

# Help to Build

An emergency plan to support housing supply

BY ALEX MORTON





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## About the Author

Alex Morton is Head of Policy at the Centre for Policy Studies. He was previously a Director at Field Consulting, and before that was responsible for housing, planning and local government in the No 10 Policy Unit under David Cameron, including working on key policies in the 2015 manifesto. He was previously Head of Housing at Policy Exchange and has worked in the civil service and parliament.

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# Executive Summary

The housebuilding industry is not just economically vital, but particularly vulnerable to the impact of recession. Between 2007 and 2009, housing starts in England fell by 54%. Yet it took six years from the start of the crisis for completions to reach their lowest point – at just over 100,000 homes a year – and slowly rebound. After the 1990s crash, similarly, it took more than a decade for supply to come close to the previous peaks.

In fact, this paper shows that the biggest single issue behind the under-supply of housing in this country is the fact that in any recession the slump in supply is sharp and deep, and in any recovery the rise in supply is slow and shallow. During such periods, SME housebuilders tend to struggle, and in many cases fail, while the larger housebuilders retrench and cut output. Low housing supply in the recession is then used to predict future housing need, meaning less land is released over the coming years, while labour and suppliers, having left the sector, are slow to return.

In the wake of the COVID-19 crisis, we cannot afford a repeat of the past two recessions – not just because of the contribution of construction to employment and growth, but because of the crucial role of housebuilding in meeting the Government's ambition to deliver mass home ownership.

There are multiple measures the Government could and should take to stimulate the property market: a sharp cut in stamp duty land tax, making change of use easier and planning reform. We intend to explore many of these in future Centre

for Policy Studies research. But the most urgent question, and the core focus of this paper, is how to support the industry, especially SME housebuilders, through the current emergency in a way that limits the likely collapse in housebuilding and ensures the swiftest possible recovery. A sharp downturn, with associated losses of labour and material, will leave a scarring effect on output well into the 2020s.

Already, the data from the front line suggests that housebuilders are using the easing of lockdown restrictions to complete existing projects – but that there is little ground being broken on new projects. This implies that the housing industry's recovery will be not V-shaped but W-shaped – an immediate small surge, followed by a prolonged slump as the pipeline dries up.

There is therefore a clear need to stimulate the housebuilding sector – but in a way that guarantees, and is tied to, continuing to build new homes. This in turn requires us to understand why this pattern of sharp falls and sluggish rebounds exists, and what can be done to stop it.

The main explanation is that the housebuilders rely on a 'build to sell' model. They only build a home if they can sell at what they consider a reasonable profit. This has three key aspects:

- **Total transactions.** Obviously, the more people are buying a home, the larger the potential market for new builds. Two million buyers are a bigger possible market than one million. Historically this link has been very clear and strong.



- **Relative attractiveness of new build, and number of sites.** The more attractive new build houses are versus second hand, the more new builds will sell for any given level of transactions. Help to Buy shifted the relative attractiveness of new build, particularly for first time buyers, and so boosted supply for any given number of transactions. Multiple sites mean that builders can sell to different kinds of buyers (e.g. greenfield, brownfield, homes, flats, near or far from public transport etc.) which boosts total sales for a given number of transactions.
- **Whether house and land prices are falling or rising.** Life is hard for housebuilders in falling markets, since they are stuck with the costs of the land they have already paid for. This limits their scope to cut prices – if buyers are waiting for prices to fall, builders simply stop building rather than operating at a loss.

In terms of the immediate future, it is already clear that house prices and therefore land prices will fall – though how far and for how long is unclear. Knight Frank suggests that transactions this year will be 38% lower than last, similar to the drop of 45% between 2007 and 2008. Past data suggests that first time buyers' use of Help to Buy could halve, given they are the group most likely to delay buying.

The result is that the large housebuilders are likely to retrench – which their business model allows them to do. Just 20% of workers onsite are directly employed. The big housebuilders have minimised capital spending, e.g. by not investing in modern construction methods, building cash reserves, and should be able to lay off workers and weather the storm by restricting output to only the most profitable sites – but SMEs are likely to struggle and some will go under. Supply is likely to fall by 80,000 or so homes in 2020 and 2021 on fairly plausible estimates, and could even go lower.

The Government therefore needs to act to keep housebuilding going now. Medium-term reform is necessary but the biggest issue now is preventing a sharp drop and multi-year slump in supply. At the moment, the evidence from the sector is that use of excavators – to dig out new foundations – has collapsed. Given that concrete cannot be poured over the winter, there is only a relatively short time window for the Government to get the market moving – ideally to ensure that workers currently on furlough have new sites to go back to in August rather than being permanently laid off.

So what form should that intervention take? It has been suggested that the Government should give a big boost to affordable housing. But there are two problems. First, this would cost tens of billions over the coming years to do at sufficient scale, and effectively turn the housing industry into an arm of the state. Second, some affordable housing output is currently dependent on the contributions made by developers via Section 106. At least some spending will just counteract this.

Instead, we propose that the Government bases its intervention on a simple, single metric: **maintaining starts and completions**. This avoids vested interests pushing tangential issues and indirect goals (e.g. 'restoring market confidence'), and forces all proposals to be evaluated against the target of higher starts and completions.

A reasonable goal would be to aim for starts and completions to fall by no more than 25% this year and 10% in 2021 compared with a baseline of 2018/19 figures (so going from 213,000 new homes then to 160,000 or so this year and 190,000 next year).

In order to achieve this, the Government needs to create a short-term stimulus scheme within the next two months in order to help SMEs in particular. That scheme must be:

- **Flexible** – easy to access and supports sales/build via multiple routes.
- **Focused on sites with existing permissions** (since new permissions will take around a year even if handled well).
- **Conditional on maintaining the builder's wider housing pipeline** – rather than letting housebuilders take support to build a small number of homes they would have built anyway, or build up their land banks.

We propose the creation of **Help to Build**. This scheme would use the Help to Buy system to disburse grants up to a maximum of £25,000 per new build property (with an additional percentage cap of 10-15% based on the value of the home), to all housebuilders who signed up. The money would be conditional upon completion of a sale, with a goal of £20,000 in support on average for each unit. This grant would be capped at £3 billion, or supporting 150,000 homes in the next year.

Crucially, Help to Build would not be prescriptive. Instead, it could be used by each housebuilder to keep the pipeline flowing in whatever the most appropriate fashion would be. For example:

- **Supporting part-exchange schemes.** This would allow the housebuilder to buy the homes of those interested in a new build property, with the grant used either to provide a discount on the sale price or to help incentivise the sale of the old home in the second hand market. (This is crucial at a time when housing chains will be far harder to form due to disruption in the market.)
- **Supporting those buying by helping with the deposit,** gifting a stake of 5% or 7.5% to the purchaser. This would make it worthwhile for first time buyers to buy new homes even if they think prices will fall (since many would still be unable to afford a deposit without such help).

- **Grants for shared ownership or affordable rent.** This level of grant is below that usually needed for these schemes, but housebuilders could cut out other costs in return for shifting units. Housing associations or others might also bulk-buy homes.
- **Supporting the roll out of First Homes.** This scheme would be able to help support the roll out of the Government's First Homes scheme, which would make it less risky for those buying as they would not be paying full price, which when combined with other measures (e.g. a top-up on the deposit) could help smooth the introduction of this new approach.

This is not an exhaustive list, but meant to stimulate proposals and ideas from the sector. Support will differ from home to home, and site to site. Our only blanket rule would be that this grant should not be available for schemes which neither promote home ownership nor deliver affordable homes (ie those involving private buy-to-let landlords or commercial rents).

In return for using this scheme, the housebuilder would agree to a pipeline of starts and completions based on their performance over the 18 months prior to the end of 2019, minus a set level (e.g. 25%). If they failed to deliver this, they would repay the grant with penalties, and future support would be terminated – which at a time of economic difficulty is likely to be an unattractive prospect. At the end of this period, the grant would be written off so it was not a permanent liability for the housebuilder.

Unlike Help to Buy, this scheme would be a short-term stimulus rather than a long-term burden on Government. Indeed, it has built-in obsolescence, since over time the benefits would flow entirely to landowners (who would raise land prices to try to capture this profit for themselves). It can



also be easily recalibrated, with the grant lowered if it appears that the scheme is distorting the market away from second-hand properties and towards new build.

The main alternative to this type of approach will be either collapsing supply or costly schemes to try to prop up the entire £7.4 trillion value of the UK residential sector, likely to be both expensive and – while possibly useful in the short time – likely to have major long-term issues (and potentially be unsustainable, which means just delaying the pain at a cost to the taxpayer).

This scheme will keep housebuilding going over the next 12 months, while laying the ground for further reform, and avoiding a catastrophic slump in supply – and all the attendant chaos. Together with other measures over the coming months around Stamp Duty Land Tax, change of use, planning reform and so on, it is the simplest and most effective way to do what is needed most – namely, keep Britain building.



# 1. The future for housebuilding is grim

## The impact of COVID-19 on the housebuilding sector was rapid and immediate.

Despite firms being encouraged by the Government to continue work during the lockdown, it was estimated that construction was paused on 75% of building sites.

Slowly, the construction sector and housebuilders began to return to work, with this accelerating after the Prime Minister's statement on the May 10. The Government has sensibly moved to ensure that house sales can keep moving over the coming months, with in-person and virtual viewings.

However, on many sites this resumption in housebuilding is likely to be temporary and relief partial – with builders completing

projects that were already underway, but then waiting to see whether the market picks up.

On that score, the precedents are not encouraging. In 2008/09, the housing market slumped rapidly, and output fell sharply. The number of new builds started and completed fell rapidly, slumping over the following two years by 54% in terms of starts and 29% in terms of completions.

Just as crucially, supply remained low for a very long period. It took until 2013, more than six years after the first flickers of the financial crisis, for housing completions to bottom out and then begin to rise again: reaching a nadir of 38% down compared to 2007, with housing starts down by 32% that year compared to the peak.

New build starts and completions in England<sup>1</sup>

Year	Homes Started	Homes Completed
2007	183,600	176,640
2009	85,610	124,980
2011	113,270	114,030
2013	124,780	109,450
2015	148,160	142,480

<sup>1</sup> Ministry of Housing, Communities and Local Government, "Live tables on housebuilding: new build dwellings: Table 213: permanent dwellings started and completed, by tenure, England (quarterly)". Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/877988/LiveTable213.xlsx](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/877988/LiveTable213.xlsx); There are a variety of sources which have different methodologies and others show slightly higher totals each year, but all of them show the same sharp drop and long slump.





The private housebuilding sector, in other words, is likely to struggle over the next year and beyond. This will have significant economic and social impacts. Housebuilding is the largest single part of the construction industry, with revenues of £37.6 billion out of its £113 billion total. Around 240,000 people are directly employed by housebuilders and their contractors, and between 500,000 and 700,000 are employed if you include those in related jobs (e.g. subcontractors to help fit kitchens, bathrooms, supply chain workers and so on).

However, the industry's real economic footprint is even larger, since new private homes also contribute toward infrastructure and affordable housing via Section 106, and also help boost

the regeneration and development of commercial sites, provide work in the legal, estate agent and accounting sectors and so on. Not only this, but the sector is important socially, in ensuring that people have affordable, modern properties to rent – and of course own.

In addition, while in the last recession affordable housing helped maintain output, this merely limited the slump a little – between 2007 and 2009 private housing starts fell from 159,000 to 65,000, while affordable housing (local authority and housing association) starts fell from 23,690 to 20,610. We will discuss what such a solution could cost and look like later, but certainly in the last recession this barely made an impact.



## 2. The housing shortage is driven by recessions

Studying the recent history of English housebuilding, a clear pattern emerges: one of sharp downturns, long slumps, and slow recoveries.

The economic turmoil of the early 1990s, for example, saw housebuilding in England fall from 217,290 starts and 193,810 completions in 1988 to 129,300 starts and 143,830 completions in 1992. The figure then remained at around 140,000-150,000 or so throughout the 1990s – not getting close to the former peak until the mid-2000s.<sup>2</sup>

Indeed, the biggest issue with housing supply in England can be boiled down to a single fact:

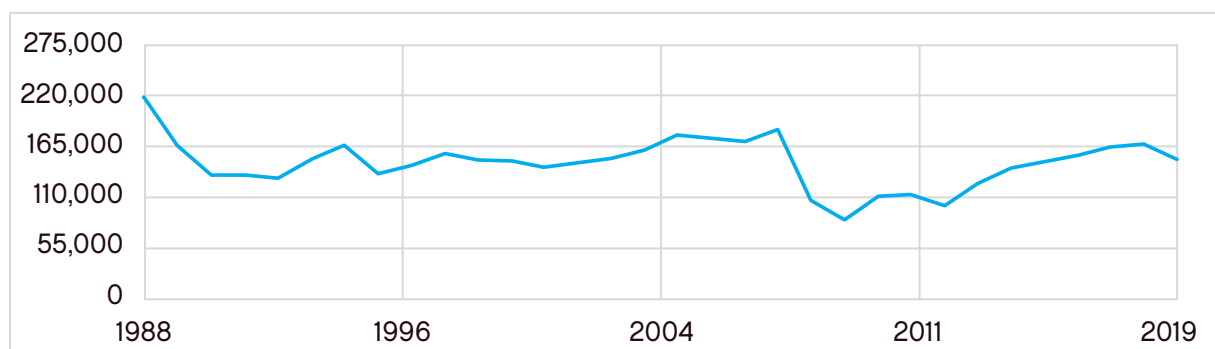
**In any recession the slump in private housing supply is sharp and deep, and in any recovery the increase in private housing supply is slow and shallow.**

This strange combination of slow boom, sharp bust – driven partly by the long lag times and heavy capital costs involved in housing development – also tends to result in a permanent long-term undersupply of housing. Just as the system has geared up to deliver the number of homes we need, a recession throws the system into chaos and slashes the number of housing starts – from which the industry takes a long time to recover.

In other words, the policy debate in recent years has focused on the inadequacy of housing supply during the ‘upswing’ – but it is the sharp downswing, and subsequent stagnation, that invariably does the greatest harm.

As this chart shows, from that late 1980s peak of over 200,000 homes, it took nearly two decades to get close to that figure again – and then the financial crisis hit, after which it took another decade to get close. Worryingly, each time the trough has got deeper.

Annual Housing Starts<sup>3</sup>



<sup>2</sup> Ministry of Housing, Communities and Local Government, “Live tables on housebuilding: new build dwellings: Table 213: permanent dwellings started and completed, by tenure, England (quarterly)”.

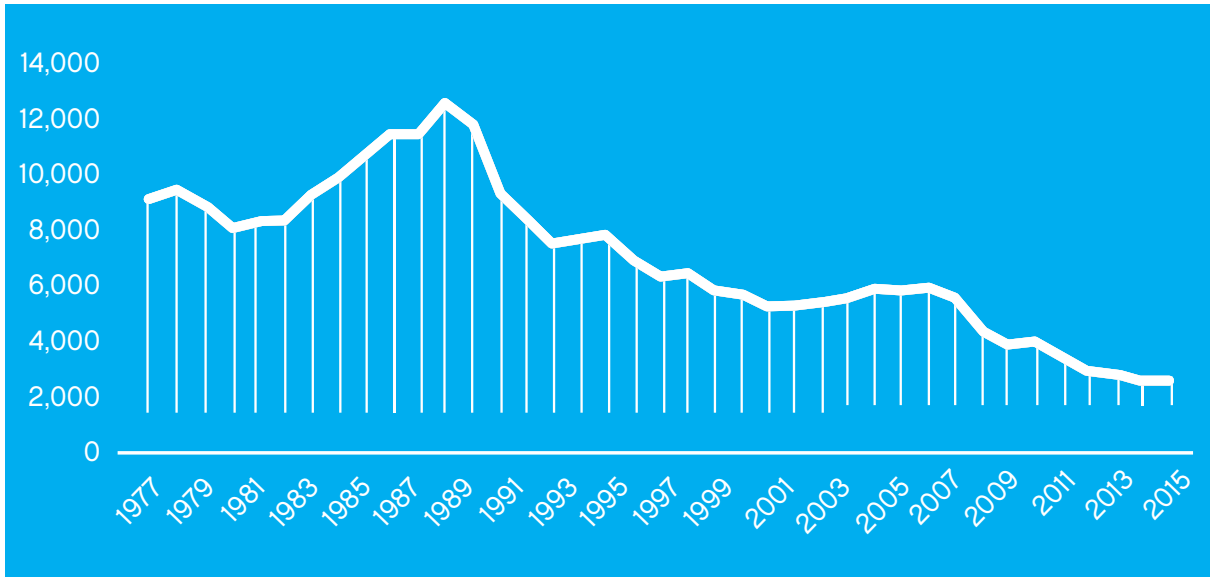
<sup>3</sup> Ibid.; Again, different sources might have slightly higher numbers, but the trend would be the same.



This cycle has also helped to produce the steady consolidation of the housing sector,

with small housebuilders driven out – especially during the downturn periods.

SME Housebuilders (1-100 units) (NHBC)



This long-run trend of downward housing supply and sector consolidation are linked for a series of reasons:

1. *SMEs tend to exit the sector in recessions, meaning fewer sites over time.* The SME sector cannot cope with the downturn (for reasons explored below) and so firms go bust and exit the industry. But the larger housebuilders do not take up the slack during the recession, or even in the immediate aftermath, so output is permanently lost – unlike other sectors where smaller companies are taken over by larger companies and output is often maintained.

This means that the housing market becomes focused on a smaller number of larger sites run by larger housebuilders. As discussed further below, the total number of sites and developers in each area is related to the total output of the sector, because sites will be built out

faster if there are ten sites of 100 homes compared to one site of 1,000 homes. So not only does a reduction in the number of firms impact in the downturn, but the resulting impact reduces supply well into the recovery.

2. *The sector finds it hard to rebuild after the slump.* After the immediate shock is over, it is hard for the sector to expand output as the crash will have resulted in significant bottlenecks. When suppliers and labour are pushed out in the downturn, they are reluctant to return in an upswing. This can last for years – those who leave the sector are likely to have found other jobs, and are unlikely to want to return for the same pay as before given the shock of unemployment and transitioning to new work. Likewise, suppliers are unwilling to ramp up output unless they think there will be a prolonged period of high demand, since they do not want to start up only to have to switch off shortly after.



For example, in 2015/16, nearly a decade after the previous slump began, a shortage of bricks and skills slowed output, in large part because past suppliers and workers were reluctant to increase output or return full time. As one study noted, *“Almost two-thirds of small and medium-sized construction businesses (SMEs) faced a two month wait for new brick orders, with almost a quarter waiting for up to four months and 1 in 6 (16%) waiting six to eight months. Moreover, half of all of construction SMEs were experiencing difficulties recruiting bricklayers.”*<sup>4</sup>

3. *The temporary downturn is built into the system via the planning system.* The English planning system has unusual features which mean that slower output results in a lower level of land released in the next upswing. If an area sees fewer homes built (and so fewer new households created), household projections are updated to show fewer new households will form in future. This allows councils to plan for fewer homes and to release less land.

To quote one study on current household projections by planning consultancy Lichfield, because of the 2008/09 slump and its aftermath, current projections *“inherently ‘bake in’ the implications*

*of a period that saw a dramatic fall in housebuilding to its lowest levels in modern history and a rise in affordability problems, a substantial increase in concealed families, and an increasing number of adults living at home. In that sense they have an endogenous circularity.”*<sup>5</sup>

Household projections are based on new households, but rather obviously, if there are no new homes for people to move into, the number of new households that can form is lower than it would otherwise be. If we build 200,000 homes each year for 10 years, we will end up with more new households than if we build 50,000 homes.

This also reinforces sector consolidation. A lower level of land release matters less to the larger housebuilders with the resources to obtain consent for large sites, often via planning appeals. But other housebuilders struggle, as they are reliant on councils to designate land through the planning system. Reducing the level of land released in local plans therefore squeezes out the SME sector in the aftermath of the recession. And again, it means a sector focused on a smaller number of large sites, and so, all other things being equal, a sector that will build out more slowly.

4 Centre for Economics and Business Research, “Bricks Campaign”. Available from: <https://www.naea.co.uk/media/1044993/bricks-report.pdf>.

5 Lichfields, “The 2016-based Household Projections for England”. Available from: [https://lichfields.uk/media/4495/lichfields\\_the\\_2016\\_based\\_household\\_projections.pdf](https://lichfields.uk/media/4495/lichfields_the_2016_based_household_projections.pdf).



### 3. The new build sales market underpins the house building sector

To understand why the market tends to collapse so rapidly, and so what measures might be able to halt this, it is necessary to understand how the English housebuilding sector operates.

Housebuilding works according to a 'build to sell' model. It is the ease with which a developer can sell a new build home on a specific site, at what they consider a reasonable profit, which prompts them to start and complete construction.

While the total number of planning permissions can be a constraint in particular circumstances, in recent years permissions have been running at a very healthy level, well above starts and completions. The most complete measure for 2018/19 showed new build starts stood at 213,860,<sup>6</sup> or around 60% of the permissions granted in 2018 and 2019, which stood at 362,000 and 380,500 respectively.<sup>7</sup> So currently – and is often the case, particularly at the 'top' of the cycle in terms of house prices and output – permissions are not the issue.

Instead, aggregated across England, it is the sales rate on each site (also termed

outlet) that drives the supply of new homes. The sales rate for housebuilders across all their sites can be broken down into three further elements:

1. The *number of transactions in the market* (e.g. how many people are buying and selling a home) which determines the total potential market.
2. The *relative attractiveness of a new build versus second hand home and the number of sites* which determine how this translates into actual sales.
3. Whether *the price of land is rising or falling* between the builder obtaining land and selling it as part of a finished home.

These are fleshed out in more detail below:

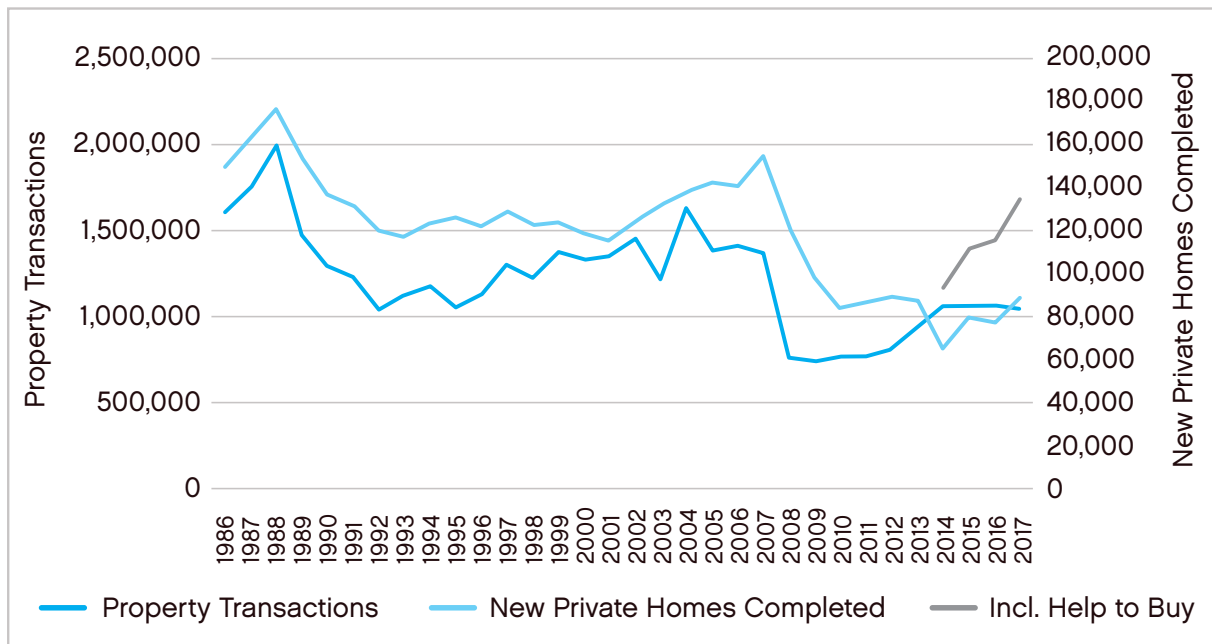
1. *Number of transactions in the market.* The first and most fundamental issue, as the graph below shows, is the link between the total possible sales for housebuilders (i.e. how many people buy a home each year) and the number of new builds. The graph shows a clear link between total transactions and new homes completed over time, particularly before the Help to Buy Equity Loan was introduced.

6 Ministry of Housing, Communities and Local Government, "Housing supply; net additional dwellings, England: 2018-19". Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/850825/Housing\\_Supply\\_England\\_2018-19.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/850825/Housing_Supply_England_2018-19.pdf).

7 Ministry of Housing, Communities and Local Government, "Planning Applications in England: January to March 2019". Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/812867/Planning\\_Applications\\_January\\_to\\_March\\_2019\\_-\\_statistical\\_release.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/812867/Planning_Applications_January_to_March_2019_-_statistical_release.pdf).



## Transactions versus new homes completed



Until the introduction of Help to Buy Equity Loan (sometimes referred to simply as Help to Buy), transactions and new build completions tracked each other very strongly, with the ratio of new builds to transactions fluctuating in a clear range between 1:8.5 and 1:12. The only exception was at the height of the financial crisis, and even then it did not depart too far from the range.

Recently, improved data on housebuilding has shown that the total number of homes built each year is usually slightly higher than recorded using quarterly data. (To add complexity, one data source operates on the financial year, another on the calendar year.) Adjusted for this, we find there is an average ratio of 8.54 transactions to each new build. So, on average, for every 8.5 transactions taking place in any year, one home is built.<sup>8</sup>

This means if there were a million transactions, you could expect 117,000 homes to be built in an ‘average’ year – if there were two million transactions,

then that same year, 234,000 homes would be built.

2. *The relative attractiveness of a new build versus second-hand home and the number of local sites.* The relationship above shows that more housing transactions means more houses being bought and sold. However, a shift in the desirability of new build homes compared to second hand properties can increase the share of the market they capture and the speed they sell at, and therefore the speed at which new homes are built.

The Equity Loan available via Help to Buy, for example, made new build homes more attractive than older properties (since you could obtain a loan for up to 20% of the property, and only needed a 5% deposit, at a time when most lenders wanted at least 10%). This shifted the market substantially. Instead of having to either buy a smaller property, or wait for longer (while they built up a deposit), households could use Help to Buy to move into home ownership earlier and/or to a better home – if they bought a new build.

<sup>8</sup> Alex Morton, “Stamping Down: Why Cutting Residential Stamp Duty is Easier than You Think”. Available from: [https://www.cps.org.uk/files/cps/CPS\\_\\_SDLT\\_1.pdf](https://www.cps.org.uk/files/cps/CPS__SDLT_1.pdf).



Thus, Help to Buy changed the relationship between transactions and new builds, meaning that for the same number of transactions, new build sales were substantially higher, since more people choose a new build compared to a second-hand property. Anything which makes new homes more attractive than before when compared to second hand homes will increase the total new build market, even assuming the number of transactions remains the same.

Related to this is how many different local sub-markets the housebuilders are selling into with new properties. The total number of transactions hides the fact there are a multitude of different markets in play – first time buyers, flats, houses, downsizers, family moves, those who need to be close to public transport and those who do not and so on. This means different sites in an area will have different possible buyers, because sites will target different audiences, and because different builders are likely to have different audiences that they focus on.

Consider two sites in the same local market, one a greenfield site with family homes in a village near a station connected to the nearest city, and one brownfield with small flats near to a town centre but no link to the local city. These sites serve different markets in terms of who is likely to buy these homes – in terms of jobs, income, and family type. Building on both at once will mean more sales as you are selling to different potential buyers, compared to two similar sites (e.g. two greenfield sites in the same village both building family homes) which are close to each other.

This variety of sites selling to different markets also helps determine sales rates and therefore build-out rates. This is also why fewer large sites tends to be worse in terms of overall output than a

greater number of smaller sites since they will tend to have more variation and obviously are in different locations. This is why embracing a variety of tenures will tend to increase build-out, because these represent different ‘markets’.

3. *Whether the price of land is rising or falling.* The third and final key factor is how land flows through the system on specific sites. If a housebuilder has bought land at price X, they have to be able to sell the land on for at least the same, and ideally a higher amount. This might seem hard to understand – surely housebuilders buy *land* and sell *homes*? But stripping out profit margins, a home is sold for the construction cost plus land price. What developers pay for land with permission in the first place is the expected final sale price of a home minus the cost of construction. If you can sell homes for £200,000 and it costs £100,000 to build a home at a profit, you will buy land with permission to build at up to £100,000 per plot. That is why, when house prices fall or rise, so do land prices.

If land prices fall between a builder obtaining the land and selling the house, each home built will be sold at a loss, eating into the housebuilder's cash and land reserves.

For this reason, over time the *direction* of house prices (and so land prices) matters more than the level. Housebuilders can keep building more easily with 2% rises in land prices each year over a five-year period than three years of 7% rises then two years of 5% falls, because in the second scenario they will end up with land they bought at the top of the market but have to sell when the land price has fallen by 10%. It is also important to note that landowners benefit from house prices rising more than the housebuilders.





## 4. Output is likely to reduce sharply in the coming months

Given the structure of the housebuilding industry outlined above, the economic shock from COVID-19 is likely – in the absence of Government intervention – to see housing supply sharply reduce over the coming months and remain low for a long period.

Part of this, of course, is that it will become harder to actually build a house while social distancing measures and PPE remain the rule for the workforce – hence the Government's welcome decision to extend hours on construction sites to compensate for lower productivity.

But there are also structural issues to consider.

As housebuilders return to work, they are likely to complete projects which are already under way, as the marginal cost of completing these homes is likely to be lower than the gains from selling them. But they are unlikely to start work on new developments, for a variety of reasons.

Firstly, and most critically:

1. House prices are likely to fall and so land values will also fall.
2. Many in the sector have a business model that allows rapid retrenchment in a falling market.

Secondly, both now and into the future:

3. Transactions are likely to be lower, which will cut new builds (and affordable supply).
4. Help to Buy will not stop buying becoming less attractive to new purchasers.

Taking these in turn:

1. *House prices are likely to fall and so land values will also fall*

In the short term, house prices and land prices are likely to fall, and this may continue for some time. There are a range of predictions at present, but all expect prices to fall at least to some degree over the next year. This means for the housebuilders that every home they build and sell may well be at a loss if house prices fall by any reasonable amount. This means those who can retrench will retrench, particularly the larger players – not least since the size and duration of price falls will be unclear, so if you start homes now, you will not be able to work out what they will sell for in six months' time.

This is particularly painful for housebuilders because land prices are more elastic than house prices. Say a house is worth £100,000, of which 50% is the value of the land and 50% is the cost of building the house. If house prices drop by £10,000, or 10%, the cost of building the house will not change – meaning that the full £10,000 fall





will be absorbed by a fall in the value of the land, from £50,000 to £40,000 (representing 20% of its value). This means each home built using land bought at the top of the market will be more likely to be loss-making.

Of course, much of the land held by housebuilders will have been amassed over a period of years, so even if it falls in value from the peak, a new home may still more than break even – but even so, housebuilders are unlikely to be keen on building too much. Over time, land prices tend to outstrip inflation. Building homes in a temporary downturn will rarely make good sense for the large housebuilder on a mass scale. Building fewer homes on sites where some profits can be still be made, while mothballing most sites until land values rise, is likely to give a better long-term return.

The best option for many firms, then, is to minimise output and wait for the recession to blow over, dipping into their cash reserves and building affordable housing units and a minimum of private homes on their most profitable sites.

This difficulty in building during price falls is why you end up with the strange sight of London – one of the most unaffordable places in the world, where the cost of building a home is a fraction of the cost of buying one – seeing housebuilding fall whenever the market wobbles. In the aftermath of the Brexit vote, private housing supply fell on one measurement from 16,330 private units a year to 11,340, even as the English total rose from 117,460 to 135,160. One forecaster predicts private housing

supply in London this year will reach just 10,000 units.<sup>9</sup>

2. *Many housebuilders have a business model that allows rapid retrenchment in a falling market*

For retrenchment to work, housebuilders have to accept temporarily lower valuations of their land, build a limited number of homes, using these receipts and any cash reserves to pay fixed costs, shed costs and hope to ride out any storm. But this is just what the big builders are well set up to do.

For a start, the larger housebuilders have built up large cash reserves. For example, Persimmon's cash reserves are £844 million, Barratt's are £958 million, and Taylor Wimpey's are £734 million. Their land reserves are also a useful shield – creditors and others are unlikely to want the company to have to sell these at the bottom of the market. Indeed, one reason why housebuilders focus on achieving very high margins on the homes they build in the 'good years' is to build up a cash pile that enables them to survive when times are lean.

But more than this, the larger housebuilders have created a model that allows them to stop building easily and quickly, with minimal fixed costs. To quote the Home Builders Federation:

*“Direct employment of trade labour by home builders is relatively low, with a recent Workforce Census carried out by the HBF and its members indicating that just over 20% of on-site surveyed workers were employed directly by the developer.”<sup>10</sup>*

9 George Hammond, “Coronavirus threatens to halve London housebuilding”. Available from: <https://www.ft.com/content/6d1361c5-1001-4ef7-8f8f-4f34c422d1cc>.

10 Home Builders Federation, “The Economic Footprint of Housebuilding in England and Wales”. Available from: [https://www.hbf.co.uk/documents/7876/The\\_Economic\\_Footprint\\_of\\_UK\\_House\\_Building\\_July\\_2018LR.pdf](https://www.hbf.co.uk/documents/7876/The_Economic_Footprint_of_UK_House_Building_July_2018LR.pdf).



Given the volatility of the housing market, large housebuilders need to be able to expand or contract rapidly, or switch labour from one part of the country to the other. Also, as well as the dominance of contractors, the sector relies so heavily on overseas workers,<sup>11</sup> who may return to their home country in a downturn.

This industry structure also explains why innovations such as Modern Methods of Construction have been slow to take off, no matter how many political initiatives are launched, because this does not work within this model. As a recent review on the productivity of construction noted:

*“The construction sector today is characterised as being ‘labour-intensive’ – it employs more people to produce each £1 of output than most other sectors and it generally employs less capital e.g. plant, machinery, computers etc. And it hasn’t changed or ‘innovated’ its productive processes as much as other sectors over the years.*

*“Construction is bottom of the productivity pile, a position that was not true 20 years ago. Manufacturing, in contrast has moved from bottom to top... Construction output has risen moderately but so has the number of construction workers and so its productivity has barely budged.”<sup>12</sup>*

Meanwhile, McKinsey noted that while infrastructure in the UK had been more efficiently delivered than in other parts of the world, there were substantial issues in much of the construction sector outside of this.

Most of all, “investment in labor-efficient technologies has been relatively low compared with other countries... the private sector has thus far been risk-averse and unconvinced about the investment case for new technologies”.<sup>13</sup>

This is all perfectly understandable if the primary goal is not maximising productivity in the short-run but building a model that is able to withstand the long-run cyclical challenges outlined above. No housebuilder wants to have a large workforce or multiple and expensive factories that they cannot cut back or scale back production as they need. No one else will invest in factories since they are well aware that the model of the large housebuilders will leave them with no purchasers in a downturn.

This also explains why the SME sector is hit so viciously by recessions. Its members cannot shed labour and capital so easily (the smallest builders of all, of course, only employ themselves, so must continue to work under all conditions). Many will go under since they cannot cut costs beyond a certain point and are unlikely to have built up large cash reserves, while they do not have large enough land reserves to be worth creditors trying to support them. Large housebuilders may, towards the bottom of the market, buy or option this released land at new and distressed values, allowing them to return to profitability faster than those SMEs stuck with land they bought pre-recession, but they are unlikely to rapidly resume building.

11 Home Builders Federation, “Home Building Workforce Census 2017”. Available from: [https://www.hbf.co.uk/fileadmin/documents/Policy/Publications/28075-Home\\_Builder\\_Report-Master-\\_V4.pdf](https://www.hbf.co.uk/fileadmin/documents/Policy/Publications/28075-Home_Builder_Report-Master-_V4.pdf).

12 Mace, “Construction productivity: the size of the prize”. Available from: <https://www.macegroup.com/perspectives/180125-construction-productivity-the-size-of-the-prize>

13 McKinsey, “Reinventing construction: A route to higher productivity”. Available from: <https://www.mckinsey.com/~media/McKinsey/Industries/Capital%20Projects%20and%20Infrastructure/Our%20Insights/Reinventing%20construction%20through%20a%20productivity%20revolution/MGI-Reinventing-construction-A-route-to-higher-productivity-Full-report.ashx>.



3. *Transactions are likely to be lower, which will cut new builds (and affordable supply)*

Even if house and land prices do not fall over the next 12 months, which seems unlikely, there will be issues with the housing supply over the rest of 2020 and into the medium term – since transactions are likely to be lower, meaning that housebuilders have a smaller market to sell into. Even as prices stabilise, this will be a continuing factor in lower supply. It is also why propping up house prices is likely to be self-defeating, since it reduces the number of possible buyers and just lengthens uncertainty, thereby cutting transaction levels.

Knight Frank have suggested transaction levels are likely to be around 38% lower this year, or around 446,000 fewer than forecast, due to the impact of COVID-19.<sup>14</sup> In 2018/19, 213,860 new homes were built.<sup>15</sup> Of this, 57,485 were affordable<sup>16</sup> and 52,446 were sold via Help to Buy – which we will discuss further below. This leaves a total of 103,929 purely private homes.

Given the link between transactions and supply, if transactions fall by 38%, this would equate to a fall in supply of around 39,500 homes from this factor alone. But it is quite possible the fall in transactions will be even sharper, either because social distancing proves to be a larger barrier to people moving home than is expected; because the move

toward a new normal is harder and less smooth than hoped; or because the fall in confidence is more sharp and severe. The fall from 2007 to 2008 was around 45%, which if followed this time would mean a fall of 47,000 or so private homes being built.

Knight Frank also forecast an optimistic rebound to just under 1.4 million transactions in 2021, as part of a surging economy that will more than make up any lost ground from 2020. But the fall in housing supply may not reverse as easily. For one thing, as mentioned above, it will be harder and more expensive to actually build homes while the workforce is unable to come within two metres of each other. Most crucially, housebuilders are not likely to start building homes, with all the costs that entails, until they are fairly sure that transactions are rising substantially. If the number of transactions remains low for some time – because people are worried about their jobs, feel they have insufficient savings, or social distancing remains in place for a long period, housing supply will remain low.

On top of this fall in market housing, the supply of affordable housing is likely to fall. Savills estimate that in a recession similar to the 2008/09 recession, the Section 106 payments made by housebuilders toward affordable housing supply will also fall sharply, likely by around 50%. This would mean around 9,000 fewer homes being built.<sup>17</sup>

14 Knight Frank, “Residential Market Outlook”. Available from: <https://www.knightfrank.co.uk/research/article/2020-04-06-residential-market-outlook>.

15 Ministry of Housing, Communities and Local Government, “Housing supply; net additional dwellings, England: 2018-19”. Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/850825/Housing\\_Supply\\_England\\_2018-19.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/850825/Housing_Supply_England_2018-19.pdf).

16 Ministry of Housing, Communities and Local Government, “Affordable Housing Supply: April 2018 to March 2019 England”. Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/847661/Affordable\\_Housing\\_Supply\\_2018-19.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/847661/Affordable_Housing_Supply_2018-19.pdf).

17 Savills, “Affordable Housing: Building through cycles”. Available from: <https://pdf.euro.savills.co.uk/uk/residential---other/affordable-housing-building-through-cycles-2018.pdf>.



#### 4. *Help to Buy will not stop buying becoming less attractive to new purchasers*

On top of this, sales from Help to Buy will fall while prices fall – the only question is how far. As noted, in England in 2019, 52,703 homes were bought using Help to Buy.<sup>18</sup> The Help to Buy scheme has increased the number of homes sold, sharply reducing the total number of transactions needed to achieve any particular level of new builds. It has done this by making new builds more attractive, particularly to first time buyers, who are the overwhelming bulk of purchasers using the scheme – 81% in the last 12 months for which data is available.<sup>19</sup>

The current Help to Buy scheme works by the Government giving a buyer a loan worth 20% of the value of a new build property, as long as the buyer has a deposit of 5% (which is why the scheme is overwhelmingly used by first time buyers). This 20% loan is then repaid after five years.

If you purchased a property worth £250,000 now, and over the next five years prices fell by 20% to £200,000, you would have to repay £40,000 to the Government. You would also have lost your deposit, so you will have lost £50,000. Though you would have saved five years' worth of rent, for many this will not be worth it. (In addition, in this scenario the Government would have made a loss of £10,000.)

If prices do fall, it would hit those who have bought under Help to

Buy in recent years, particularly first time buyers. But this would not be catastrophic for most, or the Government. The average median first time buyer price for Help to Buy was £231,950, meaning they owned a stake worth £185,560 and the Government had a stake worth £23,195.<sup>20</sup> A 10% fall in prices would lose them £18,560. However, the average house price has risen slowly in recent years, albeit not at the unsustainable bubbly rates of the past. For example, the average home rose in price from £215,236 in March 2017 to £230,332 by March 2020, so a 10% drop would in reality mean a drop of just £3,000 or so.<sup>21</sup>

So even with a 10% fall it will only really be those who have bought in the last year or two who will lose out, and even then probably only on paper, since at least some of any falls will be made up by the time they sell. (This is not to say real house prices will be lower in five years, they may well not be, but nominal house prices are unlikely to be so. And of course, lower real house prices mean an increase in transactions and home ownership rates.)

However, while this is not catastrophic, this visible hit would be enough to deter future buyers and impinge on future sales. If you are a potential buyer and you think house prices will fall by 10% over the next year or next two years, you are better off waiting and using Help to Buy then. This 'wait and see' attitude may well also be reinforced by the fact people are likely to be nervous about losing their jobs,

18 Ministry of Housing, Communities and Local Government, "Help to Buy (Equity Loan Scheme): Data to 30 September 2019, England". Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/868708/HTB\\_Equity\\_Loan\\_statistical\\_release\\_Q3\\_2019.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/868708/HTB_Equity_Loan_statistical_release_Q3_2019.pdf).

19 Savills, "Affordable Housing: Building through cycles". Available from: <https://pdf.euro.savills.co.uk/uk/residential---other/affordable-housing-building-through-cycles-2018.pdf>.

20 Ministry of Housing, Communities and Local Government, "Help to Buy (Equity Loan Scheme): Data to 31 December 2019, England". Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/883419/Help\\_To\\_Buy\\_Equity\\_Loan\\_Statistical\\_Release\\_2019\\_Q4.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883419/Help_To_Buy_Equity_Loan_Statistical_Release_2019_Q4.pdf).

21 Using land registry data available at <https://landregistry.data.gov.uk/#ukhpi>



or their partner losing their job, or major cuts to their salaries – it has hard to imagine many people coming off furlough and leaping into the property market with the biggest purchase they will ever make in their life.

If we assume that Help to Buy transactions fall by the same level Knight Frank has predicted for the market as a whole, this would mean a fall of around 20,000 sales. In practice, since Help to Buy is more heavily used by first time buyers, this may be optimistic. During the financial crisis, the number of first time buyers fell from around 400,000 in 2006 to less than 200,000 by 2008, a fall of 52% – even though lower prices meant homes theoretically became more affordable.<sup>22</sup>

If this fall was replicated among Help to Buy users, who as mentioned above are overwhelmingly first time buyers, sales would fall by around 27,405 and so supply would fall accordingly.

In short, despite the Government moving swiftly to get housebuilders back on site, the sector is likely to see major falls in housing supply. Even if house prices do not fall, it is possible that housing supply could fall by 76,000 over the next year (39,500 from lower transactions, 9,000 from lower Section 106, and 27,405 from lower Help to Buy). This is likely to be exacerbated substantially if prices do indeed fall, and COVID-19 continues to seriously disrupt our lives.

<sup>22</sup> Halifax, “Number of first time buyers highest since 2007 despite deposits doubling”. Available from: <https://static.halifax.co.uk/assets/pdf/mortgages/pdf/2018-01-27-number-of-ftb-highest-since-2007-HPI.pdf>.





## 5. We need to keep housebuilding going – particularly in the SME sector

### Measures to keep the sector moving are fairly urgent.

While the sector has on paper restarted, internal data shows that housebuilders are completing phases (e.g. a specific street or block of flats) and homes already well underway, in order to sell these now, but are in most cases not starting new phases or work on new homes, certainly at anything like the pre-crisis level

As the current wave of homes is completed, the pipeline will dry up, particularly among the larger housebuilders. Once the furlough scheme ends in full, it is likely contractors and others will be let go, and as workers finish each phase they too will be released. Supply chains will dry up, and the sector will move into a major slump as in the 1990s and 2008/09 recessions.

In the medium term, there are a range of measures that are likely to get supply moving – planning reform, change of use, SDLT cuts and so on. But as shown in the first half of this paper, the biggest issue in the next couple of months is preventing this sharp fall in supply which develops into a multi-year slump.

One solution that has been suggested – and was partially deployed in 2008 – is a massive counter-cyclical investment in affordable housing.

As noted right at the start, it is true that in the last recession, private housebuilding fell most sharply, and affordable housing helped maintain output. But this merely limited the slump a little – between 2007 and 2009 private housing starts fell from 159,000 to 65,000, while affordable housing starts (via housing associations and local authorities) fell from 23,690 to 20,610.

Today, the scale of counter-cyclical spending would have to be huge – and sustained – since even by 2013, private housing starts were still at just 98,820, so this affordable housing would have to make up the slump in private housing till at least the second half of this decade. The bill would likely run into tens of billions over the next few years.

This would essentially turn the housing sector, year in and year out, into a permanent arm of the state, at a high and ongoing cost. It would also result in a fundamental shift in focus away from ownership – contrary to the position of the 2019 Conservative Party manifesto – despite that being what the public themselves repeatedly say they want.

The other alternative – to do nothing – is likely to result in a major slump in output and a prolonged stagnation following that, which will be most heavily concentrated among the SME sector, particularly the smallest housebuilders. This will create an even more consolidated sector focused ever more on a small number of larger sites, slowing the pipeline still further.



We suggest instead that, in the short-term, while the market is in flux and prices are uncertain, the Government should do two things to maintain the pipeline of starts and completions:

- 1. Make maintaining starts and completions its main policy priority**
  - 2. Rapidly announce a wave of support to do this that is:**
    - a. Flexible and easily accessible.**
    - b. Focused on sites with permission that are (largely) ready to go**
    - c. Conditional on maintaining the housing pipeline for those who access it**
- 1. Make maintaining starts and completions its main policy priority*

This first goal is important because there will be lots of attempts to push the Government to prop up this sector and that sector. Often these will be about protecting the balance sheets or vested interests of those involved.

There is nothing wrong with private sector bodies, including housebuilders, lobbying Government with their suggestions, or coming forward with 'win-win' ideas. But the Government needs to have a clear yardstick against which they can assess such schemes: namely, how will this increase both starts and completions. This is a much clearer metric than vague measures like 'restoring confidence', or incidental goals like 'supporting prices'.

Government needs to be ruthless in focusing on those proposals which will keep the supply of homes on track. The SME sector in particular

simply does not have the clout or organisational structure necessary to lobby Government. The risk is therefore that solutions which do not support the SME housebuilders are prioritised.

A particular danger is going to be the Treasury being excessively focused on maintaining asset prices (including house prices) rather than maintaining output. This is precisely what happened in 2008/09, resulting in a temporary boost to prices while output collapsed. This policy package clearly failed to maintain housing supply. In addition, any attempt to maintain house prices across the entire £7.4 trillion UK residential sector would be crippling expensive, and risks simply moving any fall in prices to a year down the line, just when the economy needs to begin to take off again.

Instead, the Chancellor and Housing Secretary should be clearly tasked with maintaining a high and continuous supply of output over the next couple of years. There will obviously be a fall in supply, but the key is to limit it and ensure that the bounceback happens far sooner than in previous recessions – so that by 2022, we are back where we were in 2019, with supply chains largely intact and the sector able to refocus on reaching the annual 300,000 new build target that the Government has championed.

On that score, trying to limit the fall to roughly 25% this year and 10% next year compared to 2018/19 would not be unreasonable. Given new build housing supply in 2018/19 reached 213,860 homes this would give a total of 160,000 or so homes this year and 190,000 or so next year.<sup>23</sup>

23 Ministry of Housing, Communities and Local Government, "Housing supply; net additional dwellings, England: 2018-19". Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/850825/Housing\\_Supply\\_England\\_2018-19.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/850825/Housing_Supply_England_2018-19.pdf).



## 2. *Rapidly announce a wave of support*

A target alone is not enough. The sector is going to be plunged into turmoil by the after-effects of COVID-19. The Government needs to as rapidly as possible announce a wave of support both now and into 2021, with the following key points at its heart:

### **a. Flexible and easily accessible**

Support has to be easily accessible to housebuilders, with limited strings attached. Trying to push through support only on particular sites, or attaching too onerous conditions, simply won't work. Now is not the time to say 'only brownfield' or 'only affordable rent' or 'only affordable ownership'. Developers need to be encouraged to keep the churn of sites going as broadly as possible.

We also may want to bypass the bureaucracy of Homes England – which while much improved under recent leadership remains a far from perfect vehicle to deliver support on the ground. For example, the Help to Buy scheme is largely administered by the Treasury supporting the housebuilders fairly directly, which makes it simple and flexible for housebuilders compared to the support given by Homes England.

### **b. Focused on sites with permission that are (largely) ready to go**

While planning reform is important in the longer term, this short-term support is about preventing the existing pipeline from becoming blocked. That means maintaining a steady flow of homes from sites that are already permitted and largely ready to go.

The numbers of permissions in recent years has, as the start of this note pointed out, outstripped supply very substantially – meaning that there are plenty of properties to build out in the existing pipeline. In terms of new permissions, things are likely to move too slowly to be the focus of a stimulus package that prizes speed: while in theory there is a statutory limit of just 13 weeks for a decision on a major planning application, in reality pre-application discussions and preparation by housebuilders usually take longer.

This limit is voluntarily extended by those applying giving consent in two thirds of cases (and in the remaining third some will be rejected outright and then have to go through the long and costly appeals process).<sup>24</sup> This is on top of so-called 'reserved matters' which housebuilders must resolve before any construction starts, and are built into most planning permissions. It is likely that the time even for a fairly viable site already potentially considered for homes to obtain permission and be made ready would be close to a year, if not more.

However, to avoid becoming a permanent crutch, any support scheme must become redundant naturally over time – and have an inbuilt expiry date.

### **c. Make support conditional on maintaining the housing pipeline**

The worst-case scenario for any stimulus package is that housebuilders who are supported by Government take the money and build out a small number of

24 National Audit Office, "Planning for new homes". Available from: <https://www.nao.org.uk/wp-content/uploads/2019/02/Planning-for-new-homes.pdf>.





homes on sites they had identified as the most profitable already, while downing tools elsewhere. A housebuilder using land that it bought five years ago which has risen by 30% since, even if it falls in price now, may find that site profitable to build out. But if the only outcome of the Government support is that this home, which would have been built out anyway, is merely sold at a higher margin for

the housebuilder, this counts as a complete failure.

There is a risk that a badly designed support package will end up increasing the margins earned on a small number of homes rather than maintaining a wider pipeline. Any reform must avoid this problem by making support conditional on maintaining a broad pipeline, not just building out the homes which support is attached to.

## 6. Introducing ‘Help to Build’ as a potential solution

Given all this, we suggest that the Government announces a temporary support scheme based around issuing flexible grants to support housebuilding, until at least next spring, with further measures to help supply pledged in the coming months to replace this initial short-term measure.

This should have the following features:

- A. The grant is per home sold, up to a given maximum, to be used as the housebuilder sees fit.
- B. This must be paid back if the housebuilder’s overall pipeline slows.

### **How this grant per home sold scheme could work**

The Help to Build grant should be set at a flexible level – for example being based on a % value of a new home (e.g. 10% or 15%), up to a set maximum. This would allow for flexibility in terms of tailoring support – clearly a home sold for £150,000 in the Midlands needs less support than one sold at £250,000 in the South East. An initial suggestion would be to calibrate the system so that the average grant was at a given level, e.g. £20,000, with the cap set at e.g. £25,000.

Not only should the grant for each individual house be capped, but so should the overall cost of the scheme – at a maximum of either 150,000 homes, or £3 billion in Treasury spending. If it hit that cap, it would be a sign that the scheme had done a more than adequate job of maintaining the market, at much lower cost to the Treasury than alternative schemes. It would also maintain the supply chains, labour and other skills vital to the sector hitting higher targets in future years.

This would give a breathing space for more sensible and long-term reforms, including planning reform, Stamp Duty cuts and other measures.

Crucially, rather than the grant being earmarked for particular measures, the Government should be open to any scheme that housebuilders think will help them sell using this grant (within very broad parameters). They should however help to encourage innovation by suggesting the following possible avenues for housebuilders – as examples of the types of schemes they think might be useful.

- *Supporting part-exchange schemes.* Part-exchange schemes are best characterised as a ‘We Buy Any House’ approach: the housebuilder agrees to count the value of an existing property against the price of a new build (usually up to a maximum cap, which is why they are ‘part-exchange’ not ‘full exchange’). Such schemes used to be extremely common, but have



declined in popularity. However, given that those who want to move may well struggle over the coming months as chains will be disrupted, not least by a possible lack of first time buyers, this could be an extremely welcome way to get the market moving. It would also particularly help older people making a needs-based move into retirement housing or supported housing but unable to sell their existing property on the open market as the builder would be in a position to offer them a part-exchange.

Part-exchange schemes for new build would support the relative attractiveness of new build properties in the same way that Help to Buy does, but for those who already own. The grant would help by cushioning the housebuilder from much or all of the fall in house prices – indeed they may well choose to price their property below similar homes in order to facilitate a quick sale, using this grant to encourage the sale by dropping the price by this amount. This also avoids putting the Government on the hook permanently and ending up with the state propping up the entire housing market.

- *Deposit support.* Housebuilders, using this grant, would ‘gift’ a 5% or 7.5% equity stake to all those purchasing a new build property. This would help those who have a small deposit but who could not normally borrow at present to obtain a 90% mortgage. This obviously links to the fact that house prices are likely to fall in the coming months – and limits the risk for potential new purchasers buying a new build home. It also makes it more likely that those who are considering buying long term (e.g. to start a family) will proceed, since the alternative would be renting for several years.

This proposal is attractive because it makes financial sense for the buyer, even if prices fall. For example, if you have £5,000 toward a £200,000 home, you need another £15,000 for a 10% deposit. Even if house prices fall 5% to £190,000, you would still need another £14,000. But if you get cash or a slice of equity you can use as a deposit, you would be better off even if you temporarily went into negative equity, since prices are likely to rise in the long run and you would also be paying off your mortgage from day one rather than having to wait as you build up your deposit. This scheme therefore makes new builds more attractive than second hand homes to first time buyers (as Help to Buy does in a normal market).

- *Helping support First Homes rollout.* First Home is a scheme which the Government is developing which allows for people to buy a home at a proportionate discount to the market rate, and then to sell it on with the same proportionate discount embedded (e.g. if you buy a home at 80% of the market rate, you would sell it at 80% of the market rate in future). The goal has been for this to avoid using grants, but in the short term, while the policy is embedded and worked into the system, this grant of up to £25,000 could be used to help increase the speed at which First Homes becomes an embedded product in the system.

First Homes also may be attractive to first time buyers since they would be getting a home faster than normal, and the fall in prices would be shared with the Government. Unlike Help to Buy, there would be no automatic five-year period after which the owner had to purchase the whole of the property. It could be that combining this grant with the First Homes approach could be particularly useful in terms of sales and increasing new build.



Grant for shared ownership or affordable rent. Another option would be for the grant to simply be offered as a subsidy for shared ownership or affordable rent schemes. The most recent data from Homes England showed that shared ownership requires around £32,808 while affordable rent requires around £37,646, in terms of grant per unit.<sup>25</sup> The theoretical maximum above of £25,000 is slightly less, but some housing associations, councils, or private affordable housing providers may decide they can support this (e.g. a housing association with substantial borrowing headroom may decide this can be combined with additional borrowing).

This is particularly true where the housebuilder decides that the savings on marketing and a slightly lower margin are acceptable on particular units. It may be that housebuilders can push for slightly lower Section 106 on future sites for councils in return for transferring stock to affordable uses on existing properties being developed. It is also true that where Homes England have already created a partnership with housing associations or private affordable housing bodies, they could reshape how they spent that grant – as long as this about delivering more units. If a large housing association has taken £40 million to support building 1,000 homes, but by adding this grant to their existing grant, and buying in bulk, they can use (for example) £60 million to support building 2,000 homes over the next year, this is a good use of such spending.

This list is not exhaustive but sets out the kind of schemes and support that could be used to help drive sales. If housebuilders use the grant in other ways

this too should be broadly acceptable. Our only real rule is that this grant should be used in a way that supports affordable housing (either low cost home ownership options like shared ownership or affordable rents) or else supports ownership (though not only first time buyers). This grant should not be available for those buying properties to rent at a commercial rent, nor for buy-to-let landlords.

This support, if accessible enough, will hugely support the SME sector and halt a potential further round of consolidation, even though it is likely that many housebuilders will avail themselves of it. It is the SME housebuilder firms that would otherwise go to the wall, and who would exit the scene, but who through this scheme can be supported over the next year or so until further reforms can kick in.

By Government being flexible in how the support is deployed, housebuilders can use the grant in different ways on different sites, depending on the possible target market, relationships they have with affordable housing providers, councils, and other factors on each site. It gives the housebuilders the greatest chance of moving units. It also avoids simply handing over very large levels of grant now and in future, which as discussed would fundamentally shift the housing market.

A final point to support this flexibility is that the grant should not sit long on the balance sheet of those borrowing it – instead, if the pipeline by any housebuilder who takes it is maintained, as discussed below, it should be written off rapidly at the end of 12 months by the Government. If the grant is used to create an affordable housing unit (of any tenure) this grant should remain briefly with the housebuilder and then be written off,

<sup>25</sup> Homes England, “2016 to 2021 Shared Ownership and Affordable Homes Programme summary: end of September 2019”. Available from: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/865155/Allocation\\_update\\_to\\_end\\_September\\_2019\\_Final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/865155/Allocation_update_to_end_September_2019_Final.pdf); This excludes nil grant units.



rather than transferring to the new owner of the unit (e.g. a housing association or private affordable housing provider). This will allow the sector to resume borrowing and activity rapidly as (hopefully) we emerge next year from recession.

As already suggested, rather than using Homes England and the slow disbursal mechanisms employed for most schemes, the Government should try to disburse this using the existing Help to Buy scheme. And as argued further below, it should be tied to builders' overall pipelines rather than specific projects. The Government should also urgently focus on how it can support the smallest housebuilders in accessing this funding and support, and on how it can help deliver a version for those who want to commission a custom or self-build home over the coming months. It may want to ask Homes England to come up with a proposal on this in a matter of weeks.

### **This scheme buys time for further reforms – but has obsolescence built into it**

Help to Build is about buying time for further reforms – for the rollout of new schemes such as First Homes, or planning changes, or Stamp Duty cuts (or ideally all of these). It is not about a permanent shift in the market nor a long run scheme – it is explicitly about boosting new build at a time of crisis in order to preserve the housebuilding industry in a way that did not happen in previous recessions.

Most of all, this scheme has obsolescence built into it. If such a scheme did become permanent then *most of the value of this spending would simply go into land values and the acceleration of build-out would slow*. If landowners knew this scheme would continue indefinitely, they could raise the price of land, knowing that housebuilders would be happy to pay more for it. If a housebuilder could sell a new build home at £5,000 less than an identical second hand home,

and make £15,000 profit using this grant, as a housebuilder you would, in normal times, be prepared to pay up to £15,000 more per plot to the landowner, and so landowners would over time raise their price.

Obviously, since over time most of the profit went to the landowner, this would mean the acceleration in sales would shrink (though never completely vanish), since the benefit to the purchaser would shrink and shrink. Thus, this scheme has a built-in redundancy mechanism. This is also why it is suited to sites that are already largely ready to go, since most of the values of land, Section 106 and so on are all already fixed – the only variable that changes is the price of the home.

### **The support for each home built needs to be limited**

Some might argue that this scheme makes sense, but that the incentives involved will not be enough at a time of economic trauma. If the goal is to ensure that the new build market is able to function, then why not just give £30,000 or £40,000 in grant, which would definitely ensure you could move the new stock?

Firstly, this is excessively wasteful – ultimately, this money comes from taxpayers. However, even from a policy angle excessive grant is unhelpful, as the grant creates two potential problems:

1. The larger the incentive, the more housebuilders will become addicted to this scheme and the more other players start to change their behaviour. This has to be a short stopgap to buy breathing space – and only while the economy is severely disrupted and recovering from said disruption. Beyond that, more serious structural reforms are needed.

In addition, beyond a certain point, higher grant will simply result in higher land prices, or housing associations



making higher bids against each other on affordable housing, or offering lower rents for their tenants to get councils to push housebuilders to sell to them, rather than higher build out across the sector.

2. Also, the larger the incentive, the greater the risk that the second hand market will grind to a halt. If the Government is handing out say £75,000 in support to someone to buy a new build, this would mean that transactions among second-hand homes would fall as many wait for new builds to become available. This means fewer people buying second-hand homes and the rest of the housing market slowing even more.

Rescuing the new build market while collapsing the rest of the housing market is likely to result in net benefits being much smaller. Losses of jobs in sectors like removals, estate agents and so on would balance against jobs saved in construction – and deterring people from moving while they try to access subsidised properties carries an economic cost of its own in terms of people's location and so on.

The goal, in other words, should be to deliver just enough support to keep purchases of new builds where they would have been otherwise and the pipeline flowing. It is a stopgap measure and certainly an imperfect one – but if we allow the housing market to collapse while we design a perfect system, this risks decimating the industry.

### **This support can – and should – be calibrated once underway**

The aim of this policy, as mentioned above, is to maintain the flow of new build properties. The Government can – and

should – adjust the support that they need to deliver every few months in order to try to keep the broad pipeline in place.

There will always be some deadweight cost, in that some purchases are supported which would have gone through in any case. But the goal should be to try to ensure the market maintains the pipeline it would have always achieved. And overall, compared to other approaches (e.g. trying to prop up house prices across the £7.4 trillion wide UK residential sector),<sup>26</sup> any deadweight cost from this £3 billion or so scheme (assuming support for 150,000 private homes at an average of £20,000 each) is likely to be tiny – certainly much less than the cost of the sector collapsing as it did in past recessions.

### **Builders would be penalised if their overall pipeline slows**

Any stimulus package, no matter how justified, is likely to be criticised in some quarters as a bung to the industry concerned. Similarly, any stimulus measure risks just inflating profits for those using it rather than stimulating wider economic activity, as economic actors just do what they would have done anyway while taking a Government handout.

This is all the more likely in the case of the housebuilding industry, where Help to Buy and other Government programmes have translated into outside profits, by effectively ensuring that all properties built under the scheme can be sold at a very comfortable margin.

Help to Build is both generous and flexible. But the support it offers should also be absolutely conditional on the Government getting bang for taxpayers' buck. In particular, it should be tied to the level of housebuilders' pipelines, not to

26 Savills, "UK housing stock now worth a record £7.39 trillion after decade of gaining £750 million a day". Available from: <https://www.savills.co.uk/insight-and-opinion/savills-news/294601/uk-housing-stock-now-worth-a-record-%C2%A37.39-trillion-after-decade-of-gaining-%C2%A3750-million-a-day>.





their building specific units. There is no point, as discussed earlier, in this scheme supporting buildout and sales where these would have happened anyway, but simply at higher margins, while allowing the larger housebuilders in particular to down tools elsewhere so that output fell across the board.

The exact nature of this conditional nature needs to be determined by Government itself, but we propose the model below for examination:

1. On accessing this scheme, the housebuilder commits to an overall pipeline of future starts and completions from July onwards based on its output over the 18 months from mid-2018 to the end of 2019, minus a set percentage (e.g. 25%) to reflect the impact of recent disruption.
2. Should this pipeline fail to be delivered, the cost of this Government support will be repaid to Government, potentially with a penalty clause (e.g. +50%) and future access to the scheme terminated.

Let us say you divide the pipeline into six-month blocks. If a housebuilder has built 1,000 units every six months on average, they would deliver 750 units (i.e. 1,000-25%) in the second half of 2020, and again

in the first half of 2021. This would allow for some drop off in terms of housing supply, and for the housebuilder to not proceed on the least viable sites, whilst requiring them to broadly continue with supply on most sites. The length of the scheme also ensures that the companies will not simply be forced to down tools or re-furlough workers once their existing half-built stock is complete. If the housebuilders or sector is bailed out yet does this, this outcry would be deafening – including among those laid off and in supply chains left workless.

This is only a suggestion – it may be that the commitment to build could be calculated according to the size of housebuilders' land banks, or that other metrics could be brought into play. But the overall framework should be clear: those who access this support are doing so in order to keep a pipeline of supply rather than make higher margins on sales they were already planning to make.

This focus on the forward pipeline also has the positive side effect of incentivising housebuilders to work with the Government to improve housing delivery, something that will pay off for all involved over a period of years by creating a positive and collaborative framework.



# Conclusion

The country is facing a rapid downturn in housing supply, one which is likely to have major impacts across a large section of the economy.

If the pattern of previous recessions is repeated, it will cause big housebuilders to hunker down while many smaller ones go to the wall – and it will take many years for the industry, and housing supply, to recover.

Given this, there is an urgent need for a flexible package of support – one both focused on and conditional on maintaining housing supply at something approaching existing levels.

Action cannot be long delayed, or we risk major economic and social harm arising from a slump in housebuilding and disruption and damage to supply chains.

We believe the scheme outlined here represents the most efficient and cost-effective way to stimulate the market and keep housebuilding going. It would avert a major round of consolidation and the collapse of many SME housebuilders, while allowing the larger housebuilders to slash output and survive. Thus, even those who might prefer ‘creative destruction’ in the housebuilding sector will in fact be entrenching the largest players without this scheme, or something like it. In the absence of such measures, we risk a repeat of the grim years after the 2007 financial crisis began – when housing supply both collapsed and then stayed low for a long period, a crisis which would end up locking an entire generation out of the housing market for good, and substantially hit the economy at a time when it is already in dire straits.