

5/2018 Letwin Housebuilding Review – Draft Analysis



4/7/18

Key Points

- Sir Oliver Letwin has published his draft analysis of the reasons for slow build-out rates on large sites.
- He finds that build-out rates are largely dictated by the “market absorption rate” of new homes – the number that can be sold in any period without affecting house prices.
- He argues that house prices should not be allowed to fall as this would affect builders’ profits since the price they pay for land is calculated from the expected price of the homes planned to be built on it.
- More homes could be built on smaller sites but this would not remove the need to develop large sites.
- His main conclusion is that the number of homes “absorbed” by local housing markets could be significantly increased by increasing the variety of homes provided on large sites, in size, tenure and design.
- The Review considered a number of other potential constraints on build-out rates, concluding that the only factor needing urgent action is the shortage of bricklayers; Letwin urges the Government to find ways to train 15,000 additional bricklayers over the next 5 years.

Background

At Budget 2017, Sir Oliver Letwin was appointed by the Government to lead a review to “explain the significant gap between housing completions and the amount of land allocated or permissioned in areas of high housing demand and make recommendations for closing it”. In March he announced his intention to focus on large sites and, distinguishing a regulatory Stage 1 concerned with assembling the necessary consents before construction can start and a “build out” Stage 2, to focus on the latter. His new report sets out his analysis of what the build out rate on large sites is, why it is as it is, and which factors would be most likely to increase it without having other, untoward effects. The next phase of his review will consider what policies to “close the gap” he will recommend in his final report due at Budget 2018.

Analysis of the build-out rate on large sites

The median build-out period on 15 very large sites studied by the review was estimated to be 15.5 years, or 6.5% of the site per year. The Moliar data set for sites over 500 homes in London shows a lower median rate of 5.4%; for sites over 1000 homes the same data set shows a median of 3.2%. There is a clear negative relationship between the size of site and the build-out rate.

The fundamental explanation for this, the Review concluded in March, is the “absorption rate” - the rate at which newly constructed homes can be, or are believed by the developer to be able to be, sold in the local housing market without disturbing the market price. This depends on the variety of house types being constructed and their expected tenure. A relatively homogenous output is associated with a lower absorption rate. Builders universally see “affordable” homes, including social rented and shared ownership homes as additional to the number of homes that can be sold on the open market, but the rate at which they are constructed is constrained by the requirement for cross-subsidy from the open-market housing on the site.

Since March the Review has considered three questions:

- What are the implications of changing the absorption rate for the current business model of major housebuilders if the gross development value of sites starts to deviate from the original assumptions that underpin the land purchase?
- Would the absorption rate be different if the reliance on large sites to deliver local housing were reduced?
- Would the absorption rate, and hence the build-out rate, be different if large sites were packaged in ways that led to the presence on at least part of the site of:
 - other types of housebuilder offering different products in terms of size, price-point and tenure, or
 - the major housebuilders offering markedly differing types of homes and/or markedly different tenures themselves?

Forcing builders to sell at reduce prices

Letwin concludes that it would not be sensible to attempt to solve the problem of market absorption rates by forcing builders to reduce the prices at which they sell their current products. He accepts that developers will have purchased land at a price calculated by reference to the market price of the homes to be constructed on it, on the assumption that the additional supply will not affect it; subsequently forcing them to sell below this price would reduce or eliminate the developer's profit. The concept of an absorption rate that does not affect local house prices, in effect, underpins the whole system of land valuation and pricing.

Reducing reliance on large sites

The Review considered two ways of increasing the number of small sites:

- by finding some way of “packaging” large sites into smaller sites;
- to use the planning system to encourage the use of more “naturally” smaller sites.

Although the second of these might be feasible the Review concludes that it cannot substitute for the first, because large sites are necessary to unlock value to support major infrastructure investment, to meet the scale of demand in high pressure areas, and to ensure building on derelict or other brownfield sites “begging” for development.

Product differentiation

The Review examined the extent to which increasing the variety of homes constructed, whether in size, price or tenure, would help to increase the number of homes that could be “absorbed” by local housing markets without affecting prices. It concludes that homes in different tenures are, in effect, separate markets. Homes for outright sale, shared ownership, social and private rent can be treated as separate products, as can custom or self-build, which is rarely offered on large sites. Letwin also suggests that more variety in design could attract customers put off by the homogeneity of most large new developments.

Other potential constraints

In addition to considering issues affecting market absorption rates, the Review considered a number of other factors potentially holding back developments.

Lack of transport infrastructure – the time taken to provide major new transport infrastructure has had a major impact on some of the sites studied by the Review, but primarily impacts on Stage 1 of the development process and not on the second, build-out Stage.

Difficulties of land remediation – the Review was unable to find any systematic contrast between the rate of build-out on large greenfield sites and brownfield sites requiring remediation.

Delayed installation by utility companies – this has been a problem on some sites, but primarily affects Stage 1 of the development process.

Constrained site logistics – the Review concludes that these do not constitute an obstacle to faster build-out.

Limited availability of capital - the Review concludes that this is not a problem at the moment. The major housebuilders have access to credit they do not use because cash flow is normally sufficient to cover in-year expenditure. SME builders might be more challenged but are not currently involved in large sites. Housing associations and institutional investors told the Review they have appetite and equity finance for considerable expansion into the rented sector, but are held back by lack of access to large sites.

Limited supplies of building materials – Letwin finds “little reason” to expect that supply of building materials would be unable to keep pace with an increase in rates of construction, provided that suppliers are confident that the increased demand for their products will continue.

Limited availability of skilled labour – the availability and price of skilled labour is a significant concern for the major house builders. The RICS reports 40-60% of surveyed employers identifying shortages in both professions and trades. The HBF Workforce Census reports that 50% of the workforce in London, and 20% in the South East come from abroad, mainly the EU. However, the Review notes that construction of new homes occupies only around a quarter of the construction workforce, giving scope for redeploying workers from other sectors, such as house repair and maintenance or construction of infrastructure or commercial or industrial building, if the rate of home construction were to increase. In general, therefore, Letwin does not see skills shortages as a major constraint. The exception is bricklaying, where he urges the Government to find ways to train an additional 15,000 bricklayers over the next 5 years to increase the size of this workforce by 25%.

Alleged land-banking by major house builders – the Review considers whether the major house-builders are deliberately “banking” land so as to benefit from any increase in its value, as distinct from the value of any homes they construct on it, but concludes that they are not – they hold land for eventual development, indeed, need to hold land to ensure a supply for future development, and the rate at which they develop it is primarily dictated by the perceived market absorption rate of new homes and not other factors.