Understanding Builder to Builder
Residential Land Transactions
Executive Summary

This research seeks to add to our understanding of housebuilders’ land market behaviours. The study is concerned primarily with decisions made by builders and, in particular, with the factors that shape land acquisition strategies and influence the decision to purchase, sell and/or resell plots of land. More specifically the study examines the transactions that take place between one developer and another rather than those between developers and other landowners. It is hypothesised that developer to developer transactions are of central importance strategically at both the level of the individual firm and in shaping the capacity and flexibility of the industry as a whole, especially in meeting the government's targets for new housing supply. The empirical evidence presented is qualitative in nature. It is based mainly on twenty in-depth interviews with leading housebuilders. The interviews were undertaken in April and May 2008.

It is clear that developers seek to control their exposure to market risk and uncertainty by managing their relationships with other actors in the development process, primarily landowners, planners and other developers. Developers perform most effectively where these relations are well managed and stable and suffer where they are badly managed or turbulent. The main findings of the study are:

**Developer and landowner relations**

It is clear that accumulating a forward supply of land is a highly rational response to the need to secure a readily available stock of an essential business resource. The industry operates in an environment made more competitive not only by the constraints imposed by the land use planning system but also by those arising from the behaviour of land owners. The industry has developed a range of tactics to secure land supply.

The use of options is now widespread within the industry but the options market has become more competitive over time. Pricing has been distorted by the increasing sophistication of sellers and by the emergence of speculative investors. Several, mainly smaller and niche, housebuilders now rarely use options.

There is heavy reliance on informal networks and close relationships with agents to secure development sites (both with and without planning approval). Relationship management has become more important as the role of traditional landowners has diminished. Few housebuilders are comfortable dealing with public sector landowners, even though state actors now dominate the ownership of large developable sites.
**Developer and planning relations**

The planning system is generally thought to add to risk and uncertainty and to make pricing land more complex. Land buyers work closely with planning experts but it is generally felt that uncertain expectations of future planning decisions is the most common source of mis-pricing land. Planning delays exacerbate the problems associated with land acquisition. Often delays allow landowners the opportunity to revise expectations of land values and this can reduce the viability of schemes.

**Developer to developer relations**

In the last few years, developers have bought between 10 per cent and 20 per cent of their land stock from each other. The larger the firm the more likely it is that they will trade with other developers. Typically these transactions have involved part sale of larger sites and have been driven by a desire to mitigate risk and secure short term finance. Transactions are often also undertaken in order to secure a more diverse mix of locations or types of site within a firm’s forward land supply.

It is rare for developers to formally market sites. Most land buyers will seek to establish some form of reciprocal arrangement which might, for example, involve an informal agreement that will allow the vendor in the initial trade to purchase a commensurate site in the future. Legal agreements are rare and there are few formal land swaps. Trust is a significant feature of the business environment surrounding land transactions. The fact that most actors are mainly involved in land acquisition means that, even when they enter the market as sellers, they will still seek to prepare the ground for future purchases. Most developers will be highly selective in identifying a potential purchaser. In addition to exploring the possibility of future deals, they will often take a view on the degree of competition in the locality and/or on the complementarity (especially when sites are being split) of product.

**The impact of the credit crunch**

Transactions between developers have increased in volume in the last three months. It would appear that the credit crunch has led to reliance on land transactions as a source of short term finance for a large number of firms. Others, particularly those who are part of more diverse construction conglomerates or who are less reliant on debt financing, are taking the opportunity to engage in land acquisitions strategies that will enhance or consolidate their longer term prospects. There is evidence that these firms are planning beyond the downturn. The differences in responses to the credit crunch are not driven by the size of the firm or the niches in which they operate. Rather they are more closely related to the financial structures and business models adopted.
Understanding Builder To Builder Residential Land Transactions

1. Introduction

The structure and behaviour of the housebuilding industry is highly distinctive. The nature of production, for example, is dispersed and localised. This allows a degree of independence at the local level. Freedom from central office control is particularly evident in establishing the feasibility of development. Profitability and viability depend on finding land at the right price and gaining planning permission. These require highly localised knowledge sets. Shortages in developable land are the most significant constraint on the development process and this has meant that the industry has become inherently ‘land focused’. Housebuilders have built up stocks of sites, though not necessarily through direct ownership, of varying sizes and differing geographical compositions. Some developers have been more successful in securing land than others. The uneven distribution of developable land, of course, has implications for the capacity of the industry as a whole to expand the supply of new housing. It is possible that, even in relatively buoyant market conditions, the attainment of a step change in the aggregate level of new housing construction would require highly efficient market processes that would redistribute land to match available building sites to the capacity of individual firms.

Despite the land focus of the industry, the workings of the UK residential land market are not well understood. The academic literature exploring land markets is dominated by mainstream economic analyses that assume market actors make rational decisions (see Evans, 2004 for a review). The discussions tend to be theoretical rather than empirically informed. Anecdotal evidence suggests that this literature underestimates the complexity of decision-making and, in particular, the influence of the dynamic policy environment within which these decisions are made. It is clear that market actors make decisions under considerable uncertainty and with only imperfect information.

This research seeks to add to our understanding of housebuilders’ land market behaviours. The study is concerned primarily with decisions made by builders and, in particular, with the factors that shape land acquisition strategies and influence the decision to purchase, sell and/or resell plots of land. More specifically the study examines the transactions that take place between one developer and another rather those between developers and other landowners. It is hypothesised that developer to developer transactions are of central importance strategically at both the level of the individual firm and in shaping the capacity and flexibility of the housebuilding industry as a whole especially in meeting the government’s targets for new housing supply.
The empirical evidence presented is qualitative in nature. It is based mainly on twenty in-depth interviews with housebuilders. The interviews were undertaken in April and May 2008. The sample has been drawn from the population of all housebuilders in England who, on average, complete more than 100 units per annum. The respondents were selected using a stratified sampling method. Non-respondents were replaced with firms with similar profiles. The individual firms that participated in the study are of varying sizes and specialisms. The sample includes four of the top ten builders by volume in 2006. The sample was also selected to ensure coverage of all regional markets in England. The results of the survey have been tested in interviews with a large national agent who specialises in housing land transactions.

The analytical approach adopted in this study is in the institutional tradition. It has its intellectual and methodological roots in previous studies of the behaviour of landowners and real estate developers (see, for example, Barrett et al, 1978; Goodchild and Munton, 1985; Healey, 1991; Adams et al, 2001). This literature highlights the importance of institutional structures in shaping market processes and outcomes (Adams et al, 2005) and has provided evidence of what appears to be non-rational decision-making behaviour in the commercial property development industry (Henneberry and Rowley, 2002). This previous research reveals, at a general level, the importance of social relationships, formal and informal networks and trust in shaping business practices. These themes are picked up in this study where it is clear that developers seek to control their exposure to market risk and uncertainty by managing their relationships with other actors in the development process, primarily landowners, planners and other developers. Developers perform most effectively where these relations are well managed and stable, and suffer where they are badly managed or turbulent.

The report is organised in a further five sections. The next three sections look in turn at housebuilders relations with landowners, planners and other residential developers. It is clear that these relationships are shaped in part by the nature of the land market as well as the general business and policy environment. The evidence suggests that developers have established a variety of strategic and tactical responses to deal with risk and uncertainty. Although this project is primarily interested in what happens in ‘typical’ market conditions, it is evident that current market conditions have led to changes in behaviour. This is discussed in section five. Notably, it would appear that the credit crunch has led to reliance on land transactions as a source of short term finance for a large number of firms. Others, particularly those who are part of more diverse construction conglomerates or who are less reliant on debt financing, are taking the opportunity to engage in land acquisitions strategies that will enhance or consolidate their longer term prospects. There is some evidence that these firms are planning beyond the downturn. The differences in response do not appear to be driven by the size of the firm or the niches in which they operate. Rather, although larger builders seem to be disproportionately impacted, differences in fortunes are more closely related to the financial structures and business models adopted, although several larger firms appear to have been disproportionately impacted. The final section of the report offers some conclusions.
2. Developers and Landowners

This section of the report is concerned with the relationship between housebuilders and landowners. It provides an overview of land acquisition strategies and the methods used for land identification. It is clear that accumulating a stock of land is a highly rational response to the need to secure a steady supply of an essential resource. The industry operates in an environment made more competitive not only by the constraints imposed by the land use planning system but also by the constraints imposed by the behaviour of land owners (see Adams et al, 1991; 1992; 2001; Goodchild and Munton, 1985). The industry has developed a range of tactics to secure land. These include the widespread use of options and investment in the development of informal relationships with landowners and their agents.

*Land acquisition strategies*

For speculative housebuilders, land is an essential raw material that needs to be controlled well before construction is due to start. Historically, the response of housebuilders to scarcity and competition was to accumulate a stock of land with sites normally held in a land bank for at least two years prior to the planned commencement of on-site production (Smyth, 1984). Somewhat unhelpfully, there have been few recent studies of housebuilders’ landholdings. Further, direct ownership is not the only means for housebuilders to control development land (conditional contracts and longer term options may also be used). Although no consistent method of measurement yet exists, a company’s land bank is often regarded as an important indicator of its strength (Callcutt, 2007). It can be seen as a portfolio of assets with different dates of maturity and profit realisation (Ball, 1983), since it will normally contain both ‘short-term land’ that is immediately available for development and ‘strategic land’ that may take many years to come to fruition.

The need to secure and control a flow of land in an extremely competitive environment contributes to the turbulent nature of the housebuilding sector. Mergers and takeovers are often driven by the desire to acquire a competitor’s land bank. Wellings (2006) provides three such recent examples, namely the acquisitions of Senator Homes by Persimmon in December 2005, of Chartdale Homes by Galliford Try in January 2006 and of Roland Bardsley by Wilson Bowden in August 2006. According to Wellings, the land banks acquired as a result were respectively 800, 600 and 1,350 plots.

Although the size of developers’ land banks is the source of some debate, there is very little data available on strategic land banking. Most studies have focused on land with more immediate development potential. Recent but separate investigations by the HBF and the RTPI, for example, both found that, on average, major UK housebuilders currently have around 2.5 years supply of land with full planning permission (Callcutt, 2007). This is a historically low figure and compares with the mean stocks of 3.5 years noted by Barker (2003) and with the earlier figures of 3.0 years for 1997 and 4.4 years for 1991, reported by Barlow (1999).
The housebuilders surveyed universally felt that estimates of the size of land banks tended to overstate the actual position. The reporting requirement of stock market quoted companies is blamed. It is argued that “housebuilders annual reports might say we have 30,000 plots secured [but] of those there might only be 5,000 that are operational and ready to go within three years. The balance could be options which are fifteen years long and could include historic farms” [Interviewee 6].

There was a general dislike of the term land bank and some confusion arose from usage of the term. Some developers take the term to describe land that is owned outright and others assume it means, more generally, all land in their control. For example one respondent [Interviewee 5] suggests that “in a five year contracted land bank we would expect to have an 80 per cent certainty in terms of planning” while another [Interviewee 1] suggests that “…on the basis we do say four to five hundred houses a year, we’ve got three and a half years banked with either some sort of outline planning consent or even detailed planning consent. We do have strategic land, [and] we do have some strategic options tied up, probably another 2,000 plots something like that.”

Many respondents indicate that the mix of types of site (greenfield, brownfield, housing, apartments) is of great importance to them. The ideal mix of types of site varied a great deal between respondents but as one volume builder indicated “a land bank for a developer our size has to be balanced and that balance has to be a mix of green/brown albeit we’re probably 60-70 per cent brown. It has to be a mix between large and small sites. It has to be a mix between apartments and houses and within the houses it needs to be a mix of small and large. And that mix varies depending on where you are in the country but generally speaking we don’t want to go much more than 40 per cent, ideally less than that on apartments.” [Interviewee 6]

The responses imply that each firm has a series of targets, or ideals, in relation to greenfield, brownfield, housing and apartment sites. At a strategic level it is desirable to re-mix land portfolios that have strayed too far from these corporate ideals, presumably through unanticipated better (or poorer) success rates in terms of planning applications on different types of site or in different locations. There is evidence that portfolios will alter with changes in market conditions and/or the policy environment. The brownfield land target has had a pronounced impact where “we have gone from probably doing 10 per cent apartments to some companies doing 50 per cent, 60 per cent apartments,….. [and for this firm] something more in the order of 25 per cent apartments.” [Interviewee 7]

Practice varies greatly with the size of the firm and the nature of their business. The experience of respondents is very mixed with some housebuilders who emphasised the role of strategic land identification and acquisition (or control
using options), and others (usually small firms) with either little interest or without the internal resources to engage in this form of land acquisition:

“From our point of view, we don’t have a strategic land department here, we’re very sort of hand to mouth, we probably have about a two year supply of land at the moment - or two years’ business really, but the land process has been the land process from identifying an opportunity to getting cash out of it is generally two to three years.” [Interviewee 8]

The use of options

Normally, housebuilders buy land freehold only if it already has planning consent or if planning consent is virtually guaranteed in the near future. Instead to secure the right to purchase land in the future, while trying to obtain planning permission, housebuilders make extensive use of options, granted by a freeholder to the developer normally in return for payment, and of contracts for sale conditional on planning permission. Options and conditional contracts thus allow developers to seek planning permission, safe in the knowledge that if it is granted, the land can be acquired. As a result, there is an argument that the amount of land held under option or conditional contract within housebuilders’ land banks should generally be many times that owned freehold. Although options and conditional contracts enable housebuilders to commit only limited resources to land acquisition before planning permission is secure, substantial professional fees may well be incurred in the meantime on hiring lawyers and consultants to negotiate the passage of such land through the protracted process of planning applications, planning appeals and development plan inquiries.

Options on potential development land can normally be secured at a fraction of the cost of freehold purchase, and are usually expressed either as a small percentage of estimated development value or as a small absolute sum. Obviously, if the option to purchase is never taken up, the landowner retains the original option payment. Bramley et al. (1995) suggest that conditional contracts can be more costly to housebuilders, with them typically paying the landowner 10 per cent of market value when the conditional contract is signed, but thereafter benefiting from a 10 per cent discount on market value once planning permission is secured. Of course, such a division of gains will differ both in time and location, depending on the state of the housing market and the likelihood of securing planning permission.

Such arrangements have three distinct advantages to the developer over freehold purchase. First, options and conditional contracts enable developers to spread risks and reduce uncertainties. For the equivalent cost of one hectare of freehold land, developers may be able to tie up many hundreds of hectares, through options and conditional contracts. Potential land banks are extended

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1 It should be noted that according to Callcutt (2007: 140) “the fee can range in size from a purely nominal amount to several millions of pounds. The amount of the initial payment will reflect the “hope value” for the land’s future use for residential purposes.” However, the circumstances in which a developer would pay at the top of Callcutt’s range for an option or conditional contract must be exceptional.
for a fraction of the cost of freehold purchase. More importantly, all the sites can be put forward for planning consent, with the likelihood that at least one will be successful. On unsuccessful sites, the developer has no further commitment. Secondly, options and conditional contracts enable a developer to acquire land in multiple ownership gradually. They restrict the power of any one owner to hold out for a ransom sum. Options are particularly useful here, since no requirement to buy exists. They thus provide the developer with maximum flexibility at minimum cost. Thirdly, both options and conditional contracts reduce initial capital outlay, since the full cost of land purchase need not be met until planning permission is actually given. To the landowner, options and conditional contracts enable land to be retained until, at no cost to owner, development potential is fully established. The eventual sale price will then reflect the value of the land with planning permission.

The market for options appears to have become increasingly competitive. There is clear evidence of an evolving market norm in terms of option conditions which involves down payment to the land owner followed by outright sale at the rate of around 85 per cent of market valuation following award of planning permission. Some respondents indicated that the discount on market value may vary depending on the perceived probability of securing planning permission and on the housebuilders’ estimate of the costs involved. Others suggested a trade-off between the size of down payment and the eventual discount on market value. However, this appears to be driven by the behaviour of the landowner or, more accurately, the landowner’s eagerness to receive a large down payment. The explanations offered included:

“...there is competition at the point of entering into options, it’ll boil down to... who can demonstrate a good track record in getting planning, because if you don’t get planning there’s no value created; how much you are prepared to put down up front; what percentage of the open market value are you prepared to commit to upon the grant of planning, so that’s a percentage of open market value.” [Interviewee 12]

“...there might be one in there that they are saying will give you 50 per cent of the land value, we’ll have it for fifteen years and we will give you a quid for it. You know, but we will fund all the planning we will spend fifteen years money which is all abortive and if it comes out we’ll buy it, we’ll benefit because we’ll buy it at 50 per cent of the value at that time. That might be quite a low possibility of getting planning and that’s reflected in the option terms.” [Interviewee 7]

As Abbott (1999: 58) suggests: “Other factors being equal, profit-maximising builders will seek to purchase the lowest-cost sites available in areas of the strongest actual or potential demand for final housing products.” Evidence from Ashford has demonstrated that even in the 1980s, builders directed their option strategies towards those sites most likely to be released by the planning system, in the knowledge that the restrictive nature of the system prevented over production and ensured the marketability, at least in the long term, of any dwellings that were produced. At the same time, it was evident that
sophisticated developers, such as Charles Church in Surrey, were able to acquire options on a sufficient proportion of the land likely to be released in particular locations so as to achieve, if not a monopoly, certainly an oligopoly in controlling the supply of new homes in the area (Adams et al., 1992).

Barker (2003) suggested that while options were used extensively on greenfield sites, conditional contracts were more suitable for the acquisition of brownfield sites. This is confirmed in the more recent work of Payne (2008). One company she interviewed explained the reasoning for this: “If your landowner wants to make up his mind fairly quickly, a longer-term option is really just not the way to go. He wants to know “if I close my factory are you going to buy it immediately”, in other words “can I relocate my business?” We would usually make (a contract) conditional upon getting planning permission and sorting out ground conditions n those are the usual two big things you need to resolve absolutely before you’re committed.”

Perhaps a little surprisingly, not all builders view the use of options positively. Four respondents, mainly smaller and niche developers, do not use options, or do so only rarely. One respondent (from a medium sized firm) reported personal experience of having spent up to £200,000 in total on a number of options (down payments) over a 10-15 year period but had been unable to acquire planning permission on any of the sites concerned. This was largely attributed to the unpredictability of the policy environment. Another smaller developer indicated that they do use options, but normally in collaboration with one or two other housebuilders. The approaches used reflected differences in the capacity to take risks and differences in the expertise required to undertake risk analysis. There was a general view that options of between 10 and 15 years’ duration are not viewed as particularly likely to lead to planning permission, while longer options, perhaps of between 21-25 years, would be preferred by developers (although they may be less attractive to landowners). The evidence suggests that the risk and costs associated with the use of options has increased, especially for smaller firms.

It would also appear that options market has become more competitive in the last few years. It is argued that sellers are now more sophisticated. They are more likely to use an agent and to require a higher downpayment and a higher proportion of open market value than in the past. The market has also been distorted by the presence of speculative investors who hope to capitalise on above inflation increases in land prices [Interviewee 6].

There is some suggestion that changing landowners attitudes and behaviour are adding to the length of the development process. This resonates with the work of Miceli and Sirmans (2007) who highlight the extent to which the problem of landowners holding out for higher prices raises development costs. They argue that this problem creates a bias towards development on the urban fringe where ownership is less fragmented and lot sizes are larger. This, of course, contributes to urban sprawl. In recent years, there has been greater public sector intervention in the urban land market in the UK, with particular use made of ‘special delivery vehicles’ to assemble brownfield land for redevelopment.
Within the possibility of such intervention, fragmented land ownership is likely to be seen as a significant deterrent by many housebuilders. The problems associated with landowner behaviour are thought to be more widespread in the last five years than before. These problems take different forms and include changing landowner expectations in a rising market and the failure of the landowner to understand the other requirements that the developer needs to address. In these circumstances "......the landowner is sitting there thinking its worth £1m an acre and all the stuff that the government are piling on it make it only worth £800,000 an acre, they say “oh it’s £1m an acre” “no it’s not it’s only £800,000” “well I’m not going to sell it then” and in the end the piece of land doesn’t get sold, and that’s another blockage with the land supply.” [Interviewee 4].

The use of local contacts and knowledge

According to Payne (2008), housebuilders undertake ‘saturation surveys’ to spot short-term land that could become available ‘off market’ in preference to more competitive ‘on market’ acquisitions. One of the companies interviewed by Payne explained how this works: “In a saturation survey, we identify an area that we want to concentrate building in, and we identify what’s currently there, from every land use point of view …to build up a picture of what’s around there and then you then start knocking on people’s doors saying have you considered disposing of this?” This depends on good local contacts and knowledge, which Barker (2003) recognised as essential to effective site-finding and Callcutt (2007) thought created a de facto barrier to new entrants.

Some housebuilders may supplement saturation surveys by placing advertisements in the general or specialist property press, encouraging those owning land with development potential to contact them. Many will also retain estate agents, especially in pressured areas, to bring sites to their attention. Such agents are expected to know when potential development sites are likely to be marketed, who owns them, when any lease will expire and whether planning permission can be easily obtained. They would normally be rewarded with a fee of approximately one per cent of purchase price when a site is eventually acquired by the housebuilder. Competitive bidding for sites ‘on market’ is thus a last resort, when other more informal methods have failed to procure enough sites ‘off-market’.

Typically “the best way to buy land is through contacts. We only occasionally buy [land] that is fully in the market” [Interviewee 6]. There is a desire for preferential treatment and a feeling that larger agents will not offer this. The local network and localised knowledge are seen as an important source of competitive advantage. This preference for informality and special relationships resurfaces even more strongly in the discussion about transaction between developers that follows in section 4.

It is clear that regular and close contact with other actors can be an effective way to acquire sites ‘off market’ without the need for a full saturation survey. Such relationships will need to be mutually beneficial if they are to foster trust
and goodwill over time. This has become particularly important in the last decade as the nature of the market has “undergone a quiet revolution” [Interviewee 21] and the sources of development land have changed. There is little evidence that the textbook model of the housebuilder purchasing agricultural land from the farmer occurs very often. Ownership of large sites is dominated by the public sector (38 per cent) while private landowners (15 per cent) remain important. Developers hold about 32 per cent of which most is held by commercial developers who have 15 per cent, traditional housebuilders who own seven per cent and joint venture companies who have six per cent (Barnes, 2007). Although when asked who they buy land from, most respondents named a range of land owner types including public sector, owners of post industrial land and farmers, or their agents, the source of land does not map on to the current pattern of ownership.

Niche developers with a particular interest in regeneration or brownfield development, often bought disproportionately from remediation companies. These are relatively new market entrants in the UK but their significance is increasing. The approach adopted is “to get planning permission and simply sell the site” or “to buy the site, put in all the infrastructure and sell the land as serviced parcels which is probably the way to absolutely maximise the receipts you get from land” [Interviewee 15]. These sorts of smaller oven-ready sites achieve a significant premium in the market (Barnes, 2007). They also allow the buyer to control some of the risk and uncertainty associated with landowner behaviour and, as explored in the next section, the vagaries of the planning system.

Many housebuilders see the dominance of the public sector as being highly problematic, despite the opportunities presented by large state-owned sites. It is argued that “the big problem with public sector on land sales is that they don’t want any risk but they want to [share] out the upside…..when land is very hard to come by, you may do a public sector land purchase but [not] when there are private individuals and companies selling land.” [Interviewee 2]. This is a view shared by housebuilders of all sizes. The reluctance to prioritise publicly owned sites does, however, imply that concentration of large development sites in state sector ownership will increase in future years as private sources continue to be exploited at a disproportionate rate.

These attitudes are reinforced by the belief that public sector owners try to extract high prices. There was a view that “we don’t tend to buy from the public sector because generally they are under a duty to get the best price, so it’s quite widely advertised….and we don’t feel that we have land buying resources to be continually competing with however many other housebuilders” [Interviewee 15]. Another respondent observed “they are hard to negotiate with ñ they don’t give it away.” [Interviewee 9].

There are, however, builders who recognise the opportunities that might arise from working with the public sector. The scale efficiencies appear to be particularly significant because “some of these [public sector] schemes on their
own are …like a whole year’s land buying in one transaction as opposed to a site for 20 or 30 or 40 or so” [Interviewee 3].

In summary, it is clear that accumulating a forward supply of land is a highly rational response to the need to secure a readily available stock of an essential business resource. The industry operates in an environment made more competitive not only by the constraints imposed by the land use planning system but also by those arising from the behaviour of land owners. The industry has developed a range of tactics to secure land supply. The use of options is now widespread within the industry but the options market has become more competitive over time. Pricing has been distorted by the increasing sophistication of sellers and by the emergence of speculative investors. Several, mainly smaller and niche, housebuilders now rarely use options. There is heavy reliance on informal networks and close relationships with agents to secure development sites (both with and without planning approval). Relationship management has become more important as the role of traditional landowners has diminished. Few housebuilders are comfortable dealing with public sector landowners, even though state actors now dominate the ownership of large developable sites.

3. Developers and the Planning System

It has been argued that, in theory, planning permission can reduce uncertainty and increase the likelihood of development. Cunningham (2007) shows, in the US context, that clear policy decisions can alter perceptions of the possibility of future new housing development to such a degree that concerns about price volatility can be minimised or removed. In the UK, however, there are two main reasons that housebuilders maintain a significant forward supply of land. The first of these is to mitigate against the risk and uncertainty that flows from the delays incurred in seeking planning permission. The second is as a potential source of rewards. This section of the report focuses on these issues in turn.

Planning and uncertainty

Land banking is a strategic response to uncertainty in housebuilding (Bramley et al., 1995) since it not only allows time for pre-development preparations to be completed but crucially, enables flexibility of response to any planning, demand or other external changes. From this perspective, land banking is a risk reduction measure with its own opportunity costs. This explanation suggests an emphasis on short-term land to ensure continued production and protect immediate market share.

Almost all respondents expressed strong views that the delay in obtaining planning permission is increasing over time. A typical explanation suggests: “The reason we have a five year contracted land bank is because we need to allow for fall out and we need to allow for the fact there’s going to be a massive delay and the only way to do that is to contract, have enough coming through otherwise it’s absolutely hopeless.” [Interviewee 5]
Among the problems associated with the planning system commonly cited by respondents are the tensions between planning officials and elected representatives and general under-resourcing of planning authorities. This is highlighted by several interviewees whose comments include:

“...we will talk to planners about it, though to be absolutely frank the planning officers are so often now overruled by the committees.” [Interviewee 2]

“.the emphasis now needs to be on tackling committee members really and probably lobbying them and getting them on side because so many of them... don’t know anything about planning - that’s probably a bit unfair, they don’t fully understand the planning system and voted in on an anti-development ticket unfortunately, and that’s our biggest problem.” [Interviewee 8]

and:

“I feel for them, the planners, they are massively under-resourced, do not have enough people, anybody who is worth their salt gets poached to get them to work for a developer so we pay them a lot more. They cannot cope with the workload and every five minutes the rules change.” [Interviewee 1]

The interviewees’ views about planning delays, and their perception that these are increasing over time, triangulates with their evidence about forward land supply. While most housebuilders appear to require around 2-3 years’ forward supply, many have a target of up to 5 years’ supply. This appears to be a departure from practice reported in the 1970s and 1980s when 2-3 years’ supply was an industry norm. An experienced land buyer explained:

“When I first came into the business I expected to get a planning permission in about sort of 4 to 6 months and we could be on site in about 8, now I’d be very surprised if we get one in 12 months, and 18 months is probably the norm and we’ll be on site in 2 years.” [Interviewee 4]

By necessity, land identification is closely integrated with the planning process. Most housebuilders maintain and/or retain specialist expertise, precisely for this purpose. This normally links professional planning expertise (whether contracted out to consultancies or employed in-house) to the more traditional role of the land buyer. At a general level “it’s very hard for any residential developer to go and secure land cheaply, so in order to be a successful bidder, we have to make assumptions about what we can achieve planning permission for and those assumptions tend to be fairly optimistic or fairly aggressive” [Interviewee 15].

This does not guarantee that a firm will be successful in managing the uncertainly that arises. This expertise does, however, provide the rationale for exploring sites that might appear to be unattractive. For instance, “we’re buying with a detailed planning consent for a scheme that we don’t want to build, because it has a significant number of apartments, so we’re buying it on the
back of a detailed consent, but fully intending to change that consent.” [Interviewee 11]. Other developers discuss the notion of using the planning system to add value and note the importance of this line of business to their own firm. One explains: “So we will buy with a consent. But in the main we make value by identifying a site that is going to get planning or that we can enhance, and so that’s what we’re looking for, we’re looking for those opportunities where we can use our skill and expertise to increase the land value.” [Interviewee 2]

There is a trade-off between exploring large sites and maximising the level of output. On the one hand it is argued that “it is as easy to get planning for a site with 50 as it for 10” [Interviewee 14], while on the other “the significant thing is not how many plots you have but how many outlets. Because you can have a site for 300 but you are still only going to sell 40 or 50 a year. But if you have two sites of 150 you are going to sell twice as many”. Outlet maximisation and management, of course, increases the need to commit resources to steering more sites through the planning system.

This need to manage planning relations is also important in the context of strategic land. It involves detailed analysis of social, economic and demographic trends to identify broad geographical areas that may be considered suitable for development in 10 to 15 years’ time. Once options have been tied up on particular sites within these broad areas (usually by private negotiation), representations can be made at successive local planning exercises to secure their release for residential development. Strategic land identification is thus rarely a wholly speculative activity. Its essence instead is one of anticipation of, and indeed influence upon the planning process. It thus requires patient commitment and careful engagement over a number of years. There is a view that reputation can be important as “there is a credibility issue, if you are trying to promote something in here and up here you know isn’t going to happen” [Interviewee 6].

Planning and profits from land

It is, of course, widely understood that the grant of planning permission allows increases in land value to be captured, provided demand exists. There are often significant potential rewards from holding land over time and seeking to secure planning permission. In the past, speculative purchases of strategic land by larger housebuilders were considered widespread (Short, 1982). Indeed, Barlow (1999: 23) claims that: “From the 1960s to the late 1980s their main business strategy focused on capturing inflationary gains from housing and land markets.” He suggests that by the turn of the century, reliance on strategic land banking and inflationary gains was no longer a viable competitive strategy. However, even at a time of lower general inflation, it can still be beneficial to hold short-term land in an active housing market. According to Wellings (2000), for example, housebuilders were able to make excess stock profits in the late 1990s mainly because house price inflation between site purchase and the eventual sale of the completed dwellings was greater than anticipated. This practice would appear to be limited now, although there are remain examples
amongst smaller and medium-sized business where “the sale of land is a profit generating activity in its own right” [Interviewee 15].

Although securing planning permission can be a source of additional profits, it adds to the complexity of pricing land. Neo-classical economics suggests that there is an optimal time for land development to take place. This will arise when price of land for new development exceeds the land value in its current use and the cost of preparing the site. Pricing land in this context is made difficult by uncertainty (about future costs and market conditions) and associated risk. Land may remain undeveloped to preserve its ‘real option’ value. It is important to distinguish between options (which are legal contracts governing possible future sales of sites) and real options, a concept affecting the value of a site that has nothing to do with legal contracts. Real options arise because of uncertainty about the optimal use of a site (Titman, 1985) or uncertainty about future development costs and end use values. Price volatility generates real option value because a vacant site can be ‘cashed in’ at a point in the future and exchanged for a completed development, triggering development profit. A development site, considered as a real option, has a higher value in volatile market conditions just as stock options increase in value when the stock market becomes more volatile.

The complexity of the market and the way in which the planning system distorts values is thought to lead to significant differences in the way in which different builders value the same development site. There was a specific example in which one large firm was able to demonstrate the over optimism of a site vendor’s figures and then acquire the site at the ‘correct’ price. It has been suggested that larger housebuilders with strong industry reputations can alter the perceptions of smaller housebuilders.

Different builders will work to different margins and will apply a different premium to sites with planning permission. Interviewee 9 explains that “Planning is difficult for everyone so some builders will try to be competitive on price, build a bit cheaper or cut their margin”. The impact this has on valuations provides considerable comfort when a developer decides to sell land in a rising market.

“There is always someone who has some reason to want to buy….I spent time talking to a valuer for the bank who had valued [a site] and he said “it was worth X”, you know, and I said “well we’ll get a lot more than that” and he said “you are probably right but there is no reason for anyone to pay more than that”. I said “no, that is not the point, we’ll find someone who’s got a reason…and sure enough we did….there is normally someone who, we’ve found, will pay more than can make it work on paper and that is because they have taken a view on prices and margins”. The premium comes from need to secure land with planning permission. As we will discuss in section five, this practice does, of course, cause severe difficulties in a market downturn.
In summary, there is a complex relationship between planning restraint, land values and the behaviour of housebuilders. On one hand, housebuilders cite growing planning delays in their reasoning for seeking control over more land (as a proportion of output) over time. This is coupled with recognition that some land owners are now very aware of the potential rise in value associated with securing planning permission. This then creates additional problems because land owners seeking approved planning status naturally target the notionally highest value development mix and this then informs their expectations regarding a future land sale. Prospective land buyers (housebuilders) may then feel it is difficult or impossible to meet the land owners’ expectations because their view is that only a lower land value yielding development mix would be viable.

On the other hand, some of the housebuilders interviewed clearly pursue a strategy of acquiring land with existing planning permission in place and then seeking value-adding changes to that planning permission. On balance, it appears that there may be a serious problem because these findings suggest a self-fulfilling prophecy in which land owners are increasingly incentivised to obtain speculative planning permission, housebuilders increasingly see it as important to add value through changes to planning permission and planning authorities become overloaded as a result.

It is certainly clear that many housebuilders believe that long, and growing, planning delays lie at their need to secure a greater forward land supply as time goes on. In part, housebuilders blame several waves of reform to the planning system and to under-resourcing of local planning authorities. In addition, it seems likely that there is some circularity in the problem because as housebuilders seek control over a greater quantity of land, so the incentive for land owners to seek planning permission grows. This, of course, further increases the burden on planning authorities. Options are cited in the literature as one means by which developers can control land that may have distant development potential. As we note above, the market for control of land via options is now also very competitive. Landowners are better equipped than ever to negotiate prices. Smaller housebuilders apparently have relatively limited scope to access this market due to lack of internal resources and/or critical mass.

4. Trading between developers

Previous research and the previous sections highlight both that competition nature and rigidity exist simultaneously in the land market. This raises questions about the extent to which developers are willing to trade land with each other to adjust their capacity and, more specifically, about what drives transactions between developers.

In the context of the much-emphasised poor availability of suitable development land it is perhaps counter intuitive to expect that developers will freely trade land between each other. It is, of course, important to set builder to builder transactions within the context of market uncertainty and sector turbulence. It is clear that housebuilders operate in a highly dynamic business environment in
which constant change in the balance between supply and demand factors ensures that the number and size of companies active in a particular region or locality is never stable. If this is coupled with the market uncertainty engendered by planning regulation, it means that there will always be companies needing to acquire short-term land and often companies wishing to dispose of it. It is also important to remember that many land buyers working in the industry have moved around several housebuilders during the course of their career and have developed good networks and reliable contacts. This means that reliance on industry networks to solve short-term land scarcity may be a highly effective tactic, especially where ownership constraints or other impediments to market mechanisms frustrate intended development programmes.

The results of the research make it clear that land trading between housebuilders is a relatively common occurrence even in more stable market conditions (perhaps between 10 per cent and 20 per cent of the volume housebuilders’ land is sourced in this way). The overwhelmingly most common reason cited is the idea of maximising sales potential by optimising the number of outlets. Smaller housebuilders do not see land trading with other housebuilders as a common practice, and strictly, a necessary practice. However, this accords well with the lead reason given by the larger housebuilders given their more limited total completions targets. The typical explanation suggests that there:

“There [are] two reasons why you put a piece of land down to other house builders, one is to gain another outlet somewhere because you have got an over supply in one particular area and you have got a site that you can trade with, or it’s a cash raising exercise. And at the moment, because of the lack of sales, it’s a cash raising exercise.” [Interviewee 7]

“... if you’re in a growing market you’d want to do the swap because you want more outlets because you want to sell more houses... So you’d get your commitment to that site to build your 300 houses, you sell 40, you’re left with your 260 knowing your finer demand’s there, but you’re swapping it, swapping that 40 for another 40 thirty miles away...” [Interviewee 10]

Interestingly, several of the volume housebuilders interviewed noted that land sales in one region (having met its sales and profit target) may be used to compensate the failure of another region to have met its targets. In two cases, respondents talked about land as a company asset and not a regional asset and in a third case the respondent discussed the fact that one of the firm’s regional offices (Scotland) has a department dedicated to land trading (selling to other housebuilders). Notwithstanding the suggestion that volume housebuilders are reluctant to rely too heavily on profits from land transactions rather than house sales, generating profit from land speculation appears to be important (at least in some circumstance) to housebuilders of all sizes.

Typically this involves developers trading parts of sites with each other. The selection of the part of the site to be sold tends to be thought through carefully and, in large part, requires the sellers market that has dominated in the recent
past. A standard explanation of this behaviour is that “pretty much most developers in a good market are always desperate for land and generally buy what is available, so you can often off-load the poorer bits of a site so you’re left with the prime parts and you sell the rubbish basically... I’ve done that in the past, just highlighted the poor bits and sold them to somebody, because somebody will always buy it.” [Interviewee 8]

Although this practice is driven by cash flow considerations, the decision to sell is taken at the land acquisition stage. It is relatively rare, under normal economic conditions, for this to be opportunistic. Builders will seek to protect the integrity of the scheme. In this context, most respondents were generally very positive about operating with other housebuilders nearby but some expressed reservations about the potential downside of operating in partnership or proximity to competitors with lower quality output.

“Well any competition on a site’s a healthy thing actually. We’re not worried about competition per se, what we are worried about is quality and market competitiveness if you like. What we wouldn’t want to do necessarily is to bring on a developer who we had concerns on the way they operated in terms of their marketing or their customer experience or whatever...” [Interviewee 6]

“There are certain developers that I wouldn’t name that we would rather not be next to, one unfortunately which we are now next to because they’ve purchased another company that we were next to.” [Interviewee 20]

When there are sales between developers, there is usually an attempt to manage the competition between products so, for example, a typical explanation is that “we would generally only sell to another developer if they were going to have a different market niche” [Interviewee 19]. In this context it is often desirable to dictate the phasing of sales in order to minimise direct competition between products and to ensure that the local market can absorb the volume of new sales. There will, however, be times where it is desirable to seek critical mass to establish the credibility of a new area and there are limits to the number of units that a single builder can produce on one site at any point in time [Interviewees 13, 19].

Networks, relationships and trust

The power relations within these networks are likely to be of particular interest since it should not be assumed that the monetary value is the sole remuneration to be extracted from builder to builder transactions. The context of both corporate and personal plans may well ensure mutual advantage in commitment to land exchanges over the longer term.

Most housebuilders appear to regard selling land to other housebuilders as a last resort, unless there is a reciprocal arrangement. Reciprocal arrangements appear to be associated strongly with the ‘outlet maximising’ explanation for many land transactions between housebuilders. Despite this, it is also clear that
housebuilders will sell land without such an arrangement if the primary motivation is for cash flow reasons and, in addition, the larger of the volume housebuilders appear less interested in reciprocal arrangements than most others.

Most developer to developer deals rely on trust. It is argued that “….. my word is my bond' carries a lot of weight because it is that sort of industry” and that “it is actually beneficial to be a man of your word, if you can be” [Interviewee 18]. Building up reputational capital is an important means of securing land acquisition opportunities in the future. Land trading within the sector is facilitated greatly by the position occupied within the local network where “the industry is small enough for you to know who will be interested in buying or selling” (Interviewee 7). All respondents admit that, when they are in a position of relative strength and are simply restructuring their holdings rather than generating finance, they will be highly selective about their preferred buyers.

“I'm not saying we wouldn't deal with someone new but I would have to know who I was dealing with….if somebody new came to me, I would check them out. I would ask around and find out who has dealt with them and whether they have done what they said they would when they said they would” [Interviewee 19]

There is a strong preference for marketing sites informally through the network and the use of agents and formal marketing strategies is very limited.

“Sites do end up in things like Estates Gazette with a formal marketing campaign. Much more likely is industry contacts. ….there are certain companies who would perform and some won’t, so industry contacts will be the prime source” [Interviewee 3]

Typically agents are advised against using the open market, or more precisely, agents are instructed to approach a pre-identified group of potential purchasers with the instruction to “talk to them, see what the best price is. Don't go to the open market as it gets messy, just those 4 or 5, and I want the offer in a month” [Interviewee 10]. The prevailing culture is shaped by the fact that most traders normally enter the market as buyers and, in those circumstances, they are looking for preferential treatment. As a result when they enter the market as a seller, they are still preparing the ground for future purchases. There is also a business rationale underpinning this behaviour. Around a quarter of the interviewees said that deals between developers would usually be done informally to avoid showing any ‘sign of weakness’.

Most developers will only invite competitive bidding under peculiar circumstances where “you might instruct an agent when you want to avoid favouring one builder over another” [Interviewee 7]. There are also times when there is considerable internal pressure to sell and to extract the best price, even at the expense of less tangible and longer term benefits. At those times “you put it on the market, send it out via Estates Gazette…to maximise the value of
the land and to get 50 people to bid. It’s simple economics really” [Interviewee 5].

Respondents were asked about the practice of ‘land swaps’ and almost all reported that these are rare in practice. There was a suggestion that in the past land swaps may have been associated with a taxation advantage (exemption from stamp duty), but that this is no longer the case. Some respondents noted that the rarity of equal value in the two sites being swapped means, in practice, that reciprocal arrangements almost always take the form of two separate transactions. One respondent (in Scotland) indicated that a side contract or memorandum of understanding might be in place but other respondents suggested that this is not common. Some respondents also expressed concerns about the impression that might be conveyed using such agreements. For instance: “if we sell a site to somebody we’d expect to have a reciprocal arrangement but obviously you’ve got to be careful on how you do that because there are…competition rules… “ [Interviewee 5]. But the desire to secure some future benefits is a significant factor in most transactions. All but the smallest developers would accept that “if you were selling to a particular builder and there wasn’t anything available at that time that suited your needs……you would want to have an arrangement that they will bring you something later on…it is a ‘builders agreement’, not a formal arrangement” [Interviewee 7]. This does not, however, imply any discounting as “where we will sell you a piece of land but want an opportunity to buy another piece at a later date…we both have to pay value” [Interviewee 6].

There are, of course, some problems with buying from developers. Three smaller developers argue that they would never buy from other builders. It is assumed that value for money is limited unless there are some less tangible advantages attached. The explanation is that “when a developer sells you a piece of land he is aware of the profit and he wants to get his money back and invariably a fair part of the profit he would have made…so it is hard” [Interviewee 16]. There are also limits to the degree of trust that exists. Some developers will treat what is on offer with caution and will always question the motives of the seller.

“the first question is why are you selling…I could buy you as many sites as you wanted with apartments at the moment. They will normally sell land [when] they can’t sell [final product]….or it could be there is something fundamentally wrong with the site that they are trying to hide from us ñ I know they are not supposed to but…!” [Interviewee 4].

In summary, in the last few years, developers have bought between 10 per cent and 20 per cent of their land stock from each other. The larger the firm the more likely it is that they will trade with other developers. Typically these transactions have involved part sale of larger sites and have been driven by a desire to mitigate risk and secure short term finance. Transactions are often also undertaken in order to secure a more diverse mix of locations or types of site within a firm’s forward land supply. It is rare, in these circumstances, for developers to formally market sites that they are prepared to sell to other builders. Most land buyers will seek to establish some form of reciprocal
arrangement which might, for example, involve an informal agreement that will allow the vendor in the initial trade to purchase a commensurate site in the future. Legal agreements are rare and there are few formal land swaps. Trust is a significant feature of the business environment surrounding land transactions. The fact that most actors are mainly involved in land acquisition means that, even when they enter the market as sellers, they will still seek to prepare the ground for future purchases. Most developers will be highly selective in identifying a potential purchaser. In addition to exploring the possibility of future deals, they will often take a view on the degree of competition in the locality and/or on the complementarity (especially when sites are being split) of product.

5. The impact of the Credit Crunch

This research was undertaken during a serious credit crunch in the financial markets and what is widely regarded as the beginning of a housing market downturn. The analysis in the previous sections of the report focused on ‘normal’ market conditions, where normal is assumed to be the relatively healthy market climate that prevailed in the last decade. Inevitably, however, respondents tended to reflect on changing practices in the last few months. This section is concerned specifically with the likely shorter term impact of the credit crunch.

There can be little doubt that the current market conditions are having a significant impact on the behaviour of housebuilders in the land and housing markets. More than sixty per cent of the respondents suggested that transactions between developers have very recently increased in volume. There is a suggestion that transactions between builders, while considered a normal market process, are also a means of adjustment in a market downturn.

There is a view that this has had a disproportionate impact on volume builders, although they have not all been affected in the same way. This is slightly surprising. Bramley et al. (1995) point out that land banking strategies can vary over the development cycle. Well-resourced firms may well seek to make strategic land purchases counter-cyclically in order to benefit most from relatively low prices in a development downturn. Historically this practice has helped structure the UK housebuilding industry since it has advantaged larger housebuilders with the financial muscle to buy counter-cyclically and closed down the market to potential later entrants. At this point in the development cycle, we might expect larger companies to be purchasing sites from medium-sized and smaller builders. It is not clear, however, that this pattern is being reproduced in the current market.

In fact, the general view is that “Larger [builders] are selling off [land] because they are under bigger cash flow pressure than smaller private or diverse groups” [Interviewee 19] and that “most of the nationals are in the same place [as] they have the same models.” [Interviewee 6]. They have suffered by being “driven by shareholders and the need to increase output” [Interviewee 18]. These output pressures have led to the need to increase exposure to the land market disproportionately so that “...the volume house builders, because they’re
reporting on the number of units they’re building every year rather than on their profits, then they’ve got to keep buying sites just to keep their numbers up…” [Interviewee 2]

Scrutiny from the stock market is also perceived to be important. There is an assumption that because the strength of the firm is associated with the size of the land bank, volume builders will try to avoid selling land. It is argued that “developers will try and restrict their land sale profit because it’s seen by the City as a weakness in their share price, but everybody does it because it tends to be you’ve laid out a load of cash and you need a load back.” [Interviewee 1]. Shareholder perceptions of land sales are thus a secondary consideration in the current market where the key driver is the need to manage short term cash flow. Many, although not all, larger builders have become active sellers and observations include “I’ve had sites from [three volume builders] all within the last few weeks ….because they haven’t got any cash coming in the other end so got to find it somewhere.” [Interviewee 9]

In a climate when sales levels are low and the demand for houses falling, land sales are used as an alternative source of income for builders of all sizes. There is a reluctance to take this course of action, even amongst those who are not exposed to the scrutiny of the stock market.

“Given the difficulty in acquiring land and getting planning permission, land sales are a bit of a last option. [But] they do offer the availability of short term profit at the expense of losing future development profit” [Interviewee 4]

Most smaller and regional builders argue that, even in a weak market, the restrictiveness of land supply overall means that it is possible to continue to be selective and strategic about what you sell.

“…. in today’s market you’ll find a lot of developers are trying to chop out pieces of bigger sites, we’re looking at quite a few at the minute and I think that their perception is, they’re either not confident that they can sell the properties once they’ve built them or they need to get some cash in because they’re not selling on other sites so they need that cash injection.” [Interviewee 10]

Others feel that market pressures mean that the time to be selective has gone and, for at least one, there is less concern now with the need to secure a reciprocal arrangement and more with achieving the best price. It is unclear whether this is a very short term reaction to the appearance of a downturn or a trend that might continue throughout a downturn. Some are simply avoiding increasing their exposure to the land market and observe that:

“The whole market has changed drastically in the last three months, in fact in the last 8 weeks it’s an absolute nightmare. So volumes are down 30 per cent on everything we’re doing, prices are coming down, so we’re probably
pulling out of the land market at the moment, we will not be buying in that land.” [Interviewee 5]

Three others, of varying sizes and in different regions, argue that these conditions present an opportunity to strengthen their future position. There is a feeling that this is a good time to acquire more land. The change in climate has meant that there has been a switch from the sellers market of the last decade to a buyers market. Sellers are offering good value deals and buyers have more choice than they would usually expect. This is explored by several respondents who note:

“in this current market we are seeing a tremendous number of opportunities come through because a lot of developers are not only shedding land but they are pulling out of deals. And through our web of contacts we’re picking up a lot of these opportunities …. [and] actually have a lot of choice” [Interviewee 11]

“...we see this present market and the problems that other house builders may have, as being a fantastic opportunity for us to buy land from distressed companies, receivers, liquidators, those are the sorts of people. And because we are cash rich... we may very well just step in and buy it over a 24 hour period.” [Interviewee 2]

“I bought quite a lot this year in fact, I’ve been taking advantage of the drop down in the market. And before this year we were buying land at no profit and hoping that using our expertise we could improve the profit, turn it into profit.” [Interviewee 4]

The reasons for the variations in response are not obviously related to the size of the firm or the niche markets in which they operate. The most likely explanations relate to the specifics of the business model and financial structures adopted by the firm. Those whose structures are less dependent of debt finance appear to be in the best position to make minor adjustments to their forward land supply to either support future building plans or to cushion the effects of falling sales. Others are in a far more desperate position, especially those medium-sized and larger firms who have been expanding output. It is argued that these firms have been forced to accumulate land in a competitive market to support higher volumes. This has forced them to pay more for land than development appraisal models would suggest.

The dominant approach used in estimating land values is the residual valuation method. This method relies on the calculation of a residual equal to the surplus of total development revenues over development costs including minimum required developer’s profit. The development revenues are the expected income stream from house or apartment sales (noting that the lumpiness and duration of the stream and the lag between development start and commencement of the income is likely to vary between projects). Using the residual approach, prospective site buyers should be able to arrive at an idea of the maximum amount that should be paid for the site to permit a minimum required
developer’s profit. It is argued “you need to fight harder at land buying than at final sales because that is where you make your money” [Interviewee 6]. However, the pressure to secure current and strategic land has seen evidence that land values, as measured in the Savills Land Value Growth Index, have outstripped residuals (Barnes, 2007). But “Profit margin is the thing that matters. You can aim to build as many as you like but you need to make money on them. Some [builders] have forgotten this and they measure themselves on output” [Interviewee 18]. This implies that the desire to expand output has squeezed profit margins in a way that makes it difficult to deal with a downturn.

There is also a suggestion that some firms have been over-optimistic about the assumptions they have made. At a general level, as the land market becomes more competitive housebuilders become optimistic about future trends and will bid up land prices (Gillen and Fisher, 2002: Leishman et al, 2000). These assumptions about market changes may become embedded in development appraisal (see Calcutt, 2007). It has been suggested that their has been over-optimism in predicting future densities and “…there’s been so many planning applications made on….by landowners trying to up the density and the demand is not there for that particular product.” [Interviewee 10]. In addition, the sustained period of double digit house price growth has also led to problems. It has been observed that “sometimes we wonder how they can pay what they pay for the sites they want. We do the sums and we just can’t see how they justify it…. I think [volume builders] are very numbers driven and so target driven that they will do strange things and buy a site then hope that house prices will rise by ten per cent by the time they come to sell because that is the only thing that will make the site work financially” [Interviewee 15].

The problems created by over-optimistic forecasts might, in part, be salvageable through increased land sales. Although transaction levels are rising and builders have talked about better value, there is no suggestion that land prices have been falling rapidly. Rather some downward stickiness in prices has been observed. As an experienced land buyer explains “historically it has taken quite a prolonged downturn in sales before the land market has responded…Land buyers think ‘well, this isn’t going to last very long’. Conversely when there is an increase in prices, the response in the land market is immediate, absolutely immediate” [Interviewee 15].

There is a lack of sympathy in some quarters for those who have been hardest hit. The flawed business model is emphasised and in crude terms there is a feeling that in some cases “they’ve built the wrong product, they had no vision” [Interviewee 4]. There is a worry, however, that there is a contagion problem and that the way in which the press has reported the problems of some “has hit the whole market… the tabloids have talked the market down” [Interviewee 4].

In summary, it is clear that current market conditions have introduced an important imperative for some housebuilders with cash flow difficulties to sell development land to ease these difficulties. Meanwhile, the credit crunch and housing market downturn have not affected all types and sizes of housebuilder
equally to this point ñ the industry as a whole does not appear to be over-supplied in terms of development land and some housebuilders regard the market conditions as an important opportunity to increase land holdings.

6. Conclusions

This report highlights the dynamic business context in which housebuilders operate and the strategies they have developed to deal with the challenges posed by the scarcity of the essential resource, land, and the competitiveness of the market for land. These strategies have been developed in response to the severe constraints introduced into the market by the regulatory framework and by the behaviour of landowners. This operating context means that most housebuilders generally seek a balanced portfolio of sites containing those with longer-term hope value (usually held on options), land with more immediate prospects of acquiring planning permission (typically purchased on conditional contracts) and land with planning permission in place. The balance is strongly weighted towards sites with immediate or near immediate prospects. Developers maintain a ‘forward land supply’ of between two and five years. Acquiring a stock of land (with and without planning permission) is a highly rational response to the need to control for risk and uncertainty and to ensure the optimal timing of development.

The industry has developed a range of tactics to secure land. The use of options is now widespread but the options market has become more competitive over time. Pricing has been distorted by the increasing sophistication of sellers and by the emergence of speculative investors. Several, mainly smaller and niche, housebuilders now rarely use options. There is heavy reliance on informal networks and close relationships with agents to secure development sites (both with and without planning). Relationship management has become more important as the role of traditional landowners has diminished. Few housebuilders are comfortable dealing with public sector landowners, even though these now dominate the ownership of large developable sites.

Many of the respondents naturally emphasised the role of the planning system in creating or reinforcing development land shortages. Yet, the impact of planning is not straightforward. Some respondents view the planning system as creating opportunities for further profits beyond the well established principle that the acquisition of planning permission increases site value. There are opportunities that exist to take a site with planning permission and increase its value through redesign and alteration of planning permission. Other respondents argued that the growth of this practice in the industry poses considerable difficulties. They highlight the growing market and planning awareness of some land owners and suggest that the award of planning permission can sometimes reduce the immediate likelihood of development. The argument is that land owners, in securing planning permission for developments unlikely to be successful from a market demand perspective, form unrealistic expectations when they come to market their land to prospective developer buyers.
A clear message that emerges from the analysis is that land market efficiency appears to be impeded by a set of inter-relationships between land owners, housebuilders and the planning system (specifically the speed and ease of obtaining planning permission). Housebuilders’ need to secure a forward land supply depends partly on the extent of planning delay which, they argue, is increasing as time goes on. This suggests that for a given level of housing demand, demand for land is rising as housebuilders seek an expanding forward land supply. Meanwhile, this rise in demand for land makes it increasingly worthwhile for land owners to seek planning permission in order to enhance the marketability and value of their sites. If the incidence of land owners seeking planning permission and developers seeking alterations to existing consents is rising then it follows that the planning system is subject, over time, to a rising burden of planning applications (causing rising planning delay). A circular problem therefore exists.

There is evidence that, for a variety of complex reasons, there remains a sizeable volume of land with planning permission that is not being developed. Arguably, at present, the industry structure encourages developers to hold a store of land that is much bigger than their capacity to build. This need not be a problem if the market operates efficiently enough to ensure a redistribution of developable land to builders who have the capacity to increase output but lack an adequate supply of land. The results of this study suggest that land market adjustment is highly complex. Although a large number of transactions between developers are open market sales to the highest bidder, there are many more deals that reflect formal and informal relationships. It would appear that because land buyers are primarily involved in the purchase of development land, even when they enter the market as sellers, since there is a tendency to explore deals that will assist with future acquisitions.

A very important driver of developer to developer land transactions is the imperative for developers to maximise their numbers of sales outlets. This finding is further supported by recent research focused on the drivers of housebuilders’ build out rates (Adams and Leishman, 2008). Networks and good working relationships between professionals and firms are an important element of this process. Many of the respondents indicated a preference for reciprocal arrangements when trading elements of sites for the purpose of maximising their number of outlets. However, the position is by no means clear-cut. Some of the respondents interviewed were effectively net acquirers of land and therefore in no position to enter into reciprocal arrangements and this appears to apply equally to some smaller developers as well as one or two of the volume builders.

It would appear that the credit crunch has led to reliance on land transactions as a source of short term finance for a large number of firms. Others, particularly those who are part of more diverse construction conglomerates or who are less reliant on debt financing, are taking the opportunity to engage in land acquisitions strategies that will enhance or consolidate their longer term prospects. There is some evidence that these firms are planning beyond the downturn. The differences in response are not driven by the size of the firm or
the niches in which they operate. They are rather more closely related to the financial structures and business models adopted.

The credit crunch, and associated housing market downturn, is having a significant influence on the land acquisition and trading behaviour of the housebuilding industry. There has been an increase in trading between developers. These deals are less selective than those that take place in more typical market conditions. Most of the interviewees suggest that these changes are simply of a short-term nature and are driven by cash flow problems. In one sense, this is an argument that the land market is relatively efficient since the transfer of development land from the constrained to the less constrained sectors of the industry should allow smoother operation of the industry as a whole. What is less clear is whether the recent downturn heralds longer term change in land acquisition and trading behaviour.

It has been suggested that the land market has started to undergo a rather more fundamental change. This is a process that can be traced to the introduction of brownfield land targets which, of course, led to significant changes in land acquisition strategies and in development industry competencies more generally. It would appear that, notwithstanding the credit crunch, the public sector will become an increasingly important player and that housebuilders may need to embrace partnership working in a more sophisticated manner if they are to open up larger sites. Market surveys suggest that the public sector is the largest owner of large developable sites at present. Yet few of the builders in this study purchase much land from state sources. It seems likely as other sources are exhausted this dominant ownership position will be consolidated and that the land acquisition strategies and processes common at present may become less significant in the future. This is not problematic given that housebuilders see partnership as unacceptable because “[the public sector] we will say we want to control your marketing strategy which contractually they may be entitled to [and] we want to look at your contracts with contractors, we want to look at your planning application … we want to look at your design … at your sales strategy … and management regime” [Interviewee 2].

It seems likely that the current market downturn will lead to significant restructuring within the industry. There are some housebuilders who are in a position to capitalise on their well managed and stable relations with other actors and who will move forward in a position of relative strength. These developers will be best placed to deal with the ‘quiet revolution’ in the land market that had already begun and looks set to continue. The cumulative effects of this reorganisation, however, may be to slow down the recovery in supply, even in better market conditions.


