



HOUSE OF LORDS

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The Select Committee on Economic Affairs

Inquiry on

THE ECONOMICS OF THE UK HOUSING MARKET

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Questions 164 - 190

TUESDAY 1 MARCH 2016

3.35 pm

Witnesses: Mr Brian Berry and Mr Chris Carr

Mr Paul Smee and Mr Stephen Noakes

Members present

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

Examination of Witnesses

Mr Brian Berry, Chief Executive, Federation of Master Builders, and **Mr Chris Carr**, Chair of the FMB Home Builders Group, Carr and Carr (Builders)

Q164 The Chairman: Gentlemen, good afternoon. As you know, we are conducting an inquiry into housing. We are focusing on how to increase housebuilding, in particular social housing. It would be very interesting to hear from you today your experiences from the front line. We have taken quite a lot of evidence already. It is clear from that and from the written evidence you have provided that SME builders, which in the past have been a very important constituent of the building industry, have declined substantially in number. The decline started before 2008, but to a certain extent it has accelerated since then. It would be helpful to hear from you as to why you think that is, and how its revival might be encouraged.

Mr Brian Berry: Lord Chairman, you are absolutely right that there has been a long-term decline in the number of SME housebuilders, not just in recent years but over a 25-year period. In 1988, two-thirds of all new homes were built by SME housebuilders. That figure has now fallen to 26%, so there has been a marked decline in the number of homes built by local builders.

There are probably three main factors that contribute to that fall. The first is that the planning system has become much more complex over that period. The allocation of land has also changed, so larger parcels are allocated in the five-year land supplies. That has militated against SMEs looking for smaller parcels of land to develop, and they have not had that opportunity. Interestingly, lack of availability of parcels of land was the No.1 concern. We did a survey of our housebuilder members and 68% said they were having problems.

The second issue is developer contributions, which have increased over time, particularly with the introduction of the community infrastructure levy as well as the Section 106 agreements. The fact that local authorities now have to look for ways to increase their revenue, particularly during the recession and cutbacks, has worked against SME housebuilders.

The third issue, which has been very serious since the start of the recession, is the problem of access to finance. Despite the recovery in the economy, banks are still very reluctant to lend to SMEs both for development and ongoing business. That is still causing a problem for our members. In our latest survey, 62% reported that was a problem.

Mr Chris Carr: I agree with everything Brian said. We also have to understand that we have been through two or three quite deep recessions over the past 10 or 15 years. The problem has been the natural decline in developers. A lot of it is due to retirement and a lot is due to recession, but the big problem is that we cannot encourage developers to come in at the bottom. We are losing developers coming out at the top but not replacing them at the bottom. There needs to be a mechanism to promote tradespeople to become developers as they used to be. At the moment we do not have that. Although we are losing the top tier, like any industry in the UK, there is a big age gap and it is top-heavy. We need to replace them at the bottom for them to feed through, and we are not doing that efficiently enough.

The Chairman: Traditionally, how was the industry replenished?

Mr Chris Carr: Tradespeople—bricklayers, joiners and plumbers—would buy a plot of land to build one unit. Next time they would buy two plots and then carry on to become bigger developers. It is harder and harder to get into that sort of market now. Local plans are pushing for bigger development sites of 1,000 or 2,000 units, which SME tradespeople cannot access. You can set up consortia or try to do something on, probably, local authority land. If they are going to do almost a custom-type build on local authority land, you could sell off individual plots to tradespeople to progress in the market.

The Chairman: In other questions we are going to be covering some of the barriers to entry that you have raised. Can you explain for us the role SME builders play? Mr Berry, as I think you mentioned, and we have heard from other witnesses, it is increasingly the practice of local authorities to permission very large plots of land, which is not really your bag.

Brian Berry: No.

The Chairman: I think between 500 and 1,000 is the number below which you become an SME. Quite why that is I do not know, but, for instance, why do local authorities not wish to break up sites and allow smaller builders to come on to them?

Mr Brian Berry: It is probably economies of scale. It is easier for a local authority to deal with one large housebuilder and to be guaranteed that 500 homes will be rolled out, as opposed to dealing with 10 local housebuilders. Economies of scale come in there.

In relation to the numbers that our members build, 68% of our housebuilder members typically build between one and 10, so those are micro-housebuilders. To try to solve the housing crisis, we think it is better for each village or market town to build a small number of homes using local builders, who often have apprentices because they have a good reputation for training young people, and spread the economic benefits right across the country. Although local authorities are probably looking at the costs of using just one major housebuilder, there would be wider economic, social and environmental benefits through using local builders who employ local people to build local homes.

Mr Chris Carr: You also have to remember that a 2,000-unit site will deliver only 40 new homes a year. If there was one national housebuilder on one site, it would deliver 40 new homes. It does not matter how big the site is; that is what it would deliver. Two national housebuilders on the same site would deliver 60. Planning authorities seem to think that issuing a 2,000-unit site will cover their housing needs. It will not. It is proven that it is better to have a lot of smaller sites that deliver more units to a local authority than having one big site.

The Chairman: If you had permission to build 10 or 20 houses on a larger site and there was a national housebuilder already building them, would you be prepared to take the risk of building when you know you have quite a large competitor who is already building more houses?

Mr Chris Carr: It would not bother me one little bit. It is like someone who buys a Ford car. You know Ford and you can buy it all over the UK. Some people want a Mercedes, a Fiat or something different. We supply to the market something completely different from the national housebuilders. We do not compete; we cannot. The scale of the economics is such that we cannot compete with national housebuilders. We have to offer bespoke—a different type of home.

The Chairman: Would you say that that bespoke or a different type of home is more in keeping with the housing that already exists in a particular village or county town?

Mr Chris Carr: Without a doubt. I am not having a go at national housebuilders. We need both of us to work in the UK to deliver the housing numbers, but they have a certain number of designs that they use all over the UK. Every single site we build is different. Planners insist that we take into consideration the street scene and local amenity areas. We need to take control of all that. We deliver something that fits in nicely, but it complements the national housebuilders. They will give you a huge number of houses, but we will give you something slightly different.

Q165 Lord Forsyth of Drumlean: I declare my interest as a director of a challenger bank. Can I ask you about the extent to which you are hampered or hindered by restricted access to finance, and what you think the reasons behind that might be?

Mr Brian Berry: Finance is still a major issue for our members. It came out as No. 2 in our survey carried out last year; 62% of members said that it was still a problem. Despite the end of the recession, banks are still very reluctant to lend to SMEs because they are deemed high risk. The problem is that it seems to be a blanket approach; it is not done case by case, which would benefit our members. The banks deem the SME housebuilding and building sectors riskier than other sectors, and that is causing a problem for small housebuilders coming forward.

The Government have introduced some welcome new initiatives, such as the housing growth partnership and the housing development fund, but they are only quite small steps and they have not permeated right down to the microcompanies we represent. How SMEs access finance is still a big challenge. We find that SMEs are using alternative sources of funding—new institutions that have entered the market and peer-to-peer lending.

Lord Forsyth of Drumlean: You say you are regarded as riskier lending. From the point of view of banks, housing developments are treated as risk-weighted asset loans. Are you aware of the proposals from the European Union to increase risk-weighting from 75% to 150%? Have you made any representations in that respect?

Mr Brian Berry: We have not made a representation on that.

Lord Forsyth of Drumlean: From the point of view of the banks, it seems to me the issue is not that housing per se is risky; it is the cost of capital, because of the rules applied to housing development. That may be an issue you want to pursue.

Mr Brian Berry: We will follow that up.

Lord Forsyth of Drumlean: Are lenders imposing other conditions that make development difficult for small operators, perhaps wanting to restrict operations to one site? We have had evidence that lenders will not lend to second sites until a particular site has been concluded. Is that an issue?

Mr Chris Carr: It is definitely an issue. To go back to your first question, you say that the industry is a risk, but should we not be judged on companies? My company has been with my bank for 90 years. My bank has now called me a risk because I am an SME housing developer, although my company has been building for 90 years. Surely, we should almost go back to what bank managers used to do, which is to know the people they are lending to. You cannot just say that anything below a certain level is a risk. It is not, and that is a worry. I think you asked a question about access to finance.

Lord Forsyth of Drumlean: I asked about finance if you were developing on more than one site.

Mr Chris Carr: They want you to complete on one site. The repayments are predominantly front-loaded. It used to be the case that, if you sold a house for £150,000, you would give back £100,000 to the bank and retain £50,000 for cash flow. They have stopped that. Now you pay back the £150,000 straightaway on a resale. That is why it has changed dramatically.

Lord Forsyth of Drumlean: To explain the point, when banks lend, the category of lending is looked at. The regulator requires capital to be set aside according to the nature of the lending rather than the nature of the client. There is a possibility that those rules will be tightened and that may be something you want to pursue. Far be it from me to be defending the banks and lobbying you, but that is the explanation.

Mr Brian Berry: That is one we will follow up. Thank you.

Q166 Lord Lamont of Lerwick: In your opening remarks, you commented that local plans were focused too much on large sites. Your answer was that it was more convenient administratively for local authorities to have large sites, so it is probably not necessary to go over that again. If the land is not publicly owned, is it not rather difficult to expect the local authority to be able to split it up into smaller sites?

Mr Brian Berry: I agree that it is more challenging, but that is where we need more negotiation and collaborative working with other landowners to find creative ways to release land for SMEs.

Lord Lamont of Lerwick: To ask a general question, I have been sitting here for weeks listening to evidence about all this, and I am not sure I am any closer to having an idea about a solution. It seems to me that there is a spectacular market failure but I cannot quite identify where it is. You have a scarce commodity, you have great demand for it, it forces up prices and the demand is still there in a residual sense. You would think that was a wonderful opportunity for the market and the private sector to meet the increasing demand and the increasing price, and drive it down and make increasing profits. In your opinion is it just planning, or what is it? It is a bit of a mystery to me.

Mr Brian Berry: It goes back to the items I mentioned at the beginning: the complexity of the planning system—the system is a lot more complicated than it was 20 or 30 years ago—and the regulations imposed on housebuilders. There is a problem about finance, which has tightened over the last 10 years or so, and the availability of land in the sense of larger and not smaller parcels. All of them come together to create a situation where, as you say quite correctly, there is huge pent-up demand and lack of supply. It would be easier if the planning system could release more land to increase the available supply, but there is not just one thing we can pinpoint. It is finance, the availability of land and the complexity of the planning system.

Lord Lamont of Lerwick: Sometimes we are told that when there is assistance on the demand side, as with government schemes, we are increasing demand and inflaming the market, and on the other hand, when finance is restricted, we are told that scarcity is driving up the price. Which is it?

Mr Brian Berry: I think the Government have done quite a lot in helping on the demand side, but you need the same initiatives to balance the supply side. You have to have the two running in tandem, and maybe they are slightly out of kilter.

Q167 Lord Teverson: I would like to come back to the local authority planning side and sites, following up Lord Lamont's initial question and something you said earlier. Applying for planning is demand-led. I know there are local plans, but it is demand-led to a degree. It makes the smaller side sound almost quite passive in the process. Having been a substitute member on a local authority planning committee, I am sure that, if the will is there, you can get planning committees to say yes to smaller sites. We talked about local plans, but there is a growing number of neighbourhood plans, which have to reflect the overall requirements of the local plan. Does that not give the opportunity for communities to demand small-scale

development, which a lot of them like? The local villages around me like small four to six-house developments because they keep villages alive and can grow all the amenities. Are we at a turning point?

Mr Brian Berry: You are right, but some communities are not receptive to having housing in their village. Some communities recognise, quite rightly, that having a smaller development is much more attractive because it provides homes for local people and keeps the village alive, but it is a fact that, sadly, in other parts people do not want housing in their village or market town.

Lord Teverson: But is that not about scale? Large developments that are almost grafted on, like town or village extensions, will meet resistance, but in my experience a plot size of 10 or below is something local communities quite like.

Mr Brian Berry: If that is the case, it is striking that the number of SME housebuilders dropped rapidly over that period.

Lord Teverson: I guess that is my question.

Mr Brian Berry: I think it is because of those other factors. Maybe the SME housebuilder cannot find available sites or cannot find the finance to put forward a proposal. That is where builders are struggling.

Mr Chris Carr: We are just doing a community-led plan rather than a neighbourhood plan. It is a far better process to go through for villages, because it is not too technical. You gather information and feed it through to the local authority to put into the local plan. My local parish council asked me whether I would be involved in it as a developer, to give a different perspective. We said to the group straightaway, "There are no two ways about it. You have to deliver housing in this plan. If you do not deliver it, your local authority will, in the local plan, without notification to you. Are you not better off advising where you would like it?" When you tell them that, they buy into it and say, "I get it now". We need more community-led plans. Neighbourhood plans require a lot of technical information and are a bit bureaucratic to get through. The plan made a massive difference to our village. Our village is about 6,000, almost a market town. People now understand the plan and have proposed six sites they would like to see. We have gone from never having any building to, "If we are going to have building, let's have it here". One part of it was to enable a new school. All sorts of things were involved. When you get people engaged it makes a great difference, so when the applications come in there is less resistance from the parish council to the planning

committee because residents have had some sort of engagement and involvement in developing their own village plan. It is definitely the way forward. Engagement with residents is massive, and we have consultation with residents all the time on our development sites. You have to get them on board, involved and part of it.

Q168 Lord Sharkey: The Federation of Master Builders raised the cost of planning applications as hindering small and medium-sized builders. Taylor Wimpey told us that the cost of achieving planning permission is a significant issue for SME builders. If that is the case, what should be done about it? What do you propose could be done about that? For example, would the proposals in the current Housing and Planning Bill, which make provision for permission in principle to be granted for smaller housing developments, be helpful in creating more shovel-ready sites for small builders?

Mr Chris Carr: I think they would. It goes back to being open and honest with residents. To take my last two planning applications, one cost me £275,000 on consultants and legal fees. The one after that, where I did all the negotiations and spoke to residents, cost £43,000. That was because we did six public consultations. We spoke to the residents; we went back and changed the plans slightly. All those things cut down the cost. You have to change the mindset of developers. They cannot just think, “I am going to bulldoze my way through a planning application, throw as many consultants at it as I want and not care who I offend”. That is the mentality. We have to go back to engaging people. That will cut down the costs massively, especially on smaller sites. When it is a local builder, people know him; they have seen him in the town. We employ a lot of apprentices. People notice that. That sort of thing will help more than altering the planning system. The planning system has got a lot better, but it depends on how it is interpreted by each individual planning authority. We have a good one. A private company runs planning for North East Lincolnshire. It is subtle; it is more professional and quicker to get planning applications determined. Whether they are refused or approved is irrelevant. They get the process running quickly.

Lord Sharkey: Is subletting the planning process a common thing?

Mr Chris Carr: There are probably two or three local authorities doing it at the moment. We used to have Balfour Beatty WorkPlace, which was bought out by Cofely, and now it is ENGIE. It is working great, because there are professional people. There are still the same planners, but there are people above them who probably have a more businesslike mindset. I speak to planners and explain what happens if you are a developer. They say, “We thought

you were being obstructive”, but when I say why I have done something, they say, “Oh, we’ll tell the members”. The cost is in communication. The hassle of getting planning through is communication. It needs to be broken down.

Mr Brian Berry: I echo that. The recent changes in the planning framework and in the Bill that is going through will certainly help to reduce the costs. That has been a big concern for our members; 41% said that the combined costs of Section 106 and CIL were making sites unviable. Chris talked about the changes to the planning system that are helping to speed things up and simplify and reduce costs. We are beginning to see the benefits of that, so, hopefully, the situation will change over the coming months and years.

The Chairman: Mr Carr, you referred to a cost of £275,000. Can you give us an indication of what percentage that would be of your total costs on the project?

Mr Chris Carr: Per unit?

The Chairman: No, the overall cost.

Mr Chris Carr: That was for 200 units, but it was purely the professional costs. It was a reserved site under the old local plan, so it is not as if it was controversial.

Q169 Lord Teverson: I want to ask about the benefit to smaller builders of modern methods of construction, off-site pre-works and all those sorts of things. From your introduction, are you at the other end of that and much more involved in bespoke housing? I am interested in your comment on that and where your market niche is.

Mr Brian Berry: Modern methods of construction are very important in trying to solve the housing crisis. We need to look at new ways of doing things for any industry to survive. Our members are primarily providing more bespoke housing to reflect local need, so they use traditional skills. That is important. Given that 85% of our buildings will still be standing in 2050, we need a bank of skilled builders to maintain them going forward.

Off-site construction has been talked about for quite a long time; since the end of the Second World War, it has been deemed a panacea for the housing problem. There is now a lot of talk about modular housing, which can have a role to play given the huge demand for more housing in this country. Small builders could get involved in that. There are opportunities to assemble off-site housing. Small builders need to be responsive to the changes in housing construction, but primarily there is a huge need for builders with traditional skills to maintain our existing built environment.

We need to make our existing buildings fit for purpose given that our climate is changing, as we are seeing, with very warm, wet winters. If we are to make our built environment fit for purpose, we have to think of new ways to adapt those buildings, and that is where new technology comes in. Solid wall insulation is quite off-putting because it diminishes the size of rooms or changes the appearance on the outside. New technology might be able to reduce the thickness of the insulation we would need. That could be quite exciting for local builders who adapt, change and embrace new technologies and materials to meet what I think will be the coming demand to upgrade our existing building stock.

Lord Teverson: The first half of that answer suggests to me that one of the reasons smaller builders have gone out of business is that they cannot innovate enough. Are you driven only by having to comply with building regulations, or is there real innovation among smaller builders? Maybe Mr Carr would like to come in on that as well.

Mr Brian Berry: I am sure Chris Carr can speak for himself. Builders show innovation on a daily basis. They are adapting and changing; they do not follow a template. When they go into someone's house, they have to think creatively about how to put on the extension and make a repair. They need a range of skills to do that.

Lord Teverson: How do they achieve that? How do you keep up with innovation that is going on in other parts of the world, or whatever?

Mr Brian Berry: That is a good question. Anyone in this country can call themselves a builder. One of the problems we face is the image of the industry, because there are no prescribed qualifications for a general builder, which is why the Federation of Master Builders is trying to raise standards. We have changed our entry criteria so that we can differentiate our members from Joe Bloggs on the street; there are a lot of consumer programmes with people talking about being ripped off by a cowboy builder. There is an argument for some form of licensing or registration of builders in this country, because in that way you could enforce standards; or you could rely on trade bodies such as the FMB to raise standards in the building industry. That is voluntary; it is up to builders whether or not they join us.

Lord Teverson: A big building construction company probably has a research and development department and is well up to date on new techniques. How do small builders stand a chance with that sort of innovation? That is what I am trying to get at.

Mr Brian Berry: We have a builder here.

Lord Teverson: Is that one of the reasons the sector is being squeezed?

Mr Chris Carr: It is almost the other way round. If a supertanker like one of the big national housebuilders decides to change the way it builds properties, it will take months, if not years, to change the way they are delivered on site. I can change the way I build a house tomorrow, so we are more innovative with our design and build than national housebuilders. We lead and they follow, because we can change anything straightaway. We are always open. Trade magazines and organisations like the FMB send out loads of details, but we get rid of the gimmicky stuff. We are very keen on energy-efficient homes. I have worked with the Zero Carbon Hub for five or six years on the developer side to say, "That won't work; it won't be delivered on site". It comes up with some great ideas and we just try to dumb them down so that they actually physically work. We have done great work: for example, designing houses around the sun and putting porches back on houses, basic things that make homes energy-efficient. The quality of the build is also a big issue. We can do all that. We can charge a slight premium for our properties over national housebuilders, because we are not in competition with them. We offer a completely different bespoke model. We offer something with a bit more detail and quality, and we can offer more energy-efficient products.

Q170 Baroness Wheatcroft: Do you think there is any innovation that would make a significant dent in the cost of housing? You are talking about improvements that will lower running costs, but the biggest obstacle for people wanting to get on the housing ladder is the initial cost of the property. Is there anything you can think of that would make an exponential difference in bringing down the cost?

Mr Chris Carr: The quick answer is no. We have to be careful. Do you want to reduce the cost of homes now? We will put a lot of people in negative equity if we do. We need to level it off and stop increasing the price of new homes. As a developer, we hate house prices going up. It sounds bizarre, but we lose a tier of buyers every time house prices go up. We used to sell properties to those in the 20 to 30 year-old bracket. That has gone. We would love to sell to them, but we do not dictate the price of houses; the market dictates it. We are judged by lenders. A mortgage provider says, "We are valuing a house for Mr Smith". He will put a value on it, and that is its value. We do not put that value on it. We cannot ask for another £20,000 or £30,000, because the provider will not lend the money, so we will not sell it.

Baroness Wheatcroft: It is perfectly open to anybody who manufactures something to sell it at a lower price should they wish. The result might well be negative equity if there was a lot of it about, and obviously that is a problem for some people. Nevertheless, if we are trying to solve another problem, which is the lack of affordable housing, although nobody is quite clear about what affordable is, increasing the supply of lower-cost properties seems essential. If that means that house prices come down from the silly multiples to income they have reached, that is just an unfortunate consequence, is it not?

Mr Chris Carr: I agree. We have to remember that our membership is the whole of the UK, not just London and the south-east. In Grimsby, where I live, and probably in a lot of northern towns, there is not that differential. We have to be aware that we are not talking about just London and the south-east.

The thing is to get people into the market. The Government's starter homes programme has teething problems, but I believe it is a good idea. Shared ownership with social housing providers is another way to get into the market; people buy only 20% or 30% of the property and rent the rest, and over a 10-year period they eventually buy the rest. Local authorities could be doing that through their own land supply. They could build shared ownership homes and retain the land ownership, which they can borrow against for government lending; they could build properties and get a rental income from them and sell part of it. Over a 10-year period, that will generate more money than selling off the piece of land now in a market with declining house prices.

Q171 Lord Griffiths of Fforestfach: I have two questions. First, last year Parliament passed the Self-Build and Custom Housebuilding Act. It seems that the self-build sector, from the statistics I have in front of me, accounts for between 7% and 10% of completions. In Austria it is 80%. A Building Societies Association survey in 2011 suggested that 53% of people in the UK would consider building their own home. Would you like to comment on that? In particular, is there any way of creating partnerships with small builders in order to do it?

Mr Brian Berry: The FMB was very supportive when the Bill was going through Parliament. We see it as an opportunity to increase wider choice in the housing market. There is obviously a key role for small builders to be involved in working with clients and putting together those houses. You are quite right: looking at other European countries, there is a very small proportion in this country. I think it is less than 10%. That market could expand. Given that 86% of people want to own their own home, it would be another way to allow

them to get on to the housing ladder. It is something we have supported. We need to make sure that the register that is being set up is fully transparent so that local people know exactly what opportunities are available. We also need to make sure that builders have the right skill sets and link up with clients so they work in partnership. We are getting involved to try to facilitate that.

Mr Chris Carr: In dealings with a client, we are doing a self-build development—or we were until two weeks ago when we found it restrictive as to what we could do. We are not going to promote it as custom-build; we are doing it under self-build. Custom-build was a bit too restrictive as to what we could and could not do. If you have a plot of land with a house on it now, you can knock it down and build something on top, at a certain price. On custom-build, we still have to pay our Section 106 contributions, so we are paying for education, open space, road infrastructure and all the other bits. That bumps up the price of the plots, but there is a big demand. With custom-build, which people have not completely realised, we can sell plots on to developers. We talked earlier about getting developers into the market. If you have a custom-build site, a developer can buy two or three plots on that site and it will still be classed as custom-build. It does not have to be individuals; it can be smaller companies. That is a way of generating the conveyor belt for more developers to come through.

Q172 Lord Griffiths of Fforestfach: My second question is about competition. We have been told in evidence that the small-build sector was devastated by the financial crisis of 2008, which would suggest that competition is less than it was. On the other hand, to what extent do you feel squeezed out by large companies that have a lot more resources, access to capital and so on, where you feel there is not a level playing field as regards competition?

Mr Brian Berry: I do not think SMEs are in direct competition with large housebuilders. They operate to different business models. The tension is probably at the margins. For example, if small builders cannot access small sites and larger housebuilders have stepped in and developed them, there might be some tension. The other problem is finance, which we have talked about. Larger housebuilders have been able to access finance in a much easier way than small local housebuilders. Those issues have contributed to the decline of SME housebuilders, but I do not think the volume housebuilders have pushed out the SMEs *per se*; other factors have contributed to that demise.

Q173 Lord Forsyth of Drumlean: Could I take you back to the point about flexibility and innovation, and creating houses that meet people's aspirations? Perhaps I should declare an interest, having built a house 20 years ago. The small builder who built it did a brilliant job; it has not fallen down and is very satisfactory. When I talk to builders or architects, they say that now the burden of regulation and requirements on them effectively makes it very difficult to innovate and adds greatly to the cost. There is no particular thing but a whole raft of things. Do you think that is a factor in limiting the ability to do as Baroness Wheatcroft indicated, which is to build houses that people want and that are more affordable?

Mr Brian Berry: There has been an issue over the past 20 or 30 years. It is more complicated to build a house than it was at that time, and that has been a factor in why the number of small housebuilders has declined. It is often difficult for smaller builders to know where to get information, unless they belong to a trade association such as ours. Small builders do not keep up to speed about what is happening or innovate in the way they should, but that reflects the state of the building industry and the fact that anyone can be a builder in this country.

Lord Forsyth of Drumlean: What can be done about that?

Mr Brian Berry: We are trying to raise standards and provide our members with more information and training, which we make available across the country. That becomes much more attractive, and our members are better equipped to compete for work.

Lord Forsyth of Drumlean: It is not that they are not equipped to compete for the work; they know what they have to do, but the argument—tell me if it is wrong—is that there are now so many requirements, whether about additional insulation, health and safety or building methods, that it becomes extremely difficult for them.

Mr Brian Berry: It is difficult, but our members are doing it because we provide the training and make sure the information is available. The majority of builders, if they have access to that information and training, are well equipped to meet those requirements. The increase in health and safety requirements over the past 20 years has been a good thing. We would not want to reverse that. Sometimes you hear builders complain about building regulations, but for the majority it is very helpful to know what is expected. Our members tend to value building regulations. Provided they have access to training and somewhere to go if they are stuck, that overcomes some of the problems, but obviously we want to keep regulation and bureaucracy to the minimum to ensure SMEs are able to compete in the marketplace.

Mr Chris Carr: We innovate; we grasp all the modern technologies. We get a lot of information from builders' merchants and the supply chain. They get a new product and bring it forward. It does not tie in well with affordability, because there is an additional cost with any new product, but for me it is about design. If someone can design a good property, it can also make it a usable space. National housebuilders stick to one design that is repeated all over because they can build it to a high quality and to a set design. They know it ticks every U-value box and everything else. We cannot. That is where the building control people have a more common-sense approach. They and the planners see what we are trying to achieve and they relax. They say, "We can see what you are trying to achieve and we think it is going to deliver", and we can come to an area of common ground.

Lord Forsyth of Drumlean: It is not a problem.

Mr Chris Carr: It is a solution opportunity; it is never a problem.

Q174 Baroness Wheatcroft: Could I ask you a bit about the Government's plan for direct commissioning? It was said very clearly when the plans were announced that there would be scope for smaller builders to get involved. Are you seeing evidence of that yet?

Mr Brian Berry: When the announcement was made in January we welcomed the proposal, but the fact is that only 13,000 homes are in the five projects, so it is very limited in scope at the moment. I am not aware of our members directly benefiting from it, but it is early days yet. The principle is right. It is good that the Government are taking that approach, recognising the problem our members face. We would like to make sure that the initiative works, but it will have to be on a much bigger scale if it is to have a big impact on the SME sector.

Baroness Wheatcroft: They are big sites by their very nature.

Mr Brian Berry: Yes.

Baroness Wheatcroft: To go back to what you said at the beginning about dealing with the housing crisis by putting a few houses here and a few there, do you think that the sites are available now? If people changed their approach, could small builders work on lots of small sites all over the country to solve the problems?

Mr Brian Berry: They absolutely could. Those sites exist and people in communities tend to know where two or three houses could be built that would not change the character of the village or market town, but the sites are sometimes outside the local plan. Maybe we need a more flexible approach and a lot more community engagement, because I am sure that, if

we took that approach, we could find the spaces needed to build homes. Most people recognise that having additional homes in a village is good for the community.

Baroness Wheatcroft: Mr Carr, you said that consultation and getting communities involved was the way forward.

Mr Chris Carr: Yes, it is. You are right that we can have smaller sites through the local plan as exception or windfall sites, so it can still be done even under the local plan. It is the same when having open dialogue not just with the residents and parish councils but with planning officers: sustainability is the key thing. Those 2,000-unit sites are not sustainable. A 5% increase in every village or town is sustainable; it keeps the shops, the pub and the school open. We need to feed more of that into local plans.

Earlier, Lord Lamont asked how we would deliver bigger sites and force the bigger developers to release land. It is easy. We have to provide 20% social housing. They have managed to do that. Why can we not give 20% social housing and 15% to SME or custom-build? They would buy it from the landowner at the same price as the national housebuilder. It can be done. It would make houses more affordable for the SME sector if it was buying them at bulk price—the national housebuilders' price—but delivering its own products. It can be done because it happens through social housing.

Baroness Wheatcroft: Do you think the Government take into account the different requirements of SME builders from the giants when they come up with policies such as Help to Buy, or does that benefit you as well?

Mr Chris Carr: With Governments over the past six or eight years there has been a massive difference for the housing industry. There is a complete change from what we had before. They now back the industry and understand it; they know we drive the economy and that it is part of UK plc. Everything they have done over the past six or eight years has been massive input, and that is why we are seeing a stronger, healthier market.

Mr Brian Berry: Since the general election in particular we have seen more emphasis on how to get more SMEs back into the housing market. That has become a primary focus of government policy. It has been noted by our members that there has been an improvement, and the fact that we are talking about it now is recognition of the role we play. It has been overlooked for far too long, so we welcome what has been happening in the last two years.

Baroness Wheatcroft: It is the lenders who are the problem.

Mr Brian Berry: It is not just lenders; as I said earlier, it is the planning system, the land and the finance. There is no one issue that we can solve to address the housing problem; it is a mixture. We need to bring all those points together if we are to solve the housing problem and get more of my members back into the housing market. Only then will we solve the problem.

The Chairman: What is the most effective measure the Government have introduced that has encouraged people to come back into the building industry as SME builders?

Mr Chris Carr: The planning system has got better for the SME sector. Delivering smaller sites or individual units has become a lot easier. People were physically afraid to put in an application: look at the stories I gave you about the costs. Suddenly it has become more open and there is greater accessibility to planning permission, and that has made a big difference for people drifting in again. I chair the Home Builders Group for the FMB and get to see all the regional homebuilders. The big barrier is still finance. Every one of them said they would double their turnover if finance was accessible.

Q175 Lord Turnbull: My part of south London is awash with skips, which tells me that a great deal of money is being mobilised for the modification of existing houses—lofts and even basements, although not much near me. Does modification of existing houses, as opposed to building new ones, form a bigger and bigger part of the capacity of the FMB output?

Mr Brian Berry: During the recession a lot of our housebuilding members went into home extensions, particularly in London and the south-east, because people could not afford to move but saw that they could have a loft conversion, kitchen extension or basement. Our members tapped into that market and it provided a new workstream for them.

Lord Turnbull: Can they be tempted back?

Mr Brian Berry: I hope so. Unless we tempt them back, we will not be able to solve the housing problem.

Lord Turnbull: You mentioned, not in favourable terms, Section 106 and social obligations. There is a good social case to be made for them, because there is some associated infrastructure. There is a good economic case, in that there is a difference between non-permissioned and permissioned land, but you seem to be indicating that they are more burdensome for SME builders than large ones. Is that because local authorities are not using their discretion to work out more accurately what your market can bear?

Mr Brian Berry: That has been the case. As I said earlier, 41% of our members said they were put off developing because of the combined CIL and Section 106 costs, so there needs to be recognition that, if those costs are too high, proposals for development will not come forward. There is a case for local authorities and builders to be talking in a more realistic way without losing the potential for development to take place.

Lord Turnbull: There has also been discussion about fees. I distinguish the fee for an application and the fees for professional people, such as architects and so on. Taking the application fee, which goes to the local authority, some people have contended that it ought to be higher. Maybe it means that the Section 106 cost is lower, but more money needs to be got into the planning departments of many authorities, and if fees were less severely regulated by central government they would be a good thing. Do you have a view on that?

Mr Chris Carr: I was one of those people. I sit on the Government's developers' forum. One thing we said as developers—national housebuilders and the SME sector—is that we are quite happy for the fees to go up, as long as the money is ring-fenced for planning and cannot be taken out of the local authority and spent elsewhere. As long as it provides a more efficient service with more and better qualified staff and officers, we think it is quite a good thing and have no problem with it.

Lord Turnbull: What is the state of consultation with central government on that?

Mr Chris Carr: The issue at the moment is the policy that any planning fees can go into the council's general expenses. They do not have a policy to stop that at the moment. As developers we are saying, with the greatest respect, that we do not want to pump in more money that goes to social services, schools or education; it needs to go into producing a more efficient service. We have no problem at the moment, but a huge shift of policy would be required to change that.

Lord Turnbull: You seem to be saying that somehow you should be exempt from Section 106-type levies, whereas I was contending that they ought to be differentiated and lower for your sector. I certainly was not implying you should be exempted from them.

Mr Chris Carr: For Section 106, it is very difficult because you can go for viability, which is what we are talking about. If Section 106 is put in front of you, you can contest it on viability. If I pay over the odds for land in the first place, which is what we are doing—if it is not commercially viable, it means you have paid over the odds for it—my bank will not lend me money. If you are reckless enough to buy land at an inflated price, why would the bank lend

you money to develop it? The national housebuilders or bigger companies possibly pay over the odds and tell their accountants that they will get the money back by reducing the Section 106 contribution. We cannot do that. Our bank would not touch us; it would say that was reckless spending.

Q176 Lord Kerr of Kinlochard: We are not building enough houses. To achieve the Government's target, we will have to more than double the rate of building. You have described a number of small obstacles. You have not told us about any single big obstacle. Oversimplifying grossly, if you had the power to change one single thing, what would you do?

Mr Chris Carr: Access to finance.

Mr Brian Berry: You cannot choose just one thing; you have to look at planning. It is too easy to identify one issue.

Lord Kerr of Kinlochard: I agree, but on the finance front, what would you do? Say you are the Chancellor of the Exchequer writing your Budget. What are you going to do?

Mr Chris Carr: It is not the Chancellor of the Exchequer, but the banks. I do not know whether he has any influence over the banks. It is about having almost a guaranteed package with the banks. We used to be able to use the land we owned to borrow against development finance. That seems to be almost a thing of the past. There is value in land straightaway. As soon as you get planning permission it increases in value five or sixfold, so it is about having the ability to get a guarantee from the Treasury to the banks that says, "We will underwrite this land". It is not as if you do not have an asset if the company goes bankrupt; you still have the asset value of the land, so physically you are not losing anything. You are not gambling on a car manufacturer that suddenly goes out of business and you have nothing; you still have the value of the land that was there in the first place, and it is increasing in value all the time. A guaranteed finance scheme to the banks to help us access finance would be ideal. There are other things we have talked about today. The members I have spoken to tell me they can double turnover. You say we need to double the turnover of units, and we can deliver them when we have access to finance.

Lord Lamont of Lerwick: Some people argue that the key to getting the market to grow more aggressively is the first-time buyer. If you do not get the first-time buyer, you cannot get the whole chain moving. Do you agree with that?

Mr Chris Carr: Totally, and that worries me for two reasons. First, I have a 22 year-old son at home and I want him to get a house. There needs to be access to finance to get him out. That is probably not the right thing to say. We are missing a market. When I was 21 or 22 you could buy a terraced house in my town for £25,000, and it got you into the market to build up. Where do we start in the market now? It is a frightening thing. We worry about it now, but it is a generational issue; it could go on for generations if we do not sort it out now. You are not going to put up people's wages.

Lord Lamont of Lerwick: You agree that the first-time buyer is the key in the chain of transactions.

Mr Chris Carr: I prefer first-time buyers to social housing. With social housing you are almost on a downward spiral; you have to deliver more and more social housing for people who cannot afford to buy. We need to get people in their mid-20s to access and live in the houses now. I think starter homes for the under-40 first-time buyers will work; it just needs tweaking. We could definitely do shared ownership with local authorities, which would generate an income for them. It is not as if we are asking local authorities to do something that is costing them. It could generate an income for them and put a whole generation of young people into the housing market.

Lord Forsyth of Drumlean: On access to finance, what loan-to-value ratio are you thinking of?

Mr Chris Carr: The loan to value is fine. We are probably paying probably 2% or 3% more than we have been paying. It is the additional fees that are killing us at the moment.

Lord Forsyth of Drumlean: In order to get funding from the bank, you said you had land or other assets. How much of the project are you seeking to borrow against and finding it difficult to get covered?

Mr Chris Carr: We would look for a 60:40 split.

Lord Forsyth of Drumlean: Even at 60:40 it is proving difficult to get finance.

Mr Chris Carr: Yes. Banks say, "Sorry, we are invested heavily in national housebuilders". Our bank is lending 10% or 15% on construction. We are doing that, but we just do not fit into that pattern.

Q177 Lord Layard: I want to go back to Lord Lamont's question about market failure. I suppose the most extreme evidence of it is the difference in the price for permissioned land and non-permissioned land, which could be justified only if you could demonstrate an

amenity value that exceeded the difference. What would your members feel about a proposal to put an obligation on local authorities to give outline planning permission when the price differential was more than a particular number, unless they could demonstrate that the amenity value exceeded that differential? If you are looking for ways to re-energise the market, would that not put developers and builders like yourselves back into the driving seat to a greater extent, because the driving force has been removed to some extent by the planning process?

Mr Brian Berry: That would be an attractive proposal. Outline planning permission would be a good thing. We would need to look at that, but it seems to be a way we would want to consider and support.

Mr Chris Carr: We have discussed it slightly. It would be classed as the red line application they keep talking about, which is how we used to do planning. My father used to go along with an A4 sheet of paper showing a red line around a piece of field and say, “We would like to build 100 houses on there. We will give the village a playing field”, and they would say, “Yes, fine”. That was how it used to be. We would still have to do detailed planning later, but to go back to that sort of mentality at the beginning—almost a planning agreement in principle for sites—would help, because then we could possibly get a little more finance to push through an application. As we said, there is a big differential between greenfield and development-approved land. Someone would take a gamble on that if they had provisional agreement.

The Chairman: In your view, are the local plans being drawn up at the moment as comprehensive, detailed and adventurous as they should be?

Mr Chris Carr: It varies from local authority to local authority, which is why some have had their local plan sent back. Some people are not being forward-thinking. Central Bedfordshire is one. I have to say that, considering where we are, North East Lincolnshire is thinking outside the box, trying to deliver custom-build sites and all those sorts of things. In the beginning it was a challenge, but now some of them quite enjoy delivering something completely different. I think local plans will work. They need tweaking, but for me it is about deliverability. It is all right to have a plan with thousands of houses plotted on it, but there needs to be more emphasis on deliverability than just on planning applications. That needs to be a big consideration in any application.

The Chairman: Mr Berry and Mr Carr, thank you very much indeed for a very interesting session.

Examination of Witnesses

Mr Paul Smee, Director General, Council of Mortgage Lenders, and **Mr Stephen Noakes**, Director of Mortgages, Lloyds Banking Group

Q178 The Chairman: Mr Noakes and Mr Smee, good afternoon and thank you for joining us. You heard at the tail end of the previous session that lack of finance for small builders was identified as a key problem. Mr Noakes, how has your lending to SME builders developed over the past decade? We have seen a significant shrinkage in the number of SME builders, and we have heard today and from previous witnesses that lack of finance is a serious issue for them. How has your loan book developed over the past 10 years, and what are the factors driving it up, down and sideways?

Mr Stephen Noakes: I am happy to answer that, but before I start I should confess that I look after the retail mortgage business. Clearly, I am aware of some of the broader group activity, but it sits outside my domain. Leaving that to one side, in our lending to the major housebuilders we support 33 of the top 100. Since the financial crisis we have seen a number of them change the way their balance sheets look. They have strengthened their balance sheets, but we still have about £2.3 billion of lending to the major housebuilders.

To answer your specific question, lending to SMEs has been a challenge collectively, not just in the housebuilding sector. Over the last year we increased our net lending to SMEs by 5%, and by 25% over the last five years. We lend to small housebuilders, so it is an area that we continue to drive forward. To give you the broader industry numbers, last year when we were increasing by 5% the industry was broadly flat, and over the five-year perspective when we have grown by 25% the industry has been in negative double digits. There are broader challenges.

Listening to the conversation with the previous panellists, one of the key challenges that SMEs in particular face at the moment is working capital. There is no doubt that the time to get planning has been extended, and that requires greater working capital. It was for that reason that Lloyds, together with the Government, launched the housing growth fund. I do not know whether it was mentioned in the earlier session. It is £100 million of equity finance

available to SMEs that have been building between 10 and 100 units over the past three years; they have a track record but they need extra equity finance to build expansion, because there is no doubt that debt alone is inadequate to move them forward.

The Chairman: Would you like to add anything to that, Mr Smee?

Mr Paul Smee: No.

The Chairman: It is not really your parish.

Q179 Lord Layard: I want to ask about the problem of local authority building, because that is the area that has fallen most of all. What is your attitude towards lending to local authorities for housebuilding, and what do you see as the problems involved in that?

Mr Stephen Noakes: We would be supportive of lending to local authorities. We are one of the larger lenders to housing associations, with £13.5 billion of lending to that sector. Local authorities tend to present in different areas—those with cash available and those that are more challenged in the level of assets they hold.

Going back to the time when we were probably building between 200,000 and 250,000, there is no doubt that local authorities were much more active. One of the questions the Committee put to one of my colleagues, Andrew Bester—I think he provided written evidence; I am not sure whether you have yet had sight of it—was whether more could be done to support local authorities without it acting as another burden on public sector debt. There are some options that we would be keen to explore. Typically, if you are into off-balance sheet funding, you need to find some type of joint venture party that acts outside the local authority but works very closely in conjunction with it. There are schemes available. The high-level message is that Lloyds was itself involved in sponsoring a housing commission about 12 months ago. We published a report. We had two former Housing Ministers from each side of the House, Nick Raynsford and Mark Prisk, helping us on that. The key conclusion was that there was no one silver bullet for getting to between 200,000 and 250,000; everyone needs to play their part.

Going back to the earlier session, the SMEs need to step up more, and we need to find ways to encourage more self and custom-build and get local authorities building again. We need to do all those things to get to the 200,000 to 250,000. There are options for local authorities, but we will have to be creative collectively in finding solutions.

Lord Forsyth of Drumlean: Would it not be much more expensive for local authorities to borrow commercially than they can borrow themselves on the market? Is it not going to add to the cost?

Mr Stephen Noakes: Depending on the structure, I do not think it is, necessarily. One of the areas that we might talk about further on in this session is self and custom-build. Local authorities can play a very important role in that area. One of the challenges in self and custom-build—we are probably one of the few majors that support that sector—is that numbers are tiny. It is tough to get market data, but there are probably about 10,000 completions. It is not even 10% of national production at the moment, whereas you will probably be aware that it is a much bigger part of new-build construction in continental Europe; it is pushing up to 40%.

From a lending perspective, at the moment it is a difficult proposition. Much of that 10,000 presents a bit like Kevin McCloud's programme "Grand Designs". Typically, at the end, Kevin asks people whether they ran to budget, and the answer is usually never and that normally it took longer.

Lord Forsyth of Drumlean: I could never understand how they ran out of money, yet at the end of the programme the place was palatially dressed with every conceivable gadget.

Mr Stephen Noakes: The reason for that is because it is a sector in the UK that plays only to the affluent and to those who can afford to overspend, but as a lending proposition it is quite difficult because you do not have certainty on time and cost. Typically, we and the rest of the industry—probably the smaller building societies in this case—will cap out at probably 75% loan to value. That is almost impossible for prospective first-time buyers who want to self-build or custom-build; the opportunity is for another party to play the role of developer and take out that risk.

The Government are trying to encourage local authorities on the right to build. They have to survey the local area and determine how much interest there is, but they could go further and do the early stage of development. If we are working in a situation where we have agreed an approval in principle to the prospective first-time buyer—the self-builder—local authorities could develop on their behalf. That is a model that we could actively pursue.

Q180 Lord Forsyth of Drumlean: To what extent are you concerned about the impact of Basel III and the changes in the risk-weighting of lending for housing and development

purposes? Obviously, the bigger banks may have their own standardised model, but what about the sector as a whole?

Mr Stephen Noakes: Indeed. Without getting into the intricacies, there is always something planned in the capital regime. Paul can probably touch on that from a broader industry perspective, but I do not see that it would create undue obstacles or barriers to encourage each of the individual sectors of the housing market to step up their game. If we are to be successful in getting the 200,000 to 250,000 new starts, we need a number of actors in the market to play their part. I do not think the potential changes in capital regime should influence any of those individual abilities, but it will require some resolve and a degree of creativity.

Mr Paul Smeeth: One of the problems we have with the capital regime is that it is not quite clear. We have been seeking clarification from the European authorities about how they see the regime applying for self-build and custom-build. We have not had an answer yet.

More widely, I would like to see more of the CML membership joining Stephen in developing their appetite for self-build and custom-build. We are having increasingly productive discussions with a wider range of lenders than those that have been traditionally involved in that market, but it is a slow process to get critical mass in this area.

The Chairman: You referred to the letter we received from your colleague. We received a number of submissions from banks with a wide variety of ideas. One consistent idea was about developers working with local authorities, with the local authorities contributing the land and developers then taking forward the project. Presumably, it would be structured in such a way that the borrowing the entity would take on would not fall within the PSBR. Does Lloyds do that sort of project financing? Is there a demand for that kind of project financing? Another bit of evidence that we have heard consistently is that the amount of undeveloped land owned by the public sector, be it local authorities, the Ministry of Defence or the NHS, is quite enough for building 2 million homes over the next 10 years, according to the Lloyds report, which would be a tremendous outcome. Do you see any demand from that type of entity to get to grips with large numbers of houses?

Mr Stephen Noakes: At the moment, probably no. There is limited demand, but it is one of those areas where collectively industry needs to get together to demonstrate how the model could work. In many instances, local authorities are desperately keen to play a part,

but they are not 100% clear about how that could work out. We probably need to do more on role modelling and help to provide some guidance on how that could move forward.

On your point about public sector land, perhaps I might pre-empt one of the questions you might ask me. If I had a wish, it would be about the use of public sector land and relaxing the criteria at the moment to get the best market value from it, because the other challenge we face, in addition to volume—there is a lot of discussion about the volume of housebuilding—is affordability. Irrespective of tenure type, whether rental, home ownership or whatever it may be, one of the key challenges that we face today is affordability. To address affordability, you need to find a way to put subsidy in the system. Clearly, in the current economic period that is challenging, but public sector land, which is more of a balance sheet item, would be a good solution if there was a view to change that policy.

The Chairman: It seems to be an opportunity for ingenious bankers.

Mr Stephen Noakes: Indeed.

Q181 Lord Turnbull: If I may come to mortgages, life is a lot tougher than it was in, say, 2006. Gone are the days of the 125% mortgage, or whatever it was. People are talking about 75% loan to value. You also have to know your customer and estimate whether they can still pay the mortgage in some kind of stress-test situation. Some very interesting figures have been provided by the Financial Conduct Authority. Back in the good old days of 2006 there were about 300,000 applications, of which 10,000 were refused; in January 2015, there were 150,000 applications, of which 50,000 were refused. The rate of refusal has gone up quite substantially. Is that recognition that there was a lot of slack practice in the past that needed to be corrected, or do you think the tightening up has gone too far?

Mr Paul Smee: I think the figures from the middle of the 2000 decade reflected a view that somehow house prices could go on rising for ever and the underwriting process could be pretty lax. There were ways in which people could get mortgages very quickly, with self-certification of income, and their applications could be turned round very quickly through an automated process. The underwriting process was almost an afterthought in some institutions. That was what led to the very high acceptance rate.

Since then, there has been financial tightening. Undoubtedly, those running the major lending institutions have become more risk-averse, and on top of that there has been what I would describe as an elongated process introduced by the regulator. I am not sure that regulation in itself accounts for that great discrepancy in mortgage acceptances. It is a much

longer and more challenging process out of which people drop during the course of going through it.

Lord Sharkey: Is the mortgage market review a driver of that level of failure?

Mr Paul Smee: It contributes; I do not think it is a driver. There is wider concern about risk aversion and greater understanding of the need to have a proper underwriting process in place. Lenders have become more acutely aware of whether they are building up excessive risk in a particular bucket, be it shared equity or a particular loan to value.

Mr Stephen Noakes: Your initial question was about 2006 to the current position. To build on Paul's point, there is no doubt that, if you go back to the industry in 2006, there were self-certification mortgages and laxer underwriting standards. Interestingly, acceptance levels before and after the implementation of mortgage market review are not dramatically different.

As to Paul's point, one thing that has changed is that the process is now much more rigorous, and you could raise a question as to whether it delivers the best customer experience. If you go into a Lloyds Banking Group branch for a mortgage interview, you could be there for two and a half hours. For a first-time buyer who needs hand-holding in the house purchase process more holistically, that may not be a bad thing, but someone who may be on their third house move and feels that they know the market pretty well still has to go through the same process. There are challenges in whether we can improve the way the system operates to keep the conduct regulators comfortable but deliver a better customer experience, because if and when the market ever picks up further there will be operational challenges in the system just because of the time it takes to manage those types of processes.

Lord Turnbull: What you are saying is that the regulator may have moved the pendulum slightly too far, but the banks themselves would have got pretty near that point anyway.

Mr Stephen Noakes: If we step back and look at the key principles of the mortgage market review—income verification, affordability assessment and a stress test of affordability assessment, assuming that base rates might increase at some stage—most of the major banks had already adopted those principles. The thing that changed as far as the mortgage market review was concerned was the way the process had to work with the customer and ensure that they were always offered an opportunity on minimum affordable term: in other words, really understanding the full ins and outs of both income and expenditure to get to a

situation where you could advise on the minimum amount of interest affordable over the term of their mortgage. Hitherto, many customers would have said, “I am looking for a mortgage for roughly 25 years”, whereas the process now says that for the individual customer the minimum affordable term is 17 years, but to get to that you need a lot more income and expenditure information. That is the bit which, from a process perspective, is probably now more onerous than it was hitherto. Volumes are broadly the same, but customer experience has changed.

Q182 Lord Turnbull: One player not yet mentioned, which has largely been inactive up to now, is the Financial Policy Committee. I understand that its role is to take a view on whether the economy, credit conditions or some sector of it is overheating and it can then step in. Do you have an understanding of what its reaction is likely to be, or are we still making it up as we go along?

Mr Paul Smee: The Financial Policy Committee has been anything but inactive in our area. It has introduced a requirement about the amount of lending that can be done at more than four and a half times loan to income, and it has insisted on the stress-testing to which you referred in your earlier question. It did that by recommendation; it nudged the regulators to introduce appropriate rules, so we know it is taking a very close interest in the market. Recently it asked for powers to intervene in a similar fashion in the buy-to-let market, and that is the subject of a current consultation by the Treasury. From where I sit, I feel very much in the headlights of the Financial Policy Committee. I know it is watching both the residential and buy-to-let market for any sign of overheating or conduct that could be prejudicial to financial stability.

Lord Turnbull: You mentioned buy to let. There seems to be a conversion of sentiment within government, in that buy to let by individuals is a bad thing, yet they seem very keen on buy to let by L & G—professionals as they call them. Do you think it is justified to think that about buy to let by individuals? I do not quite know why the Government have taken agin them, but they definitely have.

Mr Stephen Noakes: In relation to housing tenure at a higher level, home ownership has been broadly flat for the past few years. There are clear challenges in the amount of money involved in social housing, and as a consequence the private rented sector has to pick up the slack. We have seen the percentage of private rented sector grow in relation to UK housing

tenure; it is up to 18% or 19%. The private rented sector, in which buy to let clearly provides part of the role, is fulfilling a customer need.

There are also questions as to whether buy to let is necessarily crowding out first-time buyers. Interestingly, in the data for between 2011 and 2015, first-time buyer numbers are up by 60%. The first-time buyer market has grown quite substantially over that period, but there is no doubt that some prospective first-time buyers, because of challenges on either affordability or what I would call accessibility, which is the ability to garner the deposit, are currently unable to get on to the housing ladder. Therefore, they need the alternative, which looks very similar to the type of property they would prefer to own but will look to rent, provided by buy-to-let landlords. The FPC understandably wants the parallel powers it has in home ownership to manage potential risks in buy to let, but I do not think we should be unduly concerned by what we are seeing in the growth of the private rented sector, because that trend is going to continue.

Mr Paul Smee: I feel that since the election the Government have had a conscious policy of encouraging home ownership rather than being tenure-neutral, and they have brought forward various schemes with that in mind. On buy to let, there is a clear need for the private rented sector. There is no way in which home ownership can instantly assume its role, although I can see why some changes at the margins may be considered desirable for broader social reasons.

Q183 Lord Teverson: I bought my house at a time of house price inflation for ever and inflation for ever. It was perfect, and we should definitely go back to that. I want to challenge on the question of financial laxity. As Lord Turnbull said, there were 125% mortgages and all that. What repossessions were there over that period? I do not have the statistics here, but I remember very well that in the recession in the early 1990s there were huge numbers of repossessions, particularly in the commercial sector, as well as negative equity on the residential side. Despite it being a far greater financial crisis this time round, we avoided all that. Are we chasing something that is irrelevant? Should we not be going after credit card indebtedness, which is not backed by assets, rather than going through all this stuff at the moment, with two-and-a-half-hour interviews, which is achieving nothing?

Mr Paul Smee: I take that point, and I am certainly not going to divert anyone's attention from the credit card industry. On the housing side, some of the strain was found within banks because of poor underwriting. There are people who have been put into forbearance,

with all the stress that entails. Banks have undoubtedly striven very hard to avoid repossession of properties, and a lot of work has gone on at industry level sorting out how arrears are handled to help people through rough patches. That has resulted in the low level of repossessions that we see today.

From the banks' point of view, there are times when there has been forbearance and they have laid off requesting payments, and that causes problems for their balance sheet. There were repercussions from a time when mortgages were given with less scrutiny, laying aside the personal side of the strain and stress people are put under when they are in arrears.

Mr Stephen Noakes: You contrasted it with the earlier recession. The difference in that recession was interest rates. The low base-rate environment has definitely seen lower loss emergence. There is no doubt that if you compare cohorts of lending, as clearly lenders do, the loss emergence from the 2006-07 period is greater than it has been more recently with the improved underwriting standards. Because of the low base rate environment, we see fewer arrears and repossessions, but for prudential management we go through the process of working out post-model adjustments on the impairment numbers to see whether, when base rates increase at some point in future—clearly, it is a question of when rather than if—we have enough cover.

We have to be careful about comparing the prior recession with the most recent one. Paul is right that forbearance has definitely stepped up, and every lender is looking at doing the right thing, from both a customer and a prudential perspective, but low base rates have definitely been a key driver to help flatten some of those arrears numbers.

Q184 Baroness Wheatcroft: I want to ask you a little about the deposits now required from first-time buyers. One can understand why they are where they are, but to what extent do you think that is a real barrier to people getting on to the housing ladder? What innovative schemes are you coming up with to help them? Obviously, there is intergenerational lending—the bank of mama and papa.

Mr Stephen Noakes: Yes. It is a barrier. The Government's Help to Buy mortgage guarantee scheme—you are probably aware that there are two Help to Buy schemes, but this is the one primarily for second-hand properties—allows lending at 95%. It does it because of risk transfer. There is a guarantee; the lender buys from the Government. The average deposit under that scheme is £7,000. Absent that scheme, the deposit required from that cohort of borrowers would be £14,000. Some data I saw a year or so ago showed that the time to save

a 10% deposit for the average house would be of four or five years' duration. That is a challenge for prospective first-time buyers. It is so far out in the future that they give up hope and find other ways to spend their discretionary income. We need to encourage savings behaviour, and the Help to Buy ISA is looking to do just that.

As to the more innovative schemes, we had a product called Lloyds Lend a Hand, which provided exactly the bank of mum and dad. We lent 95% and took legal charge over a parent's savings account. They still got the normal rate of interest on the savings account, and it was only at risk if the first-time buyer—the son or daughter—got into financial difficulty and we finally repossessed. Those are the types of schemes that are needed.

Baroness Wheatcroft: You are talking about it as something that you did and do not do any longer.

Mr Stephen Noakes: We do not do it any longer because the Help to Buy government scheme has essentially overtaken it. We have been fully supportive of that scheme from the outset. The Help to Buy mortgage guarantee scheme finishes at the end of this calendar year, and because of the improving economy we are starting to see lenders prepared to lend at 95%, absent the risk mitigation. There was mention earlier of 125% mortgages. I do not think we will ever see a return to 100% and 125%, but we will see a return to 95%, absent risk mitigation schemes. A couple of major lenders are already doing that today.

Baroness Wheatcroft: When Help to Buy comes to an end, will Lloyds relaunch its Lend a Hand scheme?

Mr Stephen Noakes: One thing I can guarantee is that we will continue to participate in 95%. There are options. Either we go back to the scheme we used to have or we take the view that a couple of other major lenders have taken, which is to lend to 95% without risk mitigation. There was reference earlier to first-time buyers. The rough rule of thumb is that every first-time buyer drives three subsequent house moves. They are the life-blood of the industry, so you need to find a way to continue to support first-time buyers. If you leave them needing to save £14,000, without rich parents they will never get on the housing ladder.

Baroness Wheatcroft: Mr Smee, would you like to add to that?

Mr Paul Smee: My contact with other lenders suggests that they will take a similar attitude at the end of the mortgage guarantee scheme. The 5% deposit is important for all parties to

have skin in the game, so I would echo Stephen's remarks that we are probably beyond the days of mortgages in excess of 100%.

Lord Sharkey: Why is the 95% mortgage returning? What has changed in your collective assessment of the situation that makes the 95% mortgage something you are now prepared to do?

Mr Stephen Noakes: It is the experience we now have of lending at that level. When the initial discussions happened between the industry and the Treasury at the launch of the Help to Buy mortgage guarantee at the back end of 2013, there was still uncertainty about the economy. The industry at large, absent the odd scheme, had not lent to 95% and there was nervousness about what potential risk emergence we might see.

The reality is that two and a half years into the scheme—at scheme level, not individual lender level—you can almost count on the fingers of one hand the number of loans that have gone bad. It now drives greater confidence in lenders. If they apply the underwriting criteria and see risk performance at the moment, the cost of the guarantee—because clearly they are paying for that—does not make sense. It makes more sense to lend without the risk mitigation.

Mr Paul Smee: In addition, to give regulation its due, there is very good granular information about the ability of the borrower to sustain the loan at that level.

Lord Sharkey: I am slightly surprised that a 95% mortgage would pass any kind of reasonable stress test.

Mr Stephen Noakes: You still have to go through the same underwriting criteria. Essentially, 95% lending drives a couple of things. There was a conversation earlier about risk weights. The way it works on mortgages is that the risk weight is driven both by the credit quality of the customer and the loan to value of the mortgage. The higher the loan to value, the higher the risk weight, so you are definitely carrying a higher cost of capital. From an affordability perspective, you need to look at whether the customer can afford that mortgage were they to land on your standard variable rate after the product term had finished and base rates were 3% higher than they are at the moment—the FPC-mandated increment. Most of us in the industry are stress-testing that customer as if they were at a pay rate of probably around 7%. You need to feel comfortable that they can afford the mortgage at that stage.

On Paul's earlier point, with that level of robustness in the underwriting decision it is probably not surprising that very few customers go bad. Typically, it tends to be because of

personal circumstances. Illness or divorce are the key things that drive it, not the integrity of the underwriting process that was used. That gives the industry greater confidence in lending at that level.

Lord Turnbull: You gave some figures about the size of deposit. Those are average national figures. Are you going to be able to sustain 95% in London and the south-east, where all the numbers and the amounts at stake will be much bigger?

Mr Stephen Noakes: They will. London presents its own affordability challenges. The initial response to your question is yes. The challenge for us collectively goes back to the call-out that Paul made about the FPC. No more than 15% of new lending must be more than 4.5 times the loan-to-income multiple. Where do you find that index most challenged? Unsurprisingly, it is in London. On average income to house price, the London geography is the area where there is the biggest challenge. If you were disproportionately focused on London, you would definitely be challenged on the 15%. Deposits in themselves are not necessarily the challenge. I come back to the point I made earlier about affordability; even 5% of the average house price in London is still a good chunk of change and a challenge for many customers, which is why some of the other schemes, such as shared ownership, make initial affordability more possible for many customers.

Q185 Lord Forsyth of Drumlean: Referring to first-time buyers, if somebody has to find £14,000 as opposed to £7,000, they give up because they cannot save it. One thing that is slightly puzzling to me is that, given the Government's drive on Help to Buy and so on, why at the same time are they putting up the transactional costs of buying by increasing stamp duty? To what extent is that counteracting the impact of those schemes?

Mr Paul Smeeth: For a long time, the CML has said that stamp duty is a poor tax because it penalises transactions and holds people back on the housing ladder. There is a mismatch between objectives.

Mr Stephen Noakes: I have a couple of points on the changes that have been announced. The Government moved away from what was commonly called a slab system. If your house just tipped over the band, all that value would be taxed at the higher level, so you could be moving from 3% to 5%, which is a material move. In moving away from that, customers in smaller-value transactions now have a lower outlay. Clearly, the scheme tried to balance the books by putting up much higher rates, so right at the top end they are up to about 12% at incremental level, but the average purchaser saved about £4,500 on stamp duty.

Lord Forsyth of Drumlean: That is the average purchaser, but if you looked at London and the south-east you would have a completely different picture from the point of view of first-time buyers.

Mr Stephen Noakes: You would, but it would still be true even in London. The tipping point, where it became more expensive in the new regime on stamp duty, was £923,000.

Lord Sharkey: The Government still claim that more than 80% of transactions have had reduced stamp duty costs.

Mr Stephen Noakes: Correct. The reason the revenue take has reduced is a decrease in transactions at the top end. It is not driven by stamp duty; I think it is broader economics. Some of those transactions were driven by overseas purchasers. It is less attractive to them, or they have fewer funds to invest in super-prime parts of the capital.

Q186 Baroness Wheatcroft: On affordability, the price of a house relative to earnings is very much higher than it has ever been, yet you will have seen the reaction of the builders to any suggestion that house prices might come down, or that they would do anything that might possibly help in that move. Is there anything that could be done? Is there a risk that, if you are back to lending 95%, you will be very wary of anything that might bring down house prices, whereas by any other measure they are far too high at the moment?

Mr Stephen Noakes: To go back to a point I made earlier, one of the key things that we need to address collectively is affordability. I mentioned the potential opportunity with public sector land. Land is typically 20% of the construction cost. If collectively we were happy to say that public sector land would be part of the development, and not sold to try to achieve best market value, there is an opportunity to produce a level of housing stock that is at least 20% potentially.

Baroness Wheatcroft: It did not sound as though the housebuilders would be keen to grasp that.

Mr Stephen Noakes: I think the housebuilders would. It is probably more a question to central government than to a housebuilder. The housebuilder would probably be under a covenant such that they would have to build on that land to a certain spec and price point, because you would not want to grant it and then have five-bedroom luxury houses built on it. You would want it to have an affordable product, but I do not think housebuilders would be averse to that development.

Mr Paul Smee: We also need to look at how housing is distributed. There is not just a first-time buyer issue but a last-time buyer issue, where people occupy houses that are probably too large for their current needs. We need to examine ways in which we can facilitate a move to property more suited to a smaller nuclear family than hitherto. That means looking at some of the transactional costs. It is also a challenge for builders in the stock they build, in that there is now a gulf between the family home and the retirement village that could be filled by a downsize home. Some builders are already looking at how that can be best designed, but building is at the heart of a lot of the issues.

Q187 Lord Teverson: I want to go back to buy-to-let mortgages; I know we talked a little about them before. Perhaps we could look at the unevenness between buy to let and owner occupier. We have been shown evidence that there are less strict criteria in lending for buy-to-let mortgages, plus they tend to be interest-only mortgages, which are much more affordable than those that include capital repayments. There is quite a substantial difference. There is perhaps unfairness in being able to purchase the sort of homes people may want to own rather than rent. Is that a true characterisation?

Mr Paul Smee: There may be mitigating factors. Buy-to-let purchases are still only about 10% of all purchases in the market, and house purchase activity by first-time buyers has recovered more sharply from the downturn in the late 2000s than buy-to-let purchases. The figures that we have for buy to let include an element of refinancing buy-to-let lending. I do not personally buy the argument that the first-time buyer is being crowded out of the market by the buy-to-let investor. There is a piece of research to be done about the habit of what you might call let to buy, where people who move into a larger house rent out the starter home, or whatever, that they were in previously. That is quite a recent phenomenon, which needs to be examined more thoroughly than we have been able to do to date. We do not have any real figures for that. We have seen a recovery in the first-time buyer market alongside increased interest in buy to let, so I am not sure that one is at the expense of the other.

Mr Stephen Noakes: From a lender perspective, you look at buy-to-let investment on a commercial basis. The underwriting is not about doing the detailed income and expenditure that you do for someone who is looking to buy a house to own and live in; it is more about cover for the mortgage from the rental. Typically, you look at 125% cover against the mortgage cost at stress rate; it is done very much on an individual property basis.

The key thing to call out is one of the changes announced in the recent Budget: the change to the taxation of buy-to-let landlords. Essentially, the tax relief will move from the current situation—the borrower’s marginal rate—to 20%, tapered in from April 2017 to 2020. That will drive changes in the way the industry needs to look at buy-to-let underwriting. Hitherto, property by property on an investment basis has been okay, but going forward we will need to understand the tax status of the buy-to-let landlord. Only about a third of the private rented sector carries mortgages, and probably only about 40% of those will be affected by that tax change. It will be able to provide more of the level playing field you described, but I do not think it runs the risk of having a disproportionate impact on buy to let and the private rented sector, which I still think is important in driving a broad tenure-neutral available UK housing stock.

Lord Teverson: Do you think there are regional variations? Is London again particularly different in those calculations around buy to let?

Mr Paul Smeeth: The London market is an individual market in all forms of housing tenure simply because of the cost of land. It will always be a very attractive location for buy-to-let landlords and it will always be very expensive for those wishing to purchase.

Mr Stephen Noakes: If you are a buy-to-let landlord—I will not ask for a show of hands—you can envisage the key considerations: the yield—what return am I getting for the investment in that property?—and what do I see as the capital appreciation? In London, the yields tend to be lower but the prospective capital appreciation is higher. Buy-to-let landlords in London tend to be in it for a longer game and are not necessarily looking for a cash return on the property. They tend to have more borrowings, so they are less leveraged. There is some difference in the dynamics in the capital from other parts of the country.

Lord Sharkey: It is still the case, is it not, that a buy-to-let mortgage has an advantage over a residential mortgage, for the obvious reason that most are interest-only. It is mitigated to some extent by the taxation changes, nevertheless the playing field is not level when it comes to lending for the different types of product. There is some concern about that on the ground that competition for funding is unfairly biased towards the buy-to-let market. Do you think that is true? Another question arises from that: why is the FCA not the regulator of the buy-to-let market? What is the reason?

Mr Stephen Noakes: I will answer the first part and definitely pass over to Paul for the response on regulation, because he is probably in a better situation on that one. On the

differences, you are right: interest-only tends to be the way lending operates in buy to let. The maximum loan to value, however, is 75% pretty routinely across the market, so the buy-to-let landlord needs to find 25%. On crowding out, I would point to the fact that first-time buyer numbers have stepped up quite dramatically from 2011 to 2015 at a time when buy-to-let lending was also increasing, but not necessarily to the detriment of first-time buyer numbers. Let me hand over to Paul to respond on regulation.

Mr Paul Smee: We have a mortgage market where new providers are coming in and bringing in new sources of funding. At the moment I do not feel that sources of funding are a constraint on people getting a mortgage in either a buy-to-let or first-time buyer situation. On regulation, to generalise, the view to date is that buy to let is essentially a business transaction, and the Financial Conduct Authority is there to protect consumers, not businesses. As a result of the mortgage credit directive, which is a phenomenally complex piece of legislation, we have the creation of a new category called consumer buy to let, which relates to people who find themselves in the position of being a landlord without ever quite meaning to be: for example, because of inheritance or because they cannot sell their property and let it out when they move away. Conduct regulation is already going into that part—the accidental part. To say that we must now move in and regulate all buy-to-let mortgages would be to give a business sector a conduct regime designed to protect individuals, and I am not sure that will work. Echoing Stephen, a lot of lenders already have stringent criteria in place.

Lord Sharkey: I am not sure that I entirely understand one of the distinctions you are making. The FCA regulates the banking system to protect the consumer. What is unreasonable about regulating the buy-to-let market to protect the consumer?

Mr Paul Smee: The market regulator would be regulating the lender of the buy-to-let mortgage to protect the buy-to-let landlord who is a business. I am not sure that businesses need the same sort of protection; they are in a commercial activity.

Lord Turnbull: In relation to your portrayal of accidental buy-to-let landlords, I suspect they are there because the pension system is collapsing and it is an alternative pension for a lot of people. That is not going to go away fast, and we will find out after the Budget whether it is to be accelerated.

Mr Paul Smee: In referring to accidental landlords, I was using a term of art as to why the Government chose to regulate consumer buy to let in recent months as part of the directive.

A lot of individuals have seen the opportunity to invest as part of supplementing their pension income. That is right, and it is one of the reasons why the buy-to-let sector at the moment is something of a cottage industry, with relatively small numbers of properties in each landlord's portfolio, although I certainly think it is something people should not enter with an amateur spirit. Being a landlord has responsibilities as well as financial advantages.

Q188 Lord Forsyth of Drumlean: To go back to stamp duty, you quite rightly picked me up on the fact that there was a change in the stamp duty regime and we got rid of the cliff edges. Looking at the rates that build up, for properties in the band £250,000 to £925,000 it is 5%, and 2% below that. It is still a substantial amount to find if you are trying to cobble together a deposit to buy a one-bedroom flat in London. I am surprised that you do not see it as a something of a barrier to first-time buyers getting moving. Although I entirely accept that the overall burden may have gone down, it is still very substantial.

Mr Stephen Noakes: It is, but the average first-time buyer property in London—Paul may have the stats—is probably at the £300,000 to £350,000 mark. In the way the new system would work, it is the bit over £250,000 that would be at 5%.

Lord Forsyth of Drumlean: And the bit over £125,000 is at 2%.

Mr Stephen Noakes: Yes. A tax on purchase is always a challenge in encouraging additional transactions. I do not say that there are no challenges. The move away from the slab system has definitely helped to encourage customers to get on to the housing ladder earlier. For the average buyer, saving £4,500 means they can get on to the housing ladder quicker. You can see the attraction of tearing up stamp duty completely and envisaging a different type of property tax, which applies when you sell rather than you buy. That type of system operates in other international markets, but going from where we are today to that is a very difficult transition.

Lord Forsyth of Drumlean: To take the example you gave me, I cannot do the arithmetic perfectly in my head—

Mr Stephen Noakes: I was not able to either.

Lord Forsyth of Drumlean: A smidgen over 2% would be the overall amount, and 2% of £350,000 is £7,000. In your earlier evidence, you said that having to find £7,000 means that people give up. The justification for having a government scheme to help them not have to find that extra £7,000 seems to me to be cancelled out by the fact that they have to find the stamp duty.

Mr Stephen Noakes: In the earlier example I was talking about Help to Buy where the average deposit is £7,000. Absent that, it would be £14,000. That is where people give up, but people's ability to save differs depending on their level of income. There is no doubt that, given the prices of houses, even looking to get a 5% deposit means that some will still be discouraged, and that is one of the reasons why we are seeing growth in the private rented sector.

Mr Paul Smee: For information, the average first-time buyer house price in London last year was £300,000. A transaction tax will obviously have an effect on the margin. That is one of the reasons why we believe stamp duty should be thoroughly reformed.

Q189 Lord Forsyth of Drumlean: They have to find stamp duty, legal costs and everything else. Anyway, that is not the question I am meant to be asking you.

Mr Smee, in your evidence to us you presented a very interesting graph that shows that half of owner occupiers are living in what you describe as underoccupied properties; they have two or more spare bedrooms. You said that better use needs to be made of the existing housing stock. How could that be done?

Mr Paul Smee: How existing stock is used and encouraging opportunities for those who are, as it were, overoccupying properties to see different routes is an issue for the Government to look at. I touched on this earlier in response to Baroness Wheatcroft. The idea that there should be more houses built with the retiring generation in mind, but not retirement villages, would open up opportunities. We are certainly looking in the CML at the obstacles to people downsizing, which may be about being able to borrow money to assist them over the period of a transaction. Older buyers in the market need to be properly served; if we could remove some of the obstacles to people transacting later in life, it would free up the market. It would not totally free it up. I totally recognise the sentimental attachment people have for their family home, but it would create more opportunities for people to right-size.

Mr Stephen Noakes: I saw some research, probably 18 months ago, by an estate agency business that showed that about two-fifths of prospective house purchasers were looking to downsize, so it is quite a big part of the potential market. The key barrier to Paul's point is availability of the right property. Recently I spent time on a site with the builder Crest Nicholson, which has definitely seen that opportunity. It does not look like a retirement home; rather, they are apartments in a development area much more suited to that particular demographic.

Lord Forsyth of Drumlean: I am still trying to get Mr Smee to rise to my fly. In your evidence you said that “some organisations, including Legal & General and the Retirement Housing Group ... advocate stamp duty relief for older home-owners” in order to create an incentive for people to downsize.

Mr Paul Smee: The International Longevity Centre has come out with a similar suggestion.

Lord Forsyth of Drumlean: Chairman, I am sorry; I am leading the witness.

Mr Paul Smee: From the point of view of CML, stamp duty needs a thorough overhaul, as I said earlier. If you start to give holidays for particular groups, to my mind it brings out more and more the fact that the whole tax needs to be overhauled, and the question of when it is levied and on whom needs to be asked. Absent that overhaul, however, I quite understand why people like Legal & General would like to see that sort of encouragement.

Lord Forsyth of Drumlean: What are you advocating? What do you want to happen?

Mr Paul Smee: Absent a proper overhaul and review of stamp duty, a key obstacle to downsizing is the cost of transactions.

Lord Forsyth of Drumlean: What do you mean by a proper overhaul of stamp duty? Do you mean getting rid of it?

Mr Paul Smee: The question of when the tax falls payable and on whom. Should it fall on the seller or the purchaser of the property?

The Chairman: You said earlier that you would prefer to see a tax on the sale, which would catch part of the profit on the house, rather than a tax on the buyer. Is that right?

Mr Paul Smee: I think that is a good way forward.

Lord Forsyth of Drumlean: Would that not contradict your view that you want to encourage people to downsize?

Lord Teverson: It would work against it, would it not?

Mr Paul Smee: Not necessarily, if they are buying a house at the same time. It depends on where the balance is.

Lord Forsyth of Drumlean: Presumably, they would be selling a more valuable house and paying more and buying a smaller house and paying less, so does it not contradict what you are advocating?

Mr Paul Smee: I take the point. That is why we want a thorough review of the whole way in which the tax operates rather than a series of ad hoc adjustments to cope with various public policy initiatives.

Lord Forsyth of Drumlean: It would be quite good to have your thoughts once you have considered it further.

Lord Turnbull: You gave us the figures for a £300,000 house. A £500,000 house might be one that a couple moved into after about five years with their growing family, or it might be the house or flat granny wanted to move down to from a more expensive house, and that is £17,000. I think £17,000 would slow the moving up and discourage the moving down, because people would prefer to stay where they are and try to avoid paying that kind of money. My overhaul of stamp duty would be to return it to about 2%, but, instead of taking a large sum of money off the people who happen to move, all dwellers would pay a smaller sum of money that was added to their council tax. It would be a much better system.

Mr Paul Smee: That would be a way of cutting the cake.

Q190 The Chairman: Mr Smee, if you want to send in a note of your thoughts on this, it would be very interesting and helpful.

Both of you have your finger on the pulse of the house buyer, and the demand side of the equation is something we are looking at very carefully. First, in your view which of the measures that Governments have introduced over the past decade, say, have had the greatest and most beneficial impact? Secondly, are there other measures that you think should be introduced to stimulate the buy side, other—presumably—than making houses more affordable?

Mr Stephen Noakes: From a government perspective, the Help to Buy mortgage guarantee scheme has probably had the biggest impact over the last three years. From the perspective of Lloyds, across the two Help to Buy schemes—the shared equity scheme and the mortgage guarantee scheme—we have provided £6.5 billion of lending to support 45,000 customers.

The Chairman: Would that make you one of the largest banks in that sector?

Mr Stephen Noakes: We would be. We tend to focus on first-time buyers—that is the way we manage the business—because of the criticality of that segment for the broader housing market. I think that is the way to look at it. That is probably over three years. Housing transactions in a year run typically between 1 million and 1.2 million. We would probably be 25% to 30% of the Help to Buy scheme, so you can gross up those numbers. They still look relatively small, but there is a multiplier effect. First-time buyers getting on the ladder enable other people to move, and it drives mobility throughout the whole system. That is the key thing.

In response to your second question, it sounds as though I am not allowed to deal with the move on public sector land.

The Chairman: You can.

Mr Stephen Noakes: Affordability is still the key challenge. If we do not address affordability, we will not be able to get to the higher number of households that will be able to access that market, irrespective of the type of tenure. We need to find a way to get subsidy in the system.

The Chairman: The report put out by Lloyds identified the number of 2 million homes. Did you get any official response to that? Has it been followed up? Are there ongoing discussions about it?

Mr Stephen Noakes: On the numbers per se, no, but there have been quite a lot of further conversations on the different areas of opportunity. This is one of those challenges where there is no one silver bullet, and we need to move forward in a number of different areas to get production moving up to the 200,000 to 250,000.

Mr Paul Smee: The mortgage guarantee scheme worked very well in enabling the high loan-to-value market almost to heal itself; it gave a catalyst that has led to high loan-to-value mortgages reappearing on the scene. It also did so in a way that hit its target audience, in that most of the loans guaranteed were outside London, were below average house prices and were for first-time buyers. That was not mandated by the scheme; it happened. If I were a builder, I would say that the equity loan scheme had transformed my ability to produce homes, particularly at the lower end of the price spectrum.

Looking forward, I would like any new government initiative, or any new initiative from any source, to be tied in with all the existing government initiatives, because they seem to appear in different parts of the landscape and are not necessarily joined up.

The Chairman: It may require another paper from you to explain how to navigate that particular challenge.

Mr Paul Smee: I would be delighted.

The Chairman: Gentlemen, thank you very much indeed.