



Building Homes Faster?

A commentary on the government's plans for increasing the pace of development

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Summary

- The government's housing white paper identifies the delivery rate of new homes, once planning permission has been granted, as 'too slow' and a 'major problem'. This is a welcome new consideration within Whitehall, to join longstanding and equally valid concerns about bottlenecks in the planning system.
- The proposals it suggests for tackling slow development include: removing the practical barriers to development that are identified by developers; requiring greater transparency about build rates; weeding out planning applications that are unlikely to result in a start; using compulsory purchase powers on sites that have stalled. These are all useful steps in the right direction.
- The white paper fails to address, however, a key barrier to speedier delivery by developers: the market absorption rate. Developers can only build homes as quickly as they can sell them and, in the current framework, they must sell them at current market prices or above. This limits for-sale housebuilding output, which has been in long-term decline as house prices have risen.
- The problem lies in the price that is paid for the land, which is calculated on the basis of current house prices. This locks the developer into a conservative build rate which cannot exceed the rate at which people are able to buy new homes at current market prices. A site of 1,500 homes may then be built at a rate of 80-90 homes a year, for example, the development taking 15-20 years to complete.
- This is a function of a planning system which grants permissions with no obligation on the landowner or developer to build any more quickly than the rate that will secure the maximum return. This virtually guarantees that developers will bid up the price of land to values at which conservative build rates are necessary.
- This is a framework that benefits anybody with a stake in the land, because it means land values – and house prices – are not undermined by new housing supply. But it also means that new supply does not generally improve the affordability of housing for those wishing to buy a home.
- Diversifying the market with a wider range of providers, including SME builders and the use of off-site construction techniques, are promoted in the white paper as a way of increasing competition. This would be a step forward but not a panacea: private-sector output will remain limited by the capacity of the

market to absorb new homes, however plentiful and diverse the providers of new housing are.

- In order for developers to build and sell homes more quickly, those homes need to be more affordable. One way of achieving this is to give homebuyers greater purchasing power, something that has been supported by low interest rates and actively pursued via the government's Help to Buy schemes. But this only holds prices up at levels that are already unaffordable to many and requires a constant flow of new resources. Demand-side policies like these are, paradoxically, one of the principal drivers of the affordability crisis we now face.
- A more sustainable way of improving the affordability of new-build homes would be for them to be sold more cheaply, at a discount rate to first-time buyers, say, compared with the current market price of second-hand homes. The government is attempting something like this with its Starter Homes policy, but this requires taxpayer-funded subsidies and reductions in affordable housing contributions without any de facto change to the market price of the homes.
- What is required is a new land and planning framework that enables developers to sell homes more cheaply, and so build them more quickly, by purchasing the land at lower prices. For this to be feasible, the landowners' right to sit on land indefinitely needs to be removed. This could be achieved by overhauling the land compensation rules and introducing the principle that sites needed for new homes but not brought forward for development will be compulsorily-purchased at a price which does not incorporate the value of the prospective planning consent.
- This would create greater competition in the land market as the onus would be on landowners to sell their land for private development at the best price they can get before the local authority has to resort to compulsory purchase powers. This would be to the advantage of developers, as they would be able to purchase land more cheaply. But at the same time there would need to be a corresponding requirement on developers to build sites more quickly than they are able to under the current regime.
- This could be achieved by imposing contractual obligations governing the build rate of certain sites, or certain portions of sites, as a condition of planning consent. By requiring quantities of homes to be built to specific timescales, and making this an explicit requirement at an early stage of the planning process, developers would have to tailor their bids for the land to ensure the viability of

selling those homes at a price that the market can absorb at the rate required. The idea would be for faster build rates eventually to be embedded in land values.

- This would enable more homes to be built, more quickly, at prices that a greater number of households can afford, bearing down on current market prices, and thus widening access to home ownership. The cost would be borne by landowners, out of the substantial windfall profits they make when planning permission is granted.
- This could be introduced incrementally, starting on individual sites in high-demand, high-price areas. If it was gradually rolled out more generally then land values would become anchored to a level at which sufficient homes could be built and sold to meet need in any given locality, rather than being maintained at a level that keeps prices high and drags on housebuilding activity.

Introduction

The government's housing white paper, *Fixing our broken housing market*, places a strong emphasis on the need to increase the pace of development, which it describes as 'too slow'.¹ This reflects concern about the time it takes developers to build homes even after planning permission has been granted. This slow pace of development is described in the white paper as the 'second big problem' in housebuilding (the first being the failure of more than 40 per cent of local authorities to have a plan in place for meeting projected household growth). 'Building homes faster' is thus the title of one of the white paper's four chapters. It describes the situation like this:

This Government's reforms have led to a large increase in the number of homes being given planning permission. But there is a large gap between planning permissions granted and new homes built. More than a third of new homes that were granted planning permission between 2010/11 and 2015/16 have yet to be built.²

The white paper cites statistics suggesting that in July 2016 there were 335,000 homes with detailed planning permission that had not been started. Of those, about 300,000 were said to be 'progressing towards a start' and another 18,000 were on sites that were 'on hold' or 'shelved'.³

This focus on build rates follows various ministerial pronouncements on this issue in recent months. Notably, communities secretary Sajid Javid singled out the activities of major developers in a speech to the Conservative Party conference last October:

The big developers must release their stranglehold on supply. It's time to stop sitting on landbanks, delaying build-out: the homebuyers must come first. Almost 280,000 planning permissions were issued over the last twelve months. I want to see each and every one of those homes built as soon as possible.⁴

In a subsequent interview with Channel 4's *Dispatches*, Javid threatened to use a combination of 'carrots and sticks' to ensure that planning permissions were turned into homes more quickly, adding:

I'm a former business person, I know how businesses work. But I also know how to disrupt business models and change things and that's the sort of experience I'm going to bring to bear down on this. ...

People can't live in a planning permission – what we need is to find ways to incentivise developers to use planning permissions. I'm determined that we really get a grip on this and do something about it, that's going to last for the long term and make a difference.⁵

This ministerial interest in the discrepancy between the numbers of planning permissions granted and the number of homes built seems to represent a shift of emphasis from housing policy during David Cameron's premiership (2010-2016), when the focus was on approving more land for development. The 2017 white paper's recognition that there is more to the under-supply of housing than increasing the number of planning permissions (though that is and remains crucial too) marks a step towards a more comprehensive understanding of the housing market. This could pave the way towards a holistic housing strategy that begins to address the fundamental barriers to significantly higher output.

However, the specific proposals in the white paper that are focused on this area are not quite so bold as some of the advance ministerial rhetoric. While the government's focus on build rates (among various issues) is welcome, its response to the issue is unlikely to change current practices except in some of the more extreme, and marginal, cases.

1: The white paper's proposals

There are a large number of measures set out in the second chapter, titled 'Building homes faster', which break down broadly into three different areas. One addresses those issues that developers cite as obstacles to speedier development; another is designed to hold local authorities to account ultimately for delivery; and another seeks to give local authorities the power to hold developers to account for building the homes that have been approved.⁶

Addressing developers' concerns

In terms of addressing developers' concerns, the white paper identifies a wide range of factors that may present practical obstacles to the delivery of new-build homes. They include the planning appeals process and wrangling over section 106 contributions; infrastructure and utilities requirements; pre-commencement conditions; skills shortages; and the presence on sites of protected species like the great crested newt. In addition to these issues, it should be noted too that the first chapter of the white paper addresses at length the most fundamental requirement for new homes: the availability of land with planning permission. Proposals in that section aim to ensure that every part of the country has an up-to-date, 'sufficiently ambitious' plan for the homes they need. In order to achieve this there is to be a new standardised methodology for assessing local housing need, to prevent local authorities setting unambitious, inadequate housing targets. There are also tools for local authorities such as measures to improve transparency in the land market, which are to be welcomed.

Holding local authorities to account for delivery

The white paper says that while some councils 'work tirelessly', others 'duck difficult decisions and don't plan for the homes their area needs'.⁷ It proposes the introduction of a new delivery test to hold local authorities to account. This will mean that they will face sanctions where housebuilding falls below certain thresholds pegged to local need. Sanctions include being required to identify 20 per cent more land, above and beyond what is needed for their new homes requirement; and, in areas where delivery is especially poor, local authorities will have the presumption in favour of sustainable development imposed on them – effectively binding their hands over future housing schemes proposed by developers. This proposal is apparently to be complemented by the publication of more open data on delivery of new homes measured against Local Plan targets and on the pipeline of development in each local authority.

The introduction of a delivery test is a potentially useful device that begins to address an anomaly in the current housebuilding system which is that no single person or organisation is ultimately in charge of getting sufficient numbers of homes *built* to meet needs. Local authorities are, under the National Planning Policy Framework, responsible for identifying a five-year land supply sufficient to meet housing need. They currently face no sanction, however, if those homes are not then built (neither do developers). The delivery test will mean that the buck stops with local authorities. This should, in theory, give local authorities an additional incentive to ensure not only that sufficient land is identified and approved for development, but to remove – where it is in their power to do so – any potential obstacles to a swift start.

Holding developers to account for delivery

Despite this mechanism for holding local authorities to account, delivery will still be down to developers. Councils don't build homes by and large, developers do (although there are early signs of a renaissance in local authority-led building that could in time change that).⁸ So the white paper's plan hinges on whether local authorities will have sufficient new powers to ensure that developers build the homes that are approved, on the timescales that are required. So, what tools will local authorities have to hold developers to account for delivery? We will consider those in turn now.

1. Information and transparency about build rates

The white paper sets out proposals for greater transparency about build rates, on a site-by-site basis and at the national level. For each site, more information is to be required from applicants at the planning application stage about the timing and pace of delivery. The housing minister, Gavin Barwell, has described this to MPs as 'a timeline for the speed of build-out', with the information requiring updating 'going forward'.⁹ Local authorities will be encouraged to take this information into consideration as they plan to meet their housing need. There will also be, subject to further consultation, a requirement for large housebuilders to publish aggregate information on their build rates.

These measures are a positive step forward that will improve the available data about what homes can be expected to be delivered by when and, at the local level, where they will be. This will help move the issue of planning on from simply approving a certain number of homes each year, and improve information and awareness about the amount of time each site is likely to take to deliver. This will give local planning authorities a better sense of how many homes might be built by

when, and whether the sites they have approved are likely to meet their housing targets for each year. This would mean, in theory, they would be equipped to manage the development pipeline in their area and ensure that sufficient homes have been approved, in the right places, to meet need.

However, while these measures will increase information about build rates, on their own they are unlikely to raise them – and without sanctions to impose on developers who fail to deliver homes at the pace they have promised, there will be no way of holding developers to account for the undertakings they have made at the application stage. This is important, because if a local authority used this information to substantially increase output levels on paper, that may undermine the sales prices that developers have been anticipating, and so developers may then be unwilling or unable to deliver the homes they initially thought they would.

At a national level, publishing aggregate build rates by developers will similarly increase understanding and transparency about the issue, which is to be welcomed, but without necessarily influencing the rates themselves. Mr Barwell described this measure to MPs as a ‘nudge policy’, but there are powerful economic factors driving current build rates that are unlikely to be overridden by additional transparency.

2. Consideration of site history and applicants’ track record

The white paper proposes that the history of a site might be a material consideration in the determination of planning applications. This is in order to encourage local authorities to consider whether sites are likely to be delivered, if approved. This is a potentially significant move: in the region of 10-20 per cent of planning permissions are thought never to be built, and another 15-20 per cent end up being reworked and recycled into future planning applications, which is a key reason why so few homes are built compared with how many have been approved by local authority planning departments.¹⁰

However, as worded in the white paper, this seems to be for invocation only in cases of ‘sites where previous permissions have not been implemented’, which narrows the application somewhat. That is to say, a landowner with no intention of building any homes could still apply for permission and expect approval, as long as his/her site has not been through the planning process before. Conversely, this test might in fact snare applications for sites where there is now a genuine desire to build even though the previous applicant on the same site did not. As well as, or instead of, taking the site’s history into consideration a more effective way of addressing the issue raised here would be to impose a contractual obligation on the applicant requiring substantive work to be under way by a certain point in time.

There is a further proposal for local authorities to take an applicant's past record into account when determining applications; this would give an authority a route for weeding out time-wasters at the planning stage. But again, as worded in the white paper, it is unlikely to have a very broad application as it is only to be used against major developers on large sites. More importantly, however, an applicant's past behaviour might not be a guide to their future intentions. In this circumstance again, it would be more effective to impose a contractual obligation on the applicant requiring work to start by a certain point in time – this could be freely agreed between applicant and local authority.

3. Shortening the timescale for start of development

The white paper suggests reducing the timescale for developers to implement a permission from the default period of three years to two years. It should be noted that this proposal is heavily caveated: it would not be applied where the shorter timescale would 'hinder the viability or deliverability of the scheme', and ministers seem particularly concerned about the potential impact on SMEs.

These are reasonable concerns which ministers are right to take into consideration. But they also point to the fact that this is unlikely to change much about the speed at which development proceeds already: most of what developers do is already justified on 'viability' grounds. Anything like this that hits developers' profitability is going to feed back into their appetite for taking on projects in the first place. In addition, where the three-year deadline is breached, developers can usually re-apply and have permission re-approved: again, without some form of sanction, it is difficult to see how a new two-year deadline would be any less malleable in its application. It is therefore unlikely to change behaviour among builders who do not currently start developments within two years.

Moreover, most developments already do start within two years. Research by the planning consultancy Lichfields shows that the average time between planning approval and the delivery of the first home ranges between roughly nine and eighteen months (depending on the size of the site – with smaller sites usually taking longer).¹¹ These are averages, but they suggest that most developers do not need incentivising to get on site and make a start (where they start at all). The much more important question about the pace of development concerns how quickly, once developers have made a start on site, homes are then built over the years ahead. In other words, the issue is not how quickly developments are started, but how quickly *each of the homes* on that development is started. A 500-home site will often take seven to eight years to build, for example, even though

they could technically be built much more quickly than that. This proposal does not tackle that.

4. Intervention on sites where work has stopped

The white paper proposes simplifying and speeding up the completion notice process, whereby if development on a site has stopped and there is no prospect of completion the local authority can withdraw planning permission for the remainder of the site. This is to be backed up by encouraging local authorities to make more active use of compulsory purchase powers on stalled sites. Ministers are looking at whether land could then be auctioned to establish a market value at which the dispossessed owner of the land can be compensated.

Increasing the use of compulsory purchase powers is a potentially bold measure. This is welcome as far as it goes to ensure that, where development comes to a halt, the land can be seized and placed in the hands of a new developer in a better position to build homes (assuming that the reason for delay is not intrinsic to the site). But, again, its application is to be very narrow if it is to be limited to use on sites where development has stopped altogether. The white paper's brief analysis of unbuilt planning permissions suggests only about five per cent were on sites that were 'on hold' (18,000 of the 335,000 approved but not yet started in July 2016). Mr Barwell told MPs that the use of compulsory purchase orders was for 'extreme cases'. Like the proposal to bring forward starts, this measure is concerned with a quite marginal issue. It might also be noted that there will be no new powers in this regard that local authorities do not have already; the encouragement to use existing CPO powers will be contained in new guidance.

Conclusion

In his select committee appearance after the publication of the white paper, Mr Barwell pinpointed his biggest concern with respect to delivery as the build rates of developers on large sites once planning permission has been granted:

My real concern is actually how long it takes [to build out a site] once you start. All of us as members [of parliament] I think are familiar with large schemes in our constituency - 1,000 homes, and they are being built out at 70, 80, 90, 100 homes a year. So the government believes that the market absorption rate, certainly in those parts of the country with high demand, is higher than maybe our developers believe it is.

The minister is right to identify this issue of slower-than-necessary build rates as the principal problem (as opposed to 'landbanking' per se). But the proposals in the white paper do not address this issue squarely.

Taken together, the measures for speeding up the pace of development are encouraging and begin to address many of the issues that are identified, by both developers and local authorities, as obstacles to quicker build-out. But when it comes to delivery they are limited in their scope and contain little that will change current practices.

There will be more information and transparency about build rates, and this might enable local authorities to better piece together the sites that are needed in their area to meet need, but they are unlikely to change those build rates, nor do they give local authorities the powers to hold developers to account for what they have indicated may be possible at the application stage. Bringing forward the timescale for starts on site is unlikely to change much at all, while greater use of completion notices and compulsory purchase orders on stalled sites will only affect the minority of developments that have come to a halt altogether. Enabling planners to take into consideration the history of a site or the track record of an applicant may be useful in certain circumstances, but unless obligations are imposed on applicants then there remains no guarantee that a development will get under way in the first place.

What is lacking is any attempt to address the central problem, identified by Mr Barwell, which is the slow rate of development on sites that *have started* but yet *have not stalled*. The white paper contains a range of proposals to address the concerns of developers, and it looks to introduce a new delivery test on local authorities requiring them to ensure that sufficient homes are built to meet need. But it fails to equip local authorities with sufficient powers to hold developers to account for the build rates that they promise at the outset – still less does it introduce anything that will raise those build rates. It is important to note that developers insist that they already build as quickly as they could do, except for issues beyond their control such as planning hurdles, skills etc.

To the extent that the proposals in the white paper do increase the number and pace of homes that are built, this will only be within the parameters of the present system which is intrinsically self-limiting in its ability to step up housing supply, and will do little if anything to improve the affordability of housing. The reasons for this we will turn to next.

2. Need and demand

Local authorities are to be required to plan for – and ensure the delivery of – enough homes in their area to meet ‘objectively assessed needs’. But market-led development does not build according to what people need, it builds according to what people are able to buy, or effective demand. This problem is at the heart of the housing shortage and is left largely unresolved by the white paper. Housing minister Gavin Barwell has suggested (as quoted in the previous section) that developers are not building as fast as the market absorption rate would allow. Even if they did, however, this is unlikely to be sufficient to meet need, assuming that this is based on some configuration of projected household growth rates.

The rate at which builders build is a contentious and complicated subject. For their part, the major private-sector developers strongly reject the claim that they restrict supply in order to push up prices, as the chief executives of three of the biggest housebuilders – Barratt, Persimmon and Taylor Wimpey – did when asked about this issue by MPs last year. David Jenkinson, group managing director of Persimmon, said:

We will meet the demand of what is there at that time. There is absolutely no way at all that we are doing that [restricting the build rate to maximise the profit]. If there is the demand for houses on our sites, we will sell them.¹²

An obvious, but important, corollary is that they cannot sell *more* than there is the demand for, either, and so there is a natural ceiling above which output cannot rise. This is the absorption rate to which Mr Barwell refers: the rate at which the local market can purchase, or absorb, new-build properties. The Office of Fair Trade described this in 2008:

... build out rates, or absorption rates as they are known... are dictated by local market conditions and not by the maximum technical speed at which homes can be built. Homebuilders deliver new homes as fast as they can sell them, not as fast as they can build them.¹³

What is critical here, however, is that those homes can only be sold at current market prices or above. This is because, under the residual land value model used by developers, the price they pay for a piece of land is predicated on selling the homes on that land at current market prices. If they assume a lower sale price they will not bid enough to secure the land. If house prices subsequently fall, or if the developer cannot achieve the prices that had been hoped for, then they stand to make a loss. This means that homes must be released into the market at such a rate that they do not depress prices in the area; in practice, homes are simply sold

as quickly as people come forward to buy them at the pre-planned market price. As David Thomas, group chief executive of Barratt Developments, told MPs:

We are clearly not incentivised to sell at below market price. That is not the basis on which we bought the land. If we bought the land on the basis of a below-market-price sale, that would be a different thing.¹⁴

Peter Redfern, chief executive of Taylor Wimpey, added:

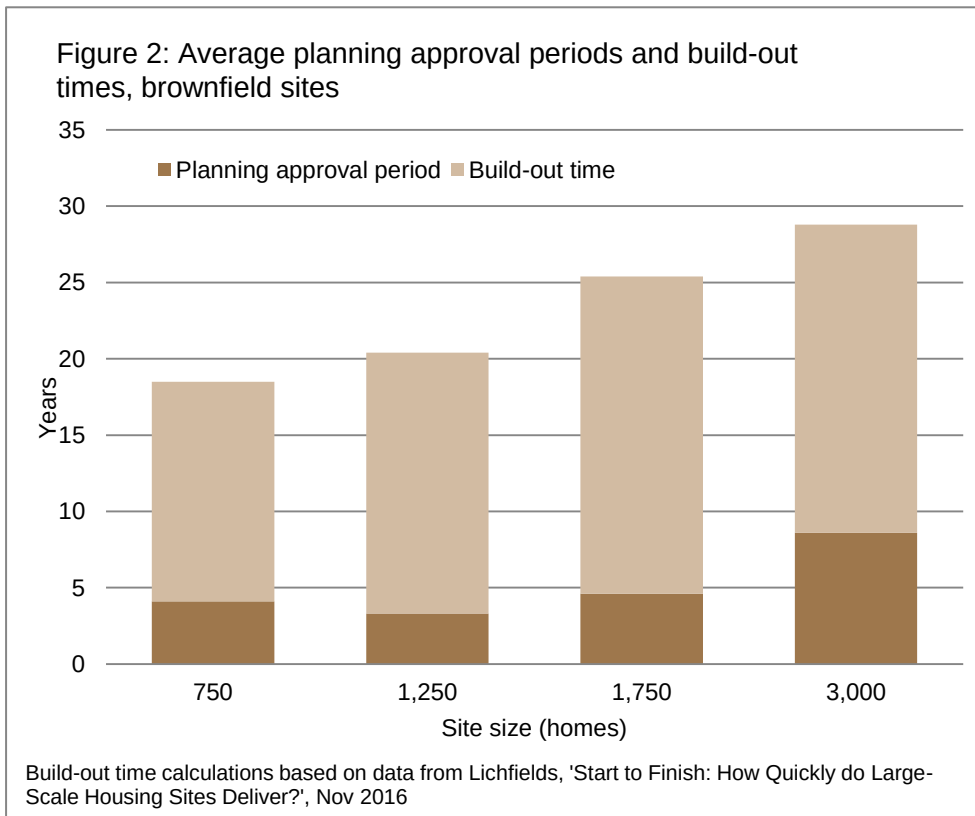
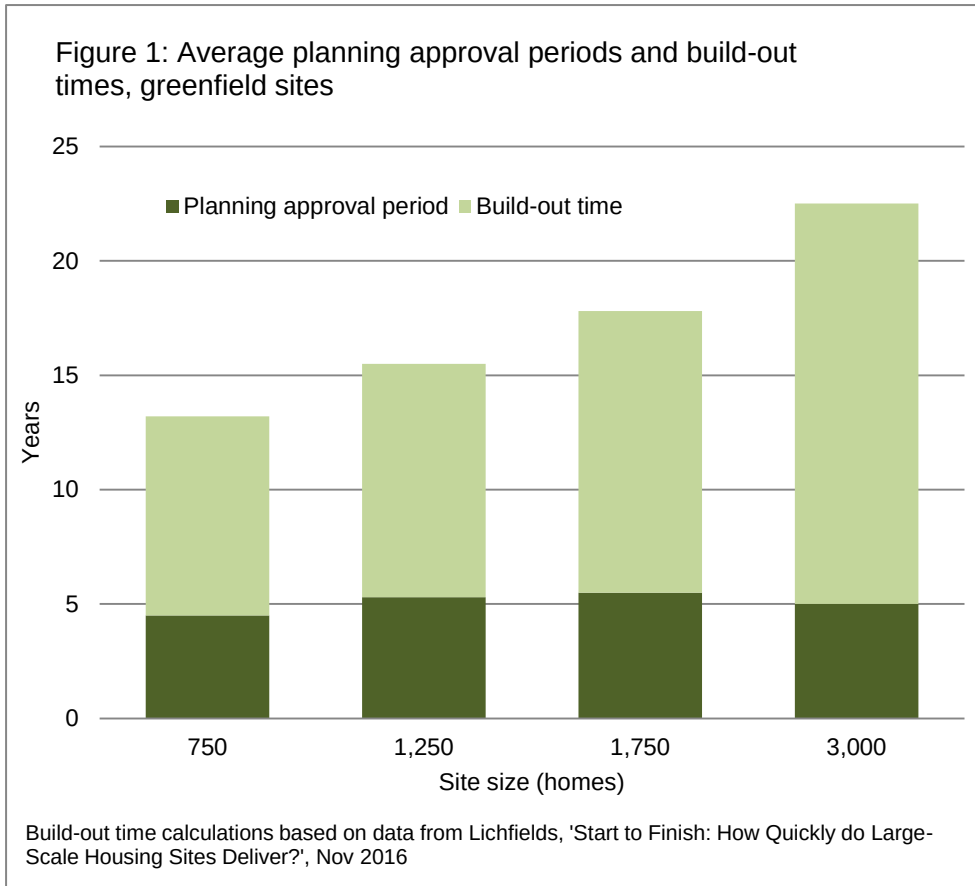
Clearly, we are not looking to drive down the market price, having bought a piece of land, but we are price-takers, not price-setters. We are not looking to control the price and we never have been, either locally or nationally. There is no attempt from the industry to restrict supply, but we are absorbing what demand we can find in the local areas where we have sites, at more or less the market price. That is because that is the financial case on which we have bought the land in the first place.¹⁵

Build rates

That homes are not built at the maximum technical speed they could be is especially true of larger sites, where the number of homes that could potentially enter the local market in a relatively short period of time could severely undermine current house prices. Past academic studies have suggested that build rates are rarely higher than 100 units per site per year, and are usually considerably lower than that, irrespective of the size of the site. One from 2008 found that the typical housebuilder aimed to build and sell one unit per week, or 50 a year.¹⁶ More recent studies, in London, have found build rates to average 68 per site in 2011, and 85 per site in 2013, but even in a best-case scenario a site of 500 homes would take at least five years to build.¹⁷

A 2016 study of larger sites by the planning consultancy Lichfields found that the average build rate increased as the size of the site increased, but not proportionately. Sites of between 100 and 499 units would deliver on average 60 units a year whereas a site of 2,000 units or above would still only deliver about 160 a year. Brownfield sites are built considerably more slowly on average than greenfield, however. Lichfields' work showed brownfield sites of 500-999 homes being built at a rate of 52 per year, sites of 1,000-1,499 at 73 a year and sites of 1,500-1,999 at 84 a year. These figures suggest a 1,500-unit brownfield site would take more than 17 years to completion even from the point at which work has begun.

The reason that a larger site can increase the output-per-year to the (limited) extent that it does is because there are more sales outlets on a bigger site. This means that there are different types, sizes and prices of houses being made

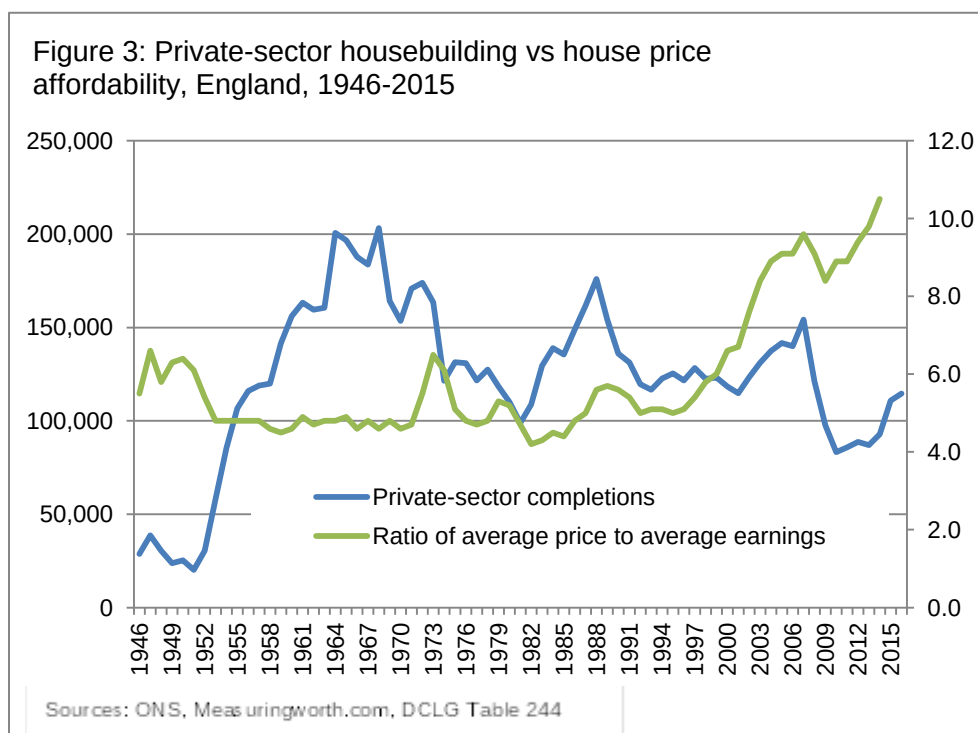


available which can be absorbed by different levels of the market.¹⁸ In other words, developers manage to tap into a wider pool of demand. However, the extent to which they can do this is not unlimited. Ultimately, there is only so much demand. So, while it often takes developers five or six years to receive planning permission, it then takes even longer to build the homes on it, as Figures 1 and 2 illustrate.

This is not about cynicism or greed on the part of developers; it is a perfectly rational response to the market framework within which they must operate. Furthermore, the high sums at stake given the record high values of land in which they must invest in order to trade, and the high degree of volatility to which the housing market is prone, increase the degree of risk to which developers are exposed and so reinforce cautious and conservative behaviours.

Nevertheless this is also a framework within which developers can turn impressive profits that are not driven by the quantity of their output alone. As Tom Archer and Ian Cole of Sheffield Hallam University have researched, the revenues of the nine biggest private builders grew by 76 per cent between 2012 and 2015 while their output grew by 33 per cent.¹⁹

But what should concern policymakers is not the profits of the developers but the system in which housebuilding output is restricted by the ability of people to afford new-build homes at the very elevated prices they have now reached as a proportion of people’s incomes. This is an especially important consideration given that those prices are in part a consequence of the failure to supply enough homes,



meaning that the problem is circular and self-reinforcing: homes cannot be built any more quickly because they are unaffordable, and they are unaffordable (in part) because homes are not being built more quickly.

The importance of affordability as a factor is underlined by Figure 3, which places private-sector building output since the Second World War alongside the ratio between average earnings and average house prices.* While this affordability ratio does not take into consideration changes in mortgage lending over the period, it remains clear that:

1. For-sale housebuilding output was highest when prices were closest to earnings, in the 1960s. In recent years, we have had record levels of unaffordability and record low output.
2. The peaks of private-sector output have steadily dropped off since the 1960s as, first, affordability became choppier in the 1970s, 1980s and 1990s; and, second, affordability worsened considerably from the late 1990s.
3. Rises in private-sector completions in the early 1970s, late 1980s and early 2000s were all accompanied by *rising* house prices followed, after a few years each time, by a slump in output.

The relationship between affordability and housing supply presents a challenge in terms of the geographical distribution of new homes as well. As previous Civitas analysis has shown, the shortfall between housing supply and projected household formation is most acute in those areas – principally London and the South East – where affordability is lowest already (Map 1). There are various factors behind that, and developers and others justifiably point to the correlation between areas of poor supply and the greenbelt. But high house prices are not just the result of undersupply, they are a contributing factor to it as well.²⁰

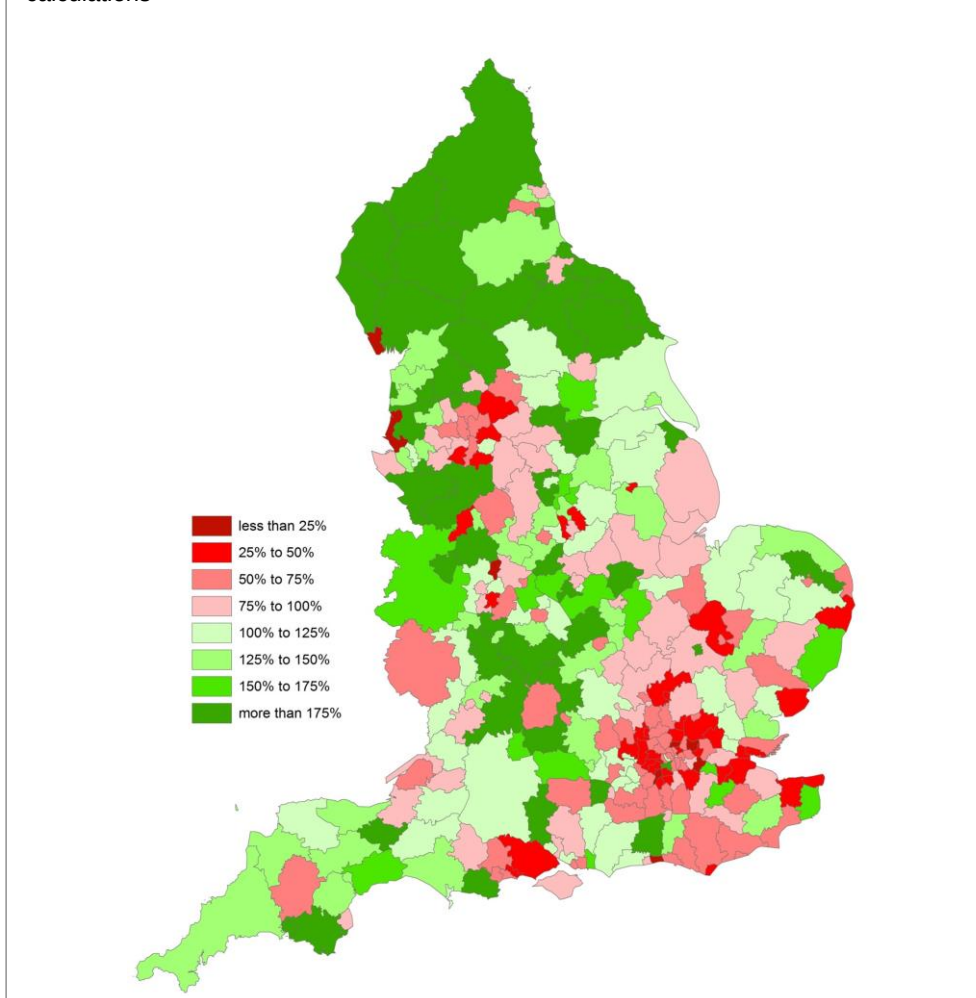
Diversifying providers

Granting more planning permissions for new homes might therefore be necessary but it will not be sufficient on its own to increase supply to levels commensurate with need. Market-led housing supply is dependent on a constant flow of new buyers with the resources to purchase homes at market prices. This limits housing output to what people (and, increasingly since the 1990s, investors) can afford rather than to what the community needs. It also means that housing supply will

* Note: this housebuilding data is from DCLG's quarterly 'Housebuilding' series, which tends to underestimate output somewhat compared with the annual 'Net housing supply' series. However, the annual series does not disaggregate private-sector completions from other provision and, in any case, the purpose here is to illustrate the historical trajectory.

not undermine current prices but keep them high. Unless private-sector builders can be persuaded to build faster, any attempt to meet housing need will require output from different providers.

Map 1: Net housing supply, 2015/16, as a percentage of projected annual household formation 2014-2039, by local authority. Sources: DCLG Tables 122 and 425. Civitas calculations



The white paper seems to acknowledge this as an issue when, at the start of chapter 3, it says: 'The business model for many commercial developers limits the number of homes that are built'. It then goes on to propose that the answer lies in (the title of chapter 3) 'Diversifying the market'. This includes support for SME builders, custom build, build-to-rent, 'accelerated construction' and council and housing association output. Does diversifying the market provide the answer? Any attempt to increase the range of housebuilding providers and increase competition is certainly to be welcomed. The number of small and medium-sized builders has declined dramatically over the past few decades, from about 12,000 firms in 1988 to about 2,500 today. The Home Builders Federation estimates that a return to the

number of firms operational in 2007 could boost SME supply by 25,000 homes a year.²¹ Small builders would take on smaller sites which may tap into additional demand. It should not be taken for granted, however, that those 25,000 SME-supplied homes would amount to a net increase in housebuilding output of that number. It is likely that some proportion (and possibly a large one) of those 25,000 units would simply draw off demand from elsewhere. In the end, SME builders – and any other private-sector developers building for sale to owner-occupiers, using faster construction methods for example – would be constrained by the same issues of market absorption as the major developers.

Build-to-rent may offer an alternative route to higher construction levels because it does not rely on homeowners to purchase the new units but instead institutional investors, such as pension funds, and therefore taps into an additional source of demand. Harnessing additional demand is not necessarily the best approach, as it too fuels house prices (as will be discussed in the next section). On the plus side, build-to-rent developments tend to be built more quickly and can offer greater stability for tenants than the traditional buy-to-let sector consisting of small-scale landlords. The white paper sets out the government's desire to 'attract major institutional investment' and says it will be consulting separately on measures to achieve that. But, again, how much scope does this model have? To date, there are still only 12,000 homes owned by institutional investors, most at the higher end of the market, not the lower end where the shortage is most acute.²² In terms of volume, analysis by Savills for the British Property Federation suggests that, if the policy framework is right, institutional investment sufficient to deliver 15,000 homes a year between now and 2030 might be available.²³ That is a modest figure compared with a housebuilding need of 200-300,000 homes a year.

Local authorities

The most powerful route to building many more homes than the major developers are prepared to do is, potentially, via councils and housing associations. This would be to use public subsidy to bypass the market and top up output to levels of need. This was the approach used in the 1920s and 1930s, and then in the 1950s and 1960s, when it was felt that the private sector could not possibly meet need in its entirety.²⁴ There is still housing association and local authority output today, but it is very much limited (in the range of 20-30,000 homes a year) due to the unwillingness of successive governments to either fund more public/social housing from the centre, or to allow councils greater freedom once more to borrow to build the homes that are needed. This is short-sighted, given the mounting costs to society of the housing shortage. The City consultancy Capital Economics has calculated that the government would achieve better value for money by part-

funding the construction of 100,000 social rent homes a year and thereby reducing future housing benefit liabilities.²⁵

The white paper says the government wants to ensure that local authorities 'have the tools they need to get homes built where the market isn't coming forward with enough'. Without fundamental reform to the provision of market housing, this is essential. However, there is still little sign from the government that it is prepared to finance large-scale council housebuilding or lift the borrowing caps on local authorities' housing revenue accounts, which would be the logical next step if such an approach were to be seriously pursued.

There are, nevertheless, growing numbers of local authorities that are finding ways to lead development within the constraints that they currently face, by setting up their own housing delivery companies or entering partnerships with private developers. How many homes they can realistically produce remains to be seen, but the government should explore ways of scaling these up where possible.²⁶

One area in which the white paper is particularly encouraging is in its promise to legislate to allow councils to set up New Town Development Corporations. This is intended to enable local authorities to initiate and oversee new developments along the same lines as the new towns and garden cities of the 20th century, when corporations purchased land, masterplanned development and collected the uplift in land values to pay for infrastructure requirements and public services. Crucial to these developments, however, was the ability of the corporations to purchase land at its existing use value (excluding the increase in value that planning permission confers). But that has since been removed by the 1961 Land Compensation Act, which established the right of the landowner to the 'hope value'; that is, the value of the site given the hope of future development.²⁷ While present compulsory-purchase compensation rules are based on a 'no-scheme world', that arrangement does not disregard the hope value that may obtain already – and will for all sites that have any reasonable prospect of being developed for housing at some point in the future. If the government wishes to see a return to new town developments on any scale, it will need to revisit and reform the 1961 Act.²⁸

Conclusion

If the government is to continue to rely on market-led housebuilding output, supply is highly unlikely to match levels of need; still less will it improve affordability. Market-led housing supply is pegged at the level at which there are buyers with the resources to purchase homes at current prices. This has serious consequences because it means that private-sector housebuilding is inherently self-limiting and, within the current planning framework, unlikely to improve affordability. Given the

unaffordability of housing to so many would-be first-time buyers already, the extent to which the market can absorb new homes appears to be close to its limit, even with historically-low interest rates and schemes like Help to Buy.

There are currently worrying signs that the latest market cycle is already reaching a peak, especially in London, where the shortage is most acute and where private-sector output is set to go into decline again. Savills estimates that completions in the capital are due to peak in 2017 at 46,500, but without 'further significant stimulus' they will then drop off to 35,000 – against a projected need of 64,000 homes a year.²⁹ This is due to lower sales volumes driven by affordability issues and weakening demand from buy-to-let investors. In any case, this market development has been geared towards higher price brackets to the neglect of more affordable provision. 'Given stretched affordability and the constraints of mortgage regulation, purchases by owner occupiers are unlikely to increase unless more affordably priced housing becomes available,' Savills says.

If the government wants to substantially increase housing supply, the surest route would be to facilitate large-scale public sector building once more. This could be achieved by lifting the housing revenue account borrowing caps, providing funds to councils from a central pot, and/or by giving councils the power to purchase land at its existing use value once more. This last would not require public funding on such a scale, and would probably be self-financing.

If the government does not pursue the public delivery route on any scale, then it will need to improve the ability of the market to absorb new homes. Diversifying the market is one way of improving the absorption rate, by bringing in additional providers who can target different parts of the market that might not be catered for already (in terms of either geography or type of housing). But there is still only so much demand and, where prices are highest such as in London, it is rarely going to be enough to match new housebuilding to levels of need.

3. Improving market absorption

For a number of decades now, as public housebuilding has been wound down and successive governments have relied on market-led output, the challenge of improving market absorption has been central to housing supply. This has been supported by wave upon wave of additional demand, starting with the deregulation of credit in the 1970s and 1980s, which enabled people to borrow more, historically low interest rates and, since 2013, Help to Buy loans and guarantees. Alongside help for owner-occupiers, ministers have also permitted and/or encouraged the entrance into the housing market of investors such as buy-to-let landlords and, increasingly in recent years, overseas buyers. All of these developments have, on the surface, improved the ability of the market to absorb market-built housing. They have all at the same time, however, contributed to the housing inflation that has seen house prices pull away from average earnings since the 1990s and rendered housing unaffordable to so many first-time buyers.

The trouble with stimulating demand in order to increase supply is that it only works by keeping prices high, which is the barrier to higher levels of market absorption in the first place. And as soon as that demand recedes – as soon as interest rates rise, buy-to-let investment declines or overseas capital moves elsewhere – the housebuilding industry seizes up. This approach requires a constant flow of new resources.

There is, perhaps, another way of increasing the affordability of new-build homes and that is for them to cost less. Instead of giving people more money to spend on new-build housing, or appealing for ever greater sums of investment money, they could just be less expensive for people to buy. If homes were cheaper, more of them could be sold more quickly and so more of them could be built more quickly. Developers may argue that this is not feasible because, as Peter Redfern says (above), they are price takers not price setters. But does it need to be this way? Not necessarily.

At the bottom of this issue lies the fact that land for new housing is only sold in line with the existing price of residential land (that with homes already on it). It is natural for landowners to demand the highest prices they can for sites, but those prices only reach the levels they do because new residential land is effectively drip-fed into the market at a rate that does not undermine existing prices. This is partly the result of way in which the planning system limits the amount of new land entering residential use to not much more (and in many places, quite a bit less) than is required. This gives those in possession of land with planning permission

(landowners, traders and developers) something like a monopoly position in the market where they can withhold supply until such time as their aspirational price (that of an under-supplied market) is met by a willing buyer. The most visible aspect of this is in the sale of a new-build home in line with existing market prices. But the process begins at the point at which the landowner trades the land at a price that presupposes that outcome.

Crucially, however, as well as restricting the amount of land for development, the planning system also gives the landowner/trader/developer almost complete liberty over the pace at which they can build a permission. And because of the competition between developers in the land market, this guarantees that they will build slowly, as that enables them to bid more for the land, without which they cannot do business in the first place. To put it simply, the planning system grants permissions but not obligations, which enables a small number of landowners to extract maximum profit from the rest of the community.

A different approach

One avenue for reform would be to redesign this framework so that developers face contractual obligations governing their build rates. Instead of being at liberty to dispose of planning permissions at a rate of their choosing, they would be required to build to timetables designed by local authorities to ensure the requisite number of homes in any area are built according to need. In such a scenario, developers would have to sell their homes for less, so that they are more affordable and so are absorbed by the market more quickly. This in turn would mean that developers would only be able to pay for the site what it is worth to them based on a lower target sales price; the intention would be to discourage them from bidding up land to a level at which they must then build slowly.

This approach would generate a supply of new-build housing at more affordable prices. Rather than the state subsidising house purchases, as with Help to Buy loans and Starter Homes, lower sales prices would be achieved by squeezing the profit made on the land. The losers from the policy would be landowners.

This raises the obvious danger that landowners would hold back their land in the hope that such a policy would be repealed later, when they would be able to achieve a higher price again. In order to avert that, local authorities would need to have stronger compulsory purchase powers. In areas where there is a shortage of land and therefore too few homes are being (or might in future) be built, councils should be able to purchase land at a price that does not incorporate prospective planning permission. This would require reform of the 1961 Land Compensation

Act, which guarantees that windfalls on land that is compulsorily-purchased fall due to the landowner.

Where councils resort to this, they could then develop sites themselves or in partnership with housing associations or developers, or they could sell them to SME builders in smaller plots. In practice this power might rarely need to be used – the threat of losing the land at little profit would be incentive enough (a greater incentive than they have now) for the owners to get their land in the pipeline and sell it to a developer for whatever they can raise within the new framework. The windfall gains associated with residential planning permission would remain substantial, even if they were lower than they currently are. Such a regime would give councils a much stronger hand in the local land market, enabling them to ensure that sufficient homes are delivered within the appropriate timeframes.

It is not envisaged that contractual obligations need be imposed on all sites across the board, nor necessarily on entire sites. There will be many problem sites where such an approach, introducing an additional hurdle for the developer, is not suitable. Local authorities would have to judge, on a site-by-site basis, where this approach would work and roll it out incrementally.

A series of pilots could first apply this approach to particularly large sites, with an accelerated timetable and lower sales prices imposed on a portion of each site, in addition to any affordable homes and infrastructure obligations. These homes would effectively be discounted against the second-hand market price, and could be offered in the first instance to first-time buyers. To reiterate, in order for this to be viable, developers would have to revise their bids for the site accordingly. Landowners that refused to strike a deal on these terms would risk losing their land, if there is a shortage, at a less favourable price under the local authority's compulsory purchase powers.

Is it really possible to influence how much developers pay for the land by amending the conditions on a planning permission? This is already the case. Land is worth to developers only what they are able to do with it. Consider, to take an obvious example, the enormous difference between land that has residential planning permission and land restricted to agricultural use. A developer is prepared to pay many times as much for a site with permission to build homes than the same site without that permission. Similarly, a site on which 50 per cent of the homes must be sub-market social housing is worth less to a developer than a site on which the social component need only be 10 per cent. The value of land varies not just according to its location but according to how it may be utilised and any infrastructure commitments that might be attached (such as CIL and s106). If local

planning authorities attached conditions to the delivery of schemes as part of the planning permission, in the same way they stipulate infrastructure requirements, social housing contributions or anything else, developers would have to pay less for the land in the first place in order that they could sell those homes more cheaply. Residential land prices would be anchored to a level at which homes can be built at the rate the local authority deemed necessary.

The developer's margins on its *housebuilding* activities should not be affected; the loss would come from the land uplift that otherwise would have been pocketed by the landowner and/or the developer. These can be very large, often life-changing sums of money. Analysis by the Centre for Progressive Capitalism shows that, in 2015, landowners profited to the tune of more than £9bn from the development of new-build homes.³⁰

The extent to which landowners profit like this is not set in stone. Indeed, the viability guidance on the National Planning Policy Framework (NPPF) states explicitly that land values should reflect any policy requirements attached to the development:

In all cases, land or site value should... reflect policy requirements and planning obligations.³¹

Viability assessments are meant to ensure that there are 'competitive returns to a willing landowner and willing developer to enable the development to be deliverable'. But by 'competitive' is meant only enough to incentivise the release of the land for this purpose, which only needs to be higher than any alternative use to which it might be put:

A competitive return for the land owner is the price at which a reasonable land owner would be willing to sell their land for the development. The price will need to provide an incentive for the land owner to sell in comparison with the other options available.³²

In most cases this would be much less than is usually paid by developers for land. There is nothing in the guidance to say that landowners should not profit to the maximum extent – but it is also explicit that the site value must reflect any policy requirements associated with a development.

The Mayor of London, Sadiq Khan, has drawn on these sections of the NPPF in his new draft Supplementary Planning Guidance (SPG), which is designed to increase the proportion of affordable homes on private developments to above 35 per cent of output. The London SPG makes explicit what the NPPF only implies:

...if the granting of planning permission will increase the value of the site, but the costs of meeting planning requirements are not factored in, *the site will be over inflated*. It is for this reason that the Mayor does not consider it appropriate within a development appraisal to apply a fixed land value as an input which is based on *price paid for land or a purely aspirational sum sought by a landowner*.³³ (my italics)

In other words, if a developer pays so much for a site that they cannot then build the required number of affordable homes, then they have overpaid and stand to make a loss. The aim of this tougher approach is to 'embed affordable housing requirements into land values across London'. What ministers should consider, similarly, is how to embed speedier build rates and lower sales prices into land values, not just in London but anywhere that housing supply is below local need.

In order for this to work in practice, there would need to be a high degree of clarity, from an early stage in the planning process, to stop land changing hands at sums that then render such an approach unviable. This is an issue that needs to be addressed more widely already in terms of Section 106 contributions, which are frequently negotiated downwards as the competitive pressures on land values rise.³⁴

Signalling

The concept of advanced planning signals, which influence land prices in order to maintain the viability of certain policy requirements, is one that has been highlighted by the Royal Society of Town Planners as a way of ensuring more efficient use of land. The RTPi points to experience in Chelmsford where, in the late 1990s, planners embarked on a drive to improve residential design in a way that placed greater demands on developers.³⁵ Contrary to what might have been expected, the net costs to developers did not increase because they had 'used the policy anchor to signal to landowners that they could afford less in bidding for the land'.

A similar approach could be used in order to drive faster build rates. A study into the Chelmsford case draws out various elements that would be essential to making the new approach work:

- Political resolve, ensuring and demonstrating to developers that there is no prospect of backsliding;
- Proactive planners, prepared to be prescriptive, scrutinise and challenge - but also prepared to negotiate to maintain viability;

- Site-specific guidance that ensures developers know clearly and early in the process the position of the planning authority.

The Chelmsford study concludes:

Why did the developers decide to go along with Chelmsford's policies? They had no choice. They were required to do so on pain of refusal of planning permission. Given that, the proactive approach was a way of saving everyone's time and money by making it very clear in advance exactly what was required of applicants.³⁶

Conclusion

A key barrier to faster build rates is the operation of the planning system, which grants permission to build a relatively small number of sites and with no obligation on the landowner or developer to build any more quickly than the rate that will secure the maximum return. This virtually guarantees that developers will bid up the price of land to values at which conservative build rates are necessary. This is a framework that benefits anybody with a stake in the land, because it means land values – and house prices – are not undermined by new housing supply. But it also means that new supply does not generally improve the affordability of housing for those wishing to buy a home.

In order for developers to build and sell homes more quickly, they need to be more affordable. One way of achieving this is to give homebuyers greater purchasing power, something that has been supported by low interest rates and actively pursued via the government's Help to Buy schemes. But this only holds prices up at levels that are unaffordable to many and requires a constant flow of new resources. Demand-side policies like these are, paradoxically, one of the principal drivers of the affordability crisis we now face.

A more sustainable way of improving the affordability of new-build homes would be for them to be sold more cheaply, at a discount rate to first-time buyers, say, compared with the current market price of second-hand homes. The government is attempting something like this with its Starter Homes policy, but this requires taxpayer-funded discounts and reductions in affordable housing contributions without any de facto change to the market price of the homes.

What is required is a new land and planning framework that enables developers to sell homes more cheaply, and so build them more quickly, by purchasing the land at lower prices. For this to be feasible, the landowners' right to sit on land indefinitely needs to be removed. This could be achieved by overhauling the land compensation rules and introducing the principle that sites needed for new homes

but not brought forward for development will be compulsorily-purchased at a price that does not incorporate the value of the prospective planning consent.

This would create greater competition in the land market as the onus would be on landowners to sell their land for private development at the best price they can get before the local authority has to resort to compulsory purchase powers. This would be to the advantage of developers, as they would be able to purchase land more cheaply. But at the same time there would need to be a corresponding requirement on them to build sites more quickly than they are able to under the current regime.

This could be achieved by imposing contractual obligations governing the build rate of certain sites, or certain portions of sites, as a condition of planning consent. By requiring quantities of homes to be built to specific timescales, and making this an explicit requirement at an early stage of the planning process, developers would have to tailor their bids for the land to ensure the viability of selling those homes at a price that the market can absorb at the rate required. The idea would be for faster build rates eventually to be embedded in land values.

Proposals

These are some suggestions that build on the proposals in the white paper as they stand in order to strengthen them in application and give local authorities the tools they need to comply with the government's proposed new delivery tests.

1. Rather than simply requiring applicants to provide information about their intended build rate, **introduce contractual obligations holding applicants to account for their undertakings at the planning stage**. This would negate the need for a subjective appraisal of whether a site is likely to be built or an applicant has any intention of building when they submit their application. Contracts could be used at the discretion of local authorities, on a site-by-site basis, dependent on the circumstances of each development. They might cover the start on site, output within a certain amount of time, or the completion date. The developer of a marginal site with a high degree of risk might not be required to give any undertakings at all if it would be an obstacle to development.
2. **Encourage the use of compulsory purchase powers not just on stalled sites but on sites where there is a failure to deliver on build rates agreed in planning contracts**. For lesser transgressions, fines could be imposed. For build-out timelines to be of value they will need to be honoured, and this will require (at times) strong backstop powers to be available to the local authority.
3. **Review the compensation rules for reimbursing the owners of compulsorily-purchased land**; auctioning the land in order to establish a market price for reimbursement would, in a rising market, carry little financial disincentive for a landowner with no intention of building new homes (note that, having gained planning permission, the value of that land will probably have risen by a large amount already). Councils need to be able to purchase land at prices that do not reflect any future increase in value arising from the granting of planning permission. This will require reform of the Land Compensation Act 1961.
4. Encourage local authorities to **explore the feasibility of imposing build rates closer to the technical maximum speeds at which homes could be built**, particularly on sites of 500 homes and above. Requirements should be set down as early as possible in the planning process and before developers agree a final price for the land. These requirements should form part of the planning contract with the developer as a condition of planning approval. This could start with a series of pilots on larger sites, with the requirement to sell a certain number of homes with a certain timeframe, at prices lower than the current second-hand market price. This could effectively be a form of discounting for purchases by first-time buyers.

5. **Require local authorities to compulsorily-purchase land for residential development, at values that do not incorporate prospective planning permission, if insufficient land is brought forward by owners/developers to maintain a five-year land supply.** This land (which could include sites for new town and garden city developments as well as sequential development) could then be developed by councils themselves, or in partnership with housing associations or developers, or sold in small plots to small builders with the council collecting any profit. The mere existence of this power should minimise the extent to which its use is required. Under the proposed regime landowners would be able to command smaller sums for their sites on the open market with developers – but if they refuse to do a deal they face losing their site for even less.

Developers may argue that such measures would be heavy-handed and discourage development. This might be true on marginal sites where the risks are high. Thus the use of these tools should be considered on a site-by-site basis as is deemed appropriate in the circumstances. The initial undertakings concerning build rates may be the subject of negotiation between local authorities and developers. With the introduction of a delivery test on local authorities, it will not be in their interests to impose contractual obligations that do not optimise the pace of development. It will be incumbent on them to use any such tools sensitively with regard to the ultimate delivery of homes on the timescales demanded by local housing need.

It should also be considered that the proposed delivery test, as described in the white paper, provides that greater amounts of land should be approved for development (or even the imposition of the presumption in favour of development) should housing supply be insufficient. Developers therefore have nothing to fear and potentially much to gain under the white paper's proposals – even though it is they who will ultimately determine how many homes are built. If local authorities are to be held to account for that delivery, they should be given a full suite of powers in order to drive it.

Conclusion

Ministers have acknowledged that there is an issue with the slow pace of housebuilding development once planning permission has been granted. The housing white paper highlights this issue and (among a large number of proposals dealing with a variety of issues) makes some suggestions for 'building homes faster'. Despite some of the ministerial rhetoric in the months leading up to the white paper's publication, however, there is little in it that will speed up development by the major developers who build the vast majority of the country's homes. Instead of 'building homes faster', the focus of the white paper's proposals is on enabling and requiring local authorities to identify and approve land for residential development in greater quantities. These initiatives may support a certain increase in housebuilding, but whether that will be enough to keep up with housing need will be determined by wider market conditions. In any case, housebuilding will not get on top of demand – homes will continue to be delivered only at a rate that does not undermine current house prices. This will do little to improve the affordability of housing.

A key barrier to higher levels of housebuilding is the inability of sufficient numbers of people to buy them in the quantities needed. If housing supply is to match housing need then new homes will have to be produced more cheaply. In the past, governments have subsidised their production on a large scale; that does not appear to be a path the present government wants to go down. The alternative, advocated here, is to reduce the cost of land as an input and thereby produce homes for sale at a lower price. This would enable more homes to be built, more quickly, at prices that a greater number of households can afford and that would bear down on current market prices, thus widening access to home ownership. The cost would be borne by the landowner, out of the substantial windfall profit they make when planning permission is granted.

Such an approach could be introduced incrementally, starting on individual sites in high-demand, high-price areas. If it was gradually rolled out more generally then land values would become anchored to a level at which sufficient homes could be built and sold to meet need in any given locality, rather than being maintained at a level that keeps prices high and drags on housebuilding activity.

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- ³³ 'Homes for Londoners: Draft affordable housing and viability - Supplementary planning guidance', GLA, Nov 2016, pp.32-33: https://www.london.gov.uk/sites/default/files/draft_affordable_housing_and_viability_spg_2016.pdf
- ³⁴ 'Viability and the Planning System: The Relationship between Economic Viability Testing, Land Values and Affordable Housing in London', Sarah Sayce et al, Jan 2017: https://www.rau.ac.uk/sites/files/rau/field/field_document/Viability%20and%20the%20Planning%20System%20Research%20January%202017.pdf
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- ³⁶ Tony Hall, 'Proactive Engagement in Urban Design – The Case of Chelmsford', *Urban Design in the Real Estate Development Process*, Blackwell (2011)