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Examining Housebuilder Behaviour in a Recovering Housing Market

Recommendations For Improving Britain's Housing Supply

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Summary Findings

- 1) Housebuilders' recovery behaviours focused on efficient capital return and the shrewd management of cash flow, rather than volume output. They employed significantly greater caution and due diligence in the identification and purchase of land and focused on prime locations/traditional products, where resilient sales prices provided confidence and predictability.
- 2) The planning problems housebuilders face stem from a lack of resources to support housebuilding. Housebuilders experienced significant procedural delays in gaining planning permission and discharging pre-commencement conditions, which affected their capacity to speed up delivery.
- 3) The research found the need for large scale government investment in infrastructure, council housebuilding and SME builders to help deliver political housebuilding ambitions.

Summary Recommendations

- ✓ Increase the funding allocated to local authority planning departments and consider requiring a minimum number of local authority planners relative to the housing need set out in the local plan
- ✓ Introduce a 'principle of development' that gives housing sites allocated in local plans a legal status
- ✓ Require local authorities to consider a range of housing sites of all sizes during local plan allocations and discourage the use of only very large housing sites
- ✓ Consider giving local authorities 'use it or lose it' powers to inject more competition into the land market and open up opportunities for SME builders
- ✓ Where plan-appropriate, require local authority-owned land to be released for housing development through sale or JV, and preferentially to SME builders
- ✓ Require local authorities to discharge pre-commencement conditions within a reasonable time frame
- ✓ Require all Members sitting on planning committees to attend training & educational programmes aimed at increasing their knowledge and understanding of development economics and principles of planning

Growth



...there's three ways of growing; there's increasing output on current sites and we're doing that as I say; there is increasing the number of outlets...shop fronts if you like. And if you increase the number of outlets exponentially you're going to need to increase the number of business units that we have around the country. And that is a considerable risk... by having more of them if you like, when the recession or the cycle starts to trip again, you've just got to work out whether those businesses will be able to survive or whether you're going to have to reduce the number of businesses again to increase the geography of the remaining ones"

...we have concentrated on trying to open more outlets and increase our output through our existing networks..."

"So our strategy is then about getting better land in better locations"

...it is a fragile recovery because if we push prices too hard it slows immediately"



Research Problem

Despite signals that the housing market is in a recovery phase, new housing output remains relatively low and the affordability crisis is worsening. Recent policies have sought to reverse this chronic housing undersupply by stimulating demand (e.g. Help to Buy), based on the expectation that supply will respond accordingly. However, when compared to previous boom and bust cycles, the very different institutional characteristics of this housing market recovery challenge existing academic and policy understandings of what limits or stimulates development activity in the recovery phase.

Research examining housing supply constraints has conventionally focused on investigating structural barriers e.g. planning, finance and land allocation systems, and there remains very little research examining how housebuilder behaviour may constrain supply, particularly as the housing market enters its recovery phase. Recent research on developer behaviour indicates that their social and organisational networks (Henneberry & Parris 2013) and their institutional relations/behaviours (Payne 2013, Adams et al 2009) play a much more significant role in constraining housing supply than traditionally thought. Given the pressing need to address Britain's housing crisis, there remains a significant gap in our understanding of how housebuilders adapt and change their business behaviours in response to significant institutional shocks in the housing market and whether this institutionally-constituted behavioural change is limiting or inhibiting housing supply, in spite of policy interventions.

This research uses behavioural analysis to examine what changes large and volume speculative housebuilders - Britain's key delivery agents of new homes - have made to their business behaviours since the onset of the recovery phase in the housing market and considers how these institutionally constituted behaviours may be constraining new housing output. The purpose of the research is to consider what new policy measures might be needed to achieve the government's housebuilding ambitions.

Research Methodology

The aim of the research was to evaluate whether large and volume housebuilders have the institutional flexibility to increase housing output

Planning Process

"...most of the problems we have as a business are internal, so getting enough bricklayers, getting enough roof-tilers you know. But they are self-help issues, they're things that as a housebuilder if we can't resolve them, then actually we don't deserve to be in business. The bit we can't resolve, the bit we can't ... it shouldn't take two years to get planning consent on a site for 50 units"

"But it does come down to planning and land supply and the market's in a position now that if that was unlocked we could be building a lot more houses. But the delays and the timescales of getting things through the planning process now are as bad as ever, if not as bad as I can remember"

"...it's a difficult one for government and for local authorities to understand that it isn't just going to happen through numbers, it's got to be sites. And it's another way of getting the smaller guys back in that if you release more smaller sites to complement ..."



in the recovery phase; and to consider what policy measures might be necessary to increase development activity as housing market recovery matures. The empirical research was undertaken between 2014 - 2015, five years after the British economy left recession and when national annual house price inflation demonstrated a positive upward trend from the previous deflation of 2008, 2009 and 2011. The research consisted of two stages:

Stage 1 targeted in-depth qualitative interviews with Managing Directors and Land Directors of large and volume housebuilders operating in the regions of Central Scotland and North West England. This enabled the examination of housebuilder recovery behaviour in distinct institutional contexts. Interviews were secured with Managing Directors and Land Directors from 15 housebuilders in total and were conducted between September 2014 and February 2015.

Stage 2 targeted elite in-depth qualitative interviews with high level CEOs and Group Directors from the top 15 British housebuilders - who together produce approximately 50% of all new homes annually - to interrogate the recovery behaviours identified in Stage 1. Interviews were secured with CEOs and Group Directors from 8 housebuilders and were conducted between April 2015 and June 2015. All interviews focused on examining:

- The impact of the recession on business strategy and culture
- The character and key business phases of recovery
- Changes in land, construction, planning and marketing practices
- National policy and the role of government
- Solutions for increasing housing supply
- Industry resilience to future challenges

The following results are presented in aggregate form to offer a synopsis of key findings from discussions with all housebuilders interviewed.

Key Finding 1: Recession Leads to New Business Practices

Housebuilders' recessionary experiences (see Payne 2015) led to changes in how they approached the business of building in the formative stages of housing market recovery. Unlike their fervent, boom phase behaviours where volume output was the primary driver for business

Planning Politics



"...the market improved, we were all trying to gear up, you'd got local authorities then not wanting to accept they'd got a housing shortfall problem, thinking that the change in policy and localism meant well we'll take control back, we haven't got government targets imposed on us anymore...So what it's ended up with is that you've then got more and more schemes getting refused on those political grounds that then go to appeal"

"...it's become very politicised hasn't it you know, you see so many politicians and councillors on the planning committee who are democratically elected for sure but actually technically they're not competent... And we do believe it should be a technical approach rather than a political approach"

"The problem is the outlines these days, there's too much detail ... I mean it's almost as if members don't trust their own officers..."



activity, housebuilders revealed a steely focus on efficient capital return and the shrewd management of cash flow through the early recovery phase. The control of work in progress (WIP) and the avoidance of sites requiring significant upfront cost or inefficient capital lock up enabled housebuilders to shift from breaking even to profit making.



This focus on return on capital employed (ROCE) and WIP, supported by new Group-wide management and reporting systems, enabled Boards of Directors to keep tighter reigns on divisional activity in their regional offices, as one Group Director explained:

"...so I can see who is spending what, where, when and what disciplines we're spending it on, how we are going to forecast against budget and where the kind of red lights are blinking and address it... Whereas in the past you'd have been those questions and it might not have been transparent because people put in invoices very late and suddenly you know, you've got this bold somewhere".

ROCE & WIP



"Price became eroded...we still have to maintain a volume, we've got to get return on our volume once we've invested in buying land and we've got to develop it out"

"... as a business... [we've] gone into, we build family houses you know, we don't do flats because of the capital lock-up in flats...you have to complete the whole block before you can actually get any occupations..."

Key Finding 2: Managing Increased Risk

To meet the specific hurdles that a prevailing focus on efficiency and capital return required during the early recovery phase, housebuilders revealed significantly greater due diligence and discretion in the identification and purchase of land, with three distinctive behaviours evident:

First, housebuilders revealed a strong tendency towards the acquisition of 'low risk low rise' sites in resilient market locations showing relatively steady and predictable sales values/rates. This approach enabled housebuilders to construct traditional family homes - their favoured product in early recovery - in a relatively predictable business environment best suited to their standardised and operationally-efficient speculative model. Such behaviour signified a large scale shift away from the flatted brownfield developments that had characterised housebuilders' development behaviours during the boom phase of the early 2000s (see Payne 2013):

"I think the market's found its ... I think it's pretty stable in the good locations at sensible prices. I think the difficult sites are the

"We've looked to improve margins but by employing return on capital employed which is one of the metrics the City will always kind of look at us against other developers to do that, you've got to be more efficient, you've got to have more profitable sites but you've really got to control work in progress... So unsold WIP on any site is controlled at £750,000 per site... what we've done is basically ensured that the Sales Team and the Construction Team are talking all the time. So if the Construction Team are building Plot 17, the Sales Team are selling Plot 17, They're not selling Plot 21 or Plot 25"



marginal locations that still remain challenging and well, those sites will not be developed because builders are not making anything on a site... with difficult ground or technical issues".

Second, housebuilders increasingly drew on their strategic land banks during the initial recovery phase as a way of feeding their depleted land banks which had resulted from recessionary financial hardship (see Payne 2015). A strong preference for drawing down optioned, allocated sites demonstrating good margins, predictable sales values/rates and relatively low planning risk was evident. Such enabled housebuilders to remove land market competition and offer trading opportunities (and therefore secure cash return) to other housebuilders of land parcels where strategic land was particularly lumpy geographically.

Third, underpinning this revised approach to land acquisition and development were a series of tighter reporting and purchasing requirements for land by Boards of Directors and, in some cases, the CEO personally. As a result, divisional offices enhanced diligence and discipline in their land acquisition activities and increased the use of phased and deferred payments for land and other upfront costs. Such enabled housebuilders to further strengthen their ROCE/WIP approach to housing development in the early recovery phase.

Key Finding 3: Rethinking The ‘Planning Problem’

The most prominent institutional constraint identified by housebuilders during the research - which they argued as a key factor in constraining housing supply during the early recovery phase - was the *procedural* delay experienced in registering planning applications, gaining planning permission and getting pre-commencement conditions signed off. This was in distinct contrast to the comparatively positive views housebuilders revealed of recent changes to planning *policy* aimed at getting Britain building, particularly Help to Buy and the NPPF:

"I mean there is no doubt about it, it [Help to Buy] kick-started the market for us...it gave us the confidence to go and push on with the build and commit to a build programme as opposed to this stop-start"

De-Risking



"So I mean we've got specific hurdles, so when we buy land we will apply a specific return on capital employed and we will also apply a margin which is demanded now in the industry standard. But we will calculate in a slightly different way, so you know it's not black and white in that sense. But we have to get over those hurdles and the sites we've bought since 2008 have had probably all that discipline and they're the ones that are generating far better profits. So they've been bought on well-researched information and dare I say they are bread and butter sites a lot of them"

"...we are looking now to source 35 or 40% of our land purchases from strategic land. One, we think it gives ... you get a better margin from that one-to-one negotiation, you're not in the market..."

"...everybody's more risk-aware and risk-averse...it's not necessarily a bad thing, we're probably a lot better versed in all aspects of the business than we were pre-recession"



Housebuilders perceived the deeply under resourced nature of local authority planning departments, specifically the lack of available planners, as the greatest cause of procedural uncertainty and delay. Housebuilders especially conveyed their ongoing frustrations with delayed site starts, which affected financial planning, project management and their ability to 'get on building':

"...you cannot predict how long it's going to take to get on-site, it's really, really hard".

Further, housebuilders also voiced their concerns over what they perceived as local authorities tactically delaying the registration of planning applications to avoid the risk of deadline-based appeals for non-determination.

As significant, housebuilders also emphasized the increasingly politicised nature of planning procedure and in particular, their frustrations over permissions being refused on what they considered to be political rather than technical or policy grounds. Despite appeals being effective in such cases, the added cost and delay of this elongated process compounded frustrations and mired recovery and growth ambitions.

Key Finding 4: Action Is Needed to Ensure Sites Are Built Out

Housebuilders reported skills and materials availability as other institutional constraints affecting their capacity to increase supply during the early recovery phase. Indeed, some volume housebuilders were actively considering modular-based construction methods as a potential medium to long term solution.

More broadly, housebuilders were honest and indeed somewhat candid about their limited ability as an industry to meet political housebuilding ambitions lauded by general election contenders. Housebuilders remained mindful of the financial hardships experienced during the recessionary years (see Payne 2015) and revealed significant caution in their ambitions for growth in volume output over the coming years. Instead, housebuilders favoured a steady path towards sustainable profit generation and a return to healthy margins:

Planning Policy



"...but hey look, things are improving, the NPPF is a fantastic result for us. I think we've got the best planning conditions that I can remember in my career, post-91 I guess. But it could still be improved, I mean it could be dramatically improved"

"...one might get planning permissions, outline planning permissions slightly more easily but a lot are on appeal. So that in itself shows there's still not a buy-in to the NPPF at a local political level"

"...It's not planners, it's the politicians"

Planning Resource



"I've got a council at the moment where they're very openly saying we have no planning resource to deal with these other sites that we're going to release and they're looking for planning performance agreements..."

"...with the cuts in local authority the standard of officer or the experience of officers is a lot less"



"You know, in a perfect world we'd have 20 outlets doing 30 a year, 600 units with full margin ... And so we're building the business back up, we have the capacity to do 600/650, with no real aspiration to drive it beyond that because I think that's when things start to creak."

To meet political housebuilding ambitions, housebuilders argued for greater government action in incentivising new players into the speculative marketplace. SMEs would require smaller sites, which may come as a challenge to local planning authorities tending towards a small number of very large sites to meet housing need.

However, it was the broader economic element facing British speculative housing supply that drew the most attention from housebuilders in their discussions around how best to increase housing supply. Whilst the NPPF, 5-year land supply and viability assessments have undoubtedly played a significant role in easing development constraints in the short term, housebuilders highlighted the need for political leadership and large scale government investment in infrastructure and council housebuilding to overcome longer term constraints to help deliver the aspirational housing numbers set out.

Arguably, the financial and business appetites of large and volume housebuilders for driving substantial housing growth remain suppressed, as the hangover of their recessionary experience endures (see Payne 2015). As the recovery phase matures, housebuilders will look to government and local authorities to play a larger part in driving growth.

Research Reflections

The recovery behaviours of Britain's biggest housebuilders represent a transitional readjustment from the once fervent times of pre-recession to a cautious, more diligent season in speculative housing provision. More than just a blip, the recession has led to a 'new normal' for the speculative housebuilding industry (Payne 2015), with a focus on capital return and profit generation rather than volume output and industry expansion.

The research echoes prevailing concerns that Britain's dominant speculative housebuilders alone will not be able to build out in sufficient

The Bigger Agenda



"...it's a massive investment in infrastructure, schools, etc, which is needed in order to deliver that. And that can't be done by the house-building industry. We can play our part but there is a much broader economic element to that which needs to be embraced if local authorities or the government want to deliver these aspirational housing numbers"

"...we can only play a part in it and somebody's got to have a bigger agenda and I don't think we've got the finances or the appetite for it on a national scale..."

"... part of it was who's open for business? Who wants the housebuilders to come and build and deliver housing?"

"I'd want to see stronger leadership with Scottish Government to put pressure on authorities to deliver their plans... it starts at the top you know, it's looking at the local plans, testing them, change them, force authorities into realistic plans..."



volume to meet the country's housing supply needs. Further, the findings remind us that the speculative volume housebuilding business model is never really just about volume output. In this sense, it will be important for government to build capacity in the wider housebuilding industry to support new entrants into the market.

The recovery phase will likely leave a long legacy. Even with an upturn in the economy, it will take time for housebuilders - with their reduced capacity from the recessionary experience - to turn around their business practices and successfully shift from an *investment return* phase to a *growth* phase. Such will depend on housebuilders' abilities to overcome those constraints that continue to frustrate them.

Further, austerity cuts have reduced funding available for the infrastructure and planning inputs needed to support a significant increase in housebuilding. Continuing concerns about development viability are a reminder of the investment and resources needed to support the building out of development projects still afflicted by suppressed values and demand.

Housebuilders' preference for an increase in outlets/sites is a warning call to those commentators who argue the speeding up of speculative housing delivery can be met simply by increasing build out rates. Moreover, the industry's propensity towards increasing the number of active sites as a favoured means of growth will not be met by an under-resourced planning system exhibiting procedural delays and politicking. Whilst changes in national planning policy have helped bring forward sites for development, there is scope for the planning system to be more responsive to market demand and for housebuilders to bring forward more land for development and to act quickly on consented schemes.

From such a perspective, getting Britain building will require a more appropriately resourced planning system with the ability to overcome procedural delays caused by capacity issues, and to allocate a greater number and broader spread of housing land. The latter would meet the land requirements of both SME and large to volume housebuilders alike and, in doing so, facilitate wider industry expansion.

One might ask how the speculative housebuilding industry could better protect itself against future significant institutional shocks in its wider operating environment. This research presents a picture of a cautious

Political Ambitions



"And certainly to get from where we are now, private 110,000 to what did David Cameron say on the 8th, I think 200,000... Well that is a huge leap, so it's almost doubling it. And it's not just about materials, it's not just about people to build the units, it's all about land, outlets and planning permissions... And you need to have greenfield as well. And I know greenfield is politically unpopular because I've got my house and that's my view forever, but it's not"

"But without new entrants, and I mean SMEs and the likes, I do not think we will hit 200,000 easily. I think we might get to 170/180,000 but 200,000 is a big ask without new players coming into the marketplace...we've talked openly with government with this, we need to incentivise new players to come into the marketplace"

"I don't think we'll become a business again that will just go hell for leather and deliver an extra 200 units a year at any cost"



and diligent industry where rationality, in a steely focus on cash return and profit generation, is dominating business activity rather than volume output. Such an approach may be tempting to housebuilders beyond the early recovery phase. Policy makers might do well in considering the implications of such potential on the geographical spread of new housing provision and indeed, on political expectations of significant rises in new housing output via market mechanisms in the coming years.

Recommendations

The following recommendations offer practical suggestions to overcome the obstacles identified in this research to increasing new housing supply. They should be considered by policy makers when developing policy solutions placing speculative housebuilders at the centre of housing delivery ambitions:

- ✓ Increase the funding allocated to local authority planning departments and consider requiring a minimum number of local authority planners relative to the housing need set out in the local plan
- ✓ Introduce a ‘principle of development’ that gives housing sites allocated in local plans a legal status
- ✓ Require local authorities to consider a range of housing sites of all sizes during local plan allocations and discourage the use of only very large housing sites
- ✓ Consider giving local authorities ‘use it or lose it’ powers to open up opportunities for SME builders and inject more competition into the land market
- ✓ Where plan-appropriate, require local authority-owned land to be released for housing development through sale or JV, and preferentially to SME builders
- ✓ Require local authorities to discharge pre-commencement conditions within a reasonable time frame
- ✓ Require all Members sitting on planning committees to attend training & educational programmes aimed at increasing their knowledge and understanding of development economics and principles of planning

Industry Capacity



“And the government knows that the industry as it is at this moment in time can only do so much. We can’t exponentially grow only to find ourselves bankrupt in five years’ time because the market’s gone bang. We will protect ourselves and do what each company needs to do. So the only time we’ve ever really produced 250,000-odd homes is when the government has stepped in and done its own building and there’s no sign of that at this moment in time”

“...unless you have ... council house building you won’t get to those levels, unless you bring in PRS but... if they are competing with the private housebuilders for the same land, then you’re not actually going to increase volume, you’re just moving around a bit. And who’s got a piece of the cake?”

“...if things went back to sort of pre-recession days... but all it does is eat your site faster. So you’re coming back to you want the land quicker”



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Build Out Rates



"Now the conundrum is well if we had two developers on site they'd probably build 25 each, so you've got 50, so why can't the first developer build 50 or sell 50 because if that's what it ... it's not the building, it's the selling. And no-one ever seems to have even dreamt of that (laughs). But there is a saturation within an area. Only so many people will want to buy a house on a site at any one time in any one year. But if you have more outlets, maybe in the same town or in the same area, you will sell more units. And that's just the way it works. So it's what's a saturation in a local area? And until we understand that I don't think we'll ever get over this land banking issue"

"...in the old days because sales were so good it was just go and build as quick and as far ahead as you want"

"...there needs to be more outlets, more sites that actually deliver housing rather than deliver 3,000 homes which will take 25 years to develop"