HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on Economic Affairs

Inquiry on

THE ECONOMICS OF THE UK HOUSING MARKET

Evidence Session No. 4 *Heard in Public* *Questions 59 - 77*

TUESDAY 12 JANUARY 2016

3.40 pm

Witnesses: Andrew Rose, Fiona MacGregor, Isobel Stephen and Stephen Aldridge
Gwyneth Nurse, Mike Williams and Stephen Farrington

Members present

Lord Teverson (Chairman)
Baroness Blackstone
Lord Forsyth of Drumlean
Lord Griffiths of Fforestfach
Lord Kerr of Kinlochard
Lord Lamont of Lerwick
Lord Layard
Lord Monks
Lord Sharkey
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

Andrew Rose, Chief Executive, Homes and Communities Agency, and **Fiona MacGregor,** Director of Regulation, Homes and Communities Agency, **Isobel Stephen**, Housing Supply Director, Department for Communities and Local Government, and **Stephen Aldridge**, Director of Analysis and Data and Chief Economist, Department for Communities and Local Government

Q59 The Chairman: Good afternoon. I welcome you to the Committee. Part of our report is on the housing market. First, although I have declared my general interests, I should declare a particular interest of my own: I chair a company that is currently seeking funding through the Builders Finance Fund, which is under the administration of the HCA. Perhaps I could ask the panel to introduce themselves in one sentence so that we know exactly what you do and what your responsibilities are. Perhaps we could start with Mr Rose.

Andrew Rose: I am Andy Rose. I am the chief executive of the Homes and Communities Agency.

Fiona MacGregor: I am Fiona MacGregor. I am director of regulation at the Homes and Communities Agency.

Isobel Stephen: I am Isobel Stephen. I am housing supply director at the Department for Communities and Local Government.

Stephen Aldridge: I am Stephen Aldridge. I am the director of analysis and data at the DCLG.

The Chairman: Thank you. Perhaps I could remind you that we are not expecting all of you to answer all the questions. I will leave it to you to work out for yourselves which to answer.

Perhaps I could start off with a broad policy question. One of the things that has been said to us on a number of occasions, one of the most basic questions, is why the Government seem increasingly to have decided that they ought to favour owner occupation over renting, which has come across as a major theme for our witnesses so far. Is that government policy? If it is, is it based on any specific evidence or research? This is fundamental to some of the areas that we are looking at in this inquiry.

Isobel Stephen: The recent spending review set out plans for investment of £20 billion in housing. Of that, £8 billion was invested in 400,000 affordable houses. Of those 400,000 affordable houses, we expect 100,000 to be homes for rent. In fact, we expect there to be more than 100,000, because where local authorities and housing associations get receipts from right to buy and high-value asset sales, we expect them to invest in houses that are appropriate for their local communities. However, it is clear at a political level that the Government are interested in home ownership. We know that 86% of people want to own their own home and that currently only 63% of people do so, so the Government are looking at that gap in aspiration, which they want to address.

The Chairman: Some witnesses have said, although some of our witnesses have disagreed with this, that the tax system, and perhaps some of the recent tax proposals, rather benefit home owners as opposed to renters. Is that a distortion in the market? Is it intentional? Indeed, do you agree with any of that?

Isobel Stephen: I will leave the specifics of tax measures to my Treasury colleagues who are talking to you later. I can say that the private rented sector is important in terms of the housing that is available for people. Nineteen per cent of people live in the private rented sector, and in particular the Government are interested in what the institutional private rented sector can contribute to supply, which is why we have both the Build to Rent fund and the private rented sector guarantee scheme, which support institutional investment in private rented sector accommodation.

Lord Lamont of Lerwick: Why would you be interested particularly in institutional investment in rented accommodation? Indeed, some people have thought that some of the Government's recent moves have discriminated against small landlords, yet small landlords are among those whom one can encourage to come forward in a very short period of time and are a very large source of supply.

Isobel Stephen: I am talking about extra houses. Where institutional investors can take money and use it to build new accommodation which they then rent to people on a private basis, that adds to the overall supply of houses.

Lord Lamont of Lerwick: Making part of a house available might also add to the supply.

Isobel Stephen: But the private rented sector institutional investors can do that on a much greater scale.

Andrew Rose: I think that other markets have been very professionally managed and that large-scale rental schemes have provided very good accommodation. The Build to Rent fund approach came out of Sir Adrian Montague's report a few years ago, which said that attracting institutional investment into the market would help to create professional asset managers at scale who will provide very high-quality accommodation. So I think it is a combination of the quality of the accommodation and the scale to make sure that we deliver the new supply that Isobel talked about.

Q60 Lord Layard: Professor Paul Cheshire talked in evidence about how the rises in house prices have transferred wealth from young to old and from poor to rich. This is obviously a big problem, a big social issue. Can anything be done about this without some new initiative in relation to the supply of building land?

Stephen Aldridge: I think the proposition is right. Compared with what has been happening to the incomes of older age cohorts, younger people's incomes have been rising less rapidly. We also know that young people have become more dependent on their parents or others in order to get a foothold on the ladder of owner occupation. These issues were set out in David Willetts' book, *The Pinch*, a few years ago, as some of the witnesses to this Committee have already said.

On the origin of these changes in the distribution of income and wealth, they might extend beyond just housing policy: there may be other reasons for them. There are things the Government can do to make a difference. You are absolutely right that increase in supply is vital; the Government have identified that as a key objective of housing policy. Although there is more to do, we have in recent years seen a significant pick-up in the numbers of first-time buyers, and, as we may no doubt get on to, there are a number of government initiatives that are intended to assist younger people to get on to the housing market ladder.

Lord Layard: You mentioned the increase in supply. Do you think that we can have an adequate increase in the supply of houses without some new initiative to increase the supply of land on which the houses can be built?

Stephen Aldridge: A number of changes have been made. We have seen planning reforms in recent years that are intended to make it easier or quicker to bring land into use for housing development. Some of the other questions that we might get on to later will touch on the way in which we assess demand and take account of market signals such as land prices, house prices and affordability and our approach to the provision of land for housing. Those sorts of changes have begun to make a difference to housing supply, and I think that is reflected in the trend in the numbers of housing completions and net additions to the housing stock.

The Chairman: From your answer, Mr Aldridge, you recognise that this redistribution from the poor and the young to the old and the rich is actually happening. Is the department concerned about this, or is it just a fact of life and the way it has to be?

Stephen Aldridge: There are two things. First, as I have already said, the reasons for it go beyond just housing policy. Secondly, as has already been pointed out, increasing housing supply is ultimately the key way to address rising house prices.

Lord Forsyth of Drumlean: This problem of asset-price inflation is not limited to housing, of course, and is in part a consequence of quantitative easing and low interest rates. No doubt Mr Aldridge will say that that is not his department, but what could be in his department is perhaps trying to find some basis on which to take forward respectable equity-release schemes that would enable people who have children and assets perhaps to help them in the housing market. Have you looked at that at all?

Stephen Aldridge: As far as I am aware, not recently. There are several government programmes concerned with making shared-ownership provision more readily available. Of course, under the Help to Buy equity loan scheme, there is a programme through which younger people can more readily gain access to mortgage finance in order to get a step on the ladder.

Lord Forsyth of Drumlean: That is my point. With Help to Buy, the Government give an implicit guarantee where they lend their balance sheet and thereby reduce the mortgage costs for young people. Could something similar not be done with elderly people—who do not have cash but do have equity in their homes—so that they were able to release cash to help youngsters who are competing in a market where asset prices have increased as a result of other factors?

Stephen Aldridge: In principle, that is right, although we have already seen a significant increase in the proportion of family members who help young people gain access to the housing market.

Lord Forsyth of Drumlean: Not all family members can do so because they do not have the cash, but they may have value sitting over their heads, which, if there were a scheme of this kind, could help. I am surprised that the Government have not looked at this.

Stephen Aldridge: There have been reviews of equity-release schemes in the past. There have also been problems in the past with equity-release schemes, as you will be aware. But it is not something that we have been looking at recently.

Q61 Lord Kerr of Kinlochard: Going back to the Chairman's original question about a policy of moving towards greater owner occupation, if the underlying problem with the housing market is simply that there are not enough houses, how will policies such as leaning on the housing associations to sell property or insisting that councils sell higher-value properties help deal with the underlying problem? I see that they assist the move to owner occupation, obviously, but that seems to be a separate issue from the problem of finding enough houses. How is that going to help?

Isobel Stephen: Where either local authorities or housing associations sell their properties through either of those schemes, they will use the funds they get from those sales to invest in building more houses.

Lord Kerr of Kinlochard: That is not what the Bill says, though. The Bill does not impose any requirement on them to build new homes in the same area or to use that as the first charge on the money they make from the sale. The Bill says something different.

Fiona MacGregor: This is specifically for housing associations. As I think you will be aware, the National Housing Federation has come up with a voluntary offer on the right to buy and it is very keen that it remains voluntary and is not enshrined in legislation, because at that point it would no longer be voluntary. You will also be aware that there have been issues about the classification of housing associations by the ONS. There is a strong willingness to keep the deal on a voluntary basis. The NHF offer states that a proportion of the discount to the purchaser—70%—will be paid to the housing association at the point of sale to the tenant, and then 30% of the discount is paid at the point it starts a new replacement home.

That is where housing associations can be incentivised to build out quickly, because it is linked to the payment of the discount. The NHF has also said that the sector has signed up replace where it can within two years.

Our analysis and our discussions with housing associations tell us that they are incentivised to build out quickly for a number of reasons. It speaks to their core social purpose of the additional supply of affordable housing, but if they are losing homes through right-to-buy sales they will want to make sure that they replace those assets both in relation to security for lending and being able to spread their fixed operating costs across the largest number of homes that they can. Our discussions with housing associations suggest that they are keen to be able to replace quickly, but they are also very keen that it is not enshrined in legislation.

The Chairman: I think we will come back to the right to buy later on in the session. Lord Kerr.

Lord Kerr of Kinlochard: I hear that some of them would like to keep it voluntary, but if the Conservative manifesto commitment was that expensive council houses "will be sold off and replaced in the same area with normal affordable housing as they fall vacant … After funding replacement affordable housing on a one for one basis, the surplus proceeds will be used to fund the extension of right to buy", why is that not in the Bill? If it is purely voluntary, is it not as likely not to work, as it has not worked up till now? One-for-one replacement in the areas of sales has not been happening.

Isobel Stephen: We have legislated in the Bill for the high-value asset sales but, as Fiona has explained, we have through a voluntary deal implemented the part of the manifesto that was to do with housing association right-to-buy sales. We will need to look at the demand for those right-to-buy sales because the manifesto also set out, and the Government's policy is, that those right-to-buy sales should be funded by the high-value asset sales. We will need to make sure that the demand for right to buy does not outstrip the amount of money that is being generated by the high-value asset sales.

Lord Kerr of Kinlochard: It sounds a little unlikely, but I will drop the point in deference to the Chairman.

The Chairman: Did you want to ask anything else?

Lord Kerr of Kinlochard: No.

The Chairman: Okay. Lord Monks.

Q62 Lord Monks: I wonder if you could comment on the debate about targets. We have had evidence presented to us that between 200,000 and 300,000 new homes are required each year to keep pace with demographic pressures and so on. In the same breath, nearly all the witnesses have said, “Of course, we will never manage to do that”. The Government have lower targets. I wonder if you could comment on those and what the means will be to ensure that they will actually be met. The sub-question is: is the construction industry up to it?

Isobel Stephen: On the question about targets, the Minister’s aspiration is that there should be 1 million new homes. That is what we are working towards. Clearly, that is a step change from where we are now, because the last time we delivered 200,000 new homes was in 1988, which is obviously quite a long time ago. However, last year we delivered 170,000 additional homes, which is a 25% increase on the previous year, so there is some cause for optimism: we are at least moving in the right direction. In the year to September 2015, 250,000 planning permissions were granted for new housing. Would you like me to move on to the question about the construction industry?

Lord Monks: Yes, sure.

Isobel Stephen: As I say, there has been a step change over the past year, but there are at least three reasons why there is still quite a way to go with the construction industry. The first is that during the recession, a lot of smaller and medium-sized enterprises either went bust in 2007-08 or exited the market, so 50% of supply is concentrated in the eight largest housebuilders. Asking for the expansion of only eight players is quite an ask. Secondly, also as a result of the recession, we have had an exit of skills from the industry. That is something else that we need to be looking at. Thirdly, housebuilders have a natural tendency to build houses only at the rate at which they think they can sell them, for obvious and financially very responsible reasons. So we are looking at how we can incentivise housebuilders to build more quickly. That is why the Government are also very interested in new, different and off-site construction methods to try to think of different ways of sorting that problem out.

Andrew Rose: We spend a lot of our time talking to the housebuilders. As Isobel says, it is quite clear that they will build at the pace they feel they can sell at. A lot of the interventions are about trying to bring new suppliers into the market and creating long-term confidence so that people will build their supply chain, whether that is the number of housebuilders or the material side of things. One of the key things is bringing in new entrants. The direct commissioning announcement that was made last week is very much about trying to create smaller sites, bringing in new SME builders which we think will build at more pace and scale by diversifying into smaller sites. We are doing five pilots, one in London and four on HCA land, to try to encourage new entrants into the market. The Chairman mentioned the BFF, which is a fund very much targeted at the smaller builders. Then there is the supply of land, which is another thing that many of your witnesses have talked about. There is a big programme about really making sure that public sector land is released into the market, with a capacity for housebuilding of 160,000. As I am sure you have heard in many of these sessions, there is no one individual component of this, but for the housebuilding industry to get to the state that it will build that number on a consistent basis, an enormous amount of interventions are going on to create the confidence for it to build. One of the really important ones is bringing new entrants into the market, which was the key theme of the announcement last week.

Lord Monks: Do you believe that housebuilders are sitting on land purchases and storing the land, waiting for inflation to raise its value?

Andrew Rose: When I talk to them, they assure me that they are not. There is a lot of commentary about this. They would say, "We have working capital tied up in this land. Why on earth, if we could build it out and sell it, would we want to tie up working capital in land that we could build out at pace?" The message from the housebuilders is very strongly that they are not land-banking. Obviously, there is a suggestion that they are, but they would argue very strongly—

Lord Monks: They would say that, wouldn't they?

Andrew Rose: They would say that, but there is a strong argument that if you are sitting on an asset that you can make productive, sitting on it is not the best thing to do with it, and that is the line that they take.

Lord Sharkey: Can you tell us what the historical correlation is between new planning permissions and houses actually built?

Isobel Stephen: The drop-out rate is, I think, around a third. But we are looking at policies to try to address that. You are right: just because we have granted planning permissions does not mean that they necessarily translate into houses being built.

The Chairman: Do you keep track of the stock of planning permissions unfulfilled? Do you keep that as a statistic?

Isobel Stephen: Yes.

Baroness Blackstone: I would like to know from anyone willing to put their head over the parapet whether you think that housebuilders are sitting on land with planning permissions. Regardless of what they say, you must have some evidence one way or the other. You must have some information about this.

Isobel Stephen: The evidence actually suggests that they are sitting on less land than they used to and that their land bank has got smaller. As I said, it is entirely rational for them to build out only at the rate they think they can sell the houses at, so we need to look at incentives. As Andy says, we talk to housebuilders all the time. We are in constant dialogue with them about how we can change those incentives in order to make sure that they build out more quickly.

Lord Griffiths of Fforestfach: Ms Stephen, perhaps you could expand on something you said in an earlier response. What is the potential of new technology to improve the pace of supply?

Isobel Stephen: The traditional housebuilders have not been very willing to invest in different technologies and that is partly because of their conservative—with a small "c"—tendency, because they need to keep their profit margins. But we think there is a lot of potential here. The Government are very keen on this. Off-site construction has quite a bad reputation for being not very good quality and not very durable, but actually it has lots to recommend it in that you are able to have factories that are not where you are building your houses; that means there is less disruption for the local community where the houses are being built. It is a different type of skills base. The workers do not have to work outdoors. They are not affected by the weather. It is also quite flexible. You can have factories that construct entire houses or you can have a more modular approach. I understand that Barratt constructs bathrooms and airing cupboards off-site and then slots them into its houses. That is what works for it. That is why BIS has invested £22 million in a factory for Laing O'Rourke in Nottinghamshire. Laing O'Rourke estimates that we might be able to get 10,000 houses a year from that factory. There is quite a lot of scope there.

Lord Lamont of Lerwick: Following up on the questions that were asked about the ratio of planning permissions to houses built and whether you keep a record of all the planning permissions granted, what evidence, if any, is there that the Government's changes to the planning regime have led to any increase in housing supply? I was talking to someone at lunch today who thought that there would be no effect at all and that small builders had gone out of business not just because of the recession but actually because they could not afford the planning delays. I know the Government have faced tremendous headwinds and controversy over this, but is it actually achieving anything at all?

Isobel Stephen: The changes were made in 2012 to create the National Planning Policy Framework. That introduced local plans. Where local plans are in place, on average they now account for 109% of the household demand that we think is in that area. Where the local plans are not in place, that figure is 86%. That suggests that where the local plans are enacted, it is making a difference.

Q63 Lord Forsyth of Drumlean: Going back to the original question about the targets, you gave a number of reasons why the targets might be difficult to achieve, such as the absence of skills, the lack of small builders and so on. How did the Government get these targets? Have they been drawn up on the basis of a business model that takes into account all these factors that you have described? How were they actually formulated?

Stephen Aldridge: Are you talking about both the supply target and the owner occupation target?

Lord Forsyth of Drumlean: I am talking about the commitment to build these houses in this Parliament. We have heard a number of reasons why it might be very difficult to achieve the target. Rather naively, I am assuming that these targets were based on an analysis of how these problems would be overcome.

Stephen Aldridge: The context for the target is: what do we know is happening to the demand and need for housing? The Committee has already heard that there are various ways of estimating what that is. The household formation projections, which have been the primary way of guiding the approach to housing provision, suggest a requirement over the next 20 or so years of about 200,000 additional households being formed each year. That gives you a starting point. We know, though, as you rightly say, that there are issues to do with the gearing up of the housebuilding sector to increase supply. The targets we have are aligned with the household formation numbers, not with some of the higher numbers for the requirement for new housing. There is a balance between the evidence that tells us what the minimum requirement from the household formation projections is and putting in place measures to enable the industry to respond.

Lord Forsyth of Drumlean: My question is about how the targets will be achieved and whether, in setting these targets, the various problems have been looked at. Could we have a piece of paper that sets out how that is made up and what the assumptions have been?

Isobel Stephen: My apologies, I misunderstood the question. As I said at the beginning, the Government have invested £20 billion in housing through the spending review, which is to address some of the issues in the housing market that we have been talking about. If you would like us to write to you with more detail on that point, we could do that.

Lord Forsyth of Drumlean: Cash is one thing, but you need people with the skills to build, and the land. I imagine that the target reflects the practical reality of overcoming these problems.

Isobel Stephen: Yes.

Stephen Aldridge: There are practical measures to do with supply-side issues.

The Chairman: I think Lord Forsyth's question is excellent. Perhaps I could ask you to take up his invitation to give us a concise paper on the things that need to change to get those targets. Very briefly, Lord Sharkey.

Lord Sharkey: Following on from that, do you have an economic forecasting model that shows the number of new houses required by 2020 that would achieve price stability?

Stephen Aldridge: We do have a housing market model. It was actually developed for us by an adviser to your Committee, Geoff Meen. It shows that the level of increase of supply that would be necessary to stabilise house prices would be very substantial indeed. There are genuine questions about whether or not that would be feasible over that period through a supply-side route alone.

Lord Forsyth of Drumlean: What does "very substantial" mean?

Lord Sharkey: Yes, what is the number?

Stephen Aldridge: The model cannot actually solve the level of supply that is needed to stabilise affordability levels. You have spoken in the Committee about 200,000 to 300,000 units a year. It would be beyond that level.

The Chairman: This is an important area. Baroness Blackstone first, and then Lord Kerr.

Baroness Blackstone: Perhaps I could add to your work and ask you to tell us, as well as indicating how you have reached the conclusions that you have reached on these targets and how they are composed, how you are going to reach the targets. Which parts of the housing market do you see as most difficult to respond to? Who is going to provide these additional homes? Are they going to be provided by private builders—large and small—the housing association sector or local authorities? It would be helpful to know how you see how these targets will be achieved in terms of who is going to build these houses.

The Chairman: Could you come back to us specifically on that as well?

Isobel Stephen: Yes, will do.

Lord Kerr of Kinlochard: After Lord Forsyth's and Baroness Blackstone's fiendish questions, mine is very simple and straightforward. You have told us that you keep data on planning consents. Could you send us a note telling us, over a convenient period of time, what these figures show? How much land has been permitted for housing development and how much of that land has been used?

Isobel Stephen: I can give you the number of planning permissions now, if that is helpful. There were 250,000 in the year to September 2015, which compares with 150,000 five years earlier.

Lord Kerr of Kinlochard: I am really trying to establish whether it is a canard, as I think you are saying, that developers seek planning permission and then do not build the houses. You say that on the whole it is a canard and there is rather less of that than there used to be. I am asking you to prove that.

Isobel Stephen: Okay.

The Chairman: We would be very interested to understand what the stock of unused planning permissions is at the moment. Lord Turnbull, are you very keen to come in at this point?

Lord Turnbull: I think you said earlier than one-third of planning permissions do not get built out. If you have 250,000 a year, that is probably going to lead to 170,000 houses, which is about what is being built at present, so we always have to allow for a gap between applications in order to hit any particular target. Will we need to increase planning permissions to 300,000 in order to get 200,000 houses built?

Isobel Stephen: Yes. It is actually even more complicated than that, because we are hoping that with some of our policies to close the gap in the number that get built out—sometimes they get built out, but it takes a long time—there are some conversions, from office to residential, that do not require permission, so they would not be captured in that number. The net additions figure I gave you earlier of 170,000 is houses that have been built but also houses that have been converted from office space.

Lord Turnbull: Are you—

The Chairman: I think we have to move on, actually.

Lord Turnbull: Is it my turn anyway?

The Chairman: No, it is not. I am sure, Lord Turnbull, you will find a method of asking your question in due course. Baroness Blackstone.

Q64 Baroness Blackstone: I want to move on to the issue of housing for the elderly. We all know that enormous demographic change is taking place and that more people are living much longer. There is plenty of modelling being done, and future projections. Do you think that enough work is being done on providing specialist housing for the elderly? Some witnesses have suggested that there is almost a gridlock, in the sense that there are lot of elderly and very old people living in houses with two or three bedrooms, which are too big for them and very hard for them to manage, and they would move, freeing up this housing for families, were there sufficient accommodation of the quality that they would want in order to get them to move.

Isobel Stephen: Clearly, the Government are interested in older people living in appropriate accommodation, partly because it means that they can age better, more safely and more healthily, and partly, as you say, because of the efficiency of the housing market. It is important that we do not assume that older people necessarily want to live in older people's accommodation.

Baroness Blackstone: No, I am not suggesting that.

Isobel Stephen: Local authorities have a responsibility, under both the National Planning Policy Framework and planning guidance, to take account of their local needs when they are planning for the accommodation that is being built in their area. They should be looking at what local older people want and making sure that the planning permissions they grant and the way that they are planning for accommodation takes that into account.

Baroness Blackstone: But local authorities are only a very small part of this picture, because on the whole those in local authority accommodation are very often in relatively small houses and flats compared with those in the private owner-occupied sector. What about that sector?

Isobel Stephen: I am talking about local authorities as planning authorities—

Baroness Blackstone: Oh, I see.

Isobel Stephen: —granting planning permission for new accommodation that is being built. They should be planning for what is going to be appropriate for their local population.

Baroness Blackstone: But are there enough builders coming forward with proposals to provide specialised accommodation for elderly and very elderly people, some of which will be supported—to use a jargon word—but some will not?

Isobel Stephen: Again, it depends on how the local authority plans it. It also depends on what the developers are providing and whether that meets the needs of people who are looking for new accommodation. I am sure that there is more we could do in relation to incentives, as we were discussing earlier, for older people to move, which are not necessarily financial incentives.

Baroness Blackstone: We have had some written evidence from McCarthy & Stone proposing that there should be a community infrastructure levy exemption for specialist housing for older people and that there should not be an obligation to provide affordable housing. What is your view on that? Are you in favour of it or not?

Isobel Stephen: We are currently undertaking a review of the community infrastructure levy. Liz Peace is doing that review for us. I expect that evidence such as that will be taken into account as part of that review.

Baroness Blackstone: So you do not know yet, until you have done the review?

Isobel Stephen: Yes.

Baroness Wheatcroft: What is your attitude towards the Government's policy on inheritance tax and family housing? Given the desirability of encouraging older people to move into smaller properties, is there not a contradiction there?

Isobel Stephen: Can I ask that you direct your question about inheritance tax to my Treasury colleagues? I am afraid that is not part of our department's remit. I do apologise.

The Chairman: I am sure we will. Thank you for the prompt. Lord Turnbull.

Q65 Lord Turnbull: I still find that too much of the conversation implicitly assumes that houses are built for people to buy them. Currently, 37% are renting and you have come up with a figure for the aspiration gap in the buying market—the people who want to be owner occupiers and cannot be. But if I had to make a judgment about where the greatest social harm is at present, it is not people who cannot quite afford the deposit in order to get into the owner-occupied sector; the most grievous deprivation is in the rented sector. I have not heard anything about what we are doing to increase the supply of good-quality rented property. The only scheme you have is one that initially takes rented properties from housing associations and then replaces them a couple of years later, thereby leaving the stock the same. Can you tell us something about what you can do to improve the supply of decent accommodation for rent?

Isobel Stephen: We have the Build to Rent fund and the private sector guarantee scheme, which provide finance for institutional investors to build properties that are suitable for renting. Often these properties are a good bet for investors because it is a long-term rental stream. They often build them to very high quality because they are building them to be rented out rather than to be sold, so they have an ongoing interest in them being of high quality. There are these funds available for investors.

Lord Turnbull: Quantitatively, what do they add up to? We have pages and pages of government initiatives, but how many houses are being built under these schemes?

Isobel Stephen: Savills has estimated that the build to rent sector could deliver 10,000 a year.

Lord Turnbull: That is not a big chunk out of 200,000.

Isobel Stephen: Yes.

Lord Turnbull: That is what I am saying. Quantitatively, the response of the rented sector is weak. No one has mentioned that there is one group of providers—housing associations—which, if you give them the money, will build the properties and rent them out. They do not wait around for the market opportunities. If you want to make progress in alleviating the suppressed demand for decent housing, that is the place to focus our efforts, is it not?

Fiona MacGregor: I think Isobel has said a number of times now that the Government made it clear in their manifesto that their priority was home ownership. Notwithstanding that, some funding remains available for affordable rented accommodation. The existing programme that has already been committed, along with a little bit of new money for affordable rented housing for vulnerable and older people, will add around 100,000 new affordable rented homes through to 2021. There remains some actual grant funding available for affordable rented housing. The other source of supply that we know housing associations are looking at—and you are quite right, they are incentivised to build out rented accommodation—is that they will do what they can to generate surpluses through either market sale or shared-ownership homes, and they are telling us that they will use those surpluses to build, without grant funding, additional rented homes wherever they can.

Indeed, as we have said already, in terms of replacing homes sold under the right to buy, it is their intention wherever possible—where it is the right thing to do in the market—to replace that with rented accommodation as well. There is a range of sources, not all of which get new grant funding, that will continue to contribute to affordable rented supply.

Lord Turnbull: You are talking about bits and pieces of things. Are they going to respond to the depth of the crisis in the rented sector that earlier witnesses have told us about?

Andrew Rose: For the registered providers, it remains a core area of activity for them to deliver rented social housing. Based on our discussions with them, we fully expect them to continue to do so. The focus is very much on the government initiatives, which, as we have discussed, are very much about home ownership. In the RP sector, low-cost home ownership is a big programme that is going to be coming in. But as Fiona says, that does not dictate to them what their tenure mix should be. They have surpluses. It is their core objective as charities. I think the expectation—certainly what they share with us—is that while there is no scheme necessarily designated and targeted for that area, it remains their core purpose, and we fully expect them to continue to build significant social rented property. That is what they are telling us they will do.

Lord Turnbull: Of the 200,000 a year, which is by and large the number that people think will simply stop the excess demand getting any worse—it does not deal with any kind of backlog—how many do you think would come from the registered social landlords?

Fiona MacGregor: I do not think I can give you a definitive answer at this point, for a number of reasons, partly because we have yet to see how providers are going to respond to the most recent set of announcements in the SR and Autumn Statement, which switched funding to prioritise shared ownership. We had some forecasts from them prior to those. We do know that around 100,000 affordable rented homes will be funded in the pipeline. It will be a bit of time before we can see the response in terms of volumes and numbers to what they do in right-to-buy replacement and what they can then do with their own resources through what they generate in surpluses from the shared-ownership programme and from market sale, so I cannot give you a definitive number at this stage.

Lord Turnbull: That 100,000—

The Chairman: Lord Turnbull, I think we need to move on.

Lord Turnbull: —that is a five-year figure?

Fiona MacGregor: That is right.

Q66 Baroness Wheatcroft: Isobel Stephen, I was intrigued to hear you talk about the factory that Laing O'Rourke has opened, with help from the Government—I think you said £10 million—and that this factory could generate 10,000 homes a year, which begins to make a difference. You said that the Government are very interested in these new forms of building and off-site development. Is there a way in which that interest could be turned into something that amounts to policy, and make a difference?

Isobel Stephen: The factory was funded with government money.

Baroness Wheatcroft: One factory?

Isobel Stephen: One factory.

Baroness Wheatcroft: Could we have 10 of them?

Isobel Stephen: Potentially. That would mean reprioritising money that the Chancellor has already allocated in his spending announcements.

Baroness Wheatcroft: What was the investment in the factory?

Isobel Stephen: £20 million.

Baroness Wheatcroft: So we would need to reprioritise maybe £200 million—not a lot in terms of government spending, but it could make a difference.

Andrew Rose: There is another way into this, although it is not for me to decide, which is designating some of the land that we have available and identifying areas that can be used for that. We mentioned Laing O'Rourke. I have visited the facility and it is incredibly impressive. There are other organisations—Legal & General is another one that has shown huge interest in this area. The thing I keep hearing from people is that there is proof of concept here—once the concept is proved, people will step into the space. That is slightly squaring the circle. If enough people saw the opportunity for sites to develop that technology, I think the money would flow largely from the private sector and we may not need government intervention to do it. Certainly, we are getting a strong steer from some of the investors that we are talking to. One of the key tricks is making it clear that there is enough opportunity to provide housing on that basis. Under the affordable homes programme, something like one in five of the homes that are being built, where we have seen the plans come forward, are looking at alternative methods of construction. It is possible that if there is enough proof of concept we might not need too much government money to go into it, because the private sector will deliver a significant amount of it.

Baroness Wheatcroft: I am glad you mentioned affordable housing, because one of the concepts I have struggled with—throughout this inquiry, actually—is what constitutes affordable. I wonder if you could give us an indication of how you judge affordability. It used to be that one looked at the ratio of rent to income, for instance. Do you have any guidelines now as to what constitutes affordable and how that has moved over time?

Andrew Rose: I am going to defer to the department on this.

Stephen Aldridge: The department does not have a formal affordability target. As you say, it depends on the context. The interventions that we have described basically enable people to access housing at below the market price. The extent of that varies depending on the programme. In some cases we are targeting groups, as Lord Turnbull said, on the cusp of owner occupation; in other cases we are providing a greater subsidy to help those on lower incomes. There is a degree of variable geometry in trying to make sure that different groups see the degree of support that is needed to enable them to access housing. There is no single approach to the provision of subsidised housing.

Baroness Wheatcroft: Does anyone in government have a guideline as to how much of their household income people should have to devote to getting a roof over their heads?

The Chairman: If we could have a concise answer to that, it would be very useful.

Stephen Aldridge: I could say that it was determined by the eligibility requirements for housing benefit, for example. That would give you an idea of what level of income was deemed appropriate in order to enable people to meet their non-housing costs while at the same time getting accommodation over their head. If it is helpful, we could give you a note setting out the position.

Baroness Wheatcroft: That would be helpful, thank you.

Q67 Lord Griffiths of Fforestfach: Moving on to the Help to Buy scheme, was it originally intended to help people get on to the ladder of buying a home, or was it also intended to have a supply impact? Whatever your response, how successful do you think it has been?

Isobel Stephen: The Help to Buy scheme was initially a response to the downturn in 2008 when it became quite difficult for people to access finance to buy their own homes. Initially, it was a demand-side measure. However, it was deliberately constructed in such a way that it also stimulated demand.

Lord Griffiths of Fforestfach: You mean supply?

Isobel Stephen: Yes, because the Help to Buy equity loan, which is what the department is responsible for, is to be used specifically for new build. You can gain access to the money only if you are purchasing a new-build house. We are about to publish an evaluation of the scheme, which is very positive. It suggests that there is 43% additionality of new-build properties purchased through Help to Buy Equity Loan. I know that some people have concerns about the distortive effects of the equity loan policy, but the evaluation also suggests that there is not such distortion. It accounts for only 2% of transactions in England, so it is a comparatively small part of the market.

Comment [AL]: 5% is all Help to Buy products

Lord Griffiths of Fforestfach: It is not primarily helping people in the middle to upper-income categories?

Isobel Stephen: It is not. The average house price of somebody purchasing a house through a Help to Buy equity loan is lower than the average house price. There is no evidence that it is contributing to house price inflation.

Andrew Rose: Again, this comes much more from what I call the practitioner side, of visiting sites and seeing what is actually going on. We are talking about the equity loan scheme, which is the part that we are responsible for. With over 80% of first-time buyers, as Isobel says, the average price is below the average house purchase price. The other thing I have found is that when you visit sites in the north, for example, you get a lot of feedback that if it was not for Help to Buy those sites would not have happened at all. It has had a big impact. A lot of people focus on the south-east, but actually Help to Buy has a much broader geographic spread. Certainly, the feedback I get when I visit sites in the north is developers and local authorities saying how powerful an intervention Help to Buy has been in those parts of the country.

The Chairman: We need to bring the session to an end. As we have the HCA here, it is particularly important to get an opinion on the final question. Lord Sharkey, perhaps you could take that on for us.

Q68 Lord Sharkey: The Office for Budget Responsibility has forecast that social rent reductions will lead to 34,000 fewer homes. What measures are you taking to boost the supply of social housing in the light of that prediction?

Isobel Stephen: I think I have set out the Government's spending review plans to deliver more than 400,000 new affordable homes. That includes starter homes; it includes 135,000 homes for shared ownership; and, as Fiona has explained, it also includes more than 100,000 affordable homes for rent. But clearly, we want to keep a close eye through the regulator on how many homes housing associations are building and the OBR's assessment of that.

Fiona MacGregor: The OBR itself said that forecasts by their very nature are quite uncertain. As I said earlier, we have had some forecasts from housing associations, although they are slightly out of date because they came prior to the SR announcements. The feedback we are getting from housing associations is that they are looking to mitigate the rent cuts through making savings in discretionary activity and that, wherever possible, they want to maintain supply, although, as we have alluded to a number of times, that might mean a slight change in the mix. We have not quite finished analysing the numbers, but once we have done that we will be able to tell you in aggregate what they are saying in the most recent forecasts about the supply numbers that they are proposing to build out.

Lord Sharkey: Does this not concern you a great deal? Earlier you talked a lot about the reliance on housing associations building between 10,000 and 20,000 new homes a year. If this deficit of 34,000 is accurate, does that not make the forecasts rather difficult to believe?

Fiona MacGregor: The OBR itself has said that its forecasts are very uncertain and that it depends on the behavioural response of the housing associations to the rent cut. The behavioural response that housing associations are telling us about is that they are trying to make savings in their operating costs and other parts of their business to ensure that wherever possible they can carry on building the supply numbers that they originally intended. That will not be possible for all of them, but there is a mixed response and I think they are trying to—

Lord Sharkey: I am just astounded that the OBR would not have taken that into account when it made the forecast.

Fiona MacGregor: This was done reasonably recently and the OBR does not have access to the housing associations and what they are proposing to do. It was very much a data-driven analytical model, which it has said makes behavioural assumptions, and it does not know how they will play out.

The Chairman: Thank you very much indeed for your evidence this afternoon. We look forward to that additional information that we have asked for, which I will ask our clerk to write to you about to make sure that we have that clear.

Examination of Witnesses

Gwyneth Nurse, Director of Financial Services, HM Treasury, **Mike Williams**, Director of Business and Tax, HM Treasury, and **Stephen Farrington**, Deputy Director of the Economics Group, HM Treasury

Q69 The Chairman: Thank you very much for joining us for the second part of our session on as part of our housing inquiry. Perhaps I could ask you to introduce yourselves very briefly, giving your role.

Gwyneth Nurse: I am Gwyneth Nurse and I am director of financial services at the Treasury.

Mike Williams: I am Mike Williams. I am the director of business and international tax at the Treasury.

Stephen Farrington: I am Stephen Farrington. I am deputy director of the economics group at the Treasury.

The Chairman: We try to keep the sessions fairly tight, so you do not each need to answer every question.

One of the graphs that have come out is that there is a growing division in the housing market between those who are younger and those who are older. I guess it has always been the case, although it is getting more extreme, that younger households are debt-laden and older households are asset-rich in terms of housing. Looking at one of the other graphs, the number of households of owner occupiers that are mortgage-free now exceeds the numbers of households that have mortgages, which is the first time the figures have recorded that.

Lord Lamont of Lerwick: I think it is a very good thing.

The Chairman: I am not saying one way or the other, Lord Lamont—you are very welcome to come in. Does the Treasury have a view on this? Does it think it is a good thing or a bad thing? Should this policy be pursued? I ask this as a home owner myself.

Stephen Farrington: As you say, over the last 20 years we have seen an increase in real house prices of a factor of about two and a half times, which has basically generated a large capital gain for people who bought their houses 20 years ago and has created this divergence in wealth and income levels between younger and older cohorts. Interestingly, though, not all of that has been driven by constrained supply, which you touched on in your earlier session with DCLG colleagues. At least part of that has been an unexpected increase in housing demand, given the slightly unexpected increase in the rate of household formation over the last 20 years. There have also been more global factors and UK macro factors over that period, such as the sustainable fall in rental yields, from levels of around 4% in the 1980s down to about 0% now. The current level is clearly cyclical, but part of that decline is also structural. At least part of the appreciation of house and asset prices in the UK is being driven by a lower real risk-free rate. That is what has generated the outcome. Housing supply was never going to be the only part of the explanation of how to get around that if it is only one part of the explanation of what has driven the increase. That is why the Government have targeted their policies in particular on first-time buyers. Those individuals are, as you say, having to take on higher levels of debt, but they are also taking on a more valuable asset. So we have targeted our support via the Help to Buy policies to make it easier for first-time buyers to get on to the housing ladder. The evidence is that that seems to be working. We have seen increases in the numbers of first-time buyers over the last few years, and falls in the number of first-time buyers who need support to make those purchases.

The Chairman: So this is something that the Treasury is positively trying to rebalance, if you like.

Stephen Farrington: It is a complex mix of factors that have generated this outcome. We targeted our support on particular issues where we think there are areas of concern. That includes access for first-time buyers to get on to the housing ladder, so that is where we concentrate our resources.

Q70 Lord Lamont of Lerwick: I am going to skip the next few questions, if I may—I thought they were contiguous—and will go on to the buy to let market. I was slightly surprised at the Chancellor implying in, I think, his Budget speech—he certainly implied it at one time—that first-time buyers were being crowded out by buy to let landlords. He seemed to take a rather fixed view of the supply of rented accommodation. If he took that view, I do not know why he would not also be equally concerned about overseas buyers of London property. I am not suggesting that he should be, but the logic seems the same in both cases. Are the changes in taxation an attempt to address this problem as he perceives it?

Mike Williams: Do you mean the increased stamp duty land tax rate where you have a buy-to-let property?

Lord Lamont of Lerwick: Yes, and the higher-rate reduction.

Mike Williams: They reflect the concern that first-time buyers should not be crowded out of the market by people who may well already own a home and who may partly, as a consequence of that, find it easier to raise funds to buy to let, so yes.

Lord Lamont of Lerwick: But why not apply the same logic—I am not suggesting that you should—to Chinese buyers of flats across the river? Why take this view that there is a fixed supply?

Mike Williams: If you have a Chinese buyer who buying to let, they, too, will face—

Lord Lamont of Lerwick: They just buy to keep vacant.

Mike Williams: I wonder to what extend Chinese buyers are doing that. I am not sure that there is a lot of evidence for that. In general, they will be buying for investment, which was often implied buying to let on the basis that they will generate more income by doing that. They, too, will pay the stamp duty supplement in consequence, so it addresses a concern about foreign buyers as well as the concern that first-time buyers are being crowded out by British people.

Lord Lamont of Lerwick: I am just concerned that these changes might actually cut off a supply of rented accommodation. On the one hand, the Government are trying to encourage institutional investment, but the tremendous increase in buy to let has had beneficial consequences, and I am concerned that the changes that have been made will stop this supply of extra rented accommodation. On top of the tax changes, I think I am right in saying that the FCA has also brought into line buy-to-let mortgages with the affordability criteria applied to other mortgages.

Gwyneth Nurse: In fact, buy to let is not regulated in the main by the FCA; it remains outside conduct regulation. You may be referring to the mortgage credit directive, where we brought in a small portion of buy-to-let lending which we deemed to be to consumers. But overall it is quite a small element of the mortgage market, so at the moment it remains outside.

Mike Williams: I go back to your earlier point, Lord Lamont, about the housing stock. We need to look on the one hand at the future supply of stock. If we look at the stock that in reality is going to be largely what there is at any point, there is a concern, which the Chancellor expressed, about first-time buyers being crowded out. Given that there is a finite stock—

Lord Lamont of Lerwick: There is not a finite stock.

Mike Williams: There is a finite stock of existing properties.

Lord Lamont of Lerwick: But a lot of buy to let goes into new property.

Mike Williams: The supply of new build, the conversion of existing property or the renovation of existing property is a second objective, which the Government are concerned about. That is why we are consulting on whether the stamp duty land tax supplement should apply in circumstances where someone is buying a significant number of properties: in a sense, the equivalent of the core tenant in a shopping centre without which the shopping centre might not be constructed. There may be circumstances, and we want to address this through the consultation, where in reality—this goes back to Isobel Stephen's point—people build only when they can sell; a developer may start a development only if they are sure that some landlord will buy, say, 20 of the properties over time. We are concerned about that, and we are concerned not to constrain the supply of additional properties.

Q71 Lord Sharkey: I would like to ask a non- contiguous version of question 3. Some witnesses have suggested to us that the reforms to the mortgage market have made lending too restrictive. Part of that restriction is under the control of FPC when it comes to major-value asset sales and so on. It seems to me that there are two questions here. First, are we satisfied that the reforms are doing what the Government intended, or are they in fact restrictive? The other question is whether, because the Bank, via the FPC, has effective control over some of the key aspects of the mortgage market, it is possible that the Government's intentions in terms of supply are thwarted by the actions of the FPC or the Bank.

Stephen Farrington: The Governor has been pretty clear in the evidence he gave in his financial stability report that he sees no conflict between the Government's measures on Help to Buy generating demand in the housing market and the FPC's efforts essentially to curtail the right-hand side of the distribution of risks to reduce the number of high LTV, high LTI mortgages. The Bank is required to give an annual assessment, and it has been pretty clear that the Help to Buy mortgage guarantee scheme, for instance, has not posed any challenges to the operation of the FPC's policies.

Lord Sharkey: But is it not clear that changing the loan-to-value ratio has an effect on the total number of houses likely to be built?

Stephen Farrington: The link is not straightforward. We have seen quite large changes in loan-to-value ratios over the past 30 or 40 years that do not correlate particularly well with developments in housing supply and build ratios, for instance.

Lord Sharkey: I still find it difficult to work out quite whether the Government, the Treasury, have given the Bank so much independence in this area that there is an effective outside restraint on the Government's ability to deliver the number of houses that they want to be delivered.

Stephen Farrington: I do not think so. The actions which the FPC is required to take are designed to curtail the potential risks of returning to the asset price bubbles that we saw pre-crisis by restricting riskiness in loans and falls in underwriting standards. I do not necessarily see a conflict between their maintaining those underwriting standards and government actions to supply houses.

Lord Lamont of Lerwick: But surely this is a double whammy. First, you get the tax changes, then you get these changes via the Bank, wiping out the buy-to-let sector just like that.

Stephen Farrington: It is not at all clear that the Bank's actions have at all wiped out the buy-to-let sector.

Lord Lamont of Lerwick: You just need to read newspapers to see that people are being advised not to invest in buy to let.

Stephen Farrington: Buy-to-let houses could represent 18% of new lending and 15% of the stock.

Lord Lamont of Lerwick: For how much longer, I wonder.

Stephen Farrington: They have been increasing their share of the stock over the past few years while the FPC has been undertaking its actions.

The Chairman: Lord Griffiths, we seem to have moved to pick and mix on the questions.

Q72 Lord Griffiths of Fforestfach: I am afraid that the comment on platitudinous questions has totally thrown me, so I will ask something quite different. If you look back at financial and monetary policy over the past 50 years or so, the housing market has proved to be a key area of instability. It seems to me that under housing policy at present, from the Government's point of view, there are so many schemes that are attempting to change structure, to increase supply, to help people to buy and sell on. At the same time, the Bank of England has gone in for quantitative easing, and we have very low interest rates indeed, which obviously will raise asset prices. The FPC's action in relation to buy to let and so on was meant to reduce demand in order to ensure that the housing sector was not the place where you would generate potential instability. As Treasury officials, as you look at the picture as a whole—given that you are not responsible for monetary policy but you have to take it into account with fiscal policy—to what extent do you think at present we could see potential instability arising?

Stephen Farrington: I do not necessarily agree that there is a particular conflict between the Bank's objectives on monetary policy and financial stability and the operation of quantitative easing and lower interest rates, which will have provided support to asset prices. We have seen that the FPC is operating on a different horizon. It is essentially attempting to pre-empt and snuff out increases in the credit cycle, which operate on a longer time horizon than the more normal cyclical effects that monetary policy is targeting, and we have seen that its actions have been relatively successful. In June 2014, for instance, house prices were rising by about 14% a year. The FPC made some recommendations, which have at least partly explained why house-price growth has moderated from that point down to 7% growth currently and to levels that feel—

The Chairman: Sorry, Mr Farrington, may I ask you to truncate your answer or make it fairly short, because there is a Division, unfortunately, and we will have to vote?

Stephen Farrington: Sure. House-price growth is close to 7% and is getting close to being aligned with household income growth in the medium term.

The Chairman: I apologise for this. It is all part of what we do. We will adjourn for 10 minutes, or until people are back, and resume then.

The Committee suspended for a Division in the House.

The Chairman: Perhaps I can suggest to Committee Members, given that we ought to finish the session by 5.30 pm, that we concentrate on the areas that you feel are particularly important to ask the Treasury about. Lady Wheatcroft.

Q73 Baroness Wheatcroft: It is often suggested that our obsession in this country with home ownership and putting our money into bricks and mortar means that people do not invest enough in companies, shares and value creation. Do you feel that is true? Are government policies exacerbating that? I would also like to hear your views on the new inheritance tax proposal that the family home can be passed on without inheritance tax. Is there a certain unfairness to that, not only in that not everybody has a home to pass on but that a family home in the north of England may not carry anything like the value that would be passed on in the south of England?

Mike Williams: Let me answer the inheritance tax question. Why have the Government in effect privileged home ownership over other assets in inheritance tax? In reality, for most households affected by inheritance tax, the home is the main asset. That gives rise to some concern, at least among some people, that they would like to pass on their house to their children free of inheritance tax, and it is that concern the Government have responded to. Equally, in introducing that change, the Government foresaw that without action in this area there was a risk of discouraging downsizing. As you may have seen, Lady Wheatcroft, there is a provision that if you do downsize and sell your home, you will still be able to use the allowance when assets of equivalent value are passed on death to direct descendants. That was an attempt to avoid causing the market to clog up and people not to downsize when perhaps they would have liked to.

Baroness Wheatcroft: Is there a time horizon on that?

Mike Williams: In terms of how soon before death? No, there is no time horizon on that. There is no time limit on the period before death in which a person must have downsized or ceased to own the property in order for the treatment to apply. If you think of the circumstances for example of a voluntary sale when someone goes into care, the time period is outside anyone's control and it would be quite hard to come up with a limit.

Baroness Wheatcroft: It is a way of passing on inheritance, of course, but could you address the disparity between the different regions, in that essentially the Government are allowing inheritance on a much greater scale in some parts of the country than in others?

Mike Williams: I think that is true. On the other hand, if you are to have inheritance tax, given the nature of it and how it is structured—which is not particularly unusual—the people with the largest-value assets on death will tend to be in the south. In a sense, to turn your question around, you are lifting a charge that is falling most heavily on the people in the south. In a sense, that is two sides of the same coin.

Baroness Wheatcroft: The first part of my question, if you would not mind, is another aspect of the same territory: is our obsession with bricks and mortar at the expense of more productive use of assets?

Stephen Farrington: It is certainly clear that a very large part of the UK financial institutions' balance sheet is occupied with mortgage lending. That accounts for a significant part of the lending and the deployment of their capital. But one of the issues that we face here is that there are some measurement difficulties in the sector. That is why the Chancellor announced part of the productivity plan in the summer Budget, and we will be working with the Bank of England to produce a more definitive measure of the funds that are available for what he termed "productive investment". We are specifically working on coming up with a measure so that we can more accurately target policy. It is a slightly undefined area at the moment, so we are working on that right now. We are hoping to come forward with some early results at the Budget.

Baroness Wheatcroft: Do you think there could be a change in tax policy as a result of that work to encourage more money to be available for "productive investment"?

Stephen Farrington: I would not want to pre-empt what the numbers say. We have yet to see when they will come out, but I have no doubt that they will inform policy in the Budget.

Q74 Lord Turnbull: Looking at the broad picture of how housing is taxed, there seem to be a number of oddities. If you looked at median principles, one of the things you would avoid is a heavy reliance on stamp duty. It seems to me that instead of dealing with the problem that the council tax gradient does not really go high enough, we have a proxy for it in that we tax high-value transactions. I have not moved house for 28 years and I have never paid the higher-rate stamp duty, but if you have to move or want to move, you are paying some very high figures. Economists would normally say that that is a bad thing. Does this not point to changing the balance between the taxation of transactions to more people paying a smaller tax every year; that is, an expansion of the council tax bands?

Mike Williams: The Government's reform of residential stamp duty in the Autumn Statement of 2014 represented a quite significant reduction in stamp duty on house purchases. If you look at the people actually paying stamp duty, 98% paid less. The equivalent figure for London is 91%, despite the fact that the average property in London inevitably will cost more and so will attract more stamp duty. To the extent that the Government did that, your concern about stamp duty has been addressed. The other side of that is: should the Government have recouped that revenue through increased council tax? I think the Government have been clear both in their present configuration and in the coalition that they are keen not to significantly increase council tax, which obviously is a burden that some households feel quite acutely.

Lord Turnbull: But what we are left with is a changing pattern in wealth that has not been addressed since 1991. Is it ever going to be addressed? These historic values, given the change in the relativities of property values, do not provide a fair basis for taxation.

Mike Williams: I think the Government have been clear that their core priority is keeping down council tax, and they have not sought to revalue council tax. Even if you thought there was a case for a revaluation, candidly, now would not be the time you would embark on it, because we are in the midst of business rates revaluation. That is occupying a considerable part of the Valuation Office Agency's time. Inevitably, it is occupying a considerable amount of the time of the private sector valuers as well. In the nature of things, some people will negotiate over the revaluations. I do not think you would want to do a council tax revaluation while everyone was engaged on this. Equally, one thing that we are looking at in the review of business rates administration is whether there is a means of resolving disputes between the parties of a valuation more efficiently. Almost certainly there are ways of doing that. Equally, before contemplating something as large-scale as a council tax revaluation, which would affect 23 million properties in England, making sure that you had an appeals system that worked better than the one we have now would be a very sensible thing to do. With the best will in the world, if you were to revalue 23 million properties, you would get disputes, and those disputes would have to be settled by appeals.

The Chairman: But you could still increase the bands or change how it works without changing the overall charge to the nation. If you did a band increase, without having to revalue everything, that would not involve a lot of the problems you are outlining, surely.

Mike Williams: I am not sure that you can easily do what you describe. When Wales introduced the additional bands, that was done as part of a full revaluation. If you do not do that, you may face difficulties in working out which properties you would put into the new additional bands at the top end of the council tax. I do not think it is that easy to do a partial revaluation in some circumstances.

The Chairman: Right. Lord Layard.

Q75 Lord Layard: We all know that there is a problem with incentives for local authorities to give planning permission. I gather that there is evidence that the new homes bonus has shown that they do respond to financial incentives, and there is a report out that says this. That amounts to something like £8,000 on average per dwelling. But obviously the difference in the land value of the site before it has planning permission and afterwards is on average something like £150,000. The average difference is just ginormous, which is an indication of the inefficiency in the allocation of resources connected with the withholding of planning permission. Of course, it is also an indication of the extraordinary inequity involved when the planning permission is given away and the landowner is given the present of £150,000. Is there a case for exploring ways in which the local community and local authorities can get hold of this difference in land value; for example, by having some right to buy at the lower price and sale at the higher price, or some other device? Would you agree that exploring ways of incentivising local authorities through exploiting that price difference could be really important in energising the housing market? We surely need something more than business as usual if we are going to get the numbers of houses that we need.

Mike Williams: In a sense, that is really a question for our DCLG colleagues. Clearly, it is important that local authorities have incentives to increase the housing supply, and we need to look at whether they have sufficient incentives. It seems to me that we will continually do that because otherwise we will not achieve what are quite demanding targets.

Q76 Lord Sharkey: I have a new question. I think the Prime Minister has said that he would like to build 1 million more homes by 2020-21. Does that seem reasonable—I mean, do you recognise the figure? Does the Treasury have a model of how many new houses per year in that period that works out as, by region and by tenure? Does your model also predict the overall effect of such a volume on average house prices?

Stephen Farrington: To answer the second part of your question on the impact on house prices, knowing the supply of houses would be only one input into forecasting the impact on prices, which will be determined by a range of other factors on the demand side—for instance, prospects to household incomes, changes in credit conditions and movements in interest rates—over that five-year period.

Lord Sharkey: But these are all things that you are used to building into forecasts.

Stephen Farrington: Indeed. I was going on to say that fortunately I do not have to do this, but the OBR has the unenviable task of having to make judgments about all those factors. It did that in its latest forecast, which was conditioned on the Government's policy to build those 1 million houses by the end of the decade and made estimates of those other factors. That led it to produce a forecast for house price growth of around 5% or 6% a year on average over the five-year forecast.

Lord Sharkey: The first part of the question was about whether or not you have a view of how these new homes are likely to be phased over the five-year period and how they are likely to be distributed by region and by tenure.

Mike Williams: Again, the detail of how the Government will implement that aim is a matter for the DCLG rather than the Treasury.

Lord Sharkey: We will ask the DCLG, but I would have thought that since the OBR has produced the forecast about the effect on house prices, it will have had to have taken into account tenure, region and number by period. I would be surprised if the Treasury did not have access to that.

Stephen Farrington: It is not the case that the OBR will have needed that information. It is making broad, macro-level judgments. The uncertainty in the forecast dwarfs additional detail that you could supply on where you think that housing supply might come from. It is making a UK, macro-level judgment about broad trends in household incomes, supply, credit conditions and interest rates. Additional information about regions and tenure is a second-order question in terms of predicting where house prices are going to go over the forecast period.

Lord Sharkey: I understand that, but one of the reasons for asking the question is that the unfulfilled demand for housing varies enormously across the country. I would have thought that it would be an issue of concern for the Government to try to say what effects the measures they are taking will have on different parts of the country.

The Chairman: In effect, I think your answer is that you do this only on a national basis.

Stephen Farrington: We do not have a regional house price forecast.

Lord Sharkey: I was not asking about house price forecasts—

The Chairman: I think that probably answers—

Lord Sharkey: —I was asking about the numbers. The answer is no, I take it.

Stephen Farrington: Correct.

Q77 The Chairman: Perhaps I could wrap up with a fundamental question. One thing that particularly struck me when we went through the initial data for this inquiry was that if you look at the graph of housing starts since the 1940s, which I am sure we all know, in the periods when we were meeting the targets that we need to meet now, there was the private sector and there was the public sector bit on top of it. If you look at it very simply, the gap between now and then is the public sector bit; it is not there any longer and the private sector bit is pretty much what it was right the way through that period. Does the Treasury recognise that as evidence? If it does feel that the public sector has a role in delivering housing, whether through social housing or local authorities, how can that be afforded? How does the Treasury see that local authorities, which are under a lot of financial pressure at the moment, could be brought into this to deliver housing in whichever way the Government might think suitable, but bringing that ability back into UK housebuilding again?

Mike Williams: Again, in a sense that is covered in what Isobel Stephen said. I am not sure that we as the Treasury have anything to add to what she said.

The Chairman: It probably needs money, does it not, of some sort?

Mike Williams: On that level, there is a sense in which everything needs money. As Ms Stephen said, the Government have allocated a large amount of money to housing as part of the spending review. I do not think it follows inevitably that it requires public sector money. As we have seen in other areas—for example, Lord Lamont's questions about private landlords—an awful lot of the money will inevitably come from the private sector. Some of that money, as we said earlier, will stimulate development, as opposed to someone coming along to a house that is already half-built or largely built. It will actually drive the developer to build homes, because it will be surer that when it has built them it will have a market for them.

The Chairman: Do any of these conversations about housebuilding come into any of the local devolution negotiations that the Treasury leads pretty strongly on, or is it not a factor?

Gwyneth Nurse: I do not think that any of us are particularly on the spending side of the Treasury, so I am not sure we are able to very easily comment on the devolution deals.

Mike Williams: It is worth noting that to the extent that the devolution of taxes is being contemplated, local authorities and city regions tend to like very stable tax revenues—not surprisingly—because they can more readily cope with that. They are less keen to acquire quite rapidly fluctuating sources of revenue, because they find that harder.

The Chairman: Okay. Thank you very much indeed. I will bring the formal public session to a close at this point. I will see if we can get five minutes with our special advisers to give us some feedback from the session. Perhaps I could ask our witnesses and other members of the public if we could go back into private session. Thank you very much indeed for your evidence.