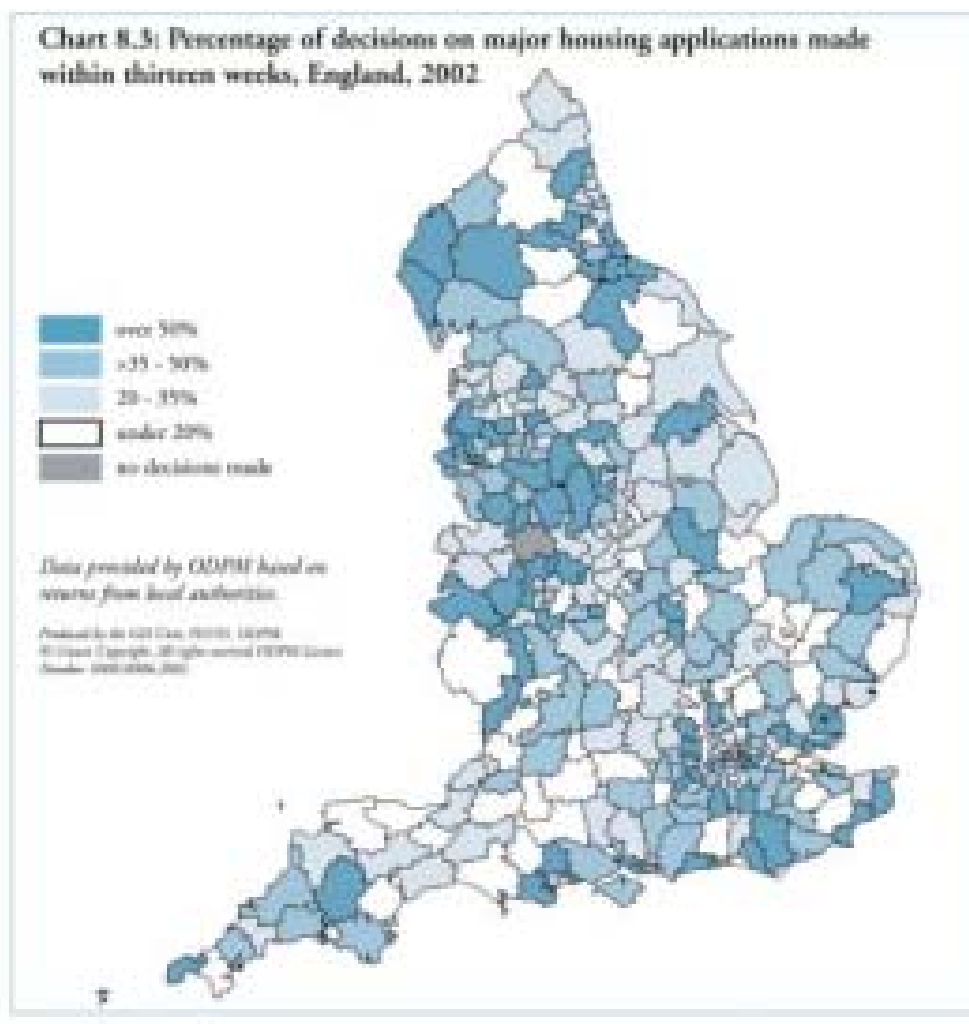
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<sup>1</sup> Joseph Rowntree Foundation, *Housing Futures; A Strategy for Social Housing in the 21st Century*, (2000).

<sup>2</sup> Development greater than 1000m<sup>2</sup>.



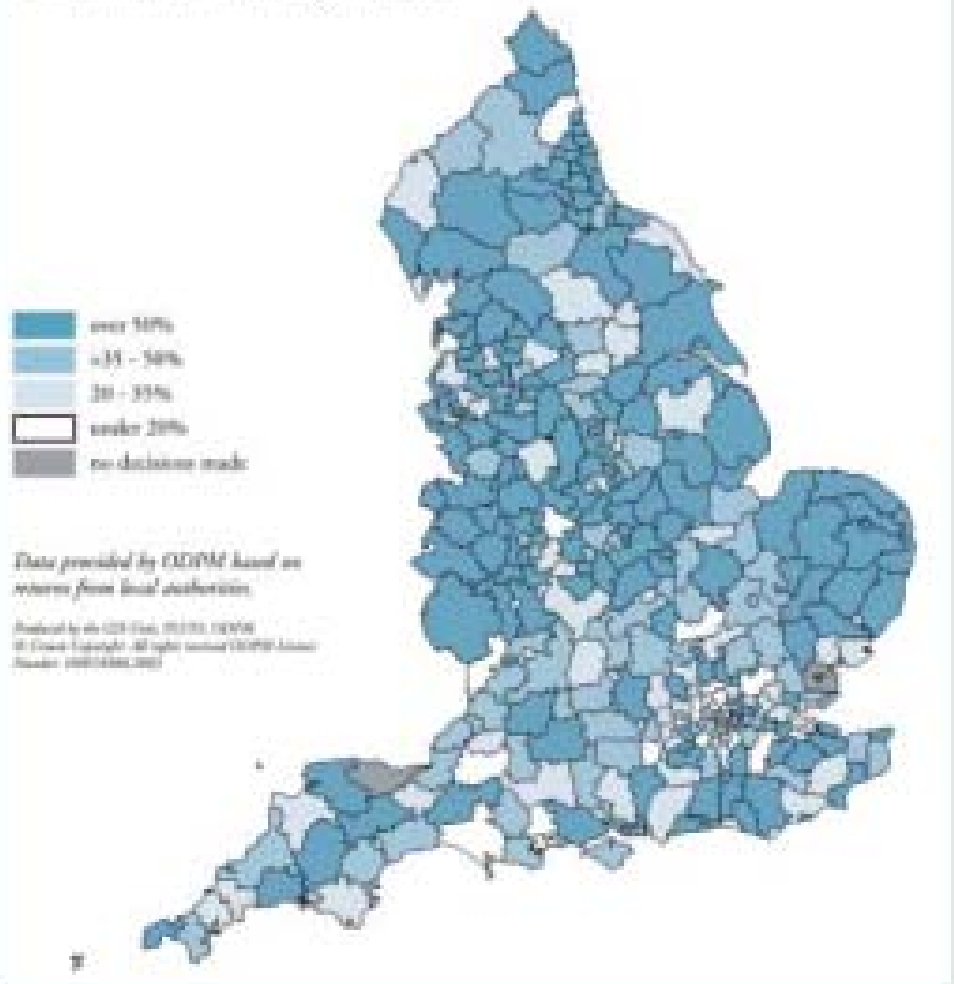
8.4 Charts 8.3 and 8.4 illustrate that housing developments take longer to gain planning permission<sup>3</sup> in England, which is also true of Scotland as Chart 8.5 demonstrates. In part this reflects the greater complexity of housing developments, in particular the need to build sustainable communities which require decisions be given more careful consideration. One example is the consideration of the mix of housing that a new housing development might include. Planning Policy Guidance 3 (Housing) sets out the Government’s policy aim of promoting mixed communities. At the very least, developments of 15 houses or more in London, or 25 or more outside London, are required to ensure that 20 per cent are affordable housing. Most local authorities set out their own requirements<sup>4</sup> in Local Plans or Supplementary Planning Guidance. Some local authorities also try to influence the size and type of market housing on new developments to promote affordability and mixed communities. Local authorities and house builders may have different perspectives on the ‘right’ mix of housing on a new development and the consequent discussion may add to decision making timescales, especially if this mix is articulated through a planning obligation.



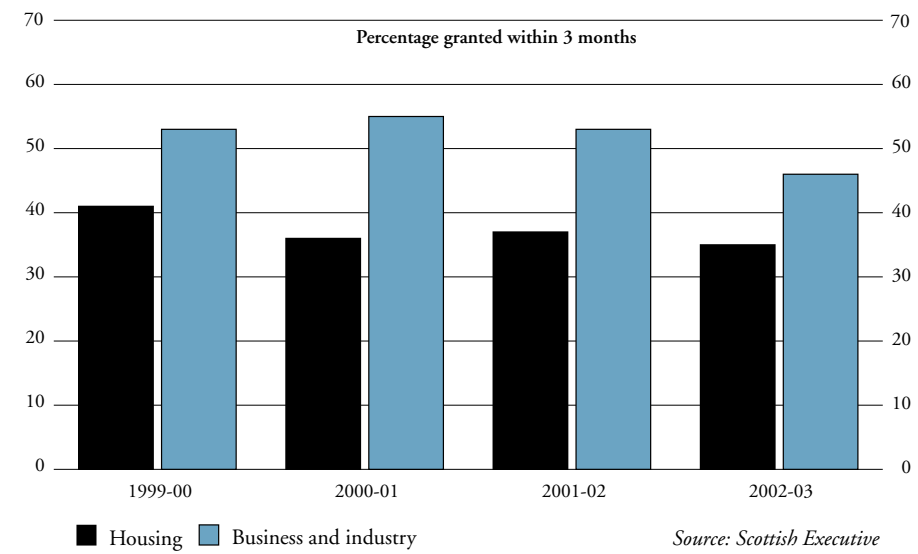
<sup>3</sup> This data measures the time taken for one particular part of the planning process – the period between the submission of an application and the final decision. There are important stages before this process including pre-application discussions that are not included in this measurement and which also influence the time taken to make decisions.

<sup>4</sup> Local authority affordable housing requirements should be informed by Local Housing Needs Assessments that assess the nature and scale of housing need in the area and provide justification for their affordable housing targets for specific sites.

**Chart 8.4: Percentage of decisions on major non-housing applications made within thirteen weeks, England, 2002**



**Chart 8.5: Speed of application decisions, Scotland**



8.5 This chapter considers how the contentious nature of planning for housing influences the availability of land and the level of development. The subsequent chapter considers constraints on land supply and the delivery of development.

### THE ROLE OF PLANNING

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8.6 As discussed in the previous chapter, planning policy aims to balance the social, economic and environmental costs and benefits of development. The Government has set out a clear commitment to delivering *sustainable* development, aiming to ensure that the places that are built today are places people continue to want to live in, so that the mistakes of the past are not repeated<sup>5</sup>. Creating such places is an important part of making development more acceptable. The Sustainable Communities Plan sets out a programme involving £22 billion of resources aimed at:

- accelerating the provision of housing in the South East by identifying four growth areas, and ensuring delivery of Regional Planning Guidance (RPG) 9 housing numbers elsewhere;
- providing affordable housing particularly for key workers and tackling homelessness;
- addressing low demand and abandonment through the establishment of low demand pathfinders; and
- bringing all social housing up to a decent standard by 2010.

8.7 The Government has also introduced a number of significant reforms to planning following the Planning Green Paper in 2001. These are outlined briefly in Box 8.1. A description of how the current plan led system works is contained in Annex A.

### ALLOCATION OF LAND FOR DEVELOPMENT

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8.8 Chapter 3 set out the current regional housing targets for England. The data indicated that in some regions there have been difficulties in delivering agreed housing numbers, and if previous levels of output are maintained these targets may not be met in the future. However it is worth noting that:

- the number of completions in any one year reflects decisions and targets in previous years due to the time lags between approving planning applications and houses being completed; and
- changing the targets, and/or national and local policy, will take a number of years to feed through into housing numbers, which has implications for the responsiveness of the system; and
- housing output has been rising since 2002, and in the RPG 9 area (London and the South East), new housing completions for the last year are broadly in line with annualised allocations.

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<sup>5</sup> ODPM, *Sustainable Communities: Building for the Future*, (2003).

**Box 8.1: Planning reform**

The Government has a major agenda for planning reform. This is reflected in the Office of the Deputy Prime Minister's Public Service Agreement.

The Planning and Compulsory Purchase Bill sets out significant changes to the arrangements for both regional and local planning, reforms elements of the development control process, introduces new tools which can help speed up development and sets out reforms to the compulsory purchase system, through:

- statutory Regional Spatial Strategies replacing Regional Planning Guidance;
- Local Development Frameworks (LDFs) which will replace Local Plans and Unitary Development Plans: the LDFs are more flexible and more easily updated than current plans;
- changes to some development control procedures including the introduction of a Statement of Development Principles. The default lifetime of planning permission will be reduced from 5 years to 3 years;
- Local Development Orders (LDOs) and Business Planning Zones (BPZs) will be introduced, allowing development to take place without the need to secure planning permission where an LDO or BPZ is in place;
- a wider power for local authorities to acquire land compulsorily and reforms to Compulsory Purchase Order procedures; and
- timetables set for cases called in, or appeals recovered, for the Secretary of State's decision.

**Revisions to Planning Policy Guidance**

The ODPM is also currently consulting on the revision of Planning Policy Statements/Guidance including PPS 1 (General Policy and Principles), PPG 3 (Housing), PPS 11 (Regional Planning) and PPS 12 (Preparation of Local Development Frameworks). Proposed changes in PPG 3 include greater re-use of disused employment land for residential development and an updated policy on the size, type and affordability of housing. The consultation on PPG3 (Housing) requires that Regional Planning Bodies should now maintain an up to date understanding of the likely housing requirements of their area, having regard to the need to reduce volatility in the housing market and promote macroeconomic stability.

**Resources and initiatives**

In the 2002 spending review, the Government injected £350 million into the planning system over the three year Spending Review period. These resources are being allocated through a Planning Delivery Grant which rewards improved planning performance. Targets and performance standards for planning have been set under the Best Value regime and a strategy for engagement with poor performers has been established. The Comprehensive Performance Assessment process is looking at how local authorities balance housing markets in their areas.

The Government is also working to improve the way the system works through such initiatives as a Planning Advisory Service, shortly to be piloted, and e-planning initiatives, particularly the Planning Portal. The Government is also addressing skills issues, through the Egan Review, as part of a wider culture change initiative in planning to promote planning as a positive tool for achieving sustainable development.

8.9 Scottish and Welsh authorities assess their own housing requirements. There are no overall targets set at the level of the devolved administrations although local authorities use population and household projections for the region as a whole as a starting point for assessing their requirements. Both Scottish and Welsh local authorities are required to maintain a 5 year land supply for housing. However, up to date Local Plans are not always in place, which means there is no way to verify the amount of land allocated for housing in the devolved administrations.

### Regional Planning Guidance

8.10 National Planning Policy Guidance 11 sets out the Government's policy on the RPG process. It is not particularly prescriptive, leaving regions considerable flexibility in determining how housing targets are derived and who is involved in the process. Evidence suggests that there are a 'wide variety of approaches' amongst Regional Planning Bodies (RPBs) in preparing housing strategies<sup>6</sup>. Usually, the figures are derived from a combination of household projections, redevelopment strategies, Urban Capacity Studies and consideration of the likelihood that the electorate will accept the figures.

8.11 Although establishing a socially optimum output of houses is not an explicit consideration, to some extent the RPG process approaches a social optimum methodology. The aim of RPG is to balance the economic, social and environmental objectives of the region. For instance:

- theory suggests that the value attached to greenfield land in the South East of England will be higher than in the North East, as undeveloped land is more scarce. Therefore, the social cost in the form of loss of amenity from building an extra house in the South East will, from this perspective, be higher than in the North East<sup>7</sup>; and
- the social benefit, however, will probably be greater in the South East than the North East, as labour markets are more tightly constrained, and accommodating additional households will improve welfare for others in the local area.

8.12 The balance between social costs and benefits (rather than the private costs and benefits) will determine the optimum quantity of housing in local areas. The vocal reactions of people dubbed 'nimby' – 'not in my back yard' – for not wanting development in their local areas is a rational reaction by those who consider their private costs to be high. The role of government is to determine whether these concerns should outweigh the social benefit.

8.13 The regeneration of poor areas is the clearest case where the social benefits of house building may outweigh the costs. The main social cost will probably be the disruption or break up of established communities. This is a problem faced by Newcastle's ambitious plans to regenerate large parts of its city. The main opposition has been from the individuals who will have to be housed during the redevelopment, and may not return to the area afterwards – for them the private costs are high. However the benefits of this regeneration include not only the private benefits to the individuals whose housing has improved, but also spillover effects (in the form of higher prices) to nearby properties in regenerated areas.

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<sup>6</sup> ODPM, *Delivering Planning Policy for Housing – PPG 3 Implementation Study*, (2003).

<sup>7</sup> However, this trade off does not necessarily consider fully the intrinsic value of environment.

**Box 8.2 Are we ‘concreting over the South East’?**

The Department of the Environment published figures in 1995 based on 1992 household projections which suggested that 4.4 million additional households would need housing between 1991 – 2016. This represented a 70 per cent increase on previous 25 year projections of 2.6 million households which were the basis for housing allocations in the RPG at the time.

“Even these more modest figures were hotly disputed by some local authorities and environmental groups, particularly in the South East. The prospect of new, yet higher allocations - once the 1992 based household projections are converted to housing requirements - is already causing alarm bells to sound across the shires.” Extract from ‘The People – where will they go?’

The U.K. land area is 243,097 kmsq (24,309,700 ha). England has a land area of 130,281 kmsq (13,028,100 ha) of which:

- 7.6 per cent of land is designated as National Park land (994,000 hectares);
- 15.7 per cent of land is within areas of outstanding natural beauty (2,040,000 hectares); and
- 12.7 per cent is designated greenbelt land (1,650,000 hectares).

**Population and housing density on developed land**

- Population density in the UK is approximately 242 people per square kilometre, which is slightly higher than Germany (230 persons per sq. km).
- However, the figure for England is much higher, at 345 people per sq. km, which is similar to Belgium (337 per sq. km). The only EU nation with higher population density is the Netherlands (390 per sq. km).
- London has a population density of around 4,486 per square kilometre (rising to 8,493 per sq. km in Inner London), which is higher than all other major European cities except Brussels and Paris (area within the peripherique), which have densities of 5,914 and 20,161 per square kilometre respectively<sup>9</sup>.

**The South East**

One area of the UK where the housing shortage is most acute is the South East of England, and there are concerns that building the required new housing would require large areas of the South East to be ‘concreted over’. The total land area of the ROSE area (Rest of South East – equivalent to the Government Office South East region, plus Essex, Hertfordshire and Bedfordshire) is approximately 2.54 million hectares, of which:

- 11.4 per cent is urbanised (289,000 hectares);
- 22.3 per cent is designated greenbelt (566,200 hectares); and
- an estimated 37 per cent is in areas of outstanding natural beauty or other designated conservation or protected areas (950,000 hectares).

This leaves around 735,000 hectares of land potentially available for development. RPG targets and the 200,000 additional homes in the growth areas imply 707,000 homes will be built in the region by 2016. The actual land required would be 11,390 hectares (including supporting infrastructure), which is equivalent to approximately 1.5% of the undeveloped land in the region<sup>10</sup>.

<sup>8</sup> Breheny, M. and Hall, P. *The People – Where Will They Go?* National Report of the TCPA Regional Inquiry into Housing Need and Provision in England.

<sup>9</sup> *Focus on London 2003* (eds. D. Virdee & T. Williams), ONS with GLA/GLO and LDA, London, TSO 2003, p8.

<sup>10</sup> This calculation assumes that 60 per cent of homes will be built on brownfield sites, and that dwellings will be built at an average of 30 per hectare, and the land required could be substantially reduced by building at higher average densities. The 1.5 per cent estimate may be a significant over-estimate of the land required, as parts of the Milton Keynes and London, Stansted and Cambridge growth area fall outside the South East Region.

### An imprecise science

8.14 Assessing the social costs and benefits of development is difficult for a number of reasons:

- the social benefits of additional housing often occur in a different spatial area from the social costs. For example it is difficult for regional bodies to assess the macroeconomic implications of the housebuilding numbers they set, although the Secretary of State will be able to take a view on this<sup>11</sup>. Similarly the benefits of housing may be region-wide and therefore difficult for local authorities to factor in to their delivery. Box 8.3 illustrates how one Regional Planning Body tried to tackle these difficulties;
- other barriers to development may exist, for example with the provision of infrastructure and services such as roads or schools, which exacerbate the costs of development; and
- some costs and benefits may be difficult to assess, in particular, the benefits (eg ecological or recreational), of keeping land undeveloped<sup>12</sup>.

In practice the regional planning process and the targets set are often believed to reflect politically feasible numbers for the region, rather than what is actually needed or demanded.

8.15 The difficulties that can be encountered in agreeing the regional figures and distributing them to local areas mean that in practice these plans can be relatively rigid. There may be a reluctance to re-visit the numbers once they are agreed and therefore the plans are limited in the extent to which they can respond to changes in housing demand. That is not to say that plans are not reviewed and changed, rather that this is not a system that adjusts quickly to changes in market conditions. It is a plan led system with the overall objective of achieving balance between different economic, social and environmental goals, although the balance may not always be struck in the right place. This rigidity is therefore due to the mismatch of costs and benefits, which causes the numbers to be disputed in the first place. If the costs and benefits of housing development were more closely aligned this would enable a more responsive planning system.

8.16 The problem associated with correctly predicting a local authority's housing requirement is one of the reasons why the 'predict and provide'<sup>13</sup> planning mechanism was replaced by 'plan, monitor and manage'<sup>14</sup>. Even so, this new policy still uses population projections, among other things, in order to project forwards the likely housing requirement.

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<sup>11</sup> The Government proposes to support RPBs with tools to assist them in making housing market assessments, as outlined in Budget 2003.

<sup>12</sup> ODPM *Valuing the External Benefits of Undeveloped land – A Review of the Economic Literature*, (2002).

<sup>13</sup> This describes the system of projecting housing demand and planning to meet it. Like all systems that use previous trends to project forwards, figures will be most heavily influenced by recent events. Therefore, household projections 20 years into the future were influenced by recent household formation and migration figures. The accuracy of these forecasts is subject to very large standard errors, which means that the further from the original start date, the less accurate the projections are likely to be.

<sup>14</sup> Plan monitor manage continues to project housing demand in the same way but there is greater emphasis on reviewing targets and monitoring the extent to which they are met in order to adapt plans as circumstances change.

8.17 This mechanism does not necessarily incorporate current information about demand pressure into the policies of the day. For instance, a local authority might be experiencing a turn-around in its economic fortunes, and see a population loss turned into a population gain. There is only a weak mechanism whereby the price pressure which the extra demand imposes on the local housing market can quickly feed through into a higher rate of house building.

8.18 Measuring regional and local authority performance against annualised housing completions may also militate against a responsive system which ensures that supply reflects demand at a particular point in time. A responsive system might imply that in some years completions would exceed annual average numbers while in other years fall below. In practice this does happen, but this usually reflects the 'lumpy' nature of bringing forward development sites rather than a planning response to the market. Consequently there are problems with annualised targets.

### **Box 8.3 The West Midlands Regional Planning Body**

The West Midlands Regional Planning Body (WM RPB) drafted Regional Planning Guidance for the region which was submitted to the Secretary of State in November 2001.

The WM RPB emphasise that the RPG review was a 'policy exercise' rather than a 'numbers game'. Furthermore, objectives for the region go further than just meeting household projections. They include an overriding aim to promote an 'urban renaissance' and wider regeneration, as well as a concern to ensure rural areas remain viable and sustainable.

In order to ensure this, they established a number of Technical and Reference groups to provide advice and support to different parts of the planning process. These groups helped make the process open and inclusive to a number of interested organisations.

According to the WM RPB, this led to the presentation of a wide range of evidence on the need (or not) for housing in the region. The WM RPB was thus required to make a balanced judgement and adjudicate between competing interests and evidence bases in order to come to a decision about the right level of housing needed in the West Midlands.

## **THE LOCAL CONTEXT**

8.19 Regional housing numbers are distributed to local authorities (or county councils) who are themselves part of the Regional Planning Body. Currently, RPB membership is comprised of 70 per cent local authority officers and 30 per cent regional organisations and stakeholders. Regional housing targets are therefore not an independent assessment of housing needs and in order to understand the target setting process it is important to appreciate the incentives and pressures acting on local authorities and the other regional players involved. The RPG housing figures are also subject to a public examination process. Ultimately the Secretary of State is responsible for the outcome and must therefore take a view on whether the targets are reasonable.

8.20 The costs and benefits of the process at a local level may be complex and will depend upon the circumstances of the local authority concerned. In general the costs and benefits can be categorised as set out in Table 8.1, Box 8.4 also considers the costs of restraining development in more detail. The potentially significant political impacts associated with development are not analysed here. However, evidence from case study areas suggests that the majority of pressure on local authorities from local residents is negative, i.e. pressure to oppose new housing developments.

**Table 8.1: Costs and benefits of development**

Costs of development	Benefits of development
Pressure on transport infrastructure: increased use of roads, increased demand for public transport	Increased council tax revenue from extra houses
Pressure on services provided by the local authority and other agencies: refuse collection; community services; leisure facilities; maintenance costs; policing costs; GP surgeries and schools	Increased Revenue Support Grant (RSG): RSG changes in response to an increase in population. Local authorities receive a basic allocation per defined unit (eg pupil for education, per km of road for highway maintenance), plus amount to reflect level of deprivation
Environmental costs: loss of amenity; increased congestion	Reduced pressure on housing need/homelessness Possible Section 106 contributions Possible benefits to economic development but likely to accrue to the wider region

8.21 Attitudes to development and the perception of costs and benefits are likely to be influenced by previous experience of growth and development within an area:

- the net benefit of one extra house in highly developed areas where the existing infrastructure is already heavily used is likely to be very different to the net benefit of an additional house where there are fewer pressures. Planning officers and other local authority officials consulted by the Review suggested that it was difficult to accept additional housing development if the local area had already experienced recent growth, particularly in the South East region;
- where the design and quality of developments has been poor in the past, winning acceptance for new development may be harder still and the perception of potential costs will be much higher; but
- conversely, areas that had experienced decline, particularly low demand areas such as Leeds and some of the West Midlands urban areas, are more likely to see development as a benefit. There may be an incentive to build (or re-build) more houses because this can lead to higher economic growth and regeneration.

8.22 There is an insider – outsider problem. Outsiders, those who would like a house and who would benefit from development, often have little or no voice in decision making. Insiders, the existing residents within a community, hold all the power and influence and often do not want housing for ‘outsiders’, although housing development for ‘local people’ is often more acceptable.

**Box 8.4: Evaluating the costs and benefits of restricting development**

Research has been undertaken by Cheshire and Shepherd (1997) on the costs and benefits of having a more restrictive planning system, by comparing two districts, Reading in the South East and Darlington in the North East. The former is regarded by the study as having a very restrictive planning regime, while the latter is more permissive. They initially look at the benefits of restricting industrial land, providing accessible open space (such as park land) and inaccessible open space (such as agricultural land without rights of way).

They conclude that, unsurprisingly, accessible open space gives the highest benefit to the community. More surprisingly, the benefits of limiting industrial land are shared the most equally throughout the population through lower exposure to pollutants, while the benefits that accrue from providing inaccessible land are shared the least equally. Interestingly, the scale of these benefits is comparable to the benefits in kind that are provided by the state in other areas, such as providing free education, the National Health Service, and food and travel subsidies.

Observing the price paid for these benefits is difficult, especially as they are provided through regulation rather than taxation. Nevertheless, there are significant costs to the community in the form of distortions in land and house prices. Indeed, there are probably other costs, such as foregone employment growth, which they have not attempted to quantify, but are examined elsewhere in this Review.

Cheshire and Shepherd conclude that all households pay more than they receive in benefits from a restrictive planning system in Reading. Tight planning regulations, they conclude, increase house prices by 6-8 per cent, with the net cost of this equivalent to tax of 10-13 per cent on household incomes. They conclude that the main welfare impact on households from planning control is the higher density at which households live.

**Financial costs**

**8.23** Additional housing may also have a real financial cost for local authorities, in part because of the way in which local authority financing operates as outlined in Box 8.5. In some circumstances financial gains from additional council tax revenues may be offset by reductions in the Revenue Support Grant. Whether the net effect on resources covers the costs of additional houses is questionable and will to a certain extent depend upon the nature of the incoming population. It may not support any significant additional infrastructure investment that may be required. In countries with a greater reliance on local taxation there may well be more financial incentives associated with housing growth.

### **Box 8.5: The effect of additional housing on local authority finances**

Local authority funds are made up of central government grant and council tax receipts. Overall, funds should increase with extra households. Extra local authority funding is affected by the following:

- local authority funding is calculated on a per person basis with top ups for deprived areas. However, the amount of cash that comes from central government is adjusted to take account of the council tax base. Broadly, areas of low deprivation and high council tax base will lose central government grant, whereas those with high deprivation and low tax base will gain.
- central government grant does not increase in proportion to the growth of the population. So in all local authorities, funding per head of population will decrease slightly as the number of households increase. In ODPM studies of two different local authorities (A and B) funds decreased (by 0.89 per cent per person in A and 0.92 per cent per person in B)<sup>15</sup> when extra households were added to the model.

This is not necessarily a problem because the costs of providing services to additional people declines with economies of scale. However at some point, additional households create demand for new infrastructure and services which may not be covered by the marginal increases in grant (eg extra schools and roads).

8.24 Where financial benefits from extra households do exist, these are not likely to be strong because:

- the scale of any financial benefit is likely to be small and so at best would only exert an influence at the margin; and
- there are likely to be a number of other changes affecting a local authority's finances in any one year, so determining the impact of housing development is likely to be difficult. If incentives are not transparent they are likely to be weak.

Local authorities may not be in a position to calculate the financial costs and benefits of development accurately in this way and certainly the perception is often that there is a net cost. In particular there may be concern that social infrastructure such as schools and hospitals will be put under pressure and existing householders will be concerned that there will be less resource available for them. There are few rewards to a more aggressive approach to housing numbers.

8.25 The absence of financial benefits from new development becomes particularly significant when compared to the overwhelming political pressure on some local authorities not to allow further housing growth. Local authority members make decisions about planning applications on Planning Committees. These members are directly elected and are therefore under strong pressures to align their decisions with the views of their constituents. Chapter 9 explores some of the evidence that decisions about housing development reflect political incentives.

<sup>15</sup> Effect of 1,000 extra households on central government grant modelled by ODPM.

**Section 106**

8.26 Section 106 of the Town and Country Planning Act (1990) allows local authorities to seek cash or contributions in kind from developers to mitigate the impact of development. This is intended to ensure that local residents are essentially no worse off as a result of development. Although the variability in Section 106 contributions makes any attempt to calculate average values hazardous (illustrated in Table 8.2), a recent study estimated that Section 106 values achieved are around 5 times higher in the South (£753,000 per site) than the North of England (£148,000 per site)<sup>16</sup>. Contributions secured are also higher for greenfield than brownfield sites.

**Table 8.2: Localised variation in Section 106 value**

Sites within local authority 'A'	Number of dwellings	Value of S106 agreement
Site 1	127	£200,250
Site 2	80	£308,950
Site 3	180	£1,237,715

*Source: Example provided by Wilson Bowden*

8.27 The most commonly sought contributions through Section 106 include:<sup>17</sup>

- affordable housing;
- education contributions;
- highways contributions;
- landscaping and open space; and
- community facilities.

8.28 In areas where land values are high and local authorities have successfully secured large-scale contributions to affordable housing<sup>18</sup> and transport infrastructure<sup>19</sup>, Section 106 may be perceived as an incentive. However, it was not designed as an incentive for development and so may not operate efficiently for that purpose:

- the value of contributions achieved varies considerably between areas and even between sites in the same housing market locality, as illustrated by Table 8.2<sup>20</sup>. The 'incentive' is not always clear and may not exist in some areas, especially where planning obligations might tip the balance away from viability;
- the process of negotiating contributions can entail long timescales. Negotiations may be protracted, particularly over items such as affordable housing, education and highways contributions, both because of the size of the contributions sought by authorities and because different parts of the authority and other statutory agencies may become involved as a result of their responsibility for these services;

<sup>16</sup> Campbell, H. *Planning Obligations and the Mediation of Development*, (2000).

<sup>17</sup> Based on consultations with the House Builders Federation, individual housebuilders and local authorities in case study areas.

<sup>18</sup> e.g. the planning agreement reached by the London Borough of Hammersmith and Fulham and St. George at the Imperial Wharf development.

<sup>19</sup> Reading Borough Council at Greenpark, Reading.

<sup>20</sup> Example provided by Wilson Bowden.

- Section 106 contributions secured from developers are not always transparent or made public, therefore local residents may not associate the benefits they receive with development; and
- in some cases, however, the level of compensation a local community would need in order to accept development would be very large and far in excess of what could be achieved through Section 106 – some communities would not accept development regardless of the compensation offered.

8.29 Given the lack of clear incentives and the countervailing political pressures it is perhaps not surprising that some local authorities will seek to ensure that regional housing numbers are set at the lowest possible level. Overcoming these political pressures in part requires that the costs of development are minimised. Ensuring that developments are well designed and meet consumer needs is an important part of this process<sup>21</sup>.

8.30 As well as a lack of enthusiasm for development in general, higher density development may be particularly less appealing. Local authority members who make decisions on planning applications are often resistant to higher densities which may be perceived as higher cost (in terms of pressure on public services and infrastructure) with an absence of compensatory benefits. On the other hand, high density development could make services more viable, especially given thresholds required to support transport and other infrastructure in rural or suburban areas. Evidence also suggests that residents often do not know the density of their local area, or what a “high density” development can look like.

### LOCAL PLANS

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8.31 The mechanism for allocating land for housing at the local authority level is through the identification of sites within the Local Development Plan. Data on the amount of land actually allocated in these plans is not collected, although Government policy requires local authority planners to identify enough land for the first five years of the plan. In the case study areas<sup>22</sup> reviewed in detail, local authorities varied in the extent to which they had allocated enough housing land:

- some did not allocate enough sites to meet their RPG housing targets and were reliant on windfall sites to bring forward land over the plan period<sup>23</sup>;
- one local authority had not experienced delivery on its planned sites in the past so was mindful that it was almost entirely reliant on windfall<sup>24</sup>;
- three of the local authorities in the case study areas had allocated sufficient sites and already given permissions for development on these sites. They all regarded their RPG targets as ‘too low’ or ‘comfortable’<sup>25</sup>.

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<sup>21</sup> ODP, *Sustainable Communities: Building for the Future*, (2003).

<sup>22</sup> Brighton and Hove, Worthing and Adur, Basingstoke and Deane, East Northamptonshire, Newcastle, York and Harrogate, Carlisle and Haringey.

<sup>23</sup> Brighton and Hove.

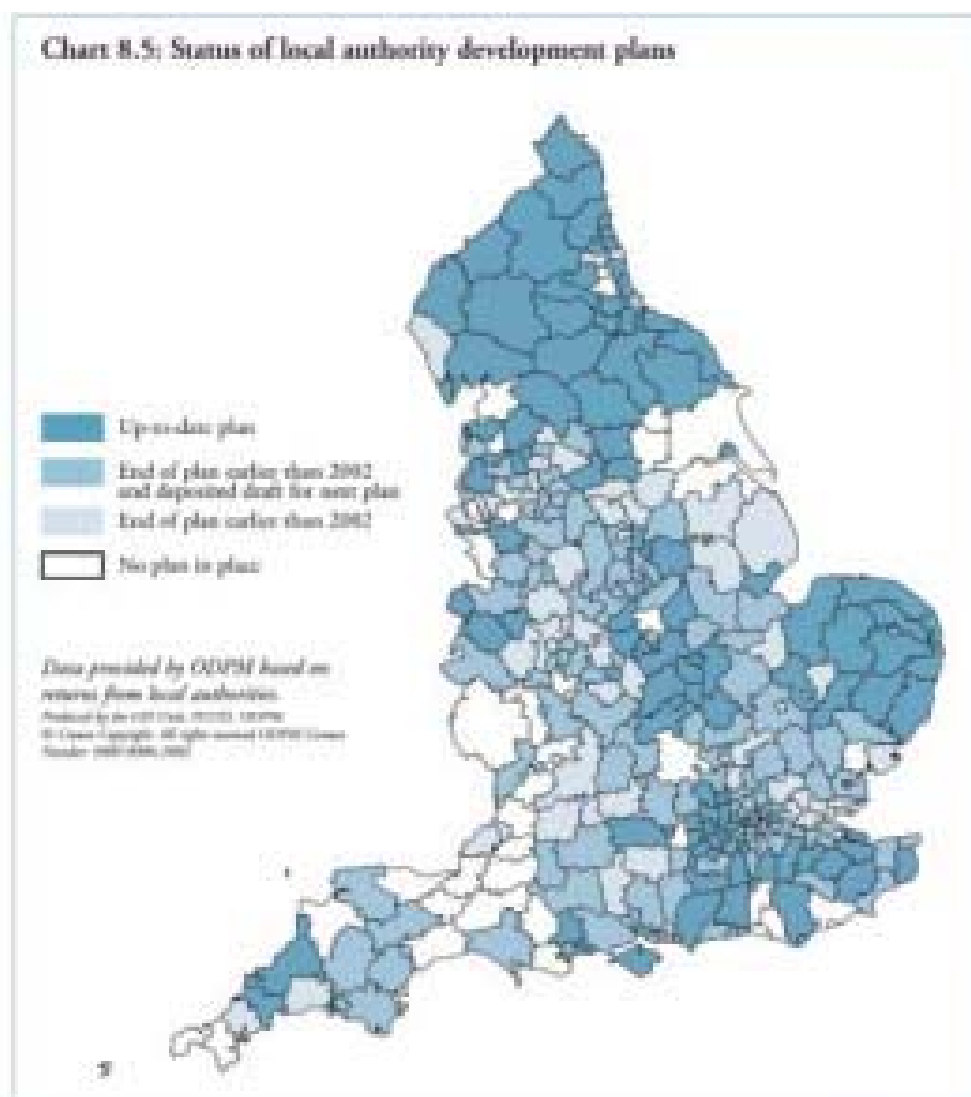
<sup>24</sup> Haringey.

<sup>25</sup> Carlisle, East Northamptonshire, Basingstoke and Deane.

8.32 A significant number of local authorities do not have up to date Local Plans and so there is no means of measuring the amount of land available for housing development. Chart 8.5 shows the status of plans for each local authority in England. Scottish and Welsh Authorities reflect a similar pattern. Authorities without an up to date plan operate on a pragmatic basis (or in some cases may refuse applications for development on the grounds that the plan is not in place). Under the new arrangements in the Planning Bill, all local authorities will need, by the end of 2004, to have put in place a three year programme to update their local plan and a target to ensure this happens.

8.33 There are also questions surrounding the extent to which local authority members, who make the decisions on planning committees, actually buy into the Local Development Plan that might be in place. Some planning committee members expressed the view that they were reluctant to deliver their plans because they had often been adopted by a previous administration. These decision makers believed the current plan did not necessarily reflect their political mandate. This further serves to highlight the mismatch between the plan (which can take years to adopt), decision making (made by politicians that have not necessarily been involved in plan making) and the changes in the housing market.

8.34 Although the Local Development Plans involve community consultation, the extent to which existing residents object to housing developments at the development control stage highlights that there is often little support for the decisions made at the plan stage. In most other European countries, the decisions about land use allocation made at the Local Development Plan stage are binding, i.e. there is little opportunity for individuals and organisations to object to developments once the plan is adopted. In the Netherlands these binding local plans can take a long time to adopt as the consultation process must be thorough. Once they are set, and as long as proposed developments comply with the plan, the granting of planning permission becomes a technical matter.



8.35 The absence of an up to date Local Plan which identifies sites for housing growth means that there is effectively an ‘implementation gap’ similar to that of the 1980s when the majority of local authorities had no plan in place, ‘whereby the land developed was not that which had been planned, and vice versa’<sup>27</sup>. But some housebuilders consulted also indicated that from their point of view there was little difference in the performance of local planning authorities whether or not they had a Local Plan. Their performance was affected more by the political commitment to advance development.

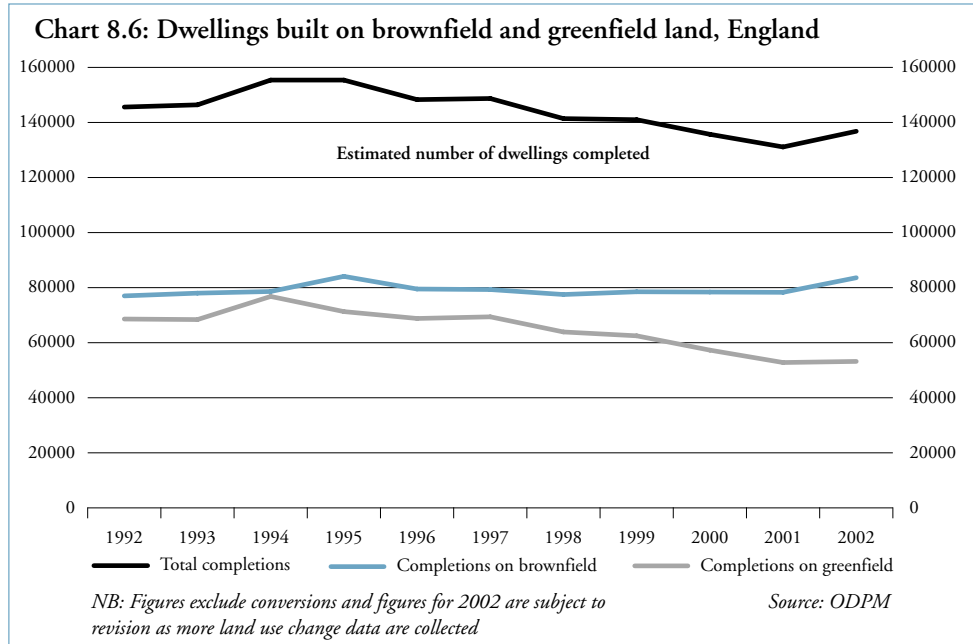
8.36 High levels of housebuilding in particular areas have often been secured by introducing new mechanisms or ‘special delivery vehicles’ to allocate land for development and deliver housing. Urban Development Corporations are one such mechanism (used in the 1980s) whereby large areas of land were allocated for development and partnerships were set up to bring together the powers to assemble land, grant planning permission and deliver infrastructure. This mechanism has been set up again to facilitate development in the growth areas identified in the Government’s Sustainable Communities Plan.

<sup>27</sup> Bramley, G., Fitzpatrick, S., Karley, N.K and Monk, S. ‘Access, Supply and Need: Theme Report 1’, *The Evaluation of English Housing since 1975*, (Unpublished, 2003).

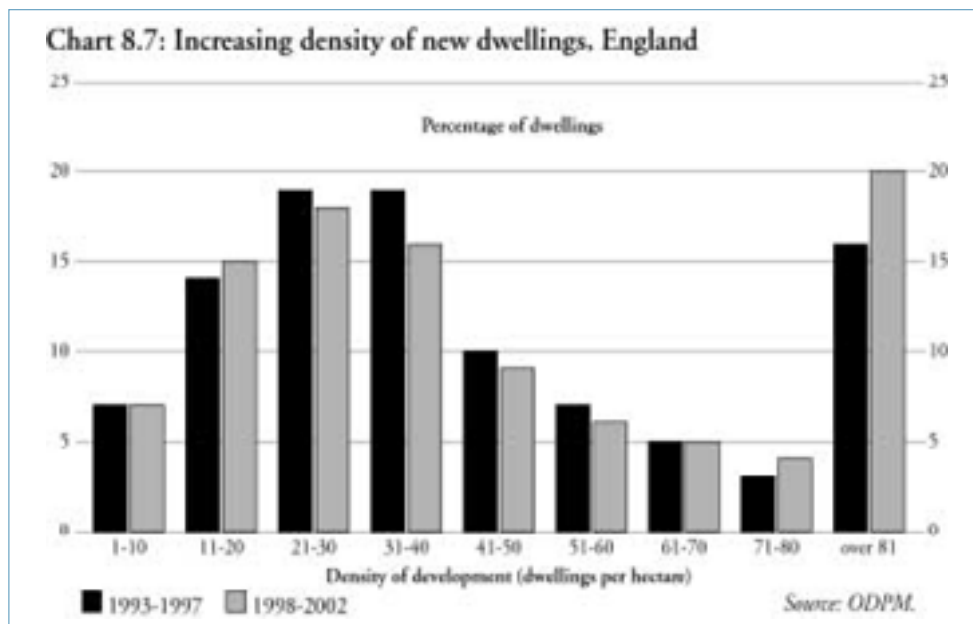
**Reduced amount of land under development for housing**

8.37 The evidence suggests that it is not easy to meet the level of development required by RPG targets. The total area of land under development for housing has declined. Chart 8.6 shows that the total number of dwellings completed on brownfield land between 1997 and 2001 was flat, at around 78,000 dwellings per annum in England. Provisional data for 2002 suggests that this may have increased slightly to around 83,000 dwellings per annum. However, this in no way compensates for the decline in the number of dwellings completed on non-previously developed land<sup>28</sup> from 70,000 dwellings per annum in 1997 to around 53,000 dwellings per annum in 2002. This has occurred even though densities have increased on some sites, making more efficient use of land. Chart 8.7 shows that the proportion of high density developments (greater than 81 dwellings per hectare) has increased as a proportion of all new development.

Decline in amount of houses being built...



...but densities have not increased on all sites



<sup>28</sup> Non previously developed land includes greenfield land, urban and rural land not previously developed.





## Delivering development

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### Overview

Once housing numbers are agreed through Regional Planning Guidance, the actual *delivery* of housing development can be constrained by a number of factors.

- land availability and in particular the complexity of brownfield land;
- the complexity of the planning process; and
- barriers associated with the provision of infrastructure.

Developing housing on brownfield land has a number of positive benefits including aiding regeneration. However, brownfield land is less attractive to housebuilders because:

- build costs are higher and brownfield has higher alternative use values than greenfield land; and
- targets for brownfield build and the sequential test have pushed up demand, and therefore prices, for brownfield land.

The release and availability of land has also been constrained by the planning process:

- refusals for major housing planning permission have gone up from 15 per cent in 1996-99 to 25 per cent in 2002;
- the end-to-end timescales for seeking and obtaining these planning permissions are very long - often years;
- the formal process of applying for planning permission (for which there is a Government target) is only a small component of the overall timescale; and
- agreeing and drafting a Section 106 agreement can be a particular cause of delay.

Specific infrastructure barriers, such as the delivery and funding of transport and water services, can 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.

A more responsive policy environment that delivered housing more effectively would include:

- a system that adjusts to market signals;
- decision making procedures that take full account of the costs and benefits of housing development;
- clear incentives for development at the local level;
- a clear and timely mechanism to provide necessary supporting infrastructure and services to accompany housing development; and
- sufficient resources available to enable effective decision making.

## INTRODUCTION

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9.1 The previous chapter considered attitudes to development, how these are influenced by the perceived costs and benefits of development and how the planning system seeks to plan for development by setting housing targets and allocating land within this context. Even when new housing numbers are agreed through Regional Planning Guidance (RPG), delivery is not certain. Alongside the behaviour of the industry and its build rate, the mechanism through which land gets released for development is a key factor in determining the responsiveness of housing supply. There are many good reasons why the planning process should take time. Development proposals require community consultation and care to ensure that housing delivers communities in which people want to live.

9.2 The Review has identified a number of common constraints to delivery of housing. These include:

- brownfield development and land availability;
- complexity of the planning system; and
- infrastructure.

The extent to which these constraints affect development varies between areas, and depends on the particular circumstances of a development.

## BROWNFIELD AND LAND AVAILABILITY

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9.3 The delivery of housing requires an effective supply of land for development. This section explores some of the constraints on land availability which include:

- the complexity and difficulty of developing on brownfield land;
- an increase in the rate of refusals for major housing developments following recent policy changes; and
- Section 106.

### Brownfield

9.4 There are clear benefits to building on previously developed or brownfield land, as it:

- ensures the most efficient use of available land and avoids utilising greenfield land;
- can make use of existing infrastructure rather than requiring new as brownfield land can be in more accessible and sustainable locations; and
- can aid regeneration of sometimes deprived neighbourhoods and areas.

However, these benefits are not reflected in the costs of developing brownfield land. The true benefits of developing brownfield land should arguably include the benefit or value of not developing on greenfield land. Recent estimates of the benefits of keeping greenfield land undeveloped indicate that people attach a high value to undeveloped land<sup>1</sup>:

- the benefits of recreation, landscape, tranquillity and ecology on rural forested land are valued at £1.3 million per hectare<sup>2</sup>;

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<sup>1</sup> ODPM, *Appraisal Guidance: Valuing the External Benefits of Undeveloped Land - A Review of the Literature*, (2002).

<sup>2</sup> Present value using a 3.5 per cent discount rate.

- the benefits of recreation, landscape, cultural heritage and ecology on agricultural land (extensive) are valued at £630,000 per hectare<sup>3</sup>.

If brownfield land was priced to reflect the true social costs and benefits of its development, in many cases it would be significantly cheaper than some greenfield land where the environmental costs of development can be very high.

9.5 Government addresses this market failure through regulation. At the national level, there is a requirement for 60 per cent of new housing to be on brownfield land although this varies between regions<sup>4</sup>:

- North East – 60 per cent;
- West Midlands – 65 per cent; and
- South West – 50 per cent.

9.6 Regulation can however have unintended side effects. Constraining the supply of greenfield land increases its price and windfall gains arising from planning permission may accrue to landowners. These act as a powerful incentive on landowners to promote their land for development. Additionally, constraining the supply of greenfield land will increase demand for brownfield land. This will increase the price of brownfield land which should consequently promote increased supply as the value of brownfield land for housing comes to exceed its alternative use value.

9.7 However, an increased supply of brownfield land is not certain to arise. Residual values associated with brownfield development may be negative. That means de-contamination and other costs associated with making the land developable may be greater than the anticipated revenue from the completed houses. As a consequence, development will not take place unless a subsidy is available. As it is likely that brownfield land has an existing use, the residual value may then fall below the existing use value and as a consequence there is no incentive for the landowner to sell the land for housing development. Section 106, discussed below, and the level of developer contributions it implies can be particularly important in determining the balance of incentives.

9.8 As discussed previously in the report, brownfield developments often involve greater risk and uncertainty and are generally more complex than greenfield development. This can reduce the number of sites which builders have the capacity to take through the planning process at any one time.

9.9 According to the National Land Use Database, around 65,500 hectares of brownfield land are currently available in England. However, a large proportion (69 per cent) of this is not suitable for housing development for a number of overlapping reasons<sup>5</sup>:

- 32 per cent (21,000 hectares) of this brownfield land is subject to regulatory constraints such as flood risk areas and greenbelt designations; and
- 58 per cent (38,000 hectares) of this brownfield land is located in areas with weak housing markets.<sup>6</sup>

<sup>3</sup> Present value using a 3.5 per cent discount rate.

<sup>4</sup> Targets for development on previously developed land set out in Regional Planning Guidance.

<sup>5</sup> English Partnerships, *Towards a National Brownfield Strategy – Research findings for the Deputy Prime Minister* (2003).

<sup>6</sup> Brownfield land may be subject to both regulatory and *market* constraints.

This leaves 31 per cent (20,010 hectares) of brownfield land free from major regulatory and market-driven constraints. However, the majority of this stock is already in use, leaving approximately 11 per cent of the total stock (7,330 hectares) available for development. Additionally, some potential brownfield development areas have site-specific constraints such as infrastructure barriers, fragmented ownership and contamination. All of these need to be overcome, meaning that lead times are frequently longer for brownfield development.

**Urban capacity** 9.10 Urban Capacity Studies influence and, in many cases, determine the potential for development of housing on brownfield, and within local authority areas. These studies have been seen as controversial by housebuilders who sometimes see them as detached from economic reality with some of the sites identified unviable for development<sup>7</sup>.

9.11 The amount of brownfield land developed for housing in England in 2001 was 2,900 hectares<sup>8</sup>. Other developments (such as employment or industrial enterprise) mean that the total take up of brownfield land in 2001 was around 6,000 hectares per annum. In order to meet current RPG targets for housing completions, levels of brownfield development would need to be around 1,000 hectares higher (at current densities). The majority of development in 2001 was on land which was already in use:

- 53 per cent was on land previously in commercial or industrial use;
- 43 per cent was on land which had previously been vacant or derelict; and
- the remainder was on former minerals, landfill and defence sites.

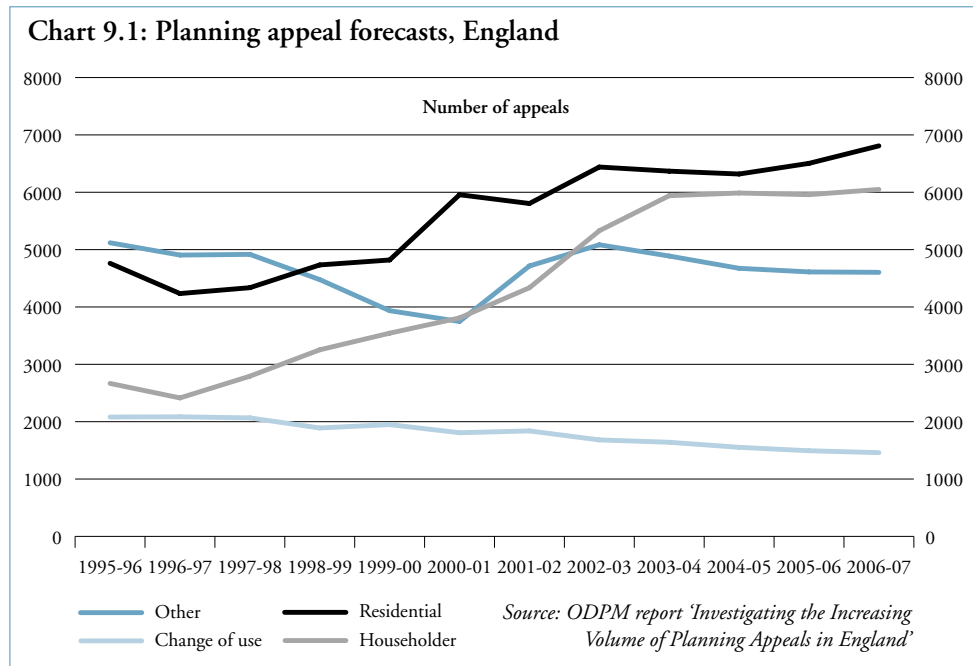
### Increasing refusals

9.12 Land, of whatever sort, being made available for development depends upon planning permission being granted. There has been an increase in refusals of applications for major housing developments over the last three years (see Chart 9.2 and Table 9.1), which has been reflected in an increase in the number of appeals to the Planning Inspectorate as shown in Chart 9.1.

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<sup>7</sup> Housebuilder submissions to the Barker Review consultations, (2003); meeting with HouseBuilders Federation regional planners.

<sup>8</sup> Data from Land Use Change Statistics.



9.13 Research commissioned by ODPM suggests that targets for determining major planning applications for housing within 13 weeks have contributed to an increase in refusals in some authorities<sup>9</sup>. The Planning Delivery Grant (introduced in 2003) has put pressure on local planning authorities to improve performance on determining planning applications by allocating larger grants to authorities meeting the target. The research concluded that there is 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'<sup>10</sup>. Cases have also been found where developers are discouraged from applying at certain times, particularly ahead of local elections, to avoid perverse decisions from members on the planning committee seeking re-election.

9.14 Table 9.1 indicates that in 2002, 25 per cent (1,800 in number) of all applications for major housing developments were turned down, in contrast to around 15 per cent between 1996 and 1999. Consequently, the increased volume of applications for major housing developments since 1999, has been offset by an increase in refusals (Chart 9.2). In contrast, the refusal rate for major non-housing developments has remained relatively flat over the same time period (Table 9.1). This trend of an increasing number of applications combined with an increase in refusals was also evident in 1990, (although in the early 2000s the increase in applications has been much less pronounced).

9.15 This raises two questions:

- why have applications not increased as they did in the last housing boom during the late 1980s; and
- why have refusals increased?

9.16 In the short term, the lower volume of applications may be a transitional issue because:

- developers who held greenfield land banks before the institution of Planning Policy Guidance 3 (Housing) (PPG3) and intended to seek permissions to develop are no longer likely to achieve planning permission in the short term because of

<sup>9</sup> ODPM, *Investigating the Increasing Volume of Planning Appeals in England* by ARUP (2003).

<sup>10</sup> *ibid* page iv.

policy changes, although local authorities might still choose to release such sites later in the planning period through phasing arrangements;

- developers are now more likely to submit only those applications that comply entirely with policy and also have capacity for fewer applications given their increased complexity, resulting in fewer speculative applications (which anecdotal evidence suggests were common in the late 1980s); and
- concern on the part of the industry that they might get caught out by a housing market downturn similar to the early 1990s.

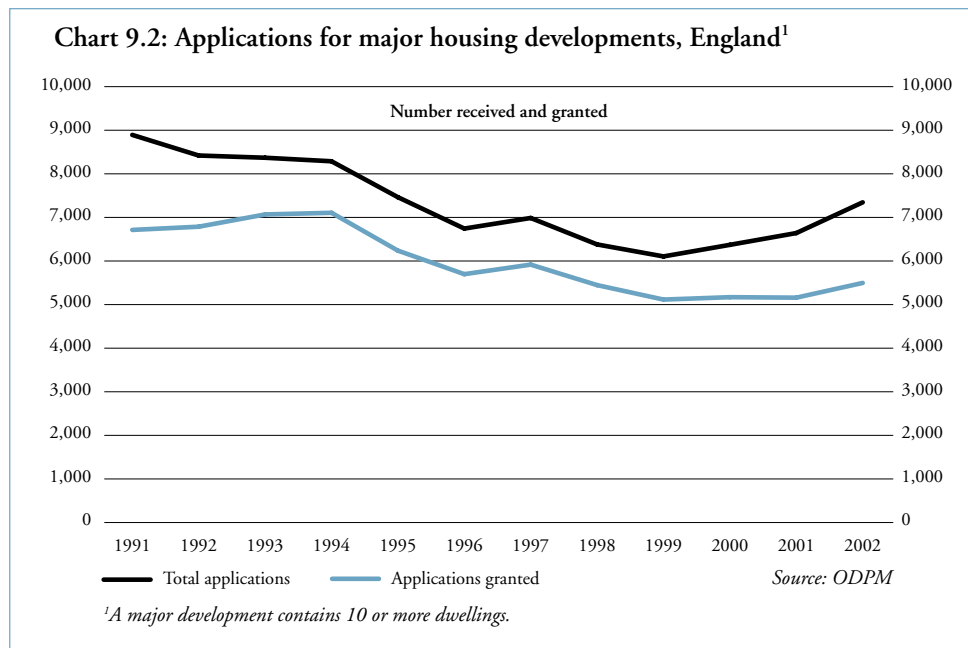


Table 9.1: Results of applications for major developments, England

	Decisions				Time taken		
	Decisions made	Housing		Non-housing	Housing		Non-housing
		Number granted	Percentage granted	Percentage granted	Number granted within 13 weeks	Percentage granted within 13 weeks	Percentage granted within 13 weeks
1996	6,772	5,723	84	87	3,627	53	63
1997	7,013	5,941	84	87	3,400	49	58
1998	6,408	5,473	85	88	2,804	43	56
1999	6,120	5,130	83	89	2,553	41	56
2000	6,382	5,181	81	89	2,435	37	53
2001	6,652	5,170	77	89	2,353	34	53
2002	7,363	5,514	75	87	2,661	36	50

Source: ODPM.

## Reasons for refusals

9.17 The increasing number of refusals and appeals is a concern, particularly if it is not simply a response to an increase in the number of speculative applications as in the 1980s. No data are held centrally about the reasons that applications for housing developments are refused, although planning officers must give policy reasons for refusing developments and these are kept on planning registers in local authorities. Local planning officers in the Review's case study areas indicated that some PPG 3 policies were common reasons for refusal, including the premature release of greenfield sites and concerns about the design of schemes, as poorly designed sites would make development even more difficult in the future<sup>11</sup>. This argument is supported by the findings in ODPM's 2003 PPG3 implementation study<sup>12</sup>. In addition, 2003 ODPM/DfT study<sup>13</sup> found that some PPG3 compliant applications were frequently modified, giving developers mixed messages on how to proceed with planning applications.

9.18 However, planning refusals are often made contrary to planning officer recommendations for approval. One housebuilder provided evidence to the Review of 50 planning applications in 2002-2003 (accounting for 5,200 units) that were turned down by planning committees despite planning officer recommendation for approval. Local authorities in the case study areas said that these generally accounted for a few cases each year, although one authority thought that the outcome of around 15 per cent of applications was an over-turned recommendation for approval at the planning committee stage. Redrow suggest that these cases account for two thirds of their refusals and that the majority are successful on appeal. These refusals may reflect the political pressures described in Chapter 8. However, this is not a new phenomenon and does not necessarily account for the increase in refusals in recent years. The recent increase in refusals is more likely to be the result of recent policy changes including PPG 3 (in particular the introduction of the sequential test) indicating that some housebuilders have failed to respond to the changed policy environment<sup>14</sup>.

**Sequential test** 9.19 The sequential test introduced in PPG 3 requires local authorities to release land for housing development in an order of preference that prioritises brownfield sites. It is not the intention of the policy to restrict land supply but some local authorities appear to have over-interpreted it to the detriment of housing being delivered. Indeed research from ODPM<sup>15</sup> supports this point, arguing that local planning authorities understand 'brownfield first' but also erroneously believe PPG3 says 'greenfield never'.

9.20 The 'prematurity of sites' is often a reason for the refusal or delay of applications for housing developments. However priority sites may not always be immediately available or suitable for development. In some local authorities, this policy is used to block development rather than actively manage the release of land.

<sup>11</sup> Discussion with Berkshire Joint Planning Officers Group.

<sup>12</sup> ODPM, *Delivering Planning Policy for Houses: PPG3 Implementation Study*, (2003).

<sup>13</sup> ODPM/DfT, *Better Streets, Better Places*, (2003).

<sup>14</sup> ODPM *Investigating the Increasing Volume of Planning Appeals by ARUP* (2003).

<sup>15</sup> ODPM *Delivering Planning Policy for Houses: PPG3 Implementation Study*, (2003).

### Section 106

9.21 The value of Section 106 contributions can reduce the residual value of land below the level that landowners would be willing to sell at and therefore prevent land being sold for development. Some sites with full planning permission for housing development are not now being developed for housing because the Section 106 agreement means that the land has a higher alternative use value.

9.22 London Residential Research show that building starts for units of housing in London are lower than the number of units with planning permission and that the gap had increased in 2001. In 2001, construction starts in London were around 14,000 units compared to around 30,000 planning permissions<sup>17</sup>. Starts and permissions in the same year do not match up because of the lead-in times on development, however the recent increase in the gap could also be explained by:

- the high alternative use value of sites with permission for housing development, which is often influenced by the value of Section 106 agreements and in particular the requirement for affordable housing to be provided as part of the development<sup>18,19</sup>;
- an increased fear of a downturn in the London housing market in recent years; and
- an increased number of large strategic sites which often take longer to develop<sup>20</sup>.

9.23 Local planning officers in our case study areas outside London confirmed that, in their local authorities, full planning permissions were almost always built out. There was little evidence of 'lapsed' planning consents, although some, like Basingstoke and Deane, were frustrated by the slow speed of build out of large sites with planning permission.

9.24 Housebuilders have also presented evidence to the Review of schemes where land with outline planning permission has not always been developed for housing. In most cases applications are not made or are withdrawn at an early stage following pre-application discussions with the local planning authority when the indication is that Section 106 and affordable housing requirements would make the scheme unviable for housing. However it is not possible to quantify the overall impact of Section 106 and indicate how much development has been prevented in this way.

9.25 Campbell et al (2000) studied the use of Section 106 within local authorities<sup>20</sup>. Around 4,000 Section 106 agreements are made annually. This represents around 1.5 per cent of all planning decisions – an increase since 1996 (1.07 per cent) and 1991 (0.5 per cent). However, looking only at major residential developments (over 10 dwellings), usage is much higher at around 28 per cent of all decisions. Residential developments comprising more than 14 units will nearly always have a Section 106 attached to them – as demonstrated by the evidence provided to the Review by some of the major house builders. In general the study concluded that practice was in advance of policy, as there had been a widening of the scope of Section 106 obligations and a growth in their use over time.

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<sup>16</sup> London Residential Research, *Residential Development in London 2002* (2002).

<sup>17</sup> London Residential Research submission to the Barker Review consultation (2003).

<sup>18</sup> Greater London Authority submission to Barker Review consultation (2003).

<sup>19</sup> FPD Savills, *Residential land issues research*, (Joseph Rowntree Foundation, 2003).

<sup>20</sup> Campbell H., *Planning Obligations and the Mediation of Development* (2000).

9.26 This section has explored how land which could be available for housing development may not be developed because of the difficulties associated with brownfield sites, recent increases in the rate of refusal for housing developments and the increasing and widening use of Section 106 which may make some schemes unviable. The Government recently issued a consultation document on proposals to reform the planning contribution system by introducing an optional charge in place of most or all of a negotiated Section 106 agreement<sup>21</sup>.

## NATURE AND COMPLEXITY OF PLANNING

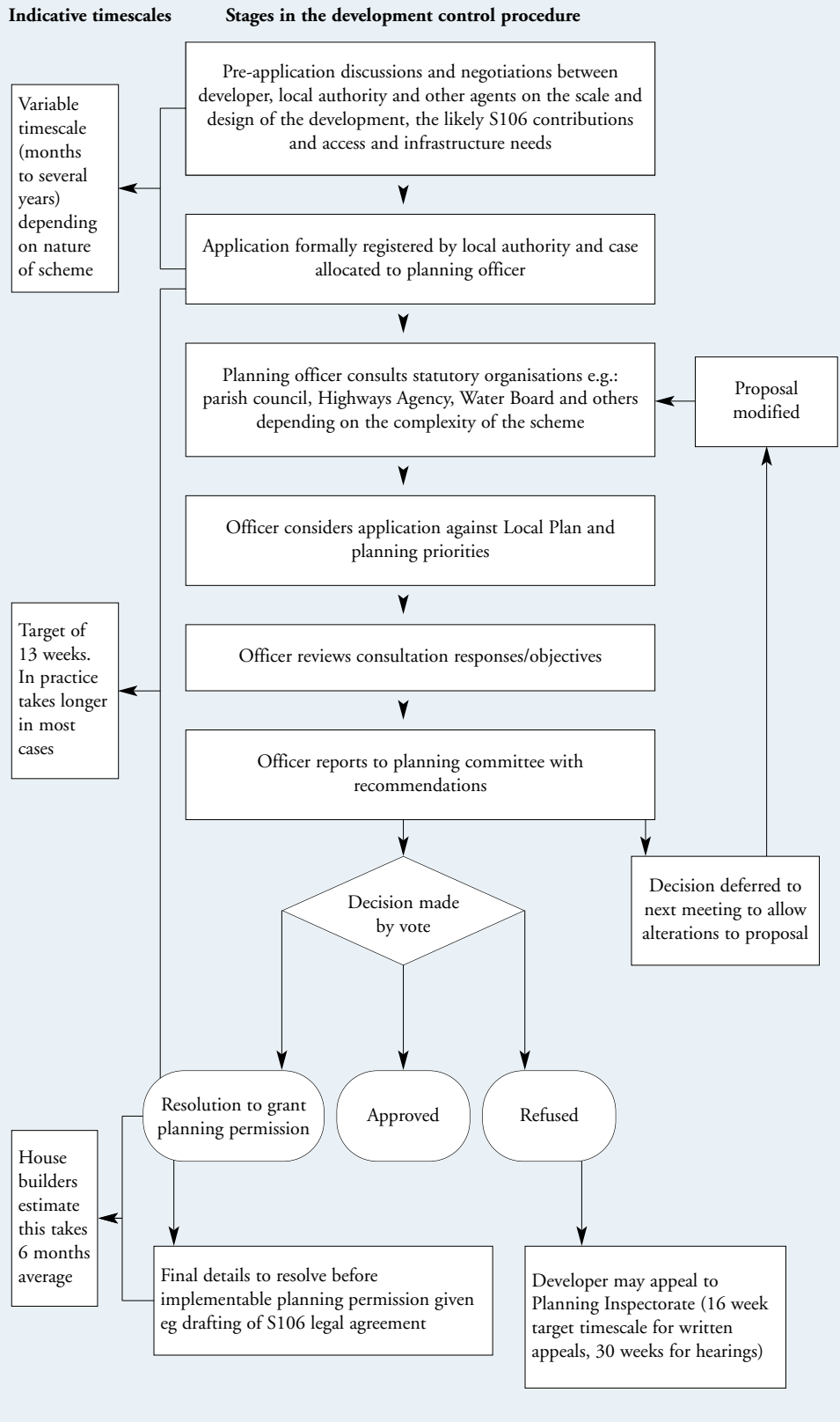
9.27 One of the key questions for this Review is the extent to which housing supply responds to demand. This implies that planning itself must be responsive to changes in demand by managing the release of land and permissions for development. The previous chapter commented on the absence of price signals in the planning system. In addition to this, timescales involved in making planning decisions also reduce responsiveness.

### Timescales involved in applying for planning permission

9.28 There are significant timescales involved in applying for planning permission for housing and other developments. There are good reasons for this: housing is important and it is necessary to ensure that a range of factors are taken into account in the decision making procedure. Fast decisions, which ignore the needs of communities, may be counter-productive in the long-term if they result in poor developments and places in which people do not want to live. This might lead to further resistance against development in the future. However, in some cases the timescales are unreasonably slow. The 'default' timescale involved in decision making on applications for major housing developments is 26 weeks (6 months). This assumes that a developer applies for outline planning permission and then detailed planning permission and that both those decisions are made within the target time periods of 13 weeks. Within this 13 week period, a number of necessary tasks must be carried out, as Box 9.1 illustrates.

<sup>21</sup> ODPM, *Contributing to Sustainable Communities – A New Approach to Planning Obligations* (2003).

**Box 9.1: The development control procedure**



9.29 The majority of applications currently take longer than 13 weeks. Considerable time is also taken up with pre-application discussions between the housebuilder and planning officer as the housebuilder seeks advice on ways to improve their proposals in order to increase the likelihood of achieving planning permission. This stage can vary from weeks to years depending on the circumstances of the individual scheme. In reality, the end-to-end timescale for large developments can take several years when both pre- and post-application stages are taken into account, as Box 9.2 illustrates. These two examples show that the development pipeline has long timescales even, in local authorities that may have contrasting attitudes to development.

**Box 9.2: Examples of stages and timescales involved in the development process**

**Sherfield Park, Basingstoke and Deane**

In 2003, building began on the first phase of Sherfield Park, a greenfield site planned for 700 units of housing.

Early 1990s – Landowner approached the developer (Croudace) who appraised the site and took out an option agreement and then began promoting the site to the local authority to get it allocated in the Local Development Plan.

1998 – The site was allocated in the Plan and the developer submitted an application for outline planning permission for 800 houses.

1998-2000- Developer negotiated Section 106 and S278 agreements<sup>22</sup> with the local authority, Highways Agency and landowner, taking 2 years.

2000 – Outline consent given by Basingstoke and Deane district council. Developer submitted application for reserved matters (detailed planning permission).

2000- 2002 – Long negotiation with local residents over access to the site. Local authority gave detailed planning permission in 16 weeks once this was resolved.

2003 – Work began on site on first phase of development.

**Elvetham Heath, Fleet, Hart**

733 houses have been completed and sold on Elvetham Heath as part of a planned development of 1,868 homes due to be completed in 2007/8.

1989 – Site included in NE Hampshire Structure Plan.

1991 – Application for outline planning permission for residential development.

Dec 1993 – Site included in Hart Local Development Plan.

1994-1997 – Local authority disputed housing allocation.

1997 – Outline planning permission granted and Section 106 obligations agreed.

April 1998 – Site sold to housebuilder – Beazer Homes – and joint project team with district council progress development.

June – October 1998 – Master plan and design brief developed, retail impact study, ecological investigations, site access explored, Section 106 revised.

Nov-Jan 1998 – Public consultation (including an on site exhibition, direct mail out and consultation of stakeholders).

February 1999 – Masterplan and design brief approved (detailed planning consent given with revised Section 106 agreement).

April 1999 – Construction commenced.

<sup>22</sup> Section 278 agreements are undertaken between the developer and Highways Agency.

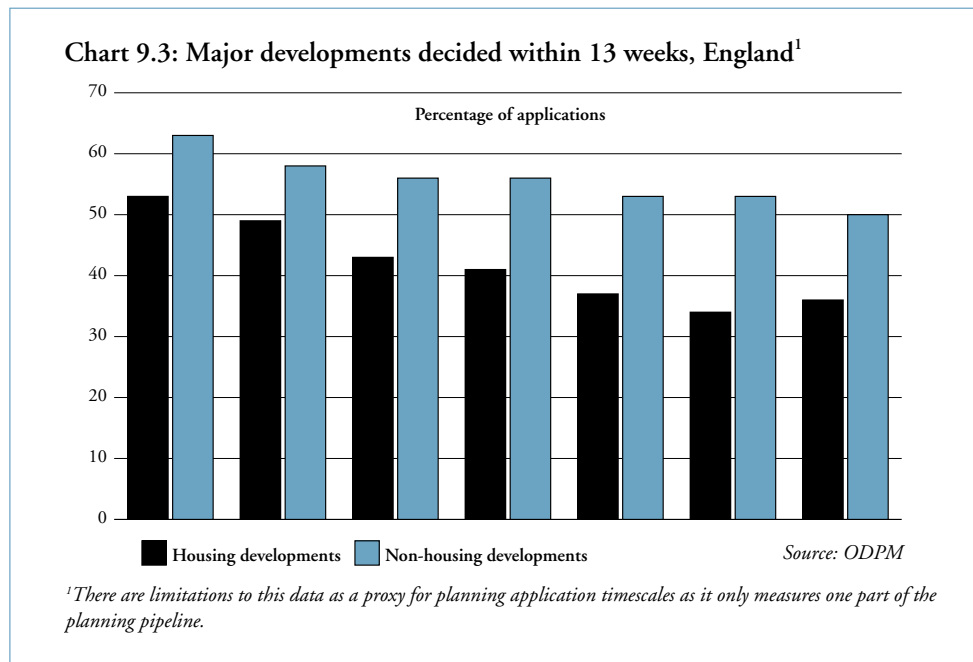
9.30 Why does planning take so long? Why have timescales for decisions been increasing in recent years as shown in Chart 9.3; and why do decision take longer than for other types of development (also shown in Chart 9.3)? There are a number of reasons:

- if a local authority is opposed to a development (even if it is in the Local Development Plan) then there is little incentive to deal with applications efficiently. One former planning officer told the Review that there is “a mindset among some opponents of development that holds that the next best thing to overturning a development proposal is to delay it indefinitely.” The increased complexity of the planning system provides numerous pretexts to delay, and ultimately refuse, applications;
- planning committees meet infrequently. Some meet only every two months, which means that applications have to wait for a resolution and sometimes agenda items are shunted onto the next meeting to avoid making difficult decisions;
- greenfield sites may be held up because preferred sites (often brownfield) have not yet been developed;
- protracted negotiations over Section 106 agreements cause delays. Issues that seem to cause the greatest delays are affordable housing, education requirements and highways contributions. Different parts of a local authority become involved in negotiations and there are sometimes disagreements between departments, or between the district and county authority (who are responsible for education) over the terms of the agreement;
- the drafting of the Section 106 legal agreement can cause significant delay. In many cases, the heads of terms of the Section 106 agreement has been agreed and the planning committee given resolution to grant planning permission yet the final planning permission is delayed because of slow legal drafting;
- local authority planning departments have limited capacity and resources have declined significantly over the period 1996-1997 and 2000-2001<sup>23</sup>. Funds have now been increased from 2003 through the Planning Delivery Grant which is linked to performance; and
- some local authorities only receive a small number of major planning applications each year. Given the complexity of major developments (particularly large schemes of over 50 or 100 houses) planners may not be skilled to deal with them. The Planning Delivery Grant and Planning Advisory Service will help to address this problem.

Each of these issues by themselves may only reduce development or slow down the planning process at the margin. However the cumulative effect may represent a considerable barrier to development.

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<sup>23</sup> DTLR, *Resourcing of Local Planning Authorities* (2002).



## Housing targets

**9.31** The housing targets set by RPG often become a ceiling on development because of the difficulties in setting them and the reluctance to revisit numbers that proved difficult enough to agree on in the first place.

**9.32** PPG 3 introduced the policy of ‘plan, monitor and manage’ (PMM) to Regional Planning Bodies and local authorities, as discussed in Chapter 8. However this has been limited to managing the release of land within the bounds of the existing RPG target, that is, preventing ‘over-supply’ rather than questioning the targets themselves in the face of price signals which suggest more housing is needed. The extent to which PMM has actually been implemented by local authorities is also variable<sup>24</sup>.

## Increased complexity may inhibit responsiveness

**9.33** Recent changes to planning policy and practice have made development more complex. According to recent research ‘the whole process has become more complex over time, with greater public involvement, more regulation and a greater need to ensure the right development takes place<sup>25</sup>. The cumulative impact of each recent change has increased complexity overall. These changes have impacted on decision making timescales and therefore the responsiveness of the planning system to the housing market.

**9.34** As a consequence of increased complexities, many housebuilders are employing more planning experts either as permanent staff or by commissioning planning consultants to assist with their applications. One company now employs 17 qualified planners, compared to 5 in 1998. Complex planning application processes requiring more and better skills in the context of declining numbers of professional planners implies increasing skills constraints on local authorities and housebuilders alike. The Egan Review is investigating the issue of skills and the built environment.

<sup>24</sup> ODPM *Delivering Planning Policy for Houses – PPG3 Implementation Study*, (2003).

<sup>25</sup> DTLR, *Resourcing of Local Planning Authorities* (2002).

## INFRASTRUCTURE

9.35 Infrastructure can constrain development by:

- creating practical impediments to development taking place if necessary road and public transport projects, water supplies and services cannot be funded and delivered; and
- engendering an adverse reaction to development when infrastructure (such as schools and medical services) is not expanded (or not perceived to expand) at a rate consistent with development and the expansion in household numbers.

9.36 ODPM estimate that over 40,000 dwellings with planning permission in the South East region alone are held up by transport infrastructure blockages<sup>26</sup>. Often, this is because decisions on infrastructure provision are not taken at the same time, or by the same people or bodies, as decisions about the size and nature of development (with the exception of Section 106 agreements). Box 9.1 illustrates some of the infrastructure related constraints and delays that can occur. However, transport infrastructure barriers do not always involve large projects and high levels of funding. They can occur because those responsible for transport planning and delivery may not have engaged in the drafting of the Local Development Plan or at an early enough stage in development control decisions. For example, South Norfolk Local Development Plan allocated three sites for housing development. The Highways Agency, concerned at the pressure this would place on existing roads in the area, blocked development at a relatively late stage. The objectives of different public organisations can conflict: for instance a local authority planning for growth and the Highways Agency trying to reduce congestion.

### Box 9.3: Imperial Wharf – rail infrastructure

Ken Livingstone, the Mayor of London, opened the first phase of St. George's Imperial Wharf development in June 2001 and commented that "The Imperial Wharf scheme is in line with all the main policies contained within my draft planning guidelines, 'Towards the London Plan.' It's a high density, mixed-use development and provides a 50 per cent affordable housing element – 815 homes. It also utilises a brownfield site, which has been derelict for a number of years. This scheme provides real housing choice for local people – the kind of choice I want all Londoners to have. I hope this can be a blueprint for good practice for future residential development in the capital."

Imperial Wharf is a mixed use development comprising 1665 homes and over 4000 square feet of commercial floorspace overlooking the river Thames at Fulham. The development is situated on a former British Gas site.

The London Borough of Hammersmith and Fulham could only approve the second phase of the development if the developer managed to get approval from the Strategic Rail Authority (SRA) for a new station adjacent to the site on an existing West London line. This station would provide the site with connections to West Brompton and Clapham Junction stations. The negotiations between St. George (the developer) and the SRA lasted 5 years with the eventual approval for a new station, funded by the developer, and subsequent granting of planning permission for the second phase.

The extensive negotiations over the provision of new infrastructure was the 'limiting factor' in the scale of the scheme and the main reason that the development encountered delays in achieving planning permission despite efficient planning negotiations.

<sup>26</sup> Based on information from Government Offices engaging with local authorities failing to deliver housing targets.

9.37 A common problem, particularly with transport infrastructure, concerns how any new infrastructure will be funded, and how it will be planned for and delivered in time to make a site viable for development. This has been a barrier for large sites like those identified in Ashford in Kent (for around 5,000 houses). These sites were delayed in being brought forward and permissioned for housing development because of the need for a new motorway junction to provide access to the settlement. This infrastructure is costly and there is also uncertainty as to whether it should be paid for from public funds or by the housebuilder.

9.38 Further problems with securing infrastructure result from:

- agencies responsible for funding transport infrastructure and other public services not necessarily planning or prioritising for growth;
- a lack of clarity as to how large infrastructure projects (motorway junctions, new railway stations etc) should be funded, given that all housebuilders in an area benefit from their provision; and
- “gap funding” issues where the developer may be prepared to pay for infrastructure but expenditure is required before the housebuilder has earned any return from houses built on the site.

9.39 The consequence is that sites identified for development are not always developed in the time period anticipated, and some potential sites are not allocated for development because infrastructure is inadequate to make them viable or sustainable. Arguably, many sites within low demand areas could be made viable if transport and other infrastructure were improved, which would help relieve pressure on higher demand areas. Of course, investment in infrastructure alone cannot always bring about regeneration of low demand areas.

9.40 One case study local authority highlighted the risk (based on their own experience) that being permissive towards new housing development would create an imbalance in town centres and a strain on local services. They saw the need for increased funding for services (particularly health) before allowing further significant development<sup>27</sup>.

<sup>27</sup> East Northamptonshire case study.



# 10 Affordable housing

## Overview

Much of the decline in the number of housing completions over the past 30 years has resulted from the fall in output of publicly funded, subsidised housing.

In 1970, 173,000 houses were built by local authorities. By 2001, local authority build was only 487 units while Registered Social Landlords (RSLs) built 22,000 dwellings. Right to Buy has also shrunk the stock of social housing – with over 1.5m dwellings transferred to the private sector<sup>1</sup>.

Although public expenditure for social housing has risen in recent years, the number of completions has not yet responded. The key constraint on expansion of the social housing stock is likely to be the cost and availability of land:

- in the market for land RSLs are likely to be frequently outbid by private housebuilders particularly when land values are increasing;
- Section 106 has increasingly been used to deliver affordable housing and overcome land availability problems. However, the cost of such housing can be higher as private housebuilders tend to develop in higher value locations; and
- in a less buoyant housing market there is likely to be much less scope to deliver affordable housing through Section 106.

However, ensuring RSLs are efficient is still an important consideration in order to maximise housing supply:

- RSL operating costs vary significantly, with large RSLs more likely to have the capacity to invest in new build;
- RSLs may have limited borrowing capacity as a result of balance sheet constraints. Some RSLs are nearing their debt ceilings and Housing Corporation grant is not written off over time;
- there are many small RSLs (1,500 RSLs own under 100 units). Few of these seek to expand their stock, this means approximately 130,000 units in total not being borrowed against; and
- only some RSLs have developed private sector arms to allow cross subsidisation of affordable housing.

The private housebuilding sector has not responded by providing more small homes to fill the gap left by reduced social build. This results from housing market upswings, high development costs, and the need to cross-subsidise Section 106 dwellings.

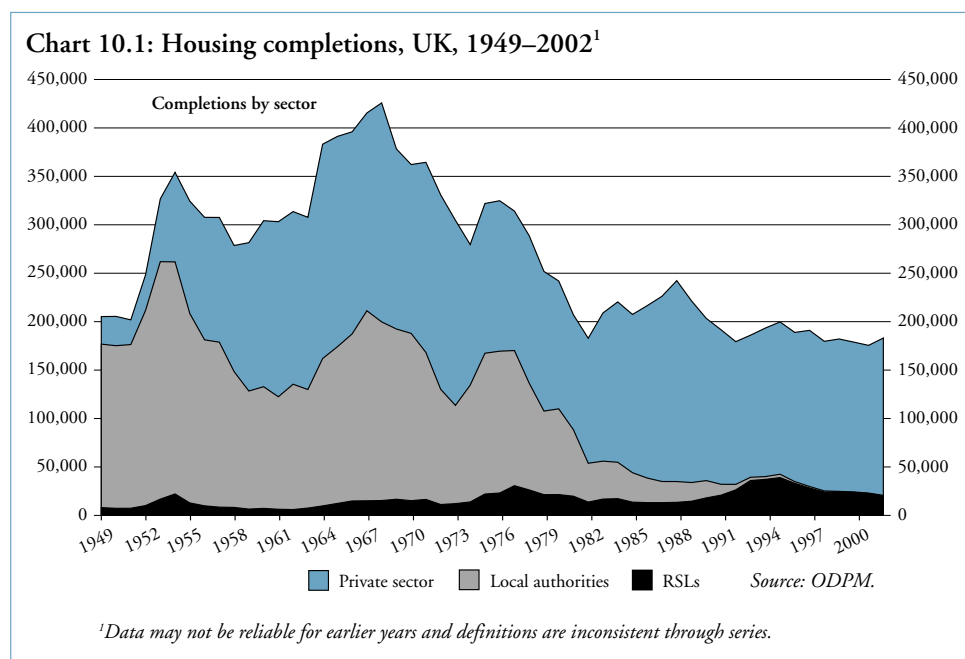
<sup>1</sup> Under Part V of the Housing Act 1985, secure tenants may buy, at a discount, the homes they rent from their local authority (Right to Buy) or registered social landlord (Right to Acquire, which has a less generous discount than Right to Buy).

## INTRODUCTION

**10.1** Chapter 7 introduced the policy levers available to government and explored the way in which they can be used to intervene in the housing market and subsequently influence supply. The previous two chapters have looked at the planning system, the context within which it operates and its role in regulating the delivery of housing. This chapter will look at government subsidy as a means of helping those households who are unable to access market accommodation and explore how effectively it is being used.

**10.2** In polls, 90 per cent of people say they would like to own their own home, although the current rate of homeownership in the UK is 70 per cent<sup>2</sup>. As the figures imply and Chapter 3 highlights, not everyone can afford a house, indeed many cannot afford private rented accommodation and some do not even have access to self contained, permanent, adequate housing. The Review sees being adequately housed as necessary to individual well-being and understands housing's vital contribution to building sustainable communities that people want to live in. The Review believes that while increasing the supply of private market housing is necessary, there is a further need for subsidised housing for those unable to access market accommodation.

**10.3** For some households market housing will never be affordable and the social housing safety net accommodates the most vulnerable members of society. The building of new social dwellings by local authorities has virtually stopped and neither RSLs nor the private sector has increased their production to fill this gap, as Chart 10.1 shows. Just over 22,000 publicly subsidised social sector units were built in the UK in 2001/02. Although some additional social units, not requiring subsidy, will have been built through Section 106 and RSL cross subsidisation, even so this is not nearly enough to bridge the gap. The social sector is shrinking further still through Right to Buy (approximately 1,550,000 dwellings have been sold under Right to Buy since 1980 in England<sup>3</sup>) and Right to Acquire sales.



<sup>2</sup> Home Ownership Task Force, *A Home of My Own*, (2003).

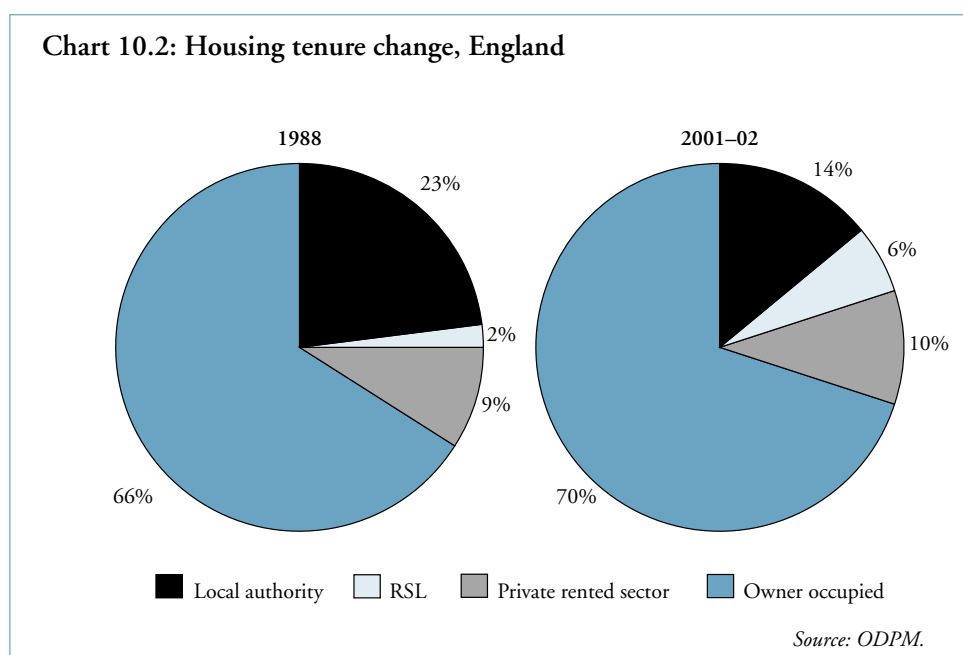
<sup>3</sup> Office of the Deputy Prime Minister.

10.4 The intermediate sector encompasses those caught in the middle – unable to afford to buy market housing but too affluent to qualify for social housing. However, it is arguable that generally those in the intermediate sector are not in need in the strictest sense. Their tenure may not be their tenure of choice, but they do have somewhere to live and are primarily catered for by the private rented sector. In some cases government may identify a market failure associated with this outcome, for example shortages of key workers, which may justify subsidising home ownership. Earlier the Review noted that defining those in housing need and determining the extent to which aspirations towards home ownership are subsidised is mainly a question for Government.

10.5 The focus of this Review is supply and it is therefore also concerned with ensuring that there is an adequate supply of housing for the most needy and for those least able to provide for themselves. This chapter begins by considering the changing nature of the social housing sector and the emergence of the intermediate sector. It then considers the role that RSLs and the private sector play in the delivery of affordable housing and explores the barriers that limit their ability to supply more subsidised housing.

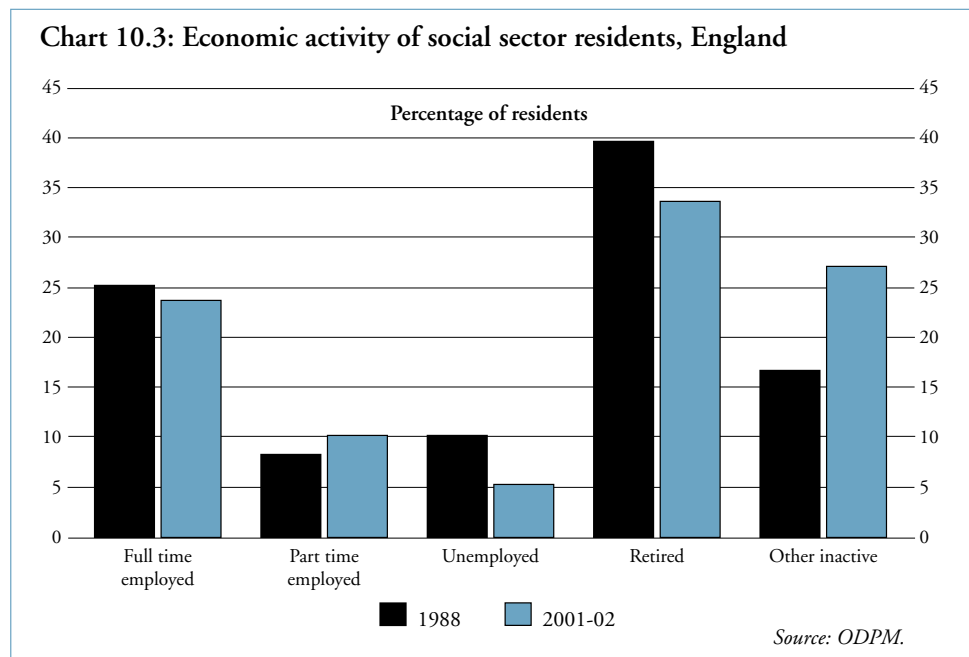
### CHANGING NATURE OF THE SOCIAL SECTOR

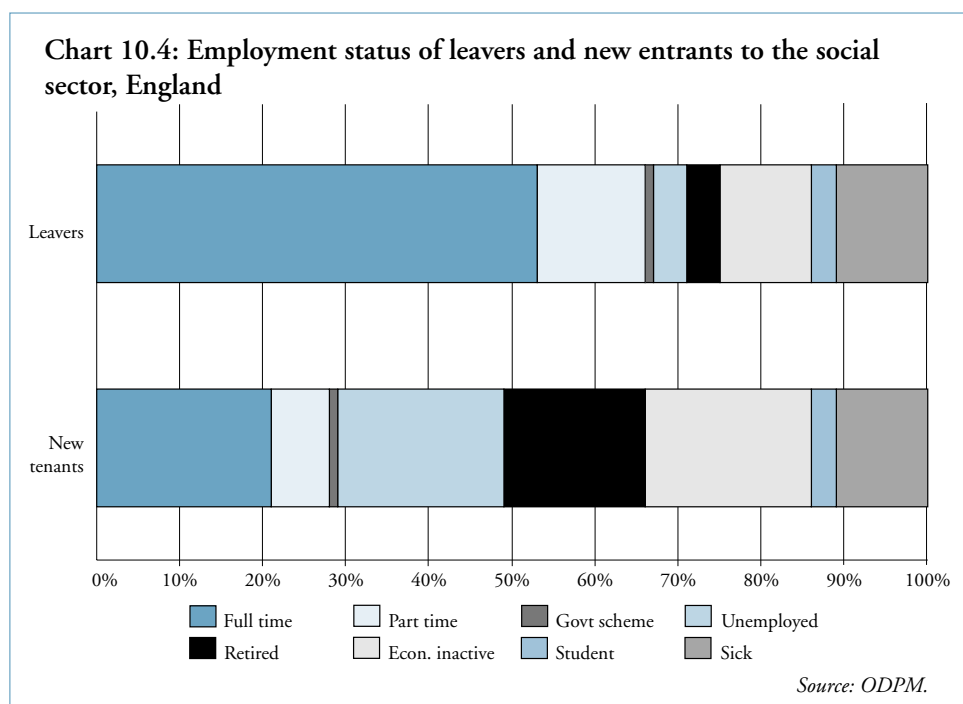
10.6 The number of households in the social sector has decreased. In 1988, as Chart 10.2 shows, one quarter of households were in the social rented sector, by 2001/02 only 20 per cent were.



10.7 The social sector is changing. As it has become smaller the make up of social housing tenants has changed, which in turn results in the sector becoming increasingly polarised from the rest of society:

- Chart 10.3 shows that the sector is increasingly housing more ‘other’ inactives (such as those who are permanently sick, disabled, full-time students or looking after the family or home and thus are not working). They now account for 27 per cent of total heads of households, as opposed to 17 per cent in 1988. This is in stark contrast to the owner-occupier sector where only 6 per cent of heads of households are deemed ‘other’ inactive. Although, the proportion of inactives in the social sector has not changed significantly as the rise in ‘other’ inactives has been offset by a decline in those residents who are unemployed or retired.
- Chart 10.4 shows that far more of those leaving the sector are in full or part time work, whereas far more of those entering the sector are either unemployed, retired or economically inactive.
- This has implications for the age profile of former tenants and new entrants. A much higher proportion of those leaving the sector are aged between 26 and 44 and a higher proportion of those entering are under 25 or over 60.
- Perception of this polarisation may have contributed to the social exclusion of social sector tenants and resulted in stigmatising the social sector as a whole.





**10.8** There is an ongoing debate about whether the Government should increasingly subsidise the individual, who is subject to review, rather than the property, which is not. Property linked subsidy, the Right to Buy and Right to Acquire are thought to constrain the supply of subsidised housing as it provides a clear incentive for under-occupation and life-time tenure regardless of circumstance. It could in turn also restrict labour mobility.

**10.9** The Government provides incentives such as Homebuy<sup>4</sup> to aid social sector tenants, who have the economic means and desire to do so, in moving out of the sector. This in turn frees up their homes for rent for others in housing need. However, even without government help, the Housing Corporation<sup>5</sup> suggest that in some places (Liverpool as an example), if house prices are very low, it might be cheaper for some people on low incomes to buy rather than rent social accommodation. Lack of savings may still be a barrier to home ownership though. 100 per cent mortgages can mitigate the need for a deposit but the transaction costs can still involve a significant outlay. In addition lack of access and familiarity with financial and estate services and an overrated perception of risk of buying a property, can also act as barriers. This encourages people with the economic means to move out of the social sector to remain within it, and thus exacerbates the demand for social rented stock. However the retention of more affluent households may help prevent further polarisation of the sector. The Home Ownership Task Force Report, led by the Housing Corporation and published in November this year, has explored how those on low incomes can realise their home ownership aspirations, and what support is cost effective in enabling these aspirations to be met.

<sup>4</sup> Homebuy helps existing social sector tenants or those on housing waiting lists to buy a home on the open market. Those qualifying for the scheme contribute 75 per cent of the purchase price of the home through a mortgage or personal savings. An RSL lends the remaining 25 per cent. When the home is sold 25 per cent of the value of the home when it is sold is repaid to the RSL. RSLs can also now provide new build specifically for Homebuy.

<sup>5</sup> Housing Corporation submission to the Barker Review consultation, (2003).

### The emerging intermediate sector

10.10 As outlined earlier, Bramley's research into the size of the intermediate housing sector shows that the sector is getting bigger. This is in spite of the mortgage market becoming more innovative with products such as the Step Ladder mortgage which allows a borrower to pay only 70 per cent of interest costs for 10 years (before moving on to a regular product). Alternatively, some lenders are offering 'generational' mortgages where family members contribute to paying part of the costs and also longer borrowing periods of up to 40 years are available.

### RSL DEVELOPMENT

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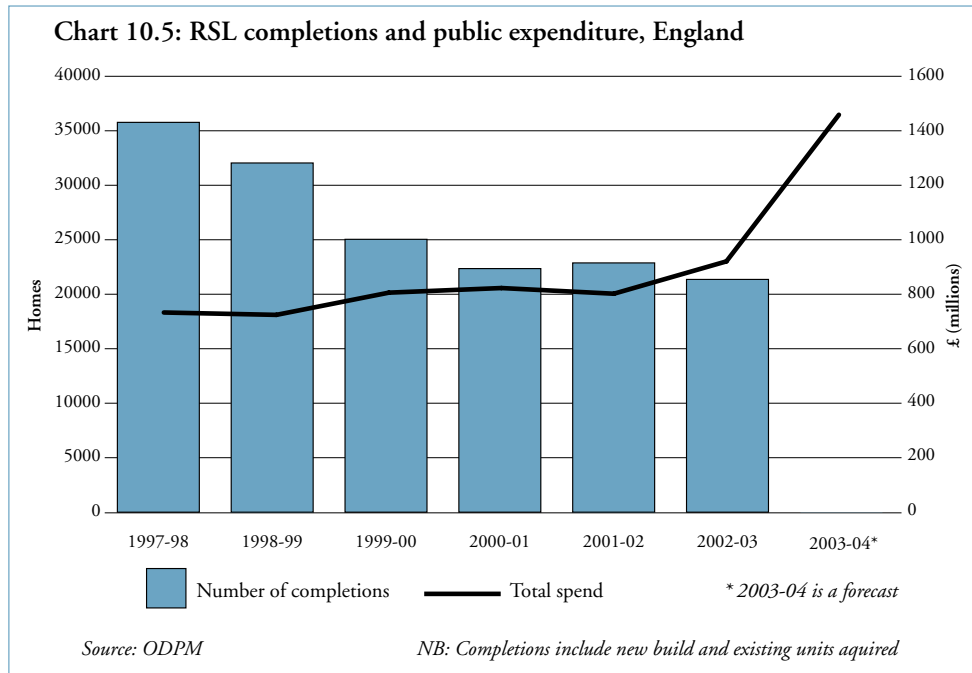
**How RSLs develop** 10.11 RSLs are private sector, non-profit making bodies, regulated by the Housing Corporation in England, Communities Scotland in Scotland and the Welsh Assembly in Wales. RSLs can develop in several different ways. Developments are generally subsidised in part, with RSLs expected to meet the remaining costs. Developments are subsidised through one or a combination of the following:

- government grant from the Housing Corporation, Communities Scotland or the Welsh Assembly;
- private subsidy in the form of discounted land or units through Section 106 agreements; and
- cross subsidisation, where the RSL may build market homes for sale and use the profits from this to build affordable homes.

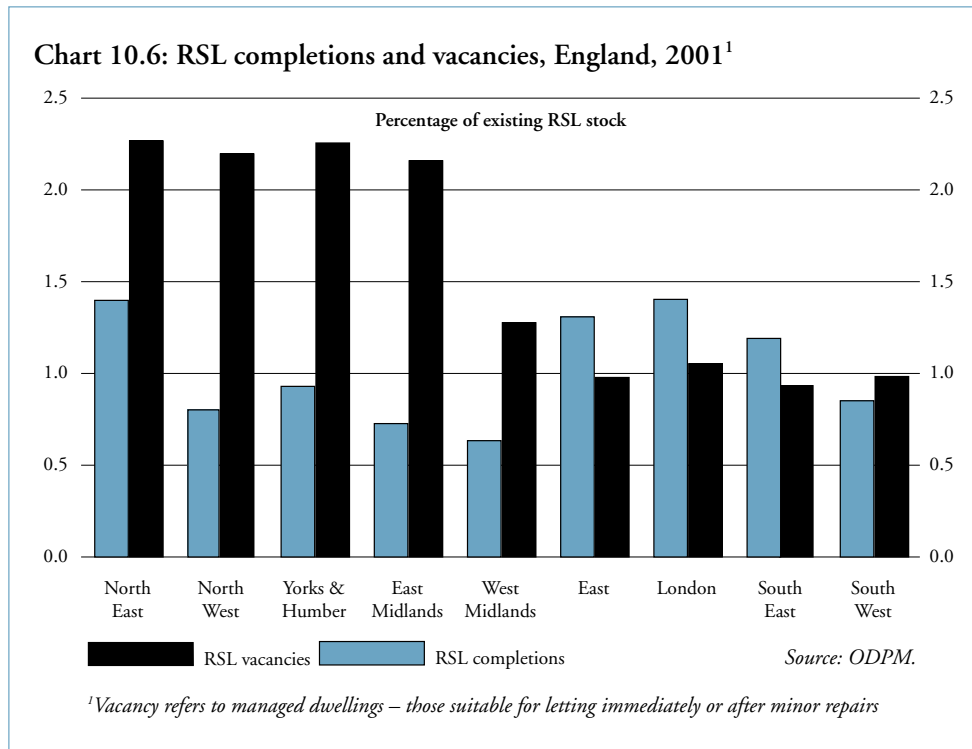
10.12 Very simply if the amount of public subsidy allocated to social housing was increased and there was no constraint on land there would be more social housing delivered. Chart 10.5 shows total public funding, which is not broken down into new build and refurbishment funding, has increased but the number of social housing completions has fallen. The main reason for low completions is that funding has not increased in line with high build and high land costs. However, this could also in part be explained by the Deputy Prime Minister's Decent Homes Target<sup>6</sup>. In 2001 33 per cent of homes were deemed non-decent compared to 46 per cent in 1996. The construction of new decent homes and the demolition of predominately non-decent dwellings will have contributed to this progress but the main factor is improvement and refurbishment of dwellings deemed non decent in 1996. This will have diverted some public funds, although only a small proportion, away from new build to refurbishment.

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<sup>6</sup> The Office of the Deputy Prime Minister's 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.



10.13 It is also important to note that the Housing Corporation’s Approved Development Programme (ADP), which distributes grant to RSLs in England, closely reflects demand with a greater proportion of the funding concentrated in areas of highest need. These areas of high demand are also the areas of highest cost (i.e. the South). Chart 10.6 shows how the English regions with the lowest RSL vacancy rates, which by implication are likely to be the areas facing greater demand, generally have the highest rates of new completions.



10.14 Although land availability is a more pressing constraint on expanding supply, it is still important to assess whether the money already allocated, and the methods of development currently used, are as effective as they can be, and whether RSLs have the capacity to add to their commitments financially. The following section examines RSL efficiency and explores what barriers limit their ability to expand supply.

## RSL OPERATING EFFICIENCY

10.15 The Housing Corporation's *2002 Global Accounts of Housing Associations* looks at the published accounts of 1,857 RSLs. The accounts show that very small RSLs have quite low operating margins of 8 per cent and turnover/total assets of 0.15 times. However larger RSLs have much healthier margins of 20-24 per cent and turnover/total assets of 0.09/0.10 times.<sup>7</sup> A low turnover to asset base is often favoured by lenders as it gives them greater comfort that if things go wrong, there is a larger cushion of assets for the RSL to fall back on. The Housing Corporation states that 'the major financial characteristics of those traditional RSLs with less than 1,000 housing units include a large growth in total debt relative to growth in assets and low and declining profitability'<sup>8</sup>. Both suggest that the smallest RSLs are not getting many scale benefits from spreading overheads across a small number of properties. This in turn is adversely affecting the amount of surpluses generated, their ability to reinvest these surpluses into the sector and their capacity to borrow. As Table 10.1 shows, 1,542 RSLs own fewer than 100 properties but their combined stock is 130,946 units. This is a significant number of units with scope for economies of scale, if fewer RSLs owned and managed this stock. (Though there may be circumstances, particularly in isolated rural areas, where it may not be advantageous for a larger RSL based miles away to manage the stock and scale benefits may not always be achievable.)

**Table 10.1: RSLs by number of homes, England**

	<1,000	1,000– 2,499	2,500– 4,999	5,000– 9,999	>10,000	Total
Number of RSLs	1,542	82	70	28	30	1,734
Number of homes	130,946	129,354	243,520	200,085	531,578	1,235,483
Average number of homes per RSL	86	1,577	3,479	7,146	17,719	713

Source: Housing Corporation, 2002

10.16 Housing Corporation figures for England in 2002 show that amongst the largest RSLs there was a threefold variation in operating costs<sup>9</sup>. Variations in running costs may reflect a number of factors:

- differences in service levels;
- regional cost variations; and
- varying client groups and other factors.

But it is still likely that there is scope for efficiency gains. Most RSLs do want to be as efficient as possible in order to be able to borrow and grow organically but there are no other clear drivers for RSLs to strive to improve. However this is changing, the Housing Corporation is introducing a new approach which will increasingly focus investment on the most efficient RSLs.

<sup>7</sup> Housing Corporation (2002), *2002 Global Accounts of Housing Associations* (Housing Corporation, London).

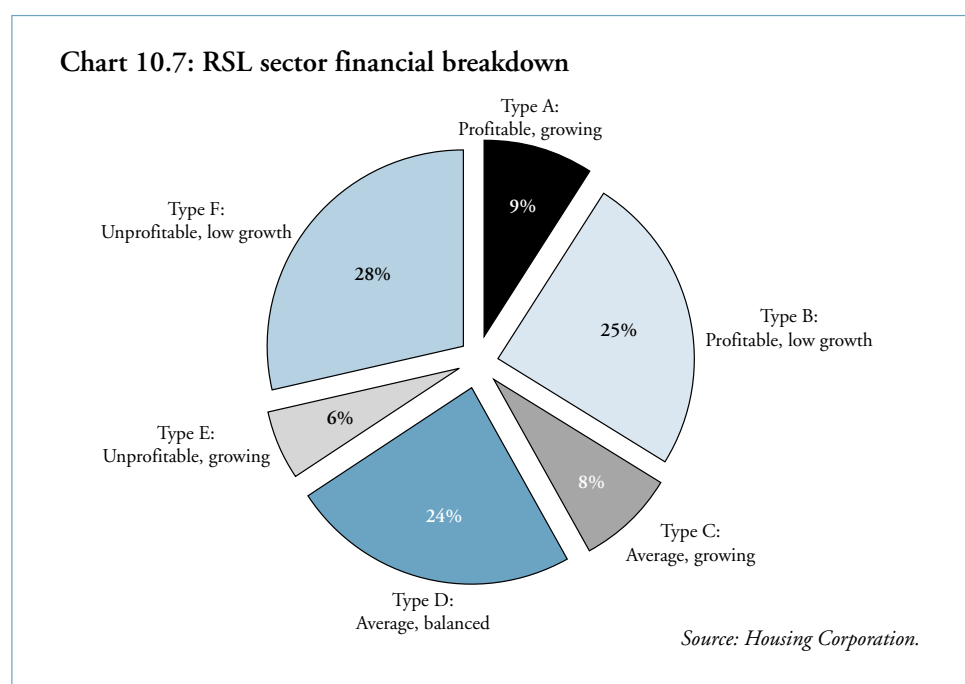
<sup>8</sup> Housing Corporation (2002), *2002 Global Accounts of Housing Associations* (Housing Corporation, London).

<sup>9</sup> Housing Corporation (2002), *Best Value Performance Indicator* (Housing Corporation, London).

### Housing Corporation ADP and borrowing against assets

10.17 Annually each region is given an allocation of Housing Corporation Approved Development Programme (ADP) grant (£1.5 billion for 2003/04 for all of England)<sup>10</sup>. RSLs then bid to the Housing Corporation for grants. The bidding system generally depends on RSLs contributing towards the costs of development in order to be able to deliver housing at sub-market rents. The RSL would then usually borrow against their assets, use surpluses generated from their mainstream business or profits from market price private housing to fund the rest of the development. The Housing Corporation recently launched their 2004-2006 Affordable Housing Programme Bidding Round, inviting RSLs to put forward proposals for a programme of development activity for the next two years. This new, longer term approach is a positive step as it will increase funding certainty for RSLs and aid in better and more efficient development planning.

10.18 The favourable (almost three to one) asset to debt ratio of the sector in recent years<sup>11</sup> should have provided plenty of scope for increased borrowing and expansion. Indeed since RSLs first began to access private finance in the late 1980s they have raised over £25 billion<sup>12</sup>. This reflects confidence and the perception of low risk in the sector, which does suggest that financial constraints may not be an issue for many RSLs. Even so some RSLs clearly have much less favourable asset to debt ratios and balance sheet capacity has been raised with the Review team as a factor in deterring future development for some RSLs. Chart 10.7 shows a financial profile of 210 RSLs with 1,000 units and over in England. Each RSL is categorised on its ability to generate surplus and its growth characteristics. This analysis illustrates the broad difference across the sector.



<sup>10</sup> Regional Housing Boards have been tasked by the Office of the Deputy Prime Minister with drawing up Regional Housing Strategies to form the basis of recommendations to Ministers on how housing capital investment (the Regional Housing Pot) should be divided between the Housing Corporation and local authorities.

<sup>11</sup> Startup, T., *A Social Market in Housing* (The Social Market Foundation, 2003).

<sup>12</sup> National Housing Federation, *Do you have the Capacity? A guide to assessing your future borrowing capacity* (NHF, 2003).

**10.19** 42 per cent of associations (Types A, B and C) have high to very high implied credit ratings from the view of potential lenders and are likely to have headroom before they reach their financial constraints. However 34 per cent (Types E and F) would be considered to have low credit ratings<sup>13</sup> and may experience difficulties in raising finance at favourable rates. This is a major concern: political decisions and RSL Boards will influence individual RSL growth, however, growth for the sector as a whole cannot occur unless RSLs have the ability to add to their financial commitments. However, borrowing constraints could be less significant for many larger RSLs, who are likely to have fairly low operating costs as a proportion of turnover. They may be more of an issue for smaller RSLs with higher operating costs and for those in low demand areas where occupancy may be less certain.

**10.20** In addition the fact that RSLs are private sector non-profit making bodies regulated by the Housing Corporation may provide some comfort to lenders and possibly enables the sector to enjoy lower borrowing rates than might otherwise be the case. Although, RSLs being private sector bodies could fail and default on their obligations to lenders – the Government does not underwrite their borrowing activities.

**10.21** Currently ADP, although effectively a grant, is treated as a loan to RSLs by commercial lenders because it is repayable under certain circumstances, for example if a RSL deregisters with the Corporation or a project fails. Some RSLs believe that this liability deters some lenders from investing in the sector. As far as a lender is concerned, this places a prior claim on the RSLs assets and they are therefore unwilling to make an unsecured loan to an RSL on these assets. This can very quickly place limits on the amount of finance an RSL can raise. They want the grant written off after a certain period of time, whilst the dwelling still has a positive value, as this would effectively free up the RSLs asset base. One large RSL indicated to the Review that they estimate that this could raise another £100 million of commercial finance. However this is only likely to help those RSLs constrained by debt:equity ratios not those constrained by interest cover. Also it is important to point out that although this may lever in additional investment from lenders, there would be no recovery of grant if a project failed either in the short or long term, meaning the grant could not be recycled to fund future development.

**Reviews of RSL efficiency** **10.22** This Review notes that more extensive work is currently being undertaken to consider RSL efficiency.

- The Audit Commission is carrying out an investigation of RSL performance and efficiency. The Review, which reports at the end of December, will consider the extent to which variations in running costs reflect differences in service levels, client groups and the extent to which they may be due to different levels of efficiency and effectiveness. The review will also explore what further steps should be taken to encourage increased efficiency and effectiveness in the sector.
- The Office of the Deputy Prime Minister announced in September 2003 the undertaking of an End-to-End Review of the Housing Corporation and its interaction with RSLs. Due to be published in Spring next year, the Review will look at the links between the development of affordable housing policy and its delivery; and ways to minimise unnecessary administrative burdens for the Housing Corporation, RSLs and other organisations with which they work. The Review will make recommendations for ways in which the Housing Corporation, RSLs and other relevant organisations can achieve a more efficient and effective delivery of Government policies and objectives.

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<sup>13</sup> Housing Corporation, *2002 Global Accounts of Housing Associations* (Housing Corporation, 2002).

## LAND AVAILABILITY

### Section 106

10.23 Through Section 106 agreements, private developers may be required to provide both land and finance for affordable housing. This policy has produced significant numbers of new affordable homes in areas where until now there has been only limited supply. Indeed in some areas, Carlisle for example, which are often not allocated any ADP for new development, Section 106 can be the only method of delivering subsidised housing. It is estimated that 10,000 new units of affordable homes were completed on Section 106 sites in 2001/02. However, only a proportion of these were wholly additional, as three quarters of all these completions required public subsidy<sup>14</sup>.

10.24 Section 106 sites are by definition those where private developers are selling market housing:

- these sites tend to be more expensive and although developer contributions reduce land prices for RSLs they still need public subsidy to make the units affordable;
- there could be circumstances where it may be possible to deliver more units elsewhere for the same subsidy and for an equivalent cash sum rather than land from the developer; and
- as Crook, Monk, Rowley and Whitehead point out in their submission to the Review, if the amount of land secured for Section 106 housing does increase, it is essential that larger financial contributions from developers are secured for affordable housing. Otherwise there is the danger that the increase in Section 106 units will absorb an ever increasing proportion of the Housing Corporation's ADP, leaving less funding for other forms of social housing.

10.25 There are several key constraints on securing affordable housing through Section 106:

- significantly, Section 106 requirements mean that the supply of affordable housing is dependent upon the rate at which the private sector develops. In a less buoyant market housebuilders may hold off from taking development forward and affordable housing will simply not be built;
- affordable housing could also not be developed where Section 106 requirements make it more profitable for the private sector to use land for purposes other than housing;
- in addition a shortage of development land above threshold size<sup>15</sup> in areas of market demand reduces the amount of affordable housing delivered;
- there are also competing priorities for inclusion in Section 106 such as infrastructure and community needs; and
- Section 106 agreements require complex negotiations, a lack of negotiating and valuation skills in local authorities may mean less planning gain being secured than is possible.

<sup>14</sup> Professor Tony Crook, Ms Sarah Monk, Doctor Stephen Rowley and Professor Christine Whitehead's submission to the Barker Review Consultation (2003).

<sup>15</sup> *ODPM Circular 06/98 Planning and Affordable Housing* indicates that Section 106 requirements for affordable housing should only apply to developments which are 15 units or more in London and 25 units or more outside of London.

### Land availability

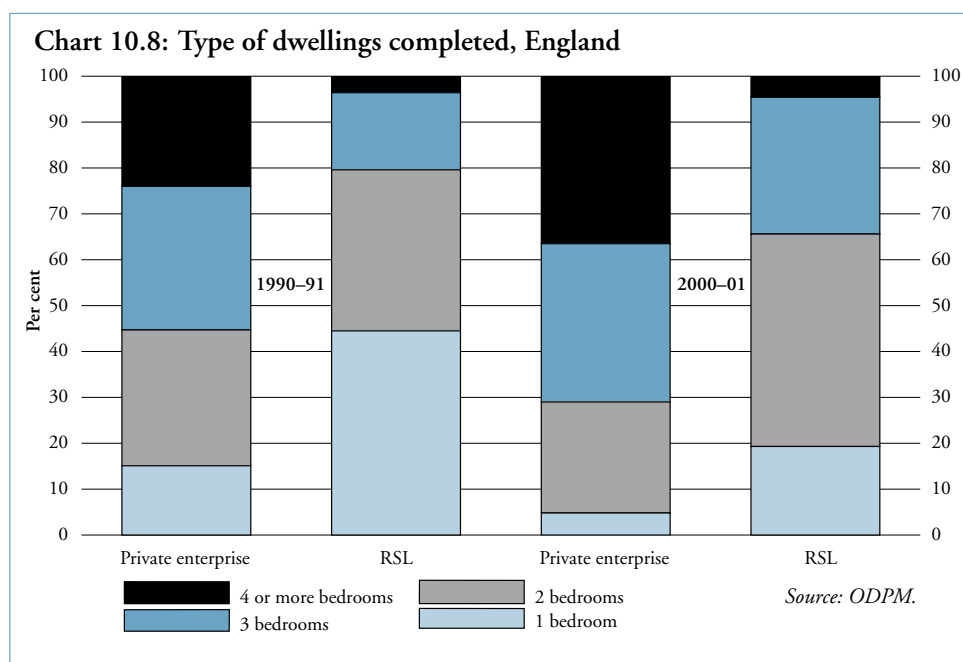
10.26 Land availability can be a serious problem affecting all developers, including RSLs. The rising cost of land is effectively increasing the subsidy bill for Government and resulting in fewer units for increasing levels of grant. Providing public sector land for affordable housing development is one way to mitigate these effects. English Partnerships (EP) have established a register of public sector land under the Section 24 of Government Accounting, which gives EP and other agencies 40 days to consider ways of maximising the use of public sector land to pursue policy objectives such as housing supply before it is offered for sale to the wider market. However, this is not without cost to government in terms of opportunities forgone. And there is also the danger of assuming that the need for social/intermediate housing will match where public sector land is available. Demand will still be dictated by market forces, of which geographical location is likely to be a large component.

10.27 The larger RSLs are increasingly landbanking – although not to the extent private housebuilders do. The introduction of the Housing Corporation's longer term funding approach should help RSLs plan their development programmes better and allow them to increase their landbanks. The Housing Corporation are keen to support developments that are deliverable and land banking helps mitigate the risk of developments falling through as land is already controlled by the RSL.

### PRIVATE SECTOR INVOLVEMENT

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10.28 The private market demands a very different type of house from those constructed by RSLs, as illustrated in Chart 10.8. In 2001 71 per cent of homes built for the private market had three or more bedrooms, whereas only 34 per cent of homes built for the social sector had three or more bedrooms. The types of units delivered in 1991 also reflect a predominance for three or more beds in the private market and one and two beds for the social sector, although the amount of private three bed dwellings being built has risen from 55 per cent in 1991 to 71 per cent in 2001. This suggests that rather than producing more, smaller homes to respond to demand and to fill any gap left by reduced social build, the private sector is tending to build even larger units in terms of number of bedrooms. Private house builders are therefore catering less and less for first time buyers.



### Why is the private sector focusing on the top end of the market?

**10.29** There are a number of possible reasons to believe that housebuilders will have an incentive to focus on more expensive output, particularly in a housing market upswing:

- during housing market upswings, capital appreciation means that the increase in wealth of existing home-owners is much greater than those of non-owners/first-time buyers. This “wealth effect” means that there will be a relatively greater increase in demand for larger properties than for smaller starter homes for first time buyers. By contrast, in an economic downturn, the wealth effect will work in the other direction with the greatest decrease in demand relating to owners of existing properties;
- housebuilders have argued that if development costs are high (e.g. because land supply is constrained and expensive), the tendency for the industry to build only for the top end of the market will be increased to ensure profits are maximised. The key point to note here is that, despite a strong market for housing, the quantity of new land being brought forward for housing has declined dramatically in recent years which means that, if the above is true, more expensive homes are more likely to be built; and
- some house builders have argued that requirements under Section 106 for them to build more affordable units for RSLs give them an incentive to build more expensive market units. It reduces the number of market units they are allowed to construct and then sell for market prices and it may reduce the saleability of market units (e.g. some developers have criticised the “pepper potting” of social units as some potential purchasers may fear social tenants will be bad neighbours, which may drive down prices). The builders claim that they increase the size of the market units on the site in order to generate greater revenues to cross subsidise social units.

### Should the private sector play a bigger role?

10.30 In the future the Government intends that private housebuilders will be able to bid for Exchequer funds to develop affordable housing on a similar basis to RSLs and thus play a greater role in the provision of subsidised accommodation. Several private investors and developers have already shown interest in developing affordable housing, albeit generally intermediate housing. First Base, Newco, North Country Homes and Assettrust have all developed models that aim to produce affordable housing more cheaply than current delivery routes, using private finance, although most require subsidy from low-cost land to achieve this, like RSLs. At the same time some large developing RSLs have a market arm of their group which trades for profit. The profits can then be reinvested in social housing.

### Cross subsidy

10.31 Expanding into market price development can enable RSLs to provide sub-market housing which does not require public subsidy. Sub-market housing can be developed in mixed tenure schemes, in effect a reverse Section 106, where the RSL may build market homes for sale to subsidise the building of affordable homes.

#### **Box 10.1: An example of cross-subsidisation**

Emblem, an arm of the Places for People Group, which focuses on providing homes for outright sale, is working on a £22 million project to develop a disused school into homes for sale at a site at Angel in Islington, North London. The 51 homes provided by Emblem will cross subsidise 21 homes for affordable rent for two RSLs within the Group. One central feature of this project is that any differentiation between the homes for sale and rent will no longer be evident.

10.32 There can be advantages from RSLs taking the lead on the development of sites, especially if the RSL can provide all tenures. It ensures that full consideration is given to the balance, mix and location of the homes of different tenures. In addition building at market rate also puts RSLs in touch with the market. Data on the number of dwellings delivered in this way are not collected, but one estimate is that 4,000 units per year are delivered without public subsidy<sup>16</sup>.

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<sup>16</sup> Shelter submission to Barker Review Consultation (2003).