

Barker Review of Housing Supply
Response by the Council of Mortgage Lenders
to HM Treasury and Office of the Deputy Prime Minister's Review Team

31 July 2003

Introduction

1. The Council of Mortgage Lenders (CML) welcomes this opportunity to respond to the Barker Review. Without doubt, inadequate housing supply remains one of the most critically **unresolved** issues in UK housing policy with considerable consequences for households, lenders and indeed the UK as a whole. It places limits on competitiveness and restricts flexibility and mobility. As the Government's recent report on influencing the size, type and affordability of housing notes (ODPM, 2003b, Annex C, paragraphs 6 and 7) -

"The risk to overall economic performance is because higher house prices may drive up wage costs and have knock-on effects on non-residential property costs (eg, office rents). Regional house price differences may impair the efficiency of the labour market at matching workers to jobs. Together these effects will tend to reduce the competitiveness of UK businesses relative to countries (such as France, Italy and the US) in which there has been no upward trend in real house prices.

In the overall Euro assessment, the Treasury highlight the UK's housing market as a key structural difference with the Euro area. The corollary is that creating a more flexible and stable housing market is one of the Treasury's main priorities for the Euro policy agenda."

2. And supply lies at the heart of this. Even with adjustments to the types of mortgage products borrowers choose, without substantial and continuing increases in supply we will still have an inflexible and unresponsive housing market and one which is exposed to even modest changes in demand.

3. The Council of Mortgage Lenders is the representative trade body for the residential mortgage lending industry in the UK. Its 144 members currently hold over 98% of the assets of the UK mortgage market. CML members lend for owner-occupation, to the private rented sector and for new-build, repair and improvement to social housing.

Executive Summary

4. Inadequate housing supply remains one of the most critically unresolved issues in UK housing policy with considerable consequences for households, lenders and the UK as a whole. Lenders cannot directly influence housing supply but are impacted by it. Even if adjustments are made to the types of mortgages available, without a substantial increase in supply the housing market will remain inflexible and unresponsive and subject to more intensive price instability.

5. The key points in our submission are:

- The Review is tackling an issue of great importance. Long lasting poor housing supply has had major consequences and must be resolved.
- The supply position varies greatly across the UK at national, regional and local level. Evidence suggests that both Northern Ireland and Scotland are better placed in terms of the balance between supply and demand than Wales or England.
- Lenders provide development finance for some housebuilders and housing associations and provide retail mortgages for the buyers of new homes. There is no evidence that there are constraints on finance in any of these areas.
- Meetings with the House Builders Federation and individual housebuilders have identified no new initiatives that lenders could take to help improve the supply process.
- An increase in supply will make a substantial contribution to evening out house price booms in the long term.
- Land supply is not an area of direct and immediate concern for lenders. However, brownfield land requires expensive remediation treatment and lenders will want to be reassured that it has been properly treated before offering mortgages to potential borrowers. More intensive use of greenbelt land and increased densities as required by PPG3, unless designed with great care, will result in a loss of amenity and adversely impact on price, value and longer term demand.
- Lenders are seeking major improvements in the operation of the Government's low cost home-ownership programme in its response to the Home Ownership Task Force. Without these improvements an increase in shared ownership mortgages cannot be guaranteed.
- Expansion of the use of off-site manufacturing techniques may help solve the supply problem. However, lenders need to be reassured that issues around lifespan, insurance, whole life costs and long term demand are addressed to ensure that the mistakes of the past are not repeated and that mortgages are available for new types of construction.
- Dealing with environmental factors such as brownfield land and flooding may impact on the cost to developers of building on particular sites. The Government may have to help towards the cost if the policy framework requires development of these sites.
- The key issue for policy and planning is to ensure that the right houses are built in the right places at the right time. Regional assessments of housing need and demand must be linked to housing strategies.
- Over-restrictive planning obligations on the provision of affordable housing will impact on the availability of mortgages.
- The slab structure of stamp duty distorts the housing market and impacts on the pricing of new houses. This needs to be reviewed.
- Supply in the social housing sector has not been supported by the Government and has been curtailed by the success of the RTB scheme.

- The growth of the private rented sector (PRS) has been supported by the growth of the buy to let market which has proved attractive to private investors. Further supply in the PRS could be stimulated by encouragement of private landlords through an overhaul of the tax regime and ensuring that licensing of the PRS is sympathetic to private landlords.

Background

6. We note the Review covers the UK. It is evident from the CML National Markets Review 2002/03 (CML, 2002) that the supply position varies greatly across the UK at national level, let alone at regional or local level. The evidence suggests that both Northern Ireland and Scotland are much better placed in terms of the balance between supply and demand, reflecting both a more active supply side and less pronounced demand side increases. The position in Wales is less favourable. Recent CML research suggests that new supply roughly matches demand but it does not deal with a backlog of unmet demand nor with the need to replace an old and worn out housing stock (CML, 2003a). The situation in England is the least positive with serious supply side shortages in key regions, eg, London and the South East. Throughout the UK there is anecdotal evidence of supply side shortages in the most pressured markets.

7. This response has been prepared by the Secretariat in consultation with members. The response is structured according to the issues set out in the note on the scope of the review supplied by the Barker Review team on 9 June 2003. The response is selective in terms of the questions raised. This reflects the specific points of interaction between mortgage lending and housebuilding and supply.

The Current Position

8. As Charts 1, 3, 5, 7 and 9 show (see Annex), new homes currently make up about 10% of transactions. Charts 2, 4, 6, 8 and 10 (see Annex) demonstrate how, despite continuing house price rises, supply has been mainly static or falling across England and the UK. The picture in Northern Ireland, Scotland and Wales is slightly better. Again this position has not changed a great deal in recent years. What this suggests is that there would have to be a significant increase in housing supply to really make a difference in the short to medium term in terms of both transactions and crucially the overall stability of house prices. It is clear that over the short term house prices are set by the interaction of demand and supply around **all** existing homes. Over the longer term new houses influence demand (by introducing better homes), supply and price.

9. The consequences of weak supply are considerable. They include-

- A very low replacement rate so homes have to last at least 1,000 years.
- One consequence is that, despite home improvements, the older terraced housing stock lags behind the needs of modern society, constraining both consumption and production.
- Poorer housing means lower educational achievement, higher health costs, more accidents, crime and social tension. Inadequate noise insulation, lighting, heating, room space, fire safety, access to technology have a range of negative consequences, all of which have a price in terms of public expenditure.
- Growing disrepair in parts of the owner-occupied sector and the clear shortfall in home improvement grant expenditure point to the strains imposed by seeking to sustain an older housing stock. The recent English House Condition Survey (ODPM, 2003c) estimates a

total cost of £50 billion to bring private sector housing up to 'decent' standard in England alone. Similarly the very substantial repair and improvement bills in the UK's social rented sector (in excess of £25 billion) point to the fact many of these homes were built with a 60-year life which now has been exceeded.

- Substantial house price pressures in a range of local and regional markets where demand outstrips supply. The consequences of this for labour supply and retention, wage pressures and competitiveness are well known. The Government has already identified the problems this creates for key workers in the public services and for their programme of reform and improvement in that sector. The same of course applies to the private sector where international competitive constraints may constrain wage settlements in not dissimilar ways to those of expenditure constraints in the public sector.

Housing Supply: the Lender Contribution

10. Mortgage lenders have a direct involvement in the housing supply process in a number of ways. Most obviously, they provide development finance for some housebuilders and they fund the retail mortgages borrowers take out to buy the new homes. However, they also part fund housing association development programmes (the remainder comes from grant). To date, there is no evidence of any finance supply blockages that are impeding either the construction or sale of new homes. There may be issues around homes built using 'modern methods' of construction and this is developed later in this response.

11. Less obviously but very important in terms of the demand for new homes, the CML recently launched its New Homes Warranty scheme. This applies in England and Wales (its applicability in Scotland and Northern Ireland is under consideration). It was designed to ensure new homes were fully habitable and properly completed. In effect, the lending industry has agreed it will not release mortgages on new homes until those homes have a full and certifiable warranty in place. This has forced **all** housebuilders to comply and it is generally recognised to have been of huge benefit to both the image and reality of the housebuilding industry and, of course, to the purchasers themselves.

12. The CML has met with both the House Builders Federation and individual housebuilding companies to discuss what other steps the mortgage lending industry might make to help improve the supply process. To date we have not identified any new initiatives to take. In 2000, the CML commissioned research on the housebuilding industry, the ways it was changing and implications for lenders (CML, 2000). The report highlighted many of the concerns now the subject of this review. It stressed the need for demonstrable improvements in the quality of new homes (addressed via the CML initiative), the benefits of continued improvements in the house buying and selling process and flagged up potential lender concerns re contaminated brownfield sites. We look to the Review to help identify any further contributions lenders might make.

13. We already know that there is a very low supply side response to increases in house prices. Part of the Review's task is to unravel why that is the case and to put forward recommendations. Equally, it is very hard to establish what impact a specified increase in supply might have on house price trends. Over the long term, we would envisage a significant step increase in supply resulting in less dramatic house price booms over a cycle because it would bring supply and demand into a better and more sustainable balance. In that respect, an increase in supply addresses a serious structural weakness. This dampening effect will build up over time but we should recognise that both in the short term and at any moment

in time in the future there will still be price surges reflecting a range of other factors other than supply itself (ie, a substantial interest rate cut or a new tax relief might stimulate demand much more quickly than supply could ever respond). As this suggests, an increase in supply will not solve all housing problems but it will make a very substantial contribution and is the single most important factor to be addressed.

Land Constraints

14. Land supply is not an area of direct and immediate concern for lenders. However, we are aware of a number of lender related problems that do need consideration. These are -

(a) Brownfield land requires expensive remediation treatment and lenders need re-assurance that it has been properly treated before offering mortgages to potential borrowers.

(b) Greenbelt development where it is permitted has its own problems. More intensive use of greenbelt land and increased densities as required by PPG3, unless designed with great care, will result in a loss of amenity and adversely impact on price and value. The nature of greenbelt areas can be destroyed by insensitive development and lose the aspects that make it attractive.

(c) where small pockets of land are released which can be uneconomic to develop, particularly where there are also constraints on developers to provide affordable housing under section 106 agreements. This is discussed in paragraphs 34 and 35.

15. From our conversations with house builders there are complex interactions between issues of land supply and planning which impact on supply. Builders maintain landbanks to ensure that they can plan their building for 2 or 3 years at a time. It is often not land supply that is the problem but the time it takes to achieve planning permission as a consequence of local political wrangling.

Industry Constraints

(a) Access to finance

16. Lenders are involved in development finance but we understand that there are no particular problems in accessing it. Likewise, with a very competitive mortgage market, we are aware of no constraint on the supply of mortgages that inhibits new supply. Commercial lending has been buoyant and CML has not received reports of blockages or restrictions with regard to the provision of loan finance for building for the private housing market.

17. Given the constraints imposed by price and affordability the industry has been active in exploring what might be done to further assist purchasers (and in this case new home purchase) via the development of mortgage products. The mortgage industry has been an active participant in the ODPM's Home Ownership Task Force. The industry has asked for major improvements in the operation of the Government's low cost home ownership programme. Currently many lenders do not offer mortgages on shared ownership, in particular, because of the way the programme has been operated by registered social landlords (RSLs).

18. Lenders are far more supportive of the Homebuy shared equity programme and this is also favoured by consumers. Indeed one lender has now launched its own shared equity mortgage product. It remains to be seen what the market demand for this might be but the industry is certainly willing to explore further developments around shared equity.

19. Lenders have also been supportive of the Starter Home and Key Worker programmes albeit with concerns that these run the risk of stimulating demand and house prices without increasing supply. Lenders will be keen to support new initiatives around affordable housing provided by builders and developers subject to the proviso that it is of good quality and will have sustainable long term demand.

20. The position with regard to finance for social housing (where CML has more data) is also satisfactory. As a report commissioned from Ernst and Young by ODPM indicated in 2002 (ODPM, 2002) in the context of Large Scale Voluntary Stock Transfer (LSVT) "Loan facilities are generally competitively priced". Anecdotal feedback from lenders and RSLs alike suggests that the latter have no difficulty in accessing loan finance for viable development projects. According to the *Private Finance Monitoring Bulletin* (Housing Corporation, 2003), 17 lenders had each committed over £100 million to the sector at March 2002; another indication of a competitive market.

21. It should be noted that in the social housing sector there has been a gradual increase in the involvement of the capital markets as funders. It is estimated that around 15% of funding has been obtained via capital market issues. While the nature of the sector tends to militate against the use of bond issues in many cases, they have provided a useful additional competitive element. Most social housing new-build remains primarily driven by the availability of grant rather than by the ability to access private finance however, though this may change to some extent in the future.

(b) Skill shortages

22. As the ODPM action plan *Sustainable Communities: Building for the Future* (ODPM, 2003b) points out, there are shortages of key on-site construction skills. Such shortages have occurred before, notably in the post First and Second World War periods. Fears have been voiced that the latest skills shortage may be more deep seated however, with the attractions of manual building site work becoming ever less easy to sell to potential trainees. At the same time it is clear that the operation of the benefits regime does little to help the situation. Trainees cannot work more than 15 hours per week and still get benefits. This needs to be rectified unless the Government wishes industry to bear the full cost of training. Given the step change which is needed with respect to supply, consideration does have to be given as to how the manpower can be put in place to achieve this.

23. The Government response to skill shortages has been to place increased emphasis on the use of off-site construction methods. The aim is to offer an approach to construction that will boost the volume of supply and create a more consistent product away from the building site. At present, costs of off-site construction are significantly higher than for so-called traditional construction. It is claimed by industry representatives that costs will come down to competitive levels as production volumes increase. This claim is so far unproven and the record of previous generations of off-site construction leaves some room for doubt. The large-scale initiatives in offsite methods immediately following the two World Wars were both eventually choked off because costs were or became significantly higher than for traditional construction, in spite of volume production.

(c) Alternative manufacturing methods

24. Lenders are not wedded to any particular construction methodology, but recognise that off-site construction has a part to play if pursued in the right way. Most non traditional building has taken place in the social housing sector but retail lenders have also had to take a view, as these properties have "leaked" into the private housing market in significant numbers via the Right to Buy. Off-site construction therefore raises issues for both retail lenders and lenders for social housing. For any lender, the key issue is whether, taking the advice of a valuer, a property or properties can function as adequate security for a loan. This involves attention to four key areas:

- Lifespan
- Insurance
- Whole Life Costs (repair improvement and modification costs)
- Long term demand

25. Retail lenders' experience of previous generations of non-traditional properties has not always been positive. Problems have arisen in terms of both lifespan and repair/remediation costs. These were sufficiently serious to result in the passage of the Housing Defects Act 1984, setting up the PRC accredited repair scheme, to remediate defective properties to a mortgageable standard. Sadly the scheme has now been closed leaving many defective properties still unremediated. There are other properties that were not declared defective but are still considered to be unmortgageable. Some non-traditional housing has also proved unpopular with tenants and owners. These problems have led some lenders to take a cautious approach to securing loans on the new generation of non-traditional properties (see CML/BRE 2002 for a brief review of the issues).

26. There are two aspects to insurance of non-traditional housing. Lenders require any new or recently-built property to have a warranty such as those provided by the NHBC or Zurich Municipal. It is very important that any new types of construction have the approval of these bodies so that individual properties are covered by them. Without this lenders are unlikely to offer mortgages. We understand that warranties are being issued on the new types of property being built. However, warranties only cover certain aspects and only last for the first 10 years therefore lenders also require standard buildings insurance cover covering against perils such as windstorm, fire, flood and subsidence. Off-site manufactured properties therefore need to be able to be insured at standard premiums and excesses.

27. Lenders to the social housing sector, where the new wave of non-traditional construction will, in the main be focussed, have funded such projects in the past. As the proportion of such properties in the total stock of RSLs grows, however, lenders will become more concerned with the potential risks. In particular they will wish to be reassured about:

- Whole life costs and the RSL's ability to manage these, and
- Future demand for the properties over the term of a loan for up to thirty years.

28. It is the view of CML and its members that increased use of off-site construction can make a valuable contribution to increasing supply if the Government and the Housing Corporation move to anticipate and alleviate potential future problems by -

- Ensuring that there is again a recognised repair scheme for existing non traditional properties, with the scope to deal with future problems that may arise with this new generation of properties.
- Promoting discussions within the OFSM construction industry about the provision of **long-term** warranties on OFSM properties. The Government may ultimately need to provide underwriting for such warranties if the industry cannot produce them unaided.
- Working with RSLs to promote and require the reliable assessment of Whole Life Costs with regard to planned OFSM developments.
- Promoting meaningful discussion and ongoing links between manufacturers, insurers, valuers and lenders to ensure that potential problems are identified early.

29. The CML would urge the Review to address these issues and ensure that long-term concerns are dealt with alongside shorter term problems. A sensible way forward would be to bring all the parties mentioned above together to agree best practice, relevant protocols and any other instruments needed to ensure there is a ready supply of mortgages for such homes over the long term.

30. Clearly there are issues for manufacturers, notably in the modular field, in terms of the need to tie up working capital in plant while production volumes are low. Volumes are low in part not only because of land supply constraints but also because costs are relatively high - a vicious circle. Attention to the issues set out above would clearly be helpful in increasing the confidence of potential customers and lenders, but may not be sufficient to boost production to economic levels without some additional assistance from Government or elsewhere in the form of a subsidy on capital or price. This is of course an issue of policy and resources for Government.

(d) Brownfield land

31. As noted earlier, brownfield land requires expensive remediation to make it suitable for residential housing. Unless Government subsidy is available to help with these costs it could make brownfield sites unattractive for development. It is also important to consider the potential impact of developing on floodplains. A great deal of work has been done by the Environment Agency and others in the last few years to understand the extent and nature of floodplains. Predictions of climate change suggest that flooding from both rivers and the sea will become more frequent and more serious. Following the significant flooding of autumn 2000, issues of ongoing insuring in floodplains have been highlighted. Insurance companies are taking a stricter line on insuring properties in floodplains and have said that, if new development is carried out without proper flood defences, insurance is likely to be unavailable. As insurance is a standard condition of getting a mortgage, without insurance mortgages will be unavailable. It will therefore be an additional cost to developers to ensure that properties are properly defended against flooding, particularly as the Government has proposed that developers should be responsible for the flood defences of any developments in the floodplain. This will impact upon the viability of some schemes and the Government may have to consider helping towards the cost if the policy framework requires development on these sites.

Policy Environment

32. The key issue for planning and policy is to ensure that the right houses are built in the right places at the right time. This means linking assessments of housing need and demand

both regionally and locally with housing strategies regionally and locally. Clearly, at present there is an aggregate imbalance with oversupply in the Midlands and North and undersupply in the South. Supply not only needs to be linked to the numbers of houses in particular places but also housing type. There are more single person households now than in the past and this is a trend that is likely to continue. Therefore more smaller properties are likely to be needed, albeit it should always be assumed that most single person households will require at least two bedrooms and that as a generality household demand for space will rise over time.

33. Although welcoming the Government's plans to substantially increase housing supply in London and the South East it has to be recognised that the London market has many drivers only some of which are based around supply. London is a global city and faces demand pressures derived from that. The mortgage industry welcomes recent announcements regarding the creation of sustainable communities in the Thames Gateway. It is essential that these new communities have a full range of facilities and amenities at the outset and that they have a diversity of residents across a range of income, occupation and age groups. Previous experience of 'expansion' suburbs is that a mix of residents is essential to ensure that the local housing market is not so fully exposed when a recession takes place. Moreover in taking forward these developments and moving forward with higher densities the Government must consider and respond to issues of long term demand.

(a) PPG3 and Section 106

34. The emphasis in PPG3 on brownfield development can increase pressure on sites in towns and make affordable housing provision more difficult. Whilst the emphasis on affordable housing is based around towns and cities' affordability can be a real issue in rural communities where brownfield land is simply not available. Stopping greenfield development in these areas may not stop the imbalance between supply and demand. The brownfield targets set at present in PPG3 do not always recognise the different regional availability of brownfield sites. Some regions have a good supply of brownfield land whilst others do not, making it difficult for them to fulfil their targets.

35. We are also concerned that some planning obligations are over-restrictive in terms of provision of affordable housing and that this does impact upon mortgage availability. For example, Annex B to PPG3 on Providing for Rural Exception Housing says that "the inclusion of clauses in planning obligations which would enable lenders of private finance to dispose of the property on the open market as a last resort if a borrower were to get into financial difficulties, are unacceptable in respect of housing schemes on exception sites". This is unnecessarily restrictive. In general, our view is that restrictive covenants should be used with care and preferably only where there is likely to be a strong and continuing market. If covenants are overly restrictive, the lender will be in a difficult position should they find themselves in possession and having to try to sell the property to recoup their money. If the property cannot ultimately be sold on the open market, they may be reluctant to lend, even on a shared ownership basis. There is potential for this problem to be addressed in any amendments to PPG3 that might flow from the consultation paper recently issued by the Government though, on the face of it, ODPM remains remarkably lender blind on this issue. Unless this issue is resolved satisfactorily it is likely there will be an ever diminishing supply of mortgage finance to this part of the market.

(b) Taxation

36. On the issue of taxation, the CML has long argued for a reduction in VAT on home improvements to 5%. The cost of VAT is rarely recovered through increases in value, and it acts as a disincentive to undertake necessary works that have wide individual and community benefits. By allowing a reduction in the VAT rate on home improvements, the Government would assist and encourage improvement in homes currently occupied. In addition, a reduction in the VAT rate would incentivise investment in bringing those properties that are not currently fit for habitation up to an acceptable standard. This would increase the degree to which the current housing stock is efficiently used, taking some of the burden away from new build as a solution to supply problems in the UK.

37. We would also argue that the current system of tax applied to residential property in the UK is not conducive to policy delivery. Currently we have council tax (broadly regressive favouring those who buy larger homes), stamp duty (broadly progressive favouring the purchase of smaller homes), inheritance tax (broadly progressive though with substantial loopholes such as equity release) and an exemption on capital gains tax for owner occupied property. While the issue of residential property taxation does not, in the main, influence house building it does influence the efficiency of the housing market. HMT views housing market taxation as a source of revenue and has failed to recognise that its own policies are part of the problem.

38. Recently the CML issued a research report, *Residential Stamp Duty: Time for a Change* (CML, 2003b). This report showed the current stamp duty regime distorts the market and is regressive, adding significantly to the burdens of first-time buyers. Given the slab structure of the tax and the fact that it is always levied at the highest marginal rate, there is considerable clustering just under each threshold above which a new higher rate applies. This must impact upon housebuilders in terms of the costing and pricing of new output and, given the Government has failed to uprate the stamp duty thresholds (including the basic exemption) in line with house price inflation, it will be impacting upon most if not all new housing. The Review needs to reflect upon the ways residential property taxation impacts upon the housing market taking account of the evidence the CML has put forward.

House buying and selling reform

39. In its draft Housing Bill the Government has set out its intention to push forward with its plans to reform the house buying and selling process. The mortgage lending industry has been seeking to work with the Government to ensure that any reforms introduced do not disrupt the market and cause shortages of homes for sale. It would be fair to suggest that, to date, because there has been insufficient progress on a number of key issues of concern to lenders, valuers and estate agents, there remains a significant risk that the market will be disrupted. The Review team need to be aware of this potential problem.

Social Housing and the Rental Sector

(a) The private housing market and the social housing sector

40. It is true that the social housing sector has declined across the UK to around 21% of all households (Wilcox, 2002). This figure masks significant regional variations. This decline reflects low levels of new build and the loss of stock to the private sector, mainly via Right to Buy. In these circumstances, it is legitimate to ask why private housing supply has

not increased to fill an apparent demand for affordable housing that is no longer being satisfied by the social housing sector?

41. To a significant degree the private housing market has absorbed that demand via the Right to Buy. Across the UK as a whole, over 2 million homes have been transferred under RTB and this accounts for the majority of the decline in the social housing sector. This is not the whole story however. Tenants and potential tenants would still seem to embody a potential demand that the private sector might satisfy. While there is clearly some unsatisfied demand from those in or attempting to enter the sector, important additional factors that need to be taken into account in assessing its size are the social and financial circumstances of social housing tenants. It has been estimated that around 70% of rental income within the social housing sector derives from Housing Benefit. This reflects the lack of employment and low incomes prevailing amongst the large majority of social housing tenants. These tenants represent a large body of housing need, but they are unable to manifest this as effective demand within the housing market. Even were there no supply problem within the private housing market, there would still be a significant number of tenants who would be unable to access that market due to their individual circumstances.

42. Even allowing for the impact of RTB and the personal circumstances of many social housing tenants, there is still a level of potential demand for owner-occupation from some social housing tenants, who, for one reason or another, do not access home-ownership via RTB. This is evidenced by large numbers of unsuccessful applications for RSL low cost home-ownership schemes such as shared ownership and Homebuy. The existence of this demand has recently been noted by the Home Ownership Task Force already referred to. It is not clear, however, that failure to secure affordable private housing for this group reflects anything other than the overall problem of the low elasticity of housing supply under review.

(b) The Private Rented Sector

43. The UK has a smaller private rented sector than many other countries not because of the size of the owner-occupied sector so much as the development of the social rented sector after the Second World War. However, it is now recognised that the development of large scale social housing estates can be problematic. This in turn is leading to a reduced level of investment from central government into social housing where supply has been curtailed by the success of RTB schemes.

44. In recent years, this, combined with current affordability constraints on access to owner-occupation, has resulted in an increasing demand for private rental. This has also been boosted by a wider range of social and demographic factors (single-person household formation, increase in student population, increase in job mobility and mobility in jobs, immigration, changing attitudes to renting/owning amongst young people).

45. However, matching this increase in demand remains the province of the private landlord. In reality the UK's private rented sector has been both growing and shrinking. The growth in supply has been largely directed at matching the demand from the more affluent, typically pre home-ownership market while the long standing poorer end of rental market which has met the needs of households unable/unwilling to get in the social rented sector has been in decline with homes being sold into home ownership or demolished.

46. The growth in the private rental market has partly been through the rise in the Buy to Let market but also through a general increase in commercial activity in this area. There are a number of reasons why this market has been growing:

- With the decline in the value of equities and the linked concerns about pension funds, property investment has been seen as very attractive - property has a more stable track record than most other forms of assets.
- Good capital growth and yield - property has a yield that exceeds most savings and investments. However, given house prices rises there has been substantial capital growth. The added benefit of gearing makes this form of investment particularly attractive to small operators.

47. Although the Buy to Let market is characterised as being made up of individual investors buying single properties, in reality there are a large number of corporate buyers as well who have built up substantial holdings (sometimes these are individual BTL landlords that have incorporated). Notwithstanding, there are clear attractions for individuals. These include; -

- Locality - buying and letting property requires local presence and knowledge. This can be proxied through an agent, but a good proportion of serious investors manage their own property.
- Linked to this, small investors have a high degree of control over the outcome of their property investment which is not the case with other forms of investment. They choose the location, the property, the tenant, when to buy, when to sell etc.

48. Many of these positives for small landlords may be negatives for larger ones - it can be a very local business and does not suit a national business model. The business is very labour intensive and requires business acumen and a wide range of other skills - a small landlord usually discounts the investment of his own time, energy and intellect in the project but a corporate would have to employ managers and staff to do this. Supply restrictions on property of an appropriate quality are also an issue for corporates in a way that they are not for small local landlords.

49. The Review asks "is the private rental sector an unattractive investment option, if so why?" We think the answer here is that it is an attractive option for private individuals but a more marginal one for larger corporate bodies who can secure better returns elsewhere. If the Government wants to further expand supply in the PRS they will need to concentrate on encouraging private landlords and not (as we have seen in the past) a series of well meaning but ultimately wasteful attempts to attract corporates into a sector that from their corporate view point has a number of structural weaknesses. Encouragement for private landlords would include responding sympathetically to landlord concerns over proposed Housing Benefit reform, overhauling the disadvantageous personal taxation regime presently applying to landlords and ensuring that proposed licensing of Houses in Multiple Occupation (HMOs) creates a proper balance between property condition and landlord constraints.

Concluding Remarks

50. Reference has been made to a number of CML research reports and copies have been supplied to the Review team. A further CML research report *Changing Households and Changing Housing Markets* (CML, 2001) that looks at the demographics of housing demand in the UK may also be of relevance as background to the supply requirements going forward.

51. Overall, while lenders recognise the importance of housing supply, especially over the longer term, in bringing and keeping demand and supply in better balance and thus tempering house price increases, the mortgage industry has a limited locus in terms of tackling the problem of inadequate supply. However, we would be happy to further assist the Review team explore the issues that may help to improve housing supply in the future and thus make the housing market less volatile overall.

52. For further information or comment in the first instance please contact Peter Williams at the CML on 020 7440 2217 or email (peter.williams@cml.org.uk).

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Chart 1: UK, Housebuilding, permanent dwellings completed and property transactions, England and Wales

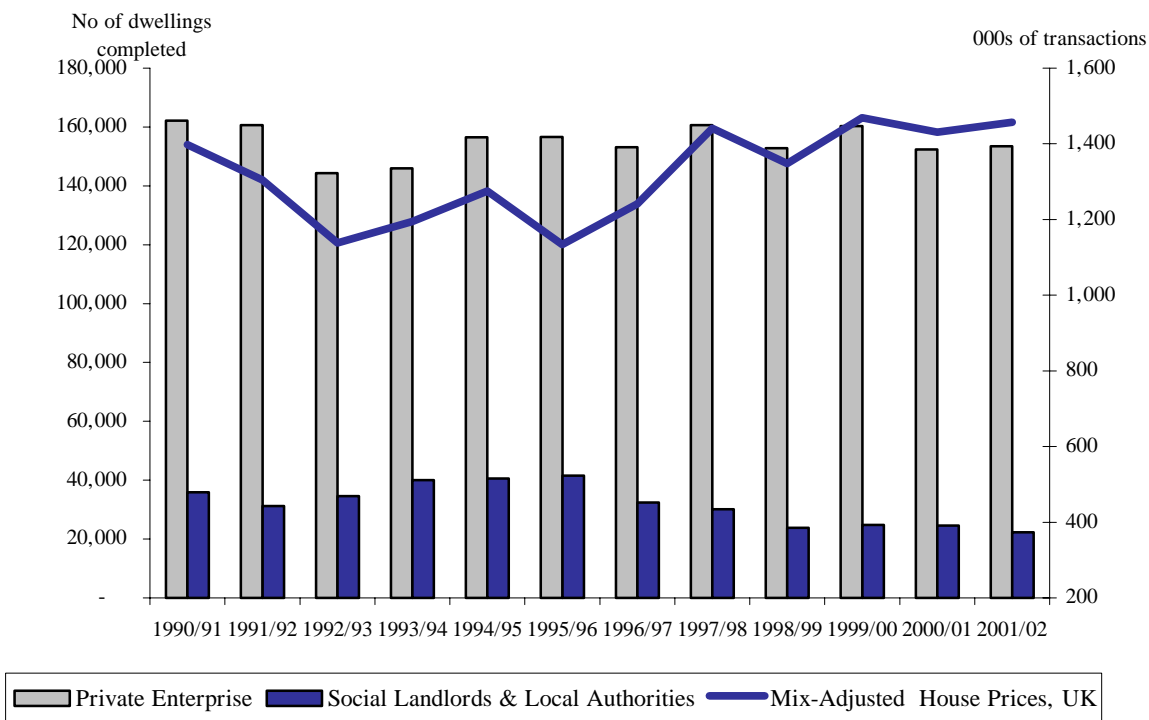


Chart 2: UK, Housebuilding, permanent dwellings completed and average mix-adjusted house prices

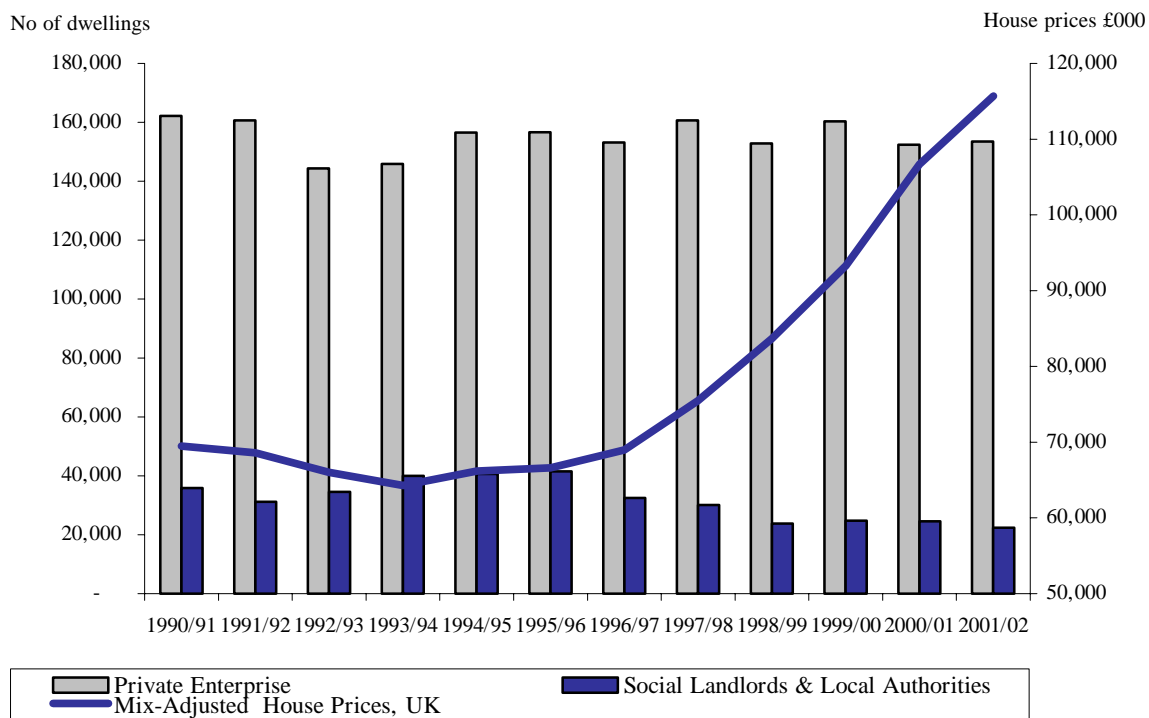


Chart 3: England, Housebuilding, permanent dwellings completed and property transactions, England and Wales

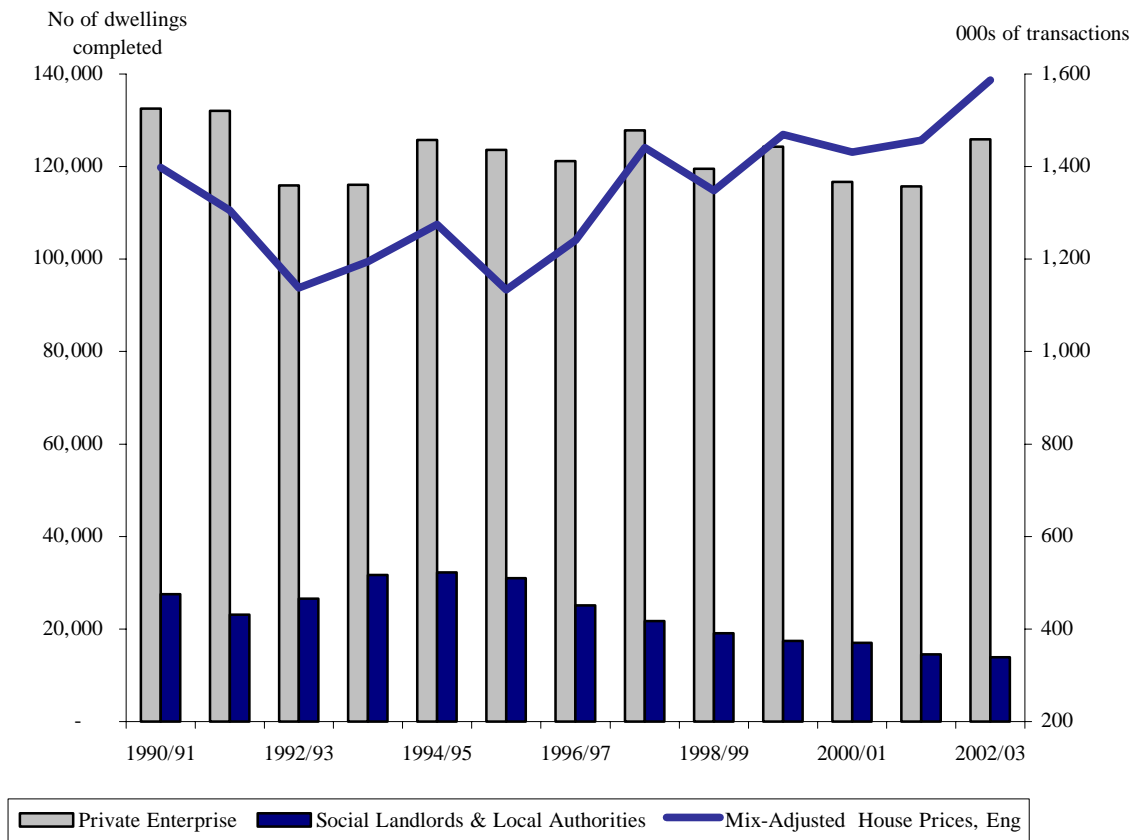


Chart 4: England, Housebuilding, permanent dwellings completed and average mix-adjusted house prices

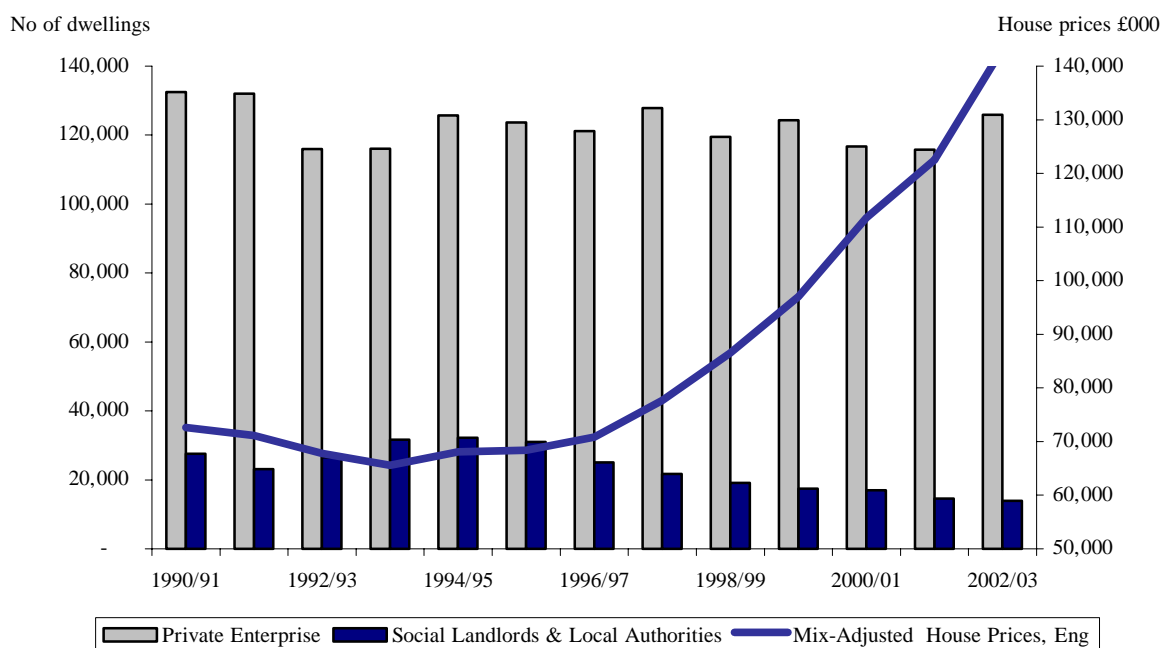


Chart 5: Wales, Housebuilding, permanent dwellings completed and property transactions, England and Wales

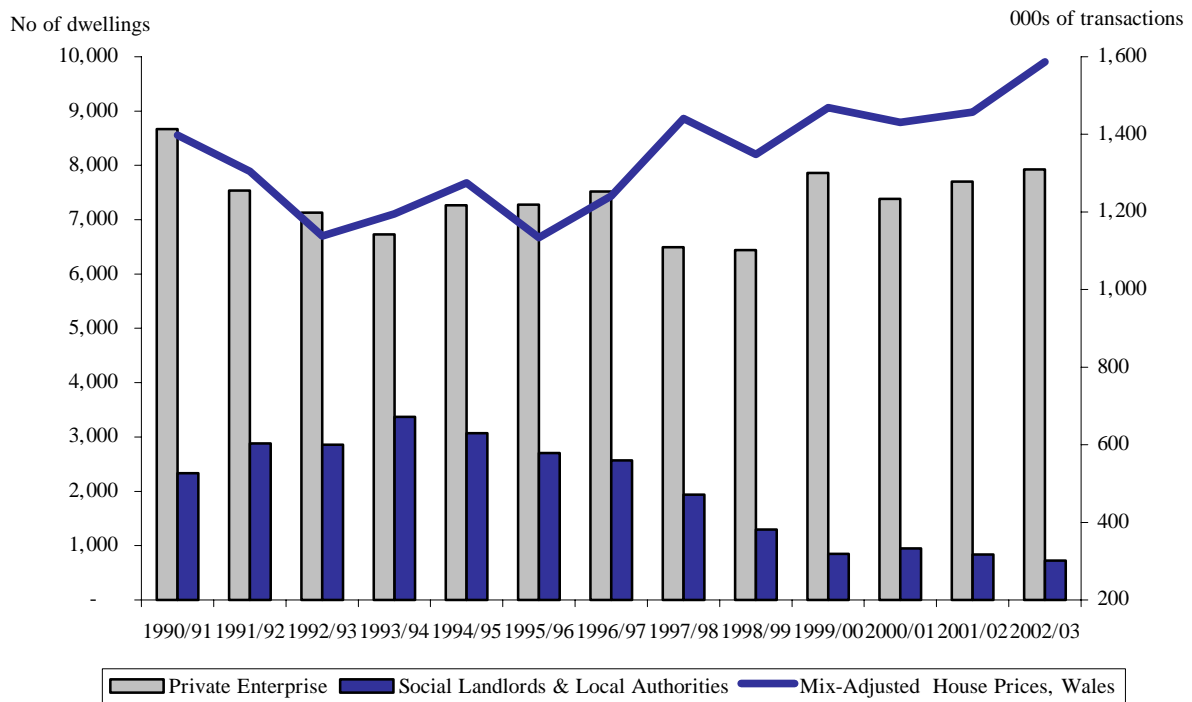


Chart 6: Wales, Housebuilding, permanent dwellings completed and average mix-adjusted house prices

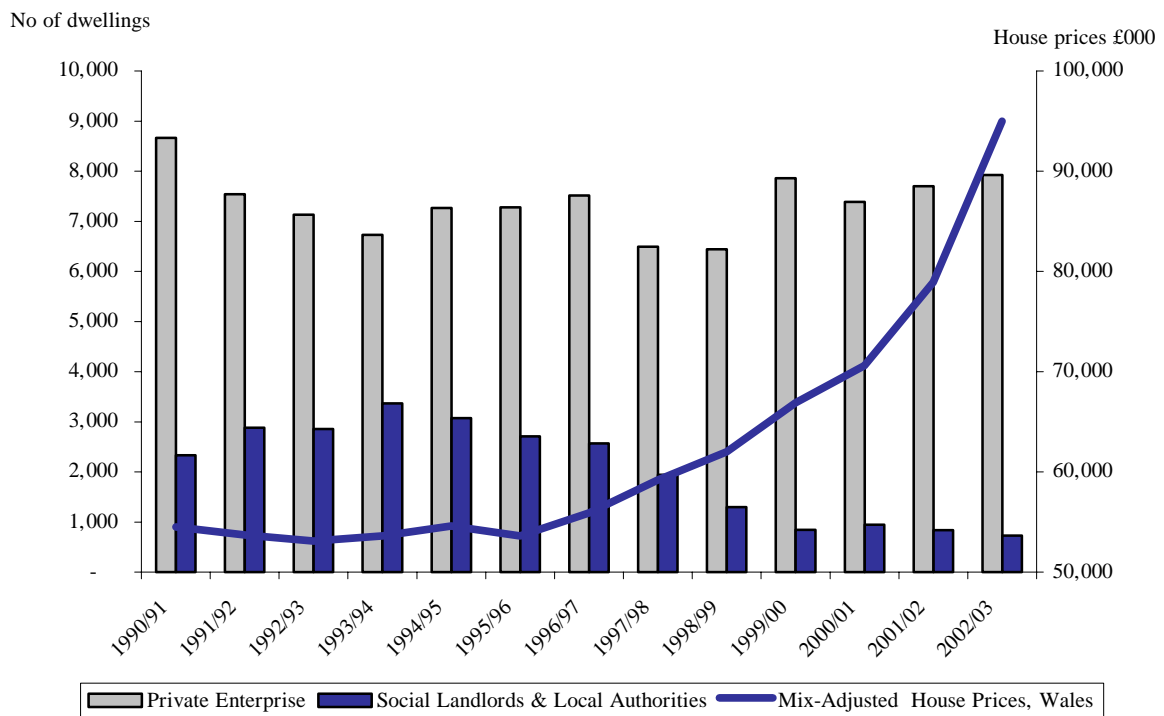


Chart 7: Scotland, Housebuilding, permanent dwellings completed and property transactions, England and Wales

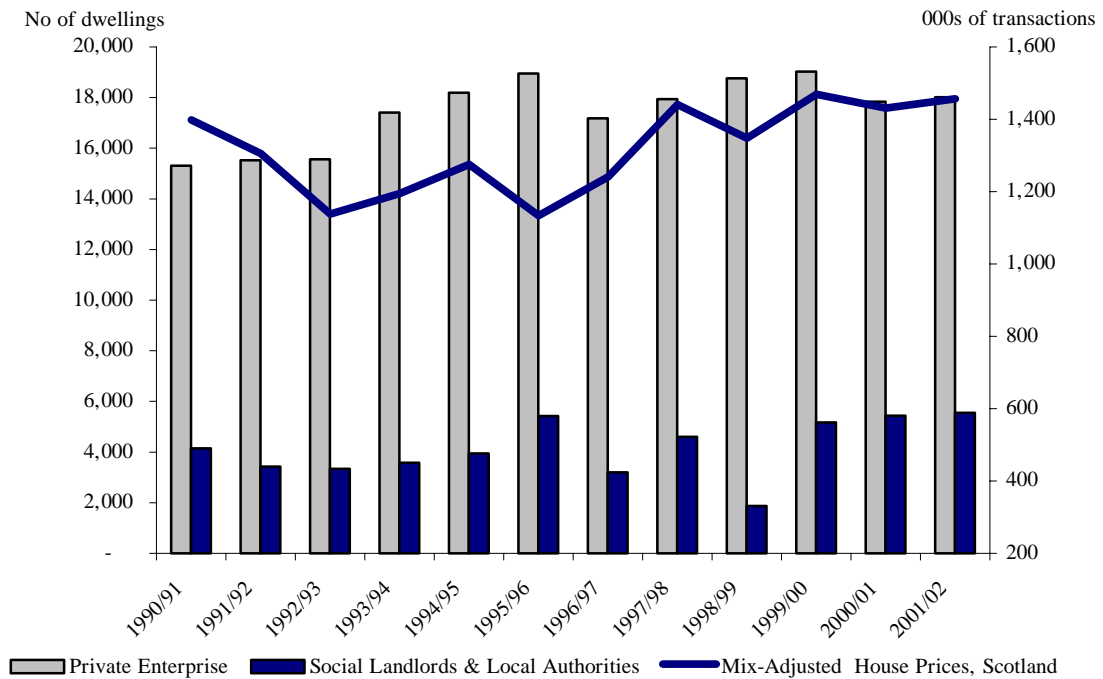


Chart 8: Scotland, Housebuilding, permanent dwellings completed and average mix-adjusted house prices

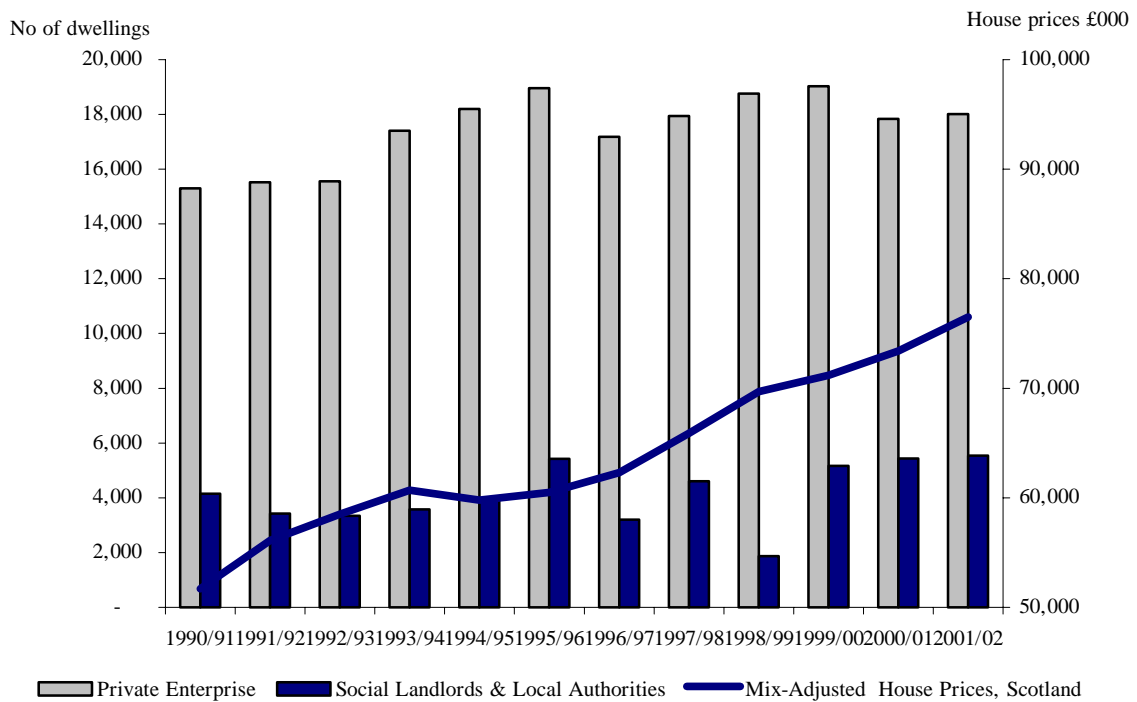


Chart 9: Northern Ireland, Housebuilding, permanent dwellings completed and property transactions, England and Wales

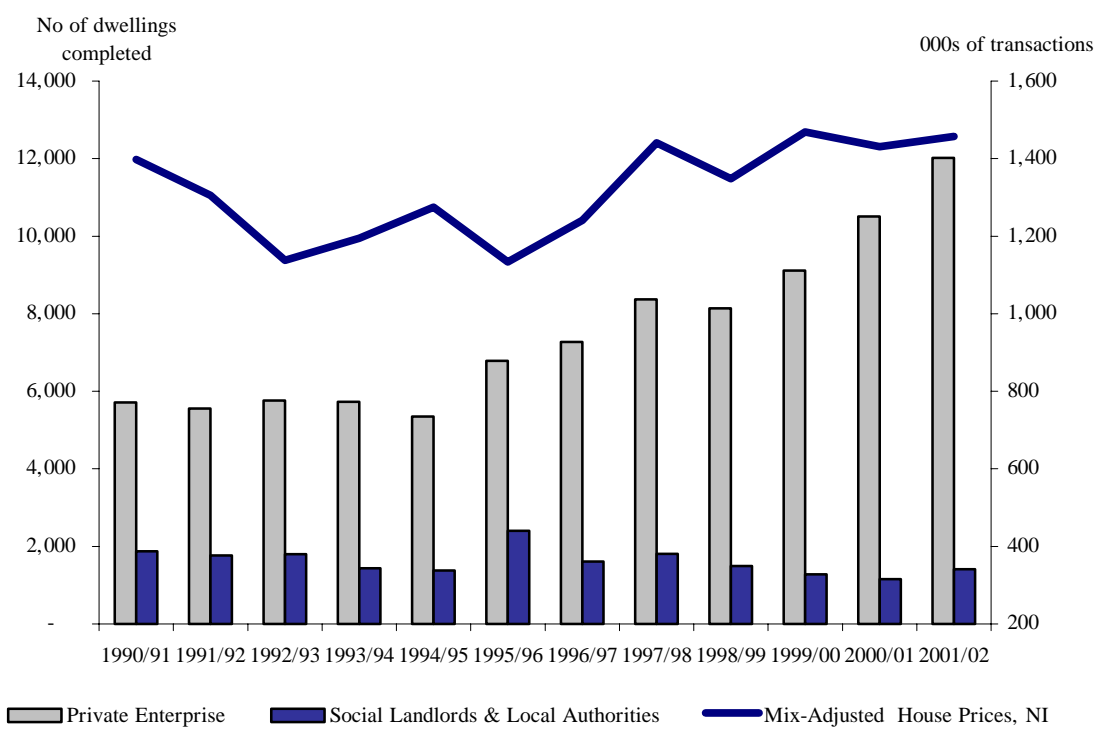


Chart 10: Northern Ireland, Housebuilding, permanent dwellings completed and average mix-adjusted house prices

