

Reform of the land compensation rules: How much could it save on the cost of a public-sector housebuilding programme?

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An important part of the response to the current housing situation needs to be a bigger role for public-sector housebuilding. While market provision has steadily increased since the last recession and net supply across all tenures hit 217,000 in 2016/17, that was still little more than two-thirds of the way towards the government's target of 300,000 a year – and further growth will be easily knocked off course by an economic downturn and/or a fall in house prices. Annual construction of 300,000 units a year has not been achieved since local-authority building went into decline from the early 1970s.

Making up this shortfall with an affordable building programme of in the region of 100,000 homes a year would require significant upfront capital investment to which ministers, despite occasional promises of a 'rebirth' of council housing,¹ seem reluctant to commit. Such an approach would also require councils to acquire substantial volumes of land, their access to which is currently limited. In a recent survey asking local authorities about the obstacles preventing them from directly delivering new housing, the most common response was 'lack of land', closely followed by 'lack of funding'.²

This note considers the scale of investment that might be required but also the extent to which the costs could be minimised through fundamental reform of the land market. Enabling councils to purchase land, before planning permission has been granted, at prices closer to existing-use value would result in substantial savings, reducing the cost of each unit built and thus enabling more to be built within any given funding envelope.

This, which was the basis on which the new town programmes of the post-war years were conducted, is possible because of the very large differences in the value of a plot of land depending on the use to which it is put. For instance, in 2015 residential land in England (outside London) was worth an estimated £2.1 million per hectare (ha) on average – in agricultural use the same piece of land would be worth in the region of £21,000/ha, while a brownfield site in industrial use would be worth £514,000/ha.

The residential value of the land reflects the market value of the homes that can be built on that land (minus construction costs and the developer's margin). The landowner's entitlement to that residential value is enshrined in case law and legislation dating back to

¹ Jessica Elgot, 'Theresa May to unveil plan for "rebirth" in council housing in conference speech', *The Guardian*, 4 Oct 2017: <https://www.theguardian.com/politics/2017/oct/04/theresa-may-to-unveil-plan-for-rebirth-in-council-housing-in-conference-speech>

² Janice Morphet and Ben Clifford, 'Local authority direct provision of housing', RTPI, 2017: <http://rtpi.org.uk/media/2619006/Local-authority-direct-provision-of-housing.pdf>

the 1961 Land Compensation Act, which determines that the price paid for land compulsorily-purchased by the state must reflect any prospective use to which it could be put. This prevents local authorities from purchasing land before planning permission is granted at anything less than its residential value.³ If, on the other hand, land could be acquired at a value which excluded a potential future planning consent, greenfield sites could be purchased at something like a hundredth of the cost, brownfield sites at approximately a quarter – but varying a great deal according to the location.

This note considers only the savings that could be made on a public-sector building programme. Were land to be acquired in this way and then sold on to developers for market housing, the uplift could be invested in local infrastructure (or indeed channelled elsewhere). Previous research has indicated that this could raise in the region of £9 billion a year (in addition to existing ‘developer contributions’ via Section 106 and the Community Infrastructure Levy).⁴ But the focus here is on how much cheaper a large-scale affordable housebuilding programme could be if the land compensation rules were amended. In practice, new developments should combine both market and affordable housing.

Inevitably the savings would vary not only in terms of the location but according to the precise specifications of each scheme, and all of the assumed costs are necessarily estimates based on hypothetical schemes. The following examples are therefore purely illustrative of the potential should the land acquisition costs be reduced while construction costs (labour, materials etc) are held constant. Two types of scheme are described: estate housing on agricultural land as might be typical of urban extensions, garden villages and new towns outside of London; and, in London, higher density apartment blocks which are assumed to be built on ex-industrial brownfield land.

The major variable is in the price of the land. With planning consent for residential use, this can range from £4-5m/ha in high-demand areas of the South East (and much higher still in London) to as little as £300,000/ha in remoter and more northerly locations. With agricultural land tending to be valued in the range of just £20-30,000/ha across all regions of the country, the increase in value from a change of use to residential is therefore usually substantial but very much more in some areas – where housing is relatively more expensive – than others. What this means is that a public-sector building programme is very much more expensive to undertake, in terms of the upfront capital costs, in those areas where market housing is already most expensive and so sub-market affordable provision is most essential. This catch-22 is bypassed under the land reform that is proposed.

Estate housing on greenfield land

We imagine a development of 40 homes per hectare, with half of those two-bedroomed properties of 66sq.m. and the other half three-bedroomed properties of 77sq.m. Based on construction costs, fees and contingencies coming to £1,625/sq.m., as well as ‘opening up’ infrastructure costs (for the installation of drainage, landscaping etc) £225,000/ha, this scheme comes to £4.9m/ha, or an average of £121,813 per unit. While construction costs

³ For a full discussion of the legal framework and the case for reform see Daniel Bentley, *The Land Question*, Civitas, 2017: <http://www.civitas.org.uk/content/files/thelandquestion.pdf>

⁴ Thomas Aubrey, ‘Bridging the Infrastructure Gap’, Centre for Progressive Capitalism, 2016: <http://progressive-capitalism.net/wp-content/uploads/2016/06/Bridging-the-infrastructure-gap-June-2016.pdf>

may vary to some extent by region, the variations are not likely to be significant in the context of our calculations and so we hold that constant by region (except in London, which we explore separately below).

To undertake this scheme in the South East, the cost of the land might be £4.4m/ha on top of the development costs of £4.9m/ha, bringing total scheme costs to £9.3m/ha or £233,000 per unit. Each £100m invested in such schemes in this region could be expected to provide 430 homes (half two-bed, half three-bed). If instead the land was purchased at, say, its agricultural value plus 50 per cent, the land cost would fall to £33,000/ha. Total scheme costs would be almost halved to £4.9m/ha, or £123,000 per unit. Each £100m investment would now buy 815 homes.

It is in the South East, where land values are highest, that there is most scope to reduce the potential outlay. Where house prices are lower, land values are too and the savings become less substantial. In the East Midlands, for example, the land value might only be £1.6m/ha and the total scheme costs therefore £6.5m/ha, or £163,000 per unit. That means a £100m investment secures 614 new homes in the status quo compared with 815 in a reformed land market. That amounts to a saving of £1.6m/ha or £40,000 per unit.

Region	Current land compensation rules			Revised land compensation rules			Saving per unit
	Land/ha	Total costs/ha	Per unit	Land/ha	Total costs/ha	Per unit	
South East	£4,440,000	£9,312,500	£232,813	£33,000	£4,905,500	£122,638	£110,175
East	£3,930,000	£7,162,500	£220,063	£36,000	£4,908,500	£122,713	£97,350
South West	£2,120,000	£6,992,500	£174,813	£31,500	£4,904,000	£122,600	£52,213
West Midlands	£2,290,000	£7,162,500	£179,063	£36,000	£4,908,500	£122,713	£56,350
East Midlands	£1,645,000	£6,517,500	£162,938	£34,500	£4,907,000	£122,675	£40,263
North West	£1,990,000	£6,862,500	£171,563	£33,000	£4,905,500	£122,638	£48,925
Yorks & Humber	£1,280,000	£6,152,500	£153,813	£31,500	£4,904,000	£122,600	£31,213
North East	£915,000	£5,787,500	£144,688	£24,000	£4,896,500	£122,413	£22,275

Multi-storey apartments on brownfield in London

In London land values and development costs are in a different league to most of the rest of the country. So too is the pressure to optimise the use of whatever land is made available for new housing. Here, then, we imagine a different type of scheme consisting of mid-to-high rise complexes of one-, two- and three-bedroomed flats. Two densities are considered, one of 200 units per hectare which might be more typical in inner London and one of 100 units per hectare which might be more typical in outer London. The land here is assumed to be ex-industrial brownfield, and so clearance costs of about £1m/ha are factored in.

The higher-density 200-unit scheme is expected to have construction costs of £3,770/sq.m. (including professional fees, external works and contingencies), putting the total development costs at £46.9m/ha. With inner London land costs factored in, too – in Wandsworth, for example, we might be looking at £29.3m/ha – we might expect total scheme costs of £76.2m, or an average of £381,000 per unit. Each £100m invested in schemes such as this might secure 262 units. If the land could be purchased at its industrial value plus 50 per cent – at £4.1m – this would reduce the total scheme costs to £51m and the average cost per unit to £255,000. Now each £100m would buy 392 new flats – a 50 per cent increase.

The lower-density 100-unit scheme is expected to have construction costs of £2,730/sq.m. (again including professional fees, external works and contingencies), bringing the total development costs to £17.7m/ha. With outer London land costs factored in, too – in Barnet, for example, we might be looking at £17.8m/ha – we can expect total scheme costs of £35.5m/ha, or an average of £355,000 per unit. Each £100m invested in schemes such as this might secure 282 units. If, again, the land could be purchased at its industrial value plus 50 per cent this would reduce the total scheme costs to £21.8m/ha and the average cost per unit to £218,000. Now each £100m would buy 459 new flats – a 63 per cent increase.

Scheme	Current land compensation rules			Revised land compensation rules			Saving per unit
	Land/ha	Total costs/ha	Per unit	Land/ha	Total costs/ha	Per unit	
Inner London - 200/ha	£29,335,000	£76,220,500	£381,103	£4,099,500	£50,985,000	£254,925	£126,178
Outer London - 100/ha	£17,783,000	£35,447,750	£354,478	£4,099,500	£21,764,250	£217,643	£136,835

Discussion

The savings to be made if land was acquired at values excluding future planning permission would be considerable in most parts of the country but clearly much higher in London and the Greater South East. How many additional units could be built under a reformed land compensation framework is contingent not only on the savings that could be made on the cost of the land but on the costs of construction. The calculations made here are illustrative only, based on schemes that are hypothetical but not untypical for each locality. Construction costs will vary from scheme to scheme, and those cited here are best estimates based on a range of sources.

With those caveats in mind, it is apparent that the effect of such an approach would be to broadly standardise the cost of building affordable housing across different parts of the country, so that it is little more expensive to build homes in the South-East, where house prices are most high, than it is in areas where they are lower. While construction costs tend to be higher in London, particularly for the sort of schemes that are more typical there, the reduced land costs again minimise the expense of building new units in the highest-price areas. In other words, the cost of the land needed for affordable housebuilding would not become relatively more expensive due to the very thing that renders affordable housebuilding necessary: the high cost of market housing.

What would this look like on a larger scale, if the suggested costs of these hypothetical schemes were scaled up to a major public-sector building programme overseen by local authorities and/or development corporations? Clearly this would depend on the regional distribution of development, but it would be logical for this to be heavily concentrated in the the Greater South East, where housing pressures are most acute. Supposing a building programme of 100,000 homes a year, let us assume that there would be 20,000 a year in London – 10,000 in inner boroughs, 10,000 in outer boroughs. Outside London, the homes could be built in a series of new towns, garden villages and urban extensions, with 25,000 a year each in the South East and the East of England, 10,000 a year each in the South West and West Midlands, and 2,500 a year each in the East Midlands, North West, Yorkshire and Humber, and North East.

Using the figures modelled above, such a programme would come to about £23.5bn if the land was acquired at residential use values under the current compensation rules. After the reforms envisaged here, the cost of this programme would drop to £14.5bn – a saving of £8.9bn. Again, these are not meant to be definitive figures, but purely illustrative of the kind of savings that could be made based on the assumptions used and the hypothetical schemes imagined.

Region	Units	Cost - current rules	Cost - revised rules	Savings
Inner London	10,000	£3,811,025,000	£2,549,250,000	£1,261,775,000
Outer London	10,000	£3,544,775,000	£2,176,425,000	£1,368,350,000
South East	25,000	£5,820,312,500	£3,065,937,500	£2,754,375,000
East	25,000	£5,501,562,500	£3,067,812,500	£2,433,750,000
South West	10,000	£1,748,125,000	£1,226,000,000	£522,125,000
West Midlands	10,000	£1,790,625,000	£1,227,125,000	£563,500,000
East Midlands	2,500	£407,343,750	£306,687,500	£100,656,250
North West	2,500	£428,906,250	£306,593,750	£122,312,500
Yorks & Humber	2,500	£384,531,250	£306,500,000	£78,031,250
North East	2,500	£361,718,750	£306,031,250	£55,687,500
Total	100,000	£23,481,425,000	£14,538,362,500	£8,943,062,500

Assumptions

All of the land values used here are based on DCLG's 'Land value estimates for policy appraisal', December 2015.⁵ This is the latest such publication; it is likely that land values in many areas will have evolved since then but not dramatically.⁶ The values used are approximations based on residential land values in across a variety of locations in each region. The figures should be regarded as illustrative of the general magnitude of increases in value between the different use categories.

The price paid for land under a revised compensation framework has been calculated at existing use value plus 50 per cent. It is important that landowners should receive fair values for their land, with compensation set generously in proportion to its worth prior to any prospective planning permission. A 50 per cent premium should be more than sufficient to allay potential concerns about the 'expropriation' of existing assets.

The development scenarios modelled above are hypothetical schemes thought to be broadly typical for the locations. Clearly there are any number of alternative potential permutations. It might be assumed that the scope for higher-density schemes would increase the residential land values quoted, while lower-density schemes would reduce them.

Construction costs are estimates based on information gathered from a variety of sources, including individuals with direct knowledge and experience of recent schemes. Professor Pat

⁵ DCLG, 'Land value estimates for policy appraisal', December 2015

⁶ On the recent trajectory of land values, see 'UK residential development land', Savills, January 2018: <http://pdf.euro.savills.co.uk/uk/market-in-minute-reports/uk-residential-development-land-january-2018.pdf>

McAllister's modelling of development costs and viability has also been of great assistance.⁷ Basic construction costs are assumed to be £2,900 per sq.m. on the high-density inner London scheme, £2,100 per sq.m. on the medium-density (100 units per hectare) outer London scheme, and £1,250 per sq.m. on the greenfield, estate housing schemes outside the capital. Additional costs for professional fees, contingencies and abnormal costs have then been factored in, in addition to assumed clearance costs for the brownfield schemes and 'opening up' infrastructure costs for the greenfield schemes.

All of these development costs might be higher or lower on any given scheme; the higher they are – relative to land values – then the fewer additional homes that could be built out of the savings made on land acquisition; the lower they are, the more additional homes that could be built.

⁷ Pat McAllister, 'Planning for the right homes in the right places: consultation proposals - Consultation on further measures set out in the housing white paper to boost housing supply in England'

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