PARTNERSHIP PLANNING: MAINSTREAMING THE PROVISON OF AFFORDABLE HOUSING IN PRIVATE SECTOR BUSINESS MODELS

Back in 1991, I wrote that that '"if the nineties are to be characterised by partnership and co-operation between public and private sectors with the benefits of markets and planning reinforcing each other, policy makers could perhaps do worse than start with the housing market".

Total rather than just public output should be made subject to mechanisms of partnership planning undertaken between central government, and public and private providers. This, by helping to blur tenure divisions and by ending the strict separation of renting and buying while increasing total production, should enable the more effective pursuit of both economic and housing objectives'[1].

That advice remains relevant in the recessionary wake of a prolonged house price boom that not only priced first-time buyers out of the market and skewed the distribution of asset wealth upwards further in favour of existing, established, and often already asset-rich owners, but, contributed directly to a financial market crash that threatens to make the first UK recession of the 21st century a particularly sharp and prolonged one.

These combined consequences underscore the current and pressing need for a model of partnership and co-operation between private and public suppliers and enablers of housing that is demonstrably driven by twin and related aims: first, the expansion of housing opportunities to new and moderate-income households; second, the stabilization of house prices on a long term basis so smoothing the tendency of the housing market to successively swing from boom to bust. This chapter terms that model Housing Supply Partnership Planning and seeks to describe and explain how it would work.

Housing Supply Partnership Planning (HSPP) would mainstream the provision of affordable housing within private sector construction company business models.

At least half of the annual supply of new dwellings would be affordable splitr between social rented and discounted but flexible low-cost home ownership or other intermediate tenure, such as rent-to-buy.

Such a programme would expand beyond the 70,000 dwellings indicated by the 2007 HGP.

Specifically, the Town and Country planning framework would require (certainly in areas of excess housing demand) at least 50 per cent of all dwellings provided in developments over a defined size threshold to be affordable, with, say, 20 per cent to be provided by social housing landlords for rental.

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[1] *Time to put our house in order*, John Newton, CHAS, 1991.

The land for the affordable housing portion of the development would in effect be free with the cost of the affordable units being limited to construction cost, plus agreed constructor profit and overheads.

That requirement in itself would tend to deflate directly the land cost component of supplying new housing.

The HSPP definition of affordable housing would be where its cost or price excluded the value of the land on which it was provided.

In reality, of course, the affordability or other otherwise of such dwellings will be a function mainly (for purchasers) of the relationship between their monthly mortgage outgoings and income, varying according to individual household circumstance.

HSPP will simply improve affordability in general by deflating prices but will not make particular dwellings actually affordable for any particular income range of households.

For this reason, HSPP should be combined and coupled with the expansion and development of Homebuy and related programmes.

These should offer expanded opportunities to households with an income below a set threshold to purchase limited equity stakes of dwellings, the size of which could vary with the financial circumstances of individual households, starting as low as ten per cent.

The difference in value between the full market value and the construction cost of affordable dwellings provided through HSPP would remain vested in perpetuity with a registered provider.

Such a mechanism is not dissimilar to the long-established cost sale mechanism and its more recent variants, that, in effect lock-in a discounted land value (either existing public land provided at ‘free’ or at a discount or other land made suitable for housing use at public cost) within shared equity leases that then maintain the discount in perpetuity to future purchasers[2].

Social housing landlords would also with public subsidy (generally SHG) or its own resources provide affordable rented accommodation on the site in relation to the build cost of the dwellings.

Over time HSPP should accordingly induce a change in market behaviour by developers: their bids for land will be made in knowledge of discounted dwelling requirements that should serve to deflate land prices, thus reducing it both relatively and absolutely as an input cost in housing production.

[2] Developers might be provided with an incentive to establish registered provider subsidiaries.

The institutional environment in which housing was planned, delivered, and exchanged would correspondingly change as the dichotomy of separate but parallel land use planning and planning obligations systems ended.

So how would HSPP vary from the present system of Section 106 planning obligations? Developers currently assist the provision of a designated proportion of dwellings on affordable terms to a social landlord by a variety of mechanisms, including direct on- or off-site provision of rented and discounted low-cost home ownership units, on- or off-site provision of land for free or at a rate below market value, or by making commuted monetary payments or other contributions.

The level and composition of these contributions lack predictability, however; this is due to uncertainties caused by contingent market conditions, by the availability of Social Housing Grant (SHG) or otherwise, as well as by the relative negotiating position/skills of the parties.

The process overall tends to be piecemeal, reactive, cumbersome, and is hampered by the fact that information that is shared between the parties tends to be asymmetrical and imperfect.

The 'gap' public funding that is required to provide the affordable housing in high cost/value (usually through ear marked SHG) developments can also be substantial - caused by the need to invest SHG to enable the RSL receiving the 'affordable' dwellings subject to the Section 106 agreement to provide them at prescribed rental levels - comes with an attached opportunity cost with respect to the provision of affordable housing foregone

Overall, and crucially, the process is not specifically designed to effectively recycle windfall landowner and development gains into affordable housing and other public purposes but has grown rather as a user-led response to the intrinsic inability of the planning system to deliver affordable housing or balanced communities in tenure and social compositional terms.

These points are widely and generally recognized, as is their antidote that the existing planning obligations system needs to be made more certain and transparent in terms of pre-set requirements.

The government in that light indicated in 2006 that it wants the negotiating common starting point for developer contribution(s) to the provision of affordable housing to be in the 'in the form of, or equivalent to the value of, the land necessary to support the required number of affordable units on the development site'[3], at a level consistent with stated local plan requirements.

This is how HSPP would work, except that that the requirement that the land on which the affordable housing is built should be at nil cost would be made

[3] paras. 46, 51, and 52; *Changes to Planning Obligations, Planning Gain-Supplement* consultation, Department of Communities and Local Government, December 2006

explicit, certain, and mandatory. Very few developments in future would be purely private speculative.

At first glance, HSPP appears to be a startling contrarian departure from the prevailing neo-liberal reluctance to intervene in market processes; true, at least, until the Credit Crunch hit: full or part public ownership of banks and mortgage-lending institutions has now been found to be both necessary and desirable across both sides of the Atlantic.

And the principles of HSPP already, as noted above, underpin regeneration projects where public-owned land is provided at nil or discounted cost to enable affordable housing to be developed either without or with reduced public subsidy.

Moreover, in the post-credit crunch economic and housing environment, conventional speculative home purchase not only remains unaffordable for the majority of new households, but backing mortgage finance has also dried up even for those of them who could potentially afford full purchase on past income/mortgage multiples: particularly in the case of flats and apartments, deposits of at least twenty per cent are now required; in response, developers are increasingly offering the provision or a retention of equity stakes in order to shift their stock and maintain cash flow[4].

The aftermath of the 2008 credit crunch is an opportune time, therefore, to begin the introduction of HSPP as it goes with the grain of the responses that are needed to produce a sustainable housing market recovery.

More generally, the housing market has been since Edwardian times been as much a product of public policy as of private economic agent decision and preference. A long-established planning control system, differential tax and subsidy treatment of tenures, and a sensitivity to wider macro-economic aggregates, such as interest rates, provides the institutional framework within which private housing investment and consumption decisions are both moulded and made.

The treatment of uplifts in land value attributable not to actual investment but to change in allowed land use has been a problematic issue ever since the post war the planning system was established in 1948.

Developers can realize massive windfall gains by owning or possess an option to buy land that is then subject to a change of use planning decision converting it from relatively low value use into potentially lucrative residential use: the uplift in value that follows a rezoning of former agricultural land to residential use will generally exceed £1m a hectare, and in areas of high housing demand, often much more[5].

[4] For example, a major developer, Galliford Try, markets its own shared ownership product where a 75 per cent share is offered attached with an obligation to purchase the remaining share within ten years

[5] See Box 4.3, *Review of Housing Supply*, *Final Report – Recommendations*, Kate Barker, March 2004.

That translates, assuming a density of 30 dwellings per hectare (the government's minimum target density), into an input cost of 33k per dwelling subsequently built.

For commercial reasons developers will often seek also to develop their housing development landback gradually during a period of anticipated continuing house price inflation to maximise profits by capturing further uplift or overage of the land value.

They will tend therefore to postpone or withhold developments during periods when demand is outstripping supply, adding to house price inflationary pressures in the short term while exposing themselves to the risk of a future sudden market price or crash, as indeed did happen in 2008.

The supply of developable land tends to be inelastic and capable of expansion only insofar that uses can be transferred to or reclaimed for it.

One of first concepts of classical economics in the early nineteenth century was of the unearned economic rent that accrued to landowners benefiting from rises in the value of agricultural land as a growing population demanded more food.

As the demand for agricultural land is derived from the demand for food that can be grown on it, the demand for residential land is derived from conditions in the wider speculative housing market.

These conditions are, in turn, determined by the tradable value of second-hand homes, which account for nearly all sales, rather than new homes that cannot sell at an uncompetitive premium above the prices commanded by comparable secondhand ones.

Economic theory suggests that due to the inelasticity or even fixity of the supply of developable land relative to demand for the finished product, landowners will bear most of the cost of any levy on the land on which homes are built, rather than subsequent housebuyers.

This has led to calls across the political spectrum, but mainly from the left, for the imposition of VAT on residential new build or, more radically, for the imposition of a regime of site value taxation. Indeed, no added value derives from a planning permission in favour of residential development itself: the uplift in land value that may follow simply reflects an expectation of a transfer of a claim to resource from a future buyer to the existing or future owner: the actual realization of the value added is contingent on the actual construction of the dwellings taking place and on prevailing market conditions.

The Barker Review in 2004 did consider the option of levying of VAT on the sale cost of new build dwellings, but its modeling suggested that that at least 12 per cent of greenfield developments would have been affected by the imposition of VAT at 17.5 per cent over the 1998-2002 period.

That finding was attributable to the VAT charge exceeding the expected landowner profit from the land sale; it estimated a consequent loss of 6,000 homes concentrated in low value/demand regions/areas – an effect that could not be relieved by the imposition of different regional rates due to EU Treaty requirements.

But in high value areas, such as the South-east, if VAT was levied on new housing developments at 17.5per cent and was borne in full by the landowner, then the difference in value between existing and development use value of the land would have still exceeded that levy in then-prevailing market conditions: during the upswing stage of the market cycle the value of land with residential dwelling planning permission attached in the highest demand areas approached £1m per acre, not per hectare.

Barker plumped instead for a Planning Gain Supplement (PGS) to be levied at point of planning permission that should ‘extract some of the windfall gain that accrues to landowners from the sale of their land for residential development’.

Her review advised that it should be calibrated against ‘a proportion of average or actual local land prices in a local area’ and at a variable level set not to discourage landowners or developers from bringing to market developable land.

It was intended that PGS should partly defray the public infrastructure costs of development, with liability to pay it calculated on the difference between the value of a site attached with full planning permission to provide residential units (Planning Value or PV) and the value of that same in its permitted current use (Current Use or CUV).

A subsequent consultation exercise undertaken by the government in 2006 indicated, however, that the implementation of PGS would not start before 2009, adding a further proviso ‘if it continued to be deemed workable and effective’- hardly a ringing and committed endorsement[6].

The housing downturn may further discourage efforts to comprehensively roll-out PGS, as its imposition will reduce potential receipts to developers suffering cash flow problems, as land values fall.

PGS is a hybrid and adapted form of land betterment taxation; a mechanism that has posted a poor track record in the UK to the limited (but as will be shown over-ambitious and badly prepared and implemented) extent that it has been tried.

The experience of 1975 Community Land Act provides a signal example of government failure: its design and avowed intentions were not matched to realistic and attainable policy ends linked to effective means of implementation. It, too, involved the imposition of Development Land Tax

[6] para. 3, Changes to Planning Obligations, Planning Gain-Supplement consultation, Department of Communities and Local Government, December 2006

(DLT) on the difference between developed and existing use value of sites, but the local authorities that were charged with its implementation were provided with or possessed inadequate human, technical and financial capacity to properly do so.

The tax was levied at very high rates, which, in turn, encouraged landowners and developers to circumvent its intentions; a tendency compounded by the-then volatile political environment that generated uncertainty as to the sustainability of the measure.

More fundamentally, and as a general principle, the long timescales involved in housing development mean that interventionist measures that are not carefully designed, certain, and sustainable are likely to distort, rather than support, the functioning of effective and efficient land and housing markets; drawing another key lesson that either cross-party support or a long political time horizon linked to determined and prioritised policy ends must be present as an ingredient in the policy design mix if desired ends are to be actually achieved on a sustainable basis.

PGS, designed by Barker with the above lessons in mind but still waiting upon the on the provision of effective means of implementation, provides a potential mechanism to yield additional taxation receipts that then could be ring-fenced to help finance new planned mixed developments lacking prior infrastructure networks, such as the Thames Gateway.

However it would not directly reduce the cost of land as a cost input in the housing development process, nor incentivise developers to supply dwellings on affordable terms. Indeed, it is not specifically designed to do either.

HSPP, in contrast, is designed to secure those two precise ends.

As noted earlier, the monetary demand for land attached with planning permission is essentially derived from the demand for homes and their current market sale values: as at least fifty per cent of dwellings provided on HSPP sites would be purchased from their developers at construction cost (plus developer overheads and profit) only, the ability of the same developers to bid up land values would correspondingly contract with resultant and consequent impact on the monetary demand and price of residential land.

What about the case against HSPP?

<u>First</u>: developers already engaged in land sale contracts and/or those that had had assembled large landbacks would be left high and dry by its introduction. The recent housing market bust did produce such adverse and unanticipated impacts in 2008 for developers at a much wider and deeper level compared to what most conceivable public policy initiatives could do at worst.

Indeed, HSPP by reducing the development cost of land in an anticipated way would lessen the likelihood of a repetition of developer bust or near-bust caused by asset-price implosion in contrast to loss of market share.

Market-led falls in land values and the resulting shift to a buyer's market that presently are occurring as developers rush to off-load their landbacks in order to improve their solvency position, provides a real window of opportunity to introduce HSPP on a voluntary win-win public-private partnership basis.

The formal imposition of HSPP would rather require new primary legislation with its associated lead-in times; meanwhile, transitional measures could be put in place compensating landowners and developers retrospectively affected by HSPP[7].

Second: the deflation of residential land prices by HSPP and the linked loss of potential profit for either or both landowners and developers would simply reduce the supply of developable land as the incentive for owners to sell and for developers to assemble land was removed.

But developers could still offer existing land use value with a premium on top to encourage new land release by its existing owners.

True, that premium would need to be financed from the expected profits from the sale of the market dwellings, of which the windfall element attributable to post-purchase inflation of land values, would now be greatly reduced.

But if sufficient developable land was not forthcoming public authorities in default could exercise compulsory purchase powers in default to acquire and assembly land and then run competitions for developers to offer the best mix of discounted housing accordant with client development briefs focused on dwelling size and design.

In any case, the primary source of developer return under HSPP would derive from construction activity and volume; hence developers would have the incentive to seek sites on which they could build, and at the very least to build on publicly assembled sites.

Third and related to above: liberalisation of the planning system would do far more to ease supply rigidities and help smooth price fluctuations.

The planning system reflects societal social preference concerning the preservation of greenfield land. Left to their own market-driven devices, private sector developers will choose to provide predominately low density 'executive-type' homes on formerly rural or greenbelt land in a way that is likely to be wasteful of space to extend housing opportunities to mainly already established and affluent owner-occupiers rather than new entrants to the market, given that the former possess superior market purchasing power.

HSPP should serve to make more explicit the trade off between losing greenfield land and expanding affordable housing supply for the benefit of

[7] *ibid*, Recommendation 26

local people to aid decision-making and the national and local political acceptability of rezoning land for housing in areas prone to the NIMBY effect.

This is a significant potential benefit insofar that the achievement of the Government's housing supply objectives requires sites currently held within developer landbanks, and for land currently not zoned for residential development, to be developed.

Green belt covers 13 per cent of land in England, some of which is of marginal environmental and landscape quality with limited public access, often located next to railways, or major roads.

HSPP by making the housing gain secured from the development of such land demonstrable in terms of tangible expanded opportunities for local people to access owner-occupation on an affordable and sustainable basis, could provide the consensual policy underpinning for the environmentally selective and socially sustainable development of marginal green belt (and some brownfield, too) land.

<u>Fourth</u>: the ambitious scale, legislative time scales, and multiple contentious objectives of HSPP indicates a high risk of government failure in implementation terms.

This is a real risk and, indeed, there is an undoubted need to match realistic and attainable public policy objectives with means of effective implementation.

But the current economic environment is amenable to the voluntary introduction of HSPP pending any required legislative changes. Expanding access to mortgage funding (retained equity stakes should provide cushion against negative equity risk) should help to kickstart a sustainable housing market recovery

HSPP should provide a new, robust and sustainable template peg for future private sector developer business plans to hang.

It also offers a first order direct and transparent policy response to the problem of housing affordability and access, not only for the market disadvantaged but also for significant segments of the Middle England political constituency that decides elections and whose primary concerns tend to set the parameters of political action at the formal parliamentary and party level.

Rather than being foisted on unwilling public and private sector actors in the absence of any groundswell of popular support, HSPP, carefully and sensitively planned and implemented, should command stakeholder commitment and cross-party support.

<u>Fifth</u>: its cost would be unsustainable in public expenditure terms. Assuming an average build cost (including constructor profit and overheads) of 150K, a total affordable programme of 120,000 dwellings comprising 30,000 rented

dwellings with a unit grant requirement of 100K (with the remainder met by the registered provider taking a loan linked to the rental stream and management and maintenance costs) and 90,000 offered on shared equity terms with an average unit grant requirement of 50K (assuming an average purchase price of 100K), the total annual programme cost would be £7.5bn.

This would reduce over time as equity stakes were purchased by part owners were recycled.

In sum, HSPP would focus directly on core outcomes: achieving on a sustained basis housing supply targets at consistent with medium term demand requirements; securing greater social sustainability in terms of terms of an improved tenure balance; and of securing greater stability in house prices with attendant macro-economic benefits.

It would also offer to the private sector greater certainty in its business planning processes by replacing the vagaries of housing market boom-bust, which has so bedeviled the efforts of the construction industry to improve its health and safety, productivity, and innovation record, with a known and certain annual production target.

Developer profit would in future derive from construction, not landhoarding or speculation – activities that can also lead to large losses and even bankruptcy.

A refocus of their business planning focus on construction rather than speculation should help significantly to improve design, build quality, and sustainability outcomes, as both public and private sector focus on certain and clear shared ends.