GREATER**LONDON**AUTHORITY

Submission of evidence by the Greater London Authority to the Callcutt Review of Housebuilding Delivery

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CALLCUTT REVIEW – Terms of Reference

1. *To examine how the supply of new homes is influenced by the nature and structure of the housebuilding industry, the business models and its supply chain, including land, materials and skills;*

2. *To consider how these factors influence the delivery of new homes to achieve the Government's target (200,000 new homes per annum), meeting housebuyers' requirements and aspirations, achieving high standards of energy efficiency and sustainability as set out in the Code for Sustainable Homes, and progressing to a zero carbon standard; and*

3. *To make recommendations.*

This submission to the Callcutt Review call for evidence comes from the Greater London Authority (GLA) group and consequently incorporates the views of the London Development Agency (LDA) who were separately asked to respond to the Inquiry. This paper takes a London specific view of the development process and the business models used by the housebuilding industry. The evidence presented is drawn largely from detailed discussions with housing providers. As such, much of it is anecdotal: nonetheless, the GLA believes this is an accurate reflection of the structural pressures that shape prevailing business practice.

1. What published or private sources of information are used by housebuilders, analysts and others to determine current and future demand for housing, in terms of volume, type, price and location, and over the near, medium and longer term?

The Greater London Authority (GLA) has developed considerable expertise in this field. As well as housing need and supply, the GLA undertakes projections on household numbers and migration patterns, as well as population forecasts on a regular basis.

The GLA's Housing Requirements Study[1] (December 2004) estimated the need for additional homes by borough and by tenure. For the 10-year period 2002-2012, there is a need for 35,400 homes a year to clear the backlog of those living in unsuitable housing and to provide homes for London's growing population. There are also movements towards developing a housing market assessment for London in the near future.

However, it would clearly be inappropriate to set a target for new homes based on need alone without recognising that any delivery target is constrained by the availability of land on which to develop those homes. Similarly, when setting the targets for housing mix the Mayor has put sustainability and deliverability at the core of the decision-making process.

To achieve this, the London Plan aims to achieve a balanced tenure and size mix. This will meet existing and future need, as well as achieving wider policy aims such as delivering sustainable and mixed communities. The London Plan targets also take into account development economics; that is the effect of housing mix on the viability of development, taking into account the availability of public subsidy. On this basis the London Plan and London Housing Strategy set the target that 50% of new housing should be affordable, of which 35% should be social rented housing and 15% intermediate housing.

The recently adopted London Plan[2] target is for an additional 30,500 homes per annum over the ten-year period 2007/8 to 2016/7. Figure 4 demonstrates forecast growth of population and household numbers in the Capital to 2026. These targets are based on the London Housing Capacity study, which identified 1450 sites over 0.5 hectares with potential for residential development (this excludes sites that have development constraints such as protection of open space and land needs for employment and schools), and estimated small site capacity. The study included major strategic sites in London that been granted planning permission and are now moving into delivery phase such as Stratford City, Wembley, Silvertown Quays and Greenwich Millenium Village. Although capacity exits across London, the largest concentrations are in the East of London and the Thames Gateway area (Figure 2).

Figure 3 illustrates the increase in the development pipeline as housing approvals have increased over recent years. Although completions have remained relatively constant, this increase in approvals should result in an increase in the number of dwellings being built. The GLA's housing trajectories work looks at this in greater detail.

In addition to the GLA's published research, the 'Red' & 'Blue' Books produced annually by London Development Research are useful research materials for developers and the public sector, which track residential development on the ground and the intentions of site owners. Developers use these resources to monitor supply and demand, and to contact landowners for potential exchange or sales of development sites.

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[1] http://www.london.gov.uk/mayor/housing/docs/housing_reqs_2004.pdf)

[22] The London Plan: Housing Provision Targets, Waste and Minerals Alterations, GLA, December 2006

2. Does the prevailing business model of the housebuilding industry constrain how it responds to demand?

The prevailing business model undoubtedly restricts the industry's ability to respond to demand. The development process is lengthy, and at each stage there are risks and uncertainties that can undermine viability – from initial project appraisal and land acquisition, through negotiating the planning process, to construction and marketing.

When discussing housing supply it is important to note that supply comes not only from new built homes (which only makes up around 1% of London's total housing stock) but also from existing homes becoming available in the market. Relocating for employment reasons, prevailing interest rates, changes in family size and changes in household income are some of the many factors that can change the demand for housing at any one time. It is therefore difficult, if not impossible, to accurately forecast/measure effective housing demand, as this is dependent on many more factors than simply the need for homes, including external economic and fiscal regime and the relative financial performance of housing assets.

Increases in house prices are unlikely to bring new homes from the existing stock to the market. The fundamental reason is that homes are necessity goods. Those seeking to capitalise on their capital gain may downsize to a smaller home but will still require a place to live. The price supply elasticity of housing is therefore low. In other words supply is relatively unresponsive to demand, and at the very least tends to lag behind changes in demand. Figure 1 shows the relationship between housebuilding and average house prices in England since 1969.

Being better able to analyse demographic trends and labour market movements may help improve responsiveness – but if we cannot forecast accurately what residents will want then trying to analyse trends and labour market movements might give us a misleading view of what is happening. Land prices are crucial to the viability of development, yet reliable data is very scarce. Poor information and the lack of transparency in land markets create opportunities for profitable but unproductive land trading and results in "over-market" rates being paid for land. The resulting financial pressure on the development process feeds through to smaller homes, higher prices and lower build quality. Better information about land ownership, value and trading could help provide more certainty for the industry and vital knowledge for policy makers. Integrating and publishing the existing public land records (planning documents, Land Registry records, Valuation Office Agency data) would help make the market more transparent, and reduce opportunities for unproductive speculation.

The difficulties of significantly increasing the supply of housing are centred on the role of risk in the development process itself, rather than the absolute capacity of house builders to increase their output. All housing providers – public and private alike – have to compete on price for scarce land with little certainty about the costs of developing the scheme, nor the sale price of the homes built. This problem is central to our analysis of the residential development industry.

Private developers generally purchase land speculatively. The price paid for a site therefore acts as the ultimate threshold of viability, and the developer must minimise costs and maximise sale prices to recoup the land cost. The long time lag between land purchase and final sale, and the complexities of working with brownfield and contaminated land, compounds the risks faced and increases the cost of financing development.

In London large housing sites are generally built out at a slow rate. Typically these sites tend to be controlled by a single developer, who has an obvious need to maintain the price of all new units brought to the market. Housing markets are extremely localised[3]. Flooding the market with new homes in any one year could depress local property prices and eat into the developer's profits, so developers prefer to restrict the release of new housing. Anecdotal evidence suggests that developers tend not to release more than 150-200 units for sale per year from any one site, or in any one locality.

In order to compensate for the risk involved in building out large sites, developers typically demand 15-20% minimum returns on capital, but risk appetites mean that they often aim for more. This unusually high level of required profit represents a further barrier to responsiveness, as the incentives required to stimulate increased output have to be higher than in most other industries.

Is that model evolving or likely to evolve to meet changing patterns of demand?

There is some evidence that some housebuilders have adapted their business model to respond to new patterns of demand, especially at the top end of the market,[4] and in response to the need for more affordable housing. The long term approach to mixed tenure residential development adopted by companies like First Base, and public-led schemes such as the First Time Buyers Initiative are therefore welcome.

But in general housebuilding is a conservative industry that does not change quickly. High barriers to entry and the recent wave of industry consolidation have further reduced the scope for competitive pressures to drive change. In London, the relatively small number and high price of housing sites acts as a further barrier to new entrants. Ultimately, the continuation of the status quo offers considerable benefits to the handful of major companies that dominate the market, while any significant change in the way they operate offers only greater uncertainty.

What would encourage a shift towards greater responsiveness?

If the market will not transform the business models used by housebuilders, the drive for reform must come from the public sector. Public intervention aimed at reducing the risks and uncertainties faced by housing providers is therefore the best way to improve responsiveness. A strong public sector commitment to alternative models of development is an essential first step.

There are many levers through which public agencies influence development practice, including grant provision, land release, planning policies and the administration of development control. The use of these levers needs to be far better integrated under coherent strategic plans, to create a clear framework for investment that all housing providers can engage with. The forthcoming Mayor's Housing Strategy and Strategic Housing Investment Plan provide part of this for London – sub-regional development frameworks and the Mayor's increased planning powers will improve still further the Mayor's contribution towards the required co-ordination.

Improving the efficiency, consistency and predictability of the planning system is a key requirement for the industry to improve its responsiveness. These problems are particularly acute at the level of local authorities, where overstretched planning departments, unrealistic Section 106 demands and local political pressures can seriously impede development. The capacity and competency of local planning authorities is a major factor here – greater resources are needed if planning departments are to prevent the loss of the best planning staff. The introduction of the government's target regime for the time spent processing planning applications has led local authorities to shift delays away from the formal consideration phase of planning decision-making (the period between

[3] See London's Housing Sub market 2004 GLA Economics
[4] Nikos Karadimitriou, Changing the way UK cities are built: The shifting urban policy and the adaptation of London's house builders, Journal of Housing and the Built Environment, Volume 20, Number 3 / September, 2005

registration and outline permission covered under Best Value Performance Indicator 109), and onto other parts of the process. In particular there are often delays after a permission has been granted in securing Section 106 agreements, without which development cannot start. Although there are currently large numbers of outstanding planning permissions in London, many of these may not have a Section 106 agreement signed, and may not be implementable. It is currently impossible to assess the extent of this problem, as no record is kept of the length of time it takes to secure Section 106 agreements, but anecdotal evidence suggests this is a major issue in London. The BVPI regime should be extended to capture the full process up to securing an implementable planning permission.

Beyond reforming the general framework for housing provision, there are a range of potential interventions at central, regional and local levels that could help drive up the pace and quality of housing delivery. In the London context, these include:

- Increasing the number and quality of long term joint ventures between private sector developers and public sector agencies, where public partners contribute land or grant, including use of shared value initiatives, particularly to deal with heavily contaminated sites.
- A more proactive approach to land assembly, agreeing shared priorities across the investment agencies in London and, where necessary, using the existing CPO powers of these agencies to enhance the deliverability of sites.
- Working with public sector agencies that currently own undeveloped land to ensure that sites are brought to market in a way that maximises the development of new homes – providing long-term returns to the agency rather than necessarily maximising up front receipts.
- Directly allocating sites to preferred partners on the basis of commitments to quality (including affordability, design and sustainability) rather than just competitive bidding on price.
- Considering options for amending the tax regime to incentivise land release and penalise speculative land holding.
- Building stringent delivery timescales into grant conditions and development contracts when releasing public land - and parcelling out major development sites following full masterplanning to ensure a number of developers/housebuilders are working in parallel.
- Encouraging market diversity and increasing competition by encouraging RSLs to build for the private market, and private developers to set up social home building arms. We also want to assess the feasibility of new public development companies to build directly.
- Ensuring the overall delivery of homes contributes to the Mayor's affordable housing targets, but recognising the need to create sustainable communities in new large-scale developments.
- Ensuring that delivery is supported by Housing Corporation grant set at an appropriate level to deliver strategic priorities.
- Considering strategies to de-risk development, for example through price guarantees to developers that meet stringent delivery targets.

Many of these measures are aimed at reducing developers' risks: the corollary to reduced risk is that profit margins should come down too.

3. What are the alternatives to the prevailing business model? What are the constraints on the development of those alternative models, and what advantages might accrue from the development of other models?

There is potential for alternative models of development built around better forms of joint venture than are currently the norm. These should be based on a fair sharing of risk and reward, and build on the different strengths of partner agencies, in contrast to the often adversarial relationships currently prevalent in the development process. Increasing the number and types of developers active in the UK, including encouraging RSLs to take more of a lead role in housebuilding for all tenures, would help spur competition and innovation. Increasing the range of development models in operation would bring greater flexibility to the industry, and enable the development sector as a whole to cope better with changes in the economic and policy climate. The main constraints on the development of alternative models are the same issues that those discussed above: land supply, planning and the management of risk. The pattern of land ownership and supply is a major barrier to the development of alternative models. There are too few incentives for private owners to bring sites forward, and even public landowners tend to have other priorities than securing rapid housing delivery. In both cases, non-housing uses or simply waiting for values to rise are always options that have little opportunity cost to landowners.

Public agencies (EP, the LDA and others) attempt to overcome these problems by purchasing and remediating sites in order to bring more land forward for housing delivery. Better co-ordination of public land assets could help land release and assembly. Public agencies should be developing a more direct, strategic and interventionist role in land assembly, and integrating land release with strategic planning and investment plans.

High-density planning policies encourage owners to expect high prices for their sites, as they tend to assume that maximum density planning permission will be granted. The public sector could play a role in reducing expectations of high land prices, by setting more stringent density conditions on the type of permissions that are granted and enforcing maximum as well as minimum densities. High land prices also reduce developers' ability and willingness to meet important quality standards on issues such affordable housing, sustainability, design and other section 106 contributions; any systematic reduction in prices paid for development would therefore have the added benefit of increasing the quality of, and public gain from, housing development.

Public authorities' ability to release land free or at a discount has been greatly reduced, and they are generally keen to get full cash value for their sites. While understandable, this attitude means that the supply of public land is as problematic as the private market, and prevents public landowners from setting an example in terms of land release. What is needed is for public sector landowners to release land at low or not cost, and retain equity stakes in developments, which they can then sell on after scheme completion. Retaining long term stakes in regeneration will also give public agencies greater influence over the quality of development projects, and help to align interests and investment strategies between public and private partners. Increasing the use of design codes, pattern books and standard building types would help reduce uncertainty around what will be granted planning permission

The Mayor's target that 50% of all new homes should be affordable should have a beneficial effect on overall supply, as it reduces uncertainty in the planning system. As affordable homes have a guaranteed buyer, providing 50% affordable homes increases the number of homes that can be built without encountering the market absorption problem described above. The requirement for affordable housing in mixed tenure developments also creates opportunities for RSLs to build more for the private sector. This should help bring new practices and new competitors to the market. Long-term service providers like RSLs use development finance models that run over twenty years on average, whereas private house builders are capitalised at 4-5 years. Long-term service providers can therefore borrow much more cheaply – and are committed to schemes for the long term.

The GLA is working with the Housing Corporation, English Partnerships, the London Thames Gateway Development Corporation and the LDA to explore ways to better exploit the potential to deliver more homes and faster through the use of public land assets, modern methods of construction, smarter procurement and by attracting developers and those with other relevant skills from outside the UK. These partners have recently commissioned consultants to assess whether an alternative approach to the organising of land supply for development – both acquisition and disposal – together with the application of housing investment resources could help improve the delivery, speed and quality of future housing development.

Key lines of enquiry that are being explored are:

- How can public sector land be used more effectively to deliver sustainable outcomes?
- How can the procurement process for development partners be improved in order to generate sustainable regeneration outcomes?
- How can the application of housing investment be improved to generate sustainable regeneration outcomes?

The GLA would be happy to discuss this project further with the inquiry team.

4. To what extent is the housebuilding industry exposed to competitive pressures? Are there barriers to competition, including to new entrants? If so, what might be done to reduce or remove these barriers?

There are many small firms in the housebuilding industry, but it is hard for them to get to the scale required for large investments. Banks and investors will only provide money if the new business can prove it is viable, which is difficult in an industry that its based on speculative development. In practice, the housebuilding industry is dominated by a small – and shrinking – number of very large firms.

Certain developers - such as Wimpy and Persimmon - do not operate widely in London due to the nature of the development the capital, which tends to be high density and compact, and requires a specific set of skills. Even some specialist brownfield developers such as Urban Splash do not want to operate in London, as they require a selection of large sites to choose from, which the London land market does not offer.

The planning system, uncertainty surrounding infrastructure investment and the land market pose significant barriers to entry for international developers which could contribute new ideas and working practices to the UK industry.

5. To what extent is the volume and responsiveness of housebuilding constrained by limits in the supply of capital (including land), labour, skills or materials? Is this likely to change as a result of sustainability or other constraints? What steps might be taken to mitigate any effects?

There is no evidence that the overall supply of capital is a significant brake on housing in London. However, there may be issues around the nature of private investment in residential development and the role of the private rented sector. Around two thirds of London's new private homes are bought by investors – the bulk of whom are small scale buy-to-let investors rather than specialised companies.[5] While this investment helps reduce developer risk and so supports housing supply, there

[5] Who buys new market homes in London?, GLA, January 2007

are concerns about the vulnerability of this demand to price shocks, the quality of management provided by such owners, and the sustainability of new communities with a high proportion of private renters.

London's private rented sector accounts for 17% of the housing stock, compared to 10% in the rest of England.[6] Private rented accommodation is essential for London's labour market and economy, as it is the main form of housing for new arrivals to the capital. Institutional or equity finance involved in the provision of private rented homes is currently very limited: in 2005 only around £1 billion of institutional money was invested in residential property in London, compared to £67 billion invested in the commercial property sector.[7]

The GLA supports the development of more permanent forms of private rental of the sort attractive to institutional investors[8] because such investment is more likely to be long term and more professionally managed. Greater institutional investment could increase the supply of long term capital for housing, speed up build rates, improve management and may provide a better size. New approaches that might remove tax disincentives to institutional investment, such as Real Estate Investment Trusts[9] and Affordable Housing Trusts could help support this.

Figure 5. demonstrates that the output from the house building industry has increased significantly since 1993 without a corresponding increase in the quantity of labour, reflecting greater productivity.

In 2002, London's workplace output in construction was valued at up to £8billion, almost five per cent of London's total output. The workforce in construction, including employees and self-employed, was over 200,000 workers, 4.5 percent of London's workforce.[10] The supply of labour is relatively elastic, given international and national migration trends, but maintaining skills levels will be important. The GLA Group supports skills and training programmes in order to enhance productivity and promote sustainable employment. On construction, the London Development Agency is working with its partners through the London Construction Skills Forum and Employer Accord to guide future investment in learning and skills training in the London construction industry. The Agency's partners include the Learning and Skills Council, Construction Skills, Summit Skills, further and higher education institutions and Jobcentre Plus.

Currently 82% of freight is moved by road.[11] The freight challenges in London to deliver new infrastructure and homes include congestion costs and logistical difficulties at unloading and loading points. For example the delays to Wembley Stadium were in part due to the unexpected costs of congestion and moving materials in and out of the area. Further ways of giving priority to freight vehicles by getting cars and non-time-critical freight off the roads in peak periods need to be explored. Further consideration should be given to the increased use of water and rail for construction traffic, particularly for major developments such as the 2012 Olympic and Paralympic Games and Stratford City developments. The construction industry itself needs to consider the impact of freight movement and how this could be alleviated, especially through the use of consolidation centers or alternative modes.

[6] CLG live table 109
[7] Encouraging Institutional Investment in the Residential Sector, British Property Federation
[8] Attracting Institutional Capital', William Hill, head of property at Schroders, in More Homes for Rent: stimulating supply to match growing demand, ed Peter Bill, Smith Institute, 2006
[9] HM Treasury (March 2005) Discussion Paper Real Estate Investment Trusts
[10] Laying the Foundations, GLA Economics Feb 2006
[11] London Freight Strategy 2006 TfL

6. What constitutes good quality in housebuilding? To what extent is the housebuilding industry, as currently structured, well adapted to deliver well designed, good quality homes? What steps might be taken to improve quality?

'Good quality' is a highly subjective phrase. To the Mayor, good quality means:
- Environmental sustainability
- Well designed (aesthetically and efficiently)
- Fully supported by the right infrastructure and services
- Affordable housing, and mixed tenure neighbourhoods
- Adequate space standards, including children's play space
- Effective and high-quality management (service charges often are not adequate for this)

Good leadership from planning authorities would help here, as would the right support (subsidies or tax breaks) to encourage the use of sustainable techniques. The Mayor has launched Design for London to promote excellence in design throughout the capital, and CABE plays a similar role nationally.

The public sector must be an exemplar in its land dealings and public bodies with land holdings should make a clear commitment to ensuring that development on their land delivers the London Plan target of 50% affordable housing – whilst maintaining its clear vision of quality.

7. To what extent is sustainability, in any sense, a factor in the choices made either by housebuilders, suppliers and other providers, or by house buyers? What impact is being achieved by the Code for Sustainable Homes and the agenda set out in the Government's consultation document "Building a Greener Future: Towards Zero Carbon Development"?

Developer models should take into account sustainability needs and decent home requirements. However these features tend to have a long pay back period whilst developers' business models are more focused on short-term returns.

In London, developments that are referred to the Mayor are accompanied by an energy statement, which must show that developers have considered options to reduce the energy demands through efficient design. They are also required to ensure that 10% of the energy used is provided from renewable sources onsite, a target that should be increased to 20% under the Further Alterations to the London Plan. The draft Further Alterations require all developments to demonstrate that their heating, cooling and power systems have been selected to minimise CO_2 emissions, and specify an order of preference for selecting appropriate heating and cooling systems, from connection to existing Combined Cooling Heating and Power distribution networks down to gas fired communal heating and cooling. Developers are also expected to meet Mayoral requirements as laid out in his Supplementary Planning Guidance on Sustainable Design and Construction.

In terms of house buyers, there is evidence to suggest that homeowners are increasingly interested in sustainable housing. Based on an IPSOS survey considering the desirability of sustainable housing[12] more than fifty per cent of people were prepared to pay more to live in an eco development but suggested the Government should be doing more to provide incentives to encourage demand. The decision taken by the Chancellor, therefore, to reward house buyers buying

[12] IPSOS MORI – Sponge Report – Eco Chic or Eco Geek

carbon neutral homes through lower (and in some cases) no stamp duty[13] may act to stimulate demand as well as force the house building industry to rethink their approach to new developments. Further, Energy Performance Certificates will be in force from June this year, allowing buyers, for the first time, to compare the energy performance of homes.

The first true zero carbon developments have hit problems (for example, the Bed Zed project, which was costly and reliant on subsidy) – however it is early days still for this type of development, and knowledge and technology surrounding micro generation, sustainable building materials and energy minimisation is likely to increase markedly in the coming years.

The Mayor's position on sustainability and zero-carbon development is clearly set out in the GLA's 'Towards Zero Carbon Development' report[14]. The LDA is building London's first zero-carbon development in Gallions Park, Newham, which will set the standard for future development.

8. There is a clear public interest in the operation of a free market, in securing an adequate supply of new homes, and in sustainability. How, and how far, does the housebuilding industry respond to considerations of public interest? What public policy instruments are available to influence the performance of the industry, and how effective are they?

Development takes a long time, and once built, homes may last for centuries. It is therefore essential that the short term incentives that motivate developers should not overrule the long term public interest in providing sufficient high quality, sustainable homes.

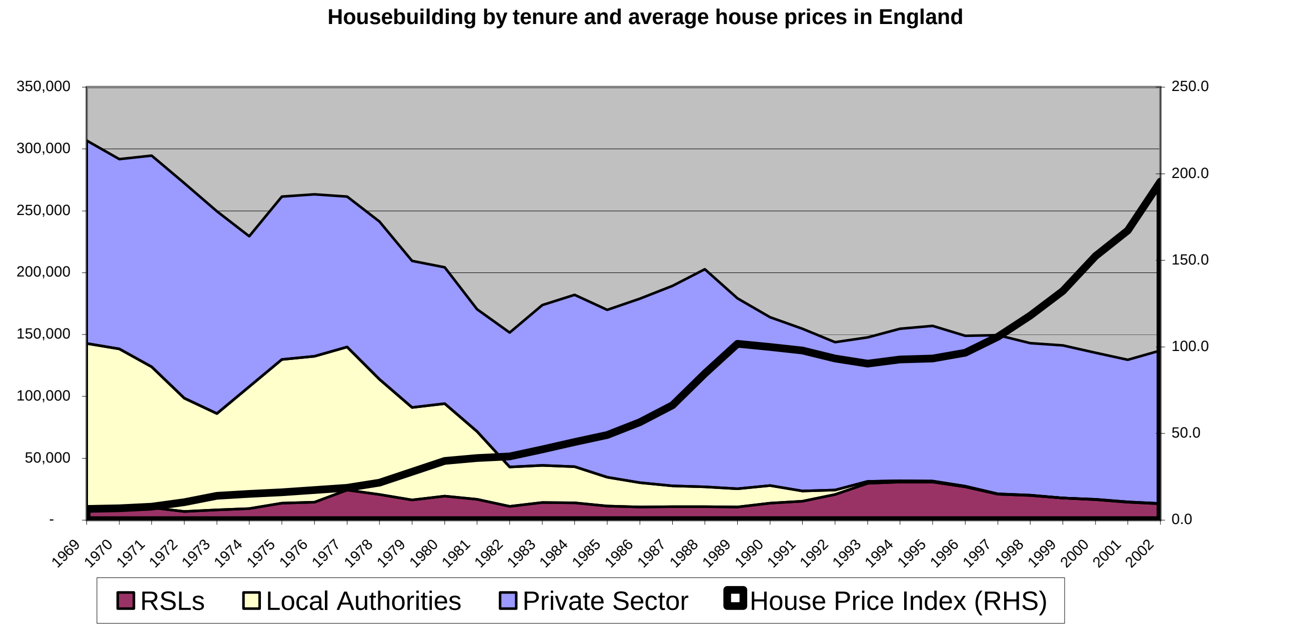
The three key levers for public influence over the development industry are land supply, subsidy and the planning system. To date, the use of land supply and subsidy has not been very effective at influencing the performance of the industry, whose business models and investment sources are well-entrenched. Planning is a powerful tool, but one which is inherently reactive and focussed on the built outcomes rather than processes of development. A more proactive public policy approach to development which integrated the use of all three main levers would offer the best possible means of altering the practices of the industry.

Integrating strategic planning, land release and assembly, grant allocation and planning powers is a major challenge for the public sector. The forthcoming Mayor's Housing Strategy and Strategic Housing Investment Plan, along with the London Plan and other published strategies, will help deliver a truly integrated vision for housing in London, and should incentivise the industry to reform. In addition, public sector-led development must act as an exemplar, in terms of how public land and financial assets are used, and in terms of the overall quality and mix of housing produced.

[13] Budget 2007 – Until 2012 all zero carbon homes up to £500,000 will be exempt from stamp duty.
[14] See http://www.london.gov.uk/mayor/environment/energy/partnership-steering-group/docs/LEP_towards_zero_carbon_developments.pdf

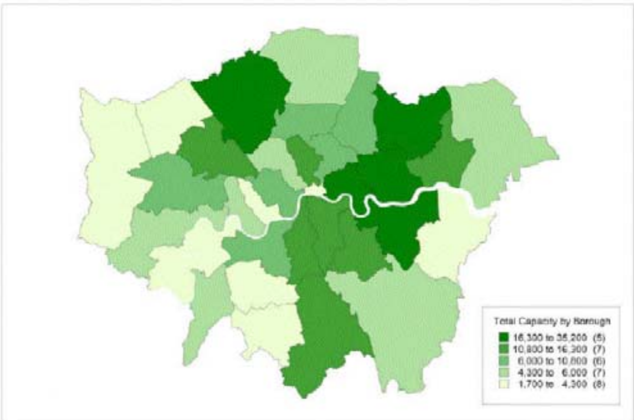
Supporting figures:

Figure 1



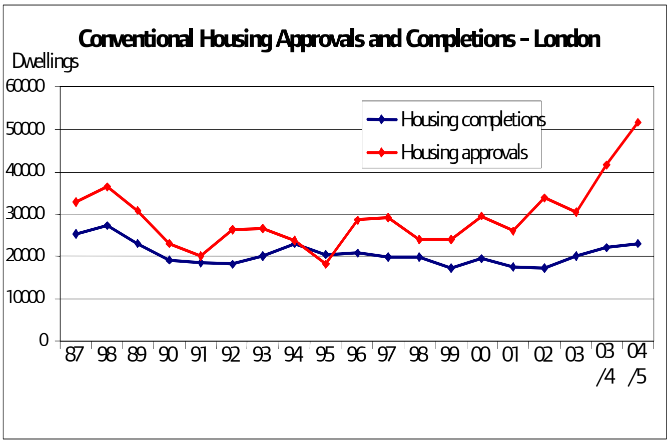
Source: CLG Live tables 244 and 528

Figure 2



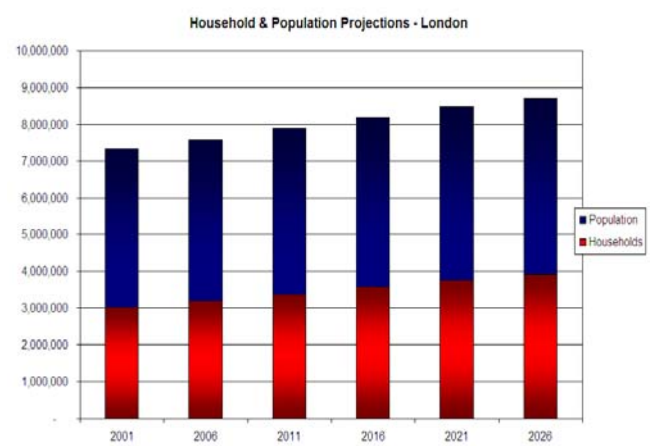
Source: 2004 London Housing Capacity Study

Figure 3



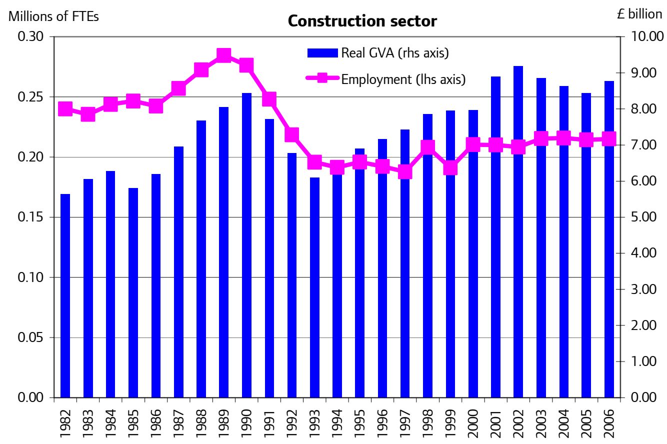
Source: Greater London Authority

Figure 4



Source: Greater London Authority

Figure 5



Source: Experian Business Strategies