

# Review of Housing Supply

*Delivering Stability: Securing our Future Housing Needs*

Final Report -  
Recommendations



Kate Barker  
March 2004

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# Foreword

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March 2004

Dear Chancellor and Deputy Prime Minister,

Housing is a basic human need, which is fundamental to our economic and social well-being. Yet housing provision is often controversial and provokes strong reactions. My Review of housing supply highlights the tensions that surface, when seeking to promote an adequate housing supply and a more responsive provision:

- A weak supply of housing contributes to macroeconomic instability and hinders labour market flexibility, constraining economic growth. These risks to stability are likely to be increased should the UK decide to join Economic and Monetary Union. The UK should have a more flexible housing market.
- For many people, housing has become increasingly unaffordable over time. The aspiration for home ownership is as strong as ever, yet the reality is that for many this aspiration will remain unfulfilled unless the trend in real house prices is reduced. This brings potential for an ever widening social and economic divide between those able to access market housing and those kept out. Rising numbers in temporary accommodation is evidence of the polarisation which exists today.
- Homes are more than shelter. They provide access to a range of services and to communities. Housing also plays a major role as an asset in household balance sheets and in household planning for their financial futures.
- The housing market indicates people's preferences for the types of housing, location and communities that they would like to live in, for example the preference for space as incomes increase.
- Increasing housing supply raises concerns about the environment and loss of open spaces.

These considerations pose a number of dilemmas for policy makers at all levels, (national, regional and local). There are issues around the relationship between the private sector as the main deliverer of housing and Government's objectives, which may not always accord with market pressures. There are no easy answers and no disguising that the choices we face are difficult. We inhabit a small island – land is a finite resource, which we must make best use of. But we also need to think about other outcomes that we wish to achieve:

- a more flexible housing market which adapts to and reflects the needs of the economy; and
- a more equitable distribution of housing wealth.

I do not believe that continuing at the current rate of housebuilding is a realistic option, unless we are prepared to accept increasing problems of homelessness, affordability and social division, decline in standards of public service delivery and increasing the costs of doing business in the UK – hampering our economic success. Indeed, the Government has already signalled the need for action through the Sustainable Communities Plan and the Planning Bill.

This Review sets out a series of policy recommendations to address the lack of supply and responsiveness of housing in the UK. The recommendations cover a broad spectrum of issues. It suggests that we need to integrate economic considerations into the planning system, that we need a better means of assessing the costs and benefits of development and land use and that we need to acknowledge market signals and use the information provided.

These recommendations will also require concerted action on the part of the housebuilding industry. In the past, quality of service to consumers and considerations of sustainability, design and innovation have been secondary to the desire to secure land. The signs are that the industry recognises these failings, which arise in part from the volatility of the housing market, and I believe there is a determination to do better.

I am grateful to the Government for giving me the opportunity to conduct this Review and I hope it will play a constructive part in what I am sure is going to be an active area of public policy over the coming years. I do not pretend that this Review provides all the answers at a detailed level. In some areas, I have sought to set out broad principles. Creating a more flexible housing market is a considerable challenge, which will take time and requires determination to engage in ongoing reforms. It will not happen overnight.

Ideas, facts and other inputs for the Review have come from a wide range of academics, professionals, policy makers, housebuilders and interested individuals. I am extremely grateful to them all. I have been struck by the desire among all those working in the housing field to secure change and to work together to promote a common goal of improving access to housing. There is clearly much common ground and a desire to elevate the policy debate. I hope that this Review will allow that debate to continue and develop.

I would like to express my thanks to all those who assisted me in producing this Report. Many individuals and organisations gave generously of their time and effort to propose ideas and support me in reaching these conclusions. These contributors are identified in Annex A. I would also like to thank warmly Jo-Anne Daniels and the team of very able people who have worked tirelessly and with good humour: Mark Aldridge, Tejinder Bassi, Rachael Clapson, Ben Dubow, Odette Fioroni, Kerry Higgins, Graham Kinshott, Adam Land, David Leam, Chris Nicholls and Bryn Welham.



Kate Barker

# Executive summary

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## INTRODUCTION

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1 The Chancellor and Deputy Prime Minister set up this Review on 9 April 2003 with the following Terms of Reference:

- Conduct a review of issues underlying the lack of supply and responsiveness of housing in the UK.
- In particular to consider:
  - the role of competition, capacity, technology and finance of the housebuilding industry; and
  - the interaction of these factors with the planning system and the Government's sustainable development objectives.

2 Demand for housing is increasing over time, driven primarily by demographic trends and rising incomes. Yet in 2001 the construction of new houses in the UK fell to its lowest level since the second world war. Over the ten years to 2002, output of new homes was 12½ per cent lower than for the previous ten years. This Review is concerned with the issues both of volatility and of long-run supply.

3 Volatility in the housing market, in the UK, combined with the strong association between house prices and private consumption (reflecting in part high levels of owner occupation) is striking. Consequently, the housing market has contributed to macroeconomic volatility, creating a more difficult environment for businesses and for economic policy makers.

4 A weak response of housing supply to demand changes has been one of the factors underlying this instability. In addition, there is growing evidence of a persistent inadequate supply. In the UK the trend rate of real house price growth over the last 30 years has been 2.4 per cent, considerably higher than the European average of 1.1 per cent. Latest evidence suggests that the trend rate of real UK house price growth has increased to 2.7 per cent over the last 20 years. The Review is fundamentally concerned with the longer-term issues of unresponsive and weak supply, rather than questions surrounding the current house price cycle.

5 The Interim Report argued that, in addition to the costs of volatility, there was a set of adverse consequences as a result of the long-run upward trend of house prices:

- Affordability has worsened between cycles. In 2002 only 37 per cent of new households could afford to buy a property compared to 46 per cent in the late 1980s.
- Wealth is re-distributed. Higher house prices result in a transfer of resources from those outside the housing market such as would be first time buyers to those inside the market, such as existing home owners. This also tends to favour older generations at the expense of younger. The wealth gap between home owners and others is widening.

- Labour mobility is restricted. Lower rates of house building can lead to significant regional house price differentials and regional price expectations, reducing labour mobility and constraining productivity.
- There is also an overall cost in terms of economic welfare from the restriction in supply.
- But against this, and the other costs identified above, have to be set important benefits from restricted supply – in particular reduced urban sprawl and the retention of open greenfield land.

6 Raising housing numbers is only part of the story. It also matters where houses are located and how much space they have. The nature of cities, towns and villages is also important, and the role of planning in shaping these as sustainable communities is recognised and valued. In considering policy recommendations, the varied nature of regional and local housing markets has been kept in mind, for example the different issues in terms of externalities and costs of development, which exist in low demand areas. The Review's recommendations in most cases aim to establish a broad framework, which is adaptable to differing regional circumstances, a one size fits all approach is not always possible or desirable.

7 New supply only accounts for 1 per cent of the housing stock, and so even measures which change new supply significantly would not have much effect on prices were it not for the role of expectations. If policy changes alter perceptions about the future course of prices, then the impact on today's prices is potentially much larger. This consideration has led to a cautious approach being taken to policy recommendations. A further reason for caution is that, with such a regulated market, it is very difficult to judge the supply response to any change.

8 Government has already taken important steps to address housing supply, (the Sustainable Communities Plan, proposals for four new growth areas, and recent reforms to the planning framework). This Review should be seen as part of that on-going process to reform housing supply, and indeed the housing market more generally. A further review of the housing market should be undertaken in three years time. This review would consider progress made towards delivering the Government's policy agenda and look at how the market is responding to the changes proposed in this Report.

## OBJECTIVES

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- 9 The overall objectives of the Review are:
- to achieve improvements in housing affordability in the market sector;
  - a more stable housing market;
  - location of housing supply which supports patterns of economic development; and
  - an adequate supply of publicly-funded housing for those who need it.



10 These objectives require a more flexible housing market, one in which supply responds more strongly to changes in price. But this raises difficult choices. Accommodating demographic projections for household numbers up to 2021 alone, will mean a higher rate of housebuilding than has been achieved recently. While the important recent steps taken by Government would address some of the problems of stability, affordability and housing those in need, more needs to be done if the present situation is to be improved.

11 Inevitably, this would bring adverse consequences for the environment and for public amenity. As Martin Wolf wrote recently: ‘We cannot have a rising population, spacious housing for each household and an unchanged quantity of undeveloped countryside’<sup>1</sup>.

12 The Review sets out three scenarios, two of which would require policy changes beyond those already being implemented by Government. (The numbers in these scenarios relate to England alone.) The estimates in these scenarios for private and for social housing are rather different in nature.

13 Taking as the baseline the level of private sector build in 2002-03, 140,000 gross starts and 125,000 gross completions, it is estimated that:

- reducing the trend in real house prices to 1.8 per cent, would require an additional 70,000 private sector homes per annum; and
- more ambitiously, to reduce the trend in real house prices to 1.1 per cent, an additional 120,000 private sector homes per annum would be required.

14 These are in line with the estimates presented in the Interim Report<sup>2</sup>, and subject to the same caveats. Going further, a zero trend in real house prices and the level of housebuilding this would imply is considered undesirable and unachievable. These estimates imply that large increases in the rate of new build would be required to achieve a reduction in the price trend, which is unsurprising given the fact that new build is only around 1 per cent of the existing stock. However, as highlighted previously, these estimates are highly dependent on how much price responds to additions to the stock. The recommendations in the Review, which should achieve a more responsive housing market, could be expected to increase the response of price, and therefore reduce the rate of housebuilding which is needed.

15 In the light of the issues raised above, it is clear that there would be significant benefits from a higher rate of housebuilding, and from the changes which aim to make the market more responsive. Even in the case of the less ambitious price trend, these benefits would include pricing an additional 5,000 new households each year into the market, and improving access for the backlog of those presently priced out. There would also be significant benefits as people would have access to housing which better meets their aspirations.

16 The scenarios for social housing are based on demographic projections. An increase in supply of social housing of 17,000 homes each year is believed to be required to meet the needs among the flow of new households. There is also a case for provision at up to 9,000 a year above this rate in order to make inroads into the backlog of need. Clearly, the scenarios for the private and social sectors for example, are to some extent independent of each other. It would be possible to take a more ambitious approach to social provision, irrespective of the approach to market provision. However, this would have implications for the level of investment needed.

<sup>1</sup> Martin Wolf FT 6.02.2004, England’s Great Housing Dilemma.

<sup>2</sup> Table 3.4, p.59, *Barker Review Interim Report*, (2003)

17 These scenarios set out the choices for Government, in the light of the trade-off which is believed to be appropriate between improving market affordability, meeting housing need and environmental considerations. In this context, it should be noted that, under the extreme assumption that all of the additional build were carried out in the South East, an additional 120,000 homes per year would take around 0.75 per cent of the total regional land area<sup>3</sup>.

18 The policy proposals listed below build up to a framework which should be more responsive, and in which incentives are aligned better with the wider costs and benefits of housing development. This greater flexibility is an important goal in itself, in light of the above discussion about the costs of housing market volatility. Generally, particular policies are not attached to each of the scenarios. Rather, the framework should be capable of delivering the rate of housing supply which Government, at national, regional and local level has concluded is best in light of the trade-off between housing market and environmental objectives.

19 Tackling issues of macroeconomic stability may also require measures to address the demand for housing alongside improvements to supply. Demand side measures, such as the reform of property taxation could help to mitigate house price cycles. In any reform of council tax, consideration should be given to having an element of this tax which is more closely related to property prices.

## PLANNING FOR DEVELOPMENT

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20 The Review makes a number of recommendations to improve the working of the planning system. At the centre of these recommendations is the principal objective that planning should take more account of, and use market information. That does not mean that planning should in all cases follow the market, in some cases decisions should contradict market signals. But there must be a clearer rationale for why this is necessary (for example, tackling market failures associated with housing abandonment in low demand areas) and a full understanding of all the consequences of these decisions, at local and national level.

21 Planning at regional and local levels needs to respond by:

- making better use of information about prices and preferences; and
- the process needs greater certainty and speed, though not at the expense of making bad decisions.

22 Central to achieving change is the recommendation to allocate more land for development. This certainly does not mean removing all restraints on land use, on the contrary the review advocates more attention be given to ensuring the most valuable land is preserved. But housebuilders would have greater choice as to which sites to develop, increasing competition. And it would also allow a quicker and more flexible response to changing market conditions on the upside.

23 A stronger role for regional planning bodies is recommended, with an independent Regional Planning Executive charged with setting out advice on market affordability targets, housing numbers, strategic growth areas and co-ordinating links between the key players (infrastructure providers, developers and English Partnerships).

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<sup>3</sup> This calculation assumes that 60% will be built on brownfield sites, and that dwellings will be built at a density of 30 per hectare. It also includes an allowance for related infrastructure.

24 At the local level, alternative routes to gaining planning permission are proposed which aim to speed up the process and increase certainty – while preserving opportunities for vital community involvement and the principles of sound design.

## DELIVERING DEVELOPMENT

25 Land will only get developed if:

- the right incentives are in place for those making development decisions; and
- development is facilitated where market or government failures, particularly co-ordination failures, block permissioned development from occurring.

26 Reforms to local government finance are proposed, to align the incentives facing individual local authorities with the costs and benefits to society more widely. Funding flows need to be more forward-looking, and local authorities allowed to ‘keep’ for a period some or all of the council tax receipts generated by new housing.

27 Infrastructure providers need to be involved in developing regional and local plans from an early stage. They should then need to use their powers to direct refusal of planning permission, for development which accords with the plan only rarely.

28 English Partnerships should play a lead role in delivering development by assembling land and managing the issues around complex sites. Planning authorities should seek the best of the range of special purpose vehicles available to drive development where there are problems with land acquisition and infrastructure. A new Community Infrastructure Fund should be established to fund the up-front costs of infrastructure needs which are blocking development.

29 Section 106 needs reform to provide more certainty and simplicity. The Government is presently consulting on one way to achieve this. However, if the recommendation to introduce a Planning-gain Supplement is accepted, this would offer the opportunity to achieve this objective by scaling back Section 106 to cover the direct impact of development and contributions to social housing only.

## CONTRIBUTING TO DEVELOPMENT

30 In principle taxation is often the best way to deal with externalities. However, using taxation as a means to increase the supply of land directly is unlikely to be successful, mainly because the role of the planning system in changing the value of sites reduces the effectiveness of price signals, and would create concerns about the fairness of the tax regime. In the context of land, tax may also be a blunt instrument, because of the individual nature of each site with regard to the balance between the social and private costs of development.

31 However, taxation can have other roles to play. In particular, windfall profits otherwise known as development gains often arise as a result of development decisions. The Government should actively pursue measures to share in these windfall gains, which accrue to landowners, so that these increases in land values can benefit the community more widely. The value captured can be used as a funding stream for a number of other policies.

32 Several options for capturing development gain have been considered, including development gains tax, changes to the VAT regime, and developer contributions paid on the grant of planning permission. It is proposed that the granting of planning permission would be a suitable point in the development process to levy a charge based on local land values. This Planning-gain Supplement would fall largely on landowners, with little impact on house prices.

33 In general, imposing a tax on an activity discourages its supply – but given the interaction of land supply with the planning system this effect could be expected to be small, provided that tax rate is not set at too high a level. More importantly, the proposed tax is part of a package of policies set out in this Review, which, taken together, aim to increase the supply of land and planning permissions.

## ACCESSING HOUSING

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34 The number of social houses built in the UK has fallen from around 42,700 per year in 1994-95 to around 21,000 in 2002-03. In recent years expenditure on social housing has increased, from £800 million in 2001-02 to over £1.4 billion in 2003-04, however the rate of new supply has continued to decline. This is due both to the strong rise in land prices (which has pushed up the cost of units) and the importance attached to improving the existing stock of social housing (bringing the proportion of social units falling below the decency threshold down from 46 per cent in 1996 to 33 per cent in 2002).

35 It is estimated that, over the next ten years, the number of social and affordable houses provided will need to be increased by at least 17,000 per year, requiring annual investment building up to around £1.2 billion, in order to meet the flow of new needy households. If the backlog of those whose need has not been met in the past is to be reduced, then up to 23,000 further houses would need to be supplied, at a cost building up to £1.6 billion. Not all of this cost would necessarily have to be met by Government – there may be further capacity among the Registered Social Landlord (RSL) sector, and some private suppliers are also developing models which seek opportunities to provide without public subsidy.

## THE DEVELOPMENT INDUSTRY

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36 The recommendations in the Review are intended to change the environment within which the housebuilding industry operates. Reduced house price volatility should lead the industry to be more willing to supply, and there should be less need to focus intensively on land. However, the industry needs to demonstrate a willingness and capability to respond to this changed environment.

37 The Review sets the industry challenging targets to improve service quality and consumer satisfaction ratings and to increase investment in skills and improved production techniques.

38 Local authorities should also consider the level of competition in the new build market when granting permissions. They should discuss the build out rates for large sites, and, where appropriate, encourage developers to split up these sites.

## CONCLUSION

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39 To improve the responsiveness of UK housing supply, many of the above recommendations are needed. Greater responsiveness could occur without there being a step change in the level of housebuilding – but this is also considered to be necessary at rate present time. Such a step change may mean more direct action by Government, for example through special purpose vehicles to drive forward delivery.

40 This Review was established with a UK remit, but given the devolved nature of housing and planning policies, many of the recommendations apply only to England. The devolved administrations will need to consider for themselves whether these recommendations are appropriate to their own circumstances, in the light of the policy changes the UK Government decides to adopt.

