

Communities and Local Government Committee

Oral evidence: Capacity in the home building industry, HC 46

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Members present: Mr Clive Betts (Chair); Bob Blackman; Helen Hayes; Kevin Hollinrake; Julian Knight; David Mackintosh; Melanie Onn; Mr Mark Prisk; Alison Thewliss.

Questions 207 - 255

Witnesses

Professor Michael Ball, Professor of Urban and Property Economics, Henley Business School, University of Reading; Philip Callan, Research Associate, ResPublica; Mark Farmer, author of *The Farmer Review of the UK construction labour model: modernise or die*.

Q207 **Chair:** Good afternoon and welcome. Thank you very much for coming to give evidence to the Committee and its inquiry into capacity in the homebuilding industry. To begin with, I will ask Committee members to put on the record any particular interests they may have with regard to this inquiry. I am a vice-president of the Local Government Association.

David Mackintosh: I am a Northamptonshire county councillor.

Kevin Hollinrake: I employ a councillor in my office.

Melanie Onn: I employ a councillor in my team.

Mr Mark Prisk: I am strategic adviser to Essential Living.

Bob Blackman: I am a vice-president of the Local Government Association.

Chair: Thank you for that. Now for our witnesses: could I ask you to say who you are and the organisation you represent?

Philip Callan: I am Philip Callan. I am the managing director of PCA, a small consultancy company. I am also a research associate with ResPublica.

Mark Farmer: I am Mark Farmer, chief executive of Cast Consultancy, and author of *The Farmer Review of the UK construction labour model*, published in October last year.

Professor Michael Ball: I am Michael Ball, professor of urban property economics, Henley Business School, University of Reading. I have done research on the housebuilding industry for many years.

Q208 **Chair:** Thank you for coming. I have a nice easy question to start off with and get you warmed up. What are your biggest concerns about the homebuilding industry at present and what do you think we should be doing to try to resolve them?

Mark Farmer: Particularly in the context of the report that I wrote last year, I see construction capacity as an overarching issue. Obviously the housing conundrum is a complex one; it is multifaceted. There are lots of issues around land availability and the planning system, but for me, probably influenced by the world in which I work, which is the construction industry, I definitely see the capacity of the construction industry to build the homes that we are targeting—this is all about the ambitions of the country to deliver 1 million new homes by 2020, if not more—to be seriously constrained by the physical ability to deliver them in terms of construction trades and professional skills.

That has an ascendancy that perhaps it has not been given. There is lots of discussion about land availability and the planning system. They are both very important components of the overall mix, but in some instances construction, the skills base and the capacity we have in the industry is underplayed in terms of its importance around the challenges we have.

Professor Michael Ball: My view is somewhat different. Capacity constraints are clearly important, particularly in raising the cost of construction and therefore the possibility of building profitably within the private sector and the costs, of course, to the public sector of any housebuilding initiatives. Within that context, it is important. If you look historically at what has happened whenever we wanted to increase housing supply, the big constraint has been land. Land is the big constraint within that context. That is still an important issue.

What concerns me about the construction industry and the housebuilding industry within it at the moment is that it is a network type of process; there are firms, land input, the planning system, Government policy and lots of suppliers who come together in a network. We need that network to work together to provide the supply and the flow through of materials and, eventually, homes.

There are two worrying things about it. First, can we increase the certainty that all those people have in particular aims—the need to increase housing supply? I am a bit concerned that if we just try to push for a lot of housing at the moment and do not have that long-term view,

we might be missing out on gearing up the industry, the land market and the planning system to deliver.

The other thing that I worry about, unfortunately, is that it is over eight years since the last downturn, and I am pretty sure that it is not going to be eight years before the next one. The concern therefore is, given the interests in expanding and getting commitment by a whole series of different agencies to expanding housebuilding, how are we going to weather that next recession?

Philip Callan: It is about certainty. That is the crucial thing that is missing at the moment within the market. We have a sales-led market, which will be cyclical. Output will vary between 110,000 and 150,000 homes depending on the pace at which housebuilders think they can sell properties. The last time we had a functioning housing market was when we had a significant amount of rented homes being produced. What is missing now is that certainty. If you could create, as we are proposing in our paper, a situation where you have an organisation that is buying 40,000 homes a year, a lot of things both my colleagues have just talked about would be addressed. People would invest if they knew they were going to have the ability to sell those homes each year for the next 10 years.

Q209 **Chair:** Coming on to the point about the particular nature of the construction industry—this more speculative model of building what you can sell on particular sites—are we unique in the United Kingdom in having such a large part of our house-construction industry reliant on that particular way of doing things, and is there anything we can do to change it fairly simply?

Professor Michael Ball: The answer is no. The nearest countries to us are Canada, the United States and Australia, in terms of the way we behave. In any market where you have a large private sector, you have people building speculatively. China is mainly speculative building at the moment, for example. You can go around the world and see speculative building being very common. It is important when we talk about speculative building to remember what we are talking about.

In the clothing trade, you go to Savile Row and get measured up, if you can afford it, or you go down to a local department store or whatever and pick up your suit. That suit was made speculatively; they did not know who was going to buy it. They knew who was going to buy the bespoke suit. When you say speculative in housebuilding, it means you are not building for a particular client; you do not know who the final purchaser is going to be. That is very common in market contexts.

Mark Farmer: I would reiterate that. If you look at the US market, there are lots of similarities between the UK and the US in terms of tenure and the relativity between rent and ownership. There are lots of similar issues in the construction industry. The issues I talk about in my report—the deep-seated problems in the UK construction industry—are

not unique to the UK. They are generic ones that are seen across the world.

If you look at markets where there is perhaps a different tenure mix, Germany has perhaps more of a rental component to it. It has a more regulated market in terms of how the rental market operates. Has that translated into a different construction market? It has to an extent, but not massively. The reality is that the link between tenure and the state of the construction industry is not a scientific one; it is a highly variable one. It is driven by cultural, historical issues in terms of how the market has been driven. Germany has a particular overlay of having unification of the western German and eastern German components, which has led to particular nuances.

The fact that we have a high proportion of owner-occupation and a speculative model for housebuilders that feeds that does not help our industry. In many respects, what we need is tenure diversity to try to create certainty around output, and to look for acyclical and countercyclical means by which we can smooth what is inherently a highly volatile market so that we can improve and modernise our construction industry.

Philip Callan: The comparison between the different markets is difficult. You have different factors coming into play. In the UK, we restrict land supply quite significantly; in the United States, they do not. They have a market that can produce many homes. It does not necessarily mean they have a functioning market over there. Our focus here is about what can happen in the UK.

Q210 **Chair:** What about the rest of the construction industry in the UK? You just said that housebuilding operates very differently from other construction activity. Are there any lessons we can learn from that?

Mark Farmer: If you look at the different sectors within construction, you obviously have infrastructure and civil engineering works, which tend to be led by public sector, government-type clients, government-led clients or regulated industries, particularly in things like utilities etc. They have more certainty by the nature of infrastructure work; it tends to be long term. When you are embarking on something like Crossrail, it is a five, six or seven-year play. You can organise yourself as a construction supply chain differently. If you look at the commercial construction market in terms of office building and shopping centres, there is more of a speculative model there as well. There is an element of commonality with housebuilding, although you tend to have the option to find your end investor or occupier so that it dilutes the risk, to an extent.

Housebuilding, in terms of the risk profile, is at the higher end of the risk spectrum in terms of that speculative model, particularly the housebuilder model. If you ignore the rented segments, which operate a different risk profile, they are completely led by speculation and by risk of exit. In recent times that has tended to be diluted by trying to achieve presales.

Lots of developers will try to achieve presales so that when they start on site they at least have a proportion that are presold. But it is very rare to have all of that de-risked at day one, unlike an office pre-let, for instance.

Professor Michael Ball: I entirely agree with what was just said. It is also the case that there is a lot of interlinkage between housebuilding and the rest of construction. It would not be right to see it as an entirely separate, enclosable part of the industry. For example, when a large scheme of blocks of flats is built, that would often be let out by the developer to a contractor—the other part of the construction industry, if you like—in a fairly artificial way, to do the works. The developer controls all the scheme, controlling the sales at the end of the day, but the actual production process is undertaken by somebody else.

Similarly, the whole process of subcontracting is very common throughout the construction industry for very good economic reasons. It is not purely specific to housebuilding. In that context, there are lots of similarities. Finally, there is a lot of mobility of resources between the different sectors in terms of firms supplying materials and also, to a degree, labour itself. You get a lot of movement between the two. Traditionally, if you go back some years, the very large firms were housebuilders and contractors quite happily. You can think of firms in the 1960s and 1970s like Wimpey and so on, which were the country's biggest contractors and the country's biggest housebuilders. The separation in terms of firms at the top has come again for particular financial and economic reasons, not the inherent nature of the work undertaken.

Philip Callan: It is interesting to pick up on the point about Wimpey. Wimpey, which became Taylor Wimpey and one of the biggest housebuilders, grew very much out of being the contractor to build council houses in the 1950s. It is that certainty of continued business that allowed them to invest in their workforce and grow.

Q211 **Chair:** The comparison with Germany was drawn a few minutes ago. The Committee went to Germany recently. They do not have the dominance there of a very small number of very large builders; they have a lot more medium-sized builders, and they probably employ a lot more of their labour force on a long-term basis as well. Is that just a difference between the German and UK economy, or is there something specific to the housebuilding industry where we are different?

Mark Farmer: An element of the German market is driven by labour regulations. They have a very different labour market. The UK construction industry is characterised by self-employment. There is a very high level of self-employment, casual labour and itinerant labour. The German market is a very different model. Labour regulations and employment laws are different and tend towards payroll and PAYE-type equivalent employment.

Also, if you look at the housing sector within Germany, it is pretty much polarised. First, single-family housing is in many instances done in a modular off-site way. They have quite a significant but SME-scale off-site manufacturing-type environment on a regional basis that is used on single-family housing. When it comes to larger apartment buildings, it tends to be done in a more conventional way, in terms of traditional concrete and steel-based construction, by a second tier of main contractors that operate in regional markets. Again, that is very much the historical make-up of that market, together with some of the legislative differences between our countries.

Philip Callan: There are a couple of other things there as well. Here, before the last recession, we had about 12,000 SME builders. We are now down to 3,000. In Germany, until they had the immigration and refugees coming in last year, they did not have a significant imbalance between supply and demand in housing. You can go to many German cities and they have not seen any real house price growth in 10 or 15 years. You do not have a speculative market in those circumstances. You are building either to rent or for sale. In the construction industry, people are focused on a different type of market there than what we have here. Here we have a significant undersupply continually happening over the last 15 to 20 years.

Professor Michael Ball: Your point about the small number of limited housebuilders in this country—of course, it has been a growing phenomenon for a number of years now—is a very interesting one. We have only a handful of the majors in existence at the moment. Earlier on, I said that the north American countries—Canada and the United States—and Australia are rather similar to us; they are not similar in that the largest housebuilders in the States are obviously much bigger than our largest housebuilders, but their market share is much smaller.

I did some research on this a couple of years ago to examine the likely reasons for that. To a certain extent, some of it is geography. We are a much smaller country and therefore firms can have management processes that can have operations across the country fairly easily, whereas if you are dealing on the east and west coasts of the United States, that is far more difficult. There is something about the nature of the geography.

It is also the particular nature of our planning system. There is a symbiosis between having large firms and the nature of our planning system, because the one big thing that is missing from the UK compared with Australia and north American countries is that we do not have independent land developers who bring land to fruition, maybe put a bit of infrastructure in place and then sell it on to small housebuilders. That brings liquidity to the land market in those countries and enables far more small housebuilders to build houses and thrive in that context. We do not have that sort of firm in this country. In fact, they are highly frowned on and regarded just as land speculators.

The planning system, partially because of the tight supply, but also because of the culture within it, does not allow this sort of land development industry to emerge. That is one of the reasons we have this very high concentration and one of the reasons changes that have been taking place in the economy and finance and so on have so badly hit small enterprises. They cannot get a supply of land. It is not simply that the planners do not let them have that supply of land; they cannot get the finance—it is the whole bundle of things together. Land developers tend to do those things in combination in the countries I mentioned.

Q212 Mr Mark Prisk: You have each cited slightly different emphases on what the problems are within the industry. What is the role, if any, of Government in changing the industry for the better?

Professor Michael Ball: There are good and bad things within the role of Government. I have been getting a little worried recently. Let me go back a little in history. When the coalition Government came in and got rid of targets, I thought, "Whoops, that is a big change. Perhaps we do not know what is going to come out of it." On the other hand, I like the message that sent: that the housebuilding industry is predominantly a market-driven industry and it should be allowed to operate as much as possible, within policy constraints, as a market-driven industry. I like that idea, because when Governments have tried to interfere in housebuilding, historically they have not been massively successful in doing so.

What worries me a little about policy at the moment is that we are starting to see a little bit of micromanaging: "You should use this technique," or, "We absolutely want this target of houses, come what may," by a particular year. It might be deleterious to the longer term development of the industry if we go for a harsh target and a particular point in time. Government have a very difficult balancing act. There are clearly areas where Government can intervene for the public good and for the good of the industry.

On the other hand, it is unfortunately like a pendulum—it swings from one side to the other—and it is that swinging of the pendulum that, to a certain extent, is a lot of the problem. If you are in an industry where timeframes are very often a decade or more—"Where am I going to be in 10 years?" is something you have to consider when you have long-term housing developments—it is very difficult, as was mentioned before, to have certainty within that context of what the parameters are going to be, let alone having to face the market risks.

Q213 Mr Mark Prisk: For you, it is less interference. If there is going to be interference, it should be thinking long term.

Professor Michael Ball: Less is good, but have a golden touch, if you like. Do the things that clearly matter but do not go back to thinking, "We have a housing crisis; we can tell industry what to do and everything will be fine." I'm afraid we will end up like Spain in 2007 if we do that.

Mark Farmer: Market enablement is a really important piece where policy can add to what we have as a challenge. Going back to this recurring theme around certainty, we have a market that is dominated by housebuilders and volume housebuilders. If you take the fact that the top 15 housebuilders deliver about half of everything in the UK, is that a healthy position to be in? It probably is not.

How are we going to address that? Tenure diversity is a critical point here. Ultimately, you need to have an intelligent housing policy that enables, first, the social housing sector. I do see a role for the social housing sector as part of the solution alongside the private sector, but perhaps in different tenures—particularly the institutionally backed build-to-rent sector, which is a critical part of giving additional supply at speed and at scale. It is fresh money; it is not recycled housebuilder capital. This is new money that is coming into the market. Government can play a role in enabling that. They cannot necessarily do that development for the private sector—the private sector has to make its own decisions—but they can set the right context, whether that be through incentives or different ways in which you can nuance the market and promote that market.

With the social housing sector, it could be more interventionist in terms of how it uses tools like the National Affordable Housing Programme or the Shared Ownership and Affordable Homes Programme, how it uses direct commissioning and the ways in which public land could be brought forward. There is a more interventionist angle. It is a balance between the two. I agree that it is not about something that becomes a centrally controlled market. That is absolutely not the case. You need to enable the private sector to maximise delivery across a range of tenures and have a supporting role in how affordable housing—with a small “a”—is brought forward.

Q214 **Mr Mark Prisk:** Mr Farmer, you started talking about capacity and therefore skills. In that context, what do you think Government should or should not be doing?

Mark Farmer: There are two related issues here. My report has effectively two themes. One is about skills and training: apprenticeships and getting people into the industry. We have a big issue with our industry in terms of its image and attraction to youngsters. People just do not want to come into it in the quantum that we need. If you overlay Brexit on that as well, which I am sure we will talk about further, that is a big risk.

The other theme that is probably more important, and the skills question is subordinate to this, is innovation. Innovation in our delivery models and innovation in the physical construction techniques that we use can redefine how productive we are as an industry. This is not a numbers game. We have so big a challenge around the declining workforce in construction that we cannot recruit or retain our way out of it. We have to be prepared for a reducing workforce, which means we need to be able to build more with less.

Innovation is critical, and that obviously brings in the whole agenda around off-site construction, pre-manufacturing and higher productivity working. If you link that to policy, going back to how the Government can be an enabler and how they can then lead by example perhaps in the social housing sector, innovation is a critical plank in terms of promoting new thinking that the rest of the industry can sit behind.

Q215 **Mr Mark Prisk:** Mr Callan, you have touched on the issue of certainty. How can the Government create certainty in the industry?

Philip Callan: It does so by having an intervention on the basis we have been talking about, in terms of a national housing fund. Nobody could say that we have a functioning housing market at the moment. People are priced out in terms of owner-occupation. They are priced out in terms of rent, especially in London and the south-east. That is a major threat to the London economy if we do not do something and intervene.

Governments of all different persuasions over the past 15 to 20 years have been quite interventionist in the housing market, and their intervention has quite often been around how they can boost housing for sale but not looking at what can be done in terms of giving certainty. If we can enter into a situation now where we are producing more rented homes, which are crucially required—and which might move into owner occupation after a period of time—you will address some of the issues that my colleagues are making here. You will provide certainty and an opportunity to innovate. If you can see that each year you can sell 40,000 homes, you will see other people come into the marketplace.

Q216 **Mr Mark Prisk:** Your fund would underpin the construction of homes that the market would otherwise not build because of the lack of demand. Is that right?

Philip Callan: It is. It is addressing two or three things. At one level, here is a site that you could build out. You have 500 homes and you can build on this site. You might build it out at 50 a year or 150 a year. The pace at which you build out will be driven solely by your view of how many homes you can sell: "Can I sell one a month or can I sell two a month?" That is what the pace is going to be there. The fund would come in and say to that developer, "Here you are. We will buy 100 of these properties. Actually, we might buy the first 50. We will get you started on the site."

A crucial issue is that whenever the market turns down, housebuilders want to sell properties to housing associations, because they want some properties built on the site first. The same thing would apply here. The fund would come in; it would market-rent those or have the opportunity to sub-market-rent them in terms of how the Government want that arrangement tied up. But it would be buying in additional properties. It would also be going into the SME sector and saying, "Here you are. Here is an opportunity to go and acquire that site." You may well have an option but you are not bringing that site forward at the moment because you are not certain of getting funding from the banks or, if you are,

post-2008, the amount of capital you have to put in is such that you are very restrained in terms of doing that.

It is about breaking through that logjam: "Here is a certainty. You can go and buy the properties. We will guarantee to buy those properties off you." That contract will be sufficient for them to go to the banks and say, "Here you are: I have a sale"—a complete sale, rather than sort some of partial sale where somebody may or may not complete, depending where the market is. It will unlock that. It is that certainty that will get you there.

There is also lots of land out there that is not being exploited: the 10 and 15-unit housing developments right across the country that are not being brought forward. Housebuilders tend to go for 50 upwards. When the market turned down, they went down to 50 unit sites, but generally they are into much bigger sites than that. It is those small sites that are really held up and not being utilised, because you do not have those SME builders you had in the past coming forward to do that.

Q217 Mr Mark Prisk: Briefly on the fund closing the gap where there is not the demand, that is quite a large and risky portfolio if someone is acquiring that type of property—the Government in this case, as you are suggesting. How do you see that operating? Mr Farmer has mentioned the role for institutions to invest in the rented sector instead. In a locality, let us say a small city in the UK, if someone is coming in and buying a substantial proportion, the chances of those capital values continuing to be suppressed are quite significant. How could that be justified in public spending terms?

Philip Callan: First of all, the whole idea is that the fund is a partnership between Government and housing associations. Associations are used to building and renting homes. They have excellent market knowledge in terms of what works in which locations, much more than you have in institutions. Institutions hopefully can get involved but they are very much small players in the marketplace at the moment. They do not really know the rented market in any great sense; associations do.

They are used to renting a whole range of rents these days. They will be looking for a situation in terms of what houses in which locations are going to work. Because they are half a shareholder with the Government, and will be the whole shareholder in year 11, they are going to be very keen to ensure that the schemes they are bringing forward are going to work. There is also a degree of tenure diversity built into the proposal. We are renting homes, but after five years people can move into owner occupation or into some partial ownership as we go forward in those circumstances.

Q218 Julian Knight: Mr Callan, I have a section of your proposal here in your report and I want to go over it. Maybe you can clarify some of the points for me. It says: "This intervention would be delivered through the creation of a yearly National Housing Fund formed with a group of housing associations who would bid to join each year of the fund."

Considering the record of housing associations in terms of delivering housing, which, in front of this Committee, it has been agreed has not quite measured up to what they themselves would like to see over a long period of time, do you think that particular industry is able to deliver the bricks and mortar required in order to fill out the supply?

Philip Callan: Absolutely. If we look at the record of housing associations and put it into some sort of context, for the vast majority of their existence they have delivered a Government programme. Government have come forward with grants at different levels over the years and said, "This is the number of homes we want to have built," supplemented by section 106, which comes from the housebuilders.

Housing associations moved into a situation probably 10 years ago where they started to be more significant builders in their own right. If you look across the sector now—our report highlights this—there is a whole series of quite significant housebuilders who are moving from a grant-based model to one where they are building homes for sale to generate the subsidy to allow them to provide subsidised rent. If you look at the top 40 or so housebuilders, housing associations are pretty much within there.

A housing association such as L&Q, which has an ambition to build 5,000 homes, will be in that market. Clarion, which has just come into existence, is looking for 5,000 homes as well. They are going through that process of skilling up. They are moving from being one type of organisation in terms of development to a different type of organisation in terms of development.

Q219 Julian Knight: Do you identify the amalgamation as a necessary part of that within the industry? In 2013 we had 1,700 registered housing associations. In order to deliver your plan, would we need to see fewer housing associations on a much bigger scale?

Philip Callan: No, the plan will act as a catalyst to drive that consolidation. If you look across the sector as a whole, there are about 3 million properties sitting within housing associations, and there are 1,500 housing associations but the vast majority of those have very few properties: almshouses and co-ops and so on. There are about 200 associations that have more than 2,000 properties. It is that group where the consolidation is taking place. As they consolidate, either through merger or collective-development agreements, which is what a number of them are looking at now, they will release that additional capacity.

Q220 Julian Knight: I understand that the funding of the scheme would be through the Government issuing 50-year gilts. Then what would happen is the housing association would come in and effectively pick up that debt over the period of time. In this instance, it is £10 billion a year for 10 years. Who then picks up the debt for the housing association? I can see how the Government can get 50-year gilts at £10 billion a year, but how does a housing association—considering their annual spend is

£13 billion—go about replacing the Government in terms of this indebtedness?

Philip Callan: The whole idea is that we create the fund as, say, a company limited by shares. The Government take half the shares. The five or 10 associations that are participants in that year take the other half. In year 11, they buy out the Government's shares and they take on the whole responsibility at that stage. The only shareholders you have then are the housing associations, and they take responsibility for the remaining 40 years of the gilt.

Q221 **Julian Knight:** How do they then fund at that 10-year stage?

Philip Callan: The Government have already raised the 50-year gilt, which it has invested into the fund.

Q222 **Julian Knight:** Presumably it is paid back.

Philip Callan: The Government have no responsibility for the debt at that point. It is a financial instrument. We have raised the money through gilts, but for the first 10 years the Government have halved the shares in the fund and therefore half the responsibility for the debt. In year 11 they sell their shares to the association, and all the responsibility for the debt sits with the association. You do not repay the debt. The associations or the fund will repay that debt at the end of 50 years.

Q223 **Kevin Hollinrake:** In terms of the question about national and local government playing a part, Mr Callan, you seem to imply that properties are not being built on small sites because there are no SMEs, while the evidence we hear is that SMEs are not building properties because there are no small sites or there are not enough being allocated in local plans. Could you respond to that?

Philip Callan: Certainly our experience is that the issue that we are getting back from SMEs builders is around access to finance and certainty.

Q224 **Kevin Hollinrake:** Definitely, but that is the second most important reason. The FMB in their recent survey said that two thirds of their members have issues finding land. Are we not trying to solve the wrong problem here? SMEs in 2008 built 44% of what was built in the UK; they are now building 25% to 26%. Is that not where we should be directing policy? Professor Ball?

Professor Michael Ball: I would entirely agree that you need to focus on mobilising in that sort of way. There seems to be quite a bit of evidence that in order to achieve planning pressures at the moment, local authorities are going for big sites. There is also a strategic thing within this context, because if you are local councillors and you know a lot of people in your neighbourhood do not particularly want more housebuilding, go through a few big sites, blame the Government and you are fine. Whereas, if you push out an awful lot of small sites, they will be in everybody's ward and they will all get picked off.

There is a bit of strategic game-playing going on within the planning process within this context. Obviously nobody is going to say they are doing that, but one has to be aware that might well be happening. I am also rather worried about the idea of a fund like this. It goes back to the role of housing associations, where they come from and their underlying business model: to provide housing for rent and to provide housing when you have a solidly guaranteed market, because you are doing below-market-rental property and your tenants typically have support within that type of context.

Recently, they have been moving to the private sector with rental housing and private housing on the basis that there is this magical 25% extra profit that they can then move over and use to subsidise social housing. If you think about that on the long-term basis, if you could get a guaranteed 25% profit as a housing developer, we would have everybody in the world coming to build houses within the UK, because it is an absolutely fabulous rate of return. The answer is that is cannot be there—we would not be sitting here having this conversation if it was.

What worries me is that a lot of risk is already being taken on board by the housing associations in terms of what happens if the demand does not turn up, which is a perpetual fear of anybody who builds a house, either because of general market context or because you picked on a scheme or site that, quote, “does not work” in some way or another. It turns out to be a bit of a market lemon.

To suggest that you would want to have more risk going down that route would highly worry me. Why you pick on a housing fund having housing associations leading it is one concern. Why that sort of developer? Why not another sort of developer? Then, once you take it into a more general developer, that raises the point raised by Mark Prisk: you have the problem of the state taking on a huge amount of financial risk. It might be moved on to some other agency, but when that agency goes wrong it will be promptly moved back again, because the state has such a commitment to it. It would be great if it worked, but if it does not work the downside is very worrying. That is my concern about it.

Q225 **Kevin Hollinrake:** Can I take you back to the SME point? Is it your belief that we could significantly increase housing delivery if we solve the problems of land and finance for SME housebuilders?

Professor Michael Ball: If we solve the problem of land, the finance would follow.

Mark Farmer: Can I bring a capacity perspective to the SME point? The idea of trying to diversify housing plots in terms of accessing those smaller lot size developments is absolutely important. We are still missing the point about who is going to build it. On the idea of “SME builders”—in inverted commas—beyond the company that buys the site, that takes it through planning, and then goes into the bank and gets debt, you still need a bricklayer, a carpenter and a plumber.

At the moment there is no dormant SME construction sector out there. Because the SME developers—collectively called SME builders—have shrunk, all of the construction tradesmen have polarised either into the repairs and maintenance sector, doing jobbing work or domestic extension work, or working for larger housebuilders or commercial contractors. The reality is that if we re-energise that SME sector—and it is important—we have to be careful to do that in concert with a capacity-building exercise as well, either training people in traditional trades or innovating new ways of building.

Philip Callan: If the sites are available, you can get SME builders to build them and you can do something in terms of helping them with funding. It still will not address the issue of who is going to buy the home. You have a market that, in terms of sales, peaks at around 160,000. If you increase the amount of production that is there, you will not necessarily change that situation; you will create more competition in terms of those sales.

Q226 **Kevin Hollinrake:** The whole essence across parties is that there is a shortage of supply and excess demand already.

Philip Callan: There is an absolute shortage of supply in terms of housing. What you need at the moment is more rented homes. That is the crucial issue that is there. That is the gap that is there within the market. When the market improves, the Barratts and Taylor Wimpeys of this world do not expand their production exponentially. They are not looking to do that because, as the professor said, there is not a 25% return there. If you build more and more homes, you create a lower return. When the market crashed in 2008, companies like Barratt were up to 22,000 homes a year in terms of output. That was where they were getting into marginal schemes.

Q227 **Kevin Hollinrake:** That was an exceptional time. Even in the 1991-92 recession, housebuilding numbers only dropped to an insignificant 10%. Either side of that there were similar numbers of delivery, but the Government and the Opposition are bringing forward rules to moderate the demand from the private rented sector—landlords coming in to buy properties for the private rented sector. You are talking about switching that to an institutional demand, which does not seem sensible. You are increasing demand.

Philip Callan: I am talking about increasing supply.

Q228 **Kevin Hollinrake:** By increasing demand. You are increasing demand, but you might increase supply.

Philip Callan: The proposal is that you build at least 40,000 homes a year for rent. On the issue about whether the liability sits back with Government, at the moment Government are paying about £28 billion a year in housing benefit, partially because of lack of housing supply. If you are looking at a concern in terms of where you are going, that is one.

Q229 **Helen Hayes:** I wanted to come back to Professor Ball's comments and

the delicacy with which you are treating the existing housing market. It is pretty clear that while the housing market delivers lots of homes each year as it is at the moment, it is not—and it has not been for quite some time—delivering anywhere near enough homes. That would seem to make the case that it is not a functional market. There are parts of it that deliver, and you do not want to stop delivery that is currently going on, but there is an argument for intervention by the Government, whether that is through direct delivery, through funding the delivery of new homes, through incentives or through additional regulation. It is not quite the kind of perfectly functioning delicate animal you painted it to be. I wondered if you might say a little bit more about that.

Professor Michael Ball: I clearly exaggerated if you got that impression. It is not a delicate animal at all. I do not, by any means, think it is a perfect market; I have made a career out of moaning about it. I could not claim that everything was wonderful. My point was more that there are lots of unintended effects of intervening. It is the worry about those unintended effects. Everybody does things because they want to see something happen, and there often seem to be simple solutions. I am not by any means unique on this but unfortunately, in my experience, there are no simple solutions to the conundrum we have in terms of housing supply.

I would make two points. Yes, the market does work in the sense that, because we do not have enough supply, lo and behold, what happens? The price goes up and therefore people are rationed on the basis of price. That is how a market works. That does not fulfil our social aims. You can make two points about that: one is the very biased nature of taxation among the housing tenures, which means some people can consume very large quantities of housing and make considerable wealth out of it, whereas other people struggle on the housing ladder. That is one sort of issue that creates some of the divergences we see.

We do not have a free market in land. The supply is rationed and the price is what the price is, given that rationing and given the demand for the land. Again, the market is working but there is a rationing process that is non-market operating there, which I and a number of other people would argue is one of the fundamental differences in the UK from many other countries. That is the point: it is not market failure; it is regulatory failure.

Q230 **Helen Hayes:** We might also say that the rationing on the grounds of price creates public consequences and consequences for society that are so unacceptable that that constitutes a failure of the market; that it is not fine that the price goes up so high that so many people cannot afford the home they need.

Professor Michael Ball: I would entirely agree with you. It is not fine, but the market tells you the consequences of doing certain actions. You make social choices. If you say, "I am going to do this," and somebody says, "Well, that is going to happen if you do it," I am afraid that is what happens. One of the issues we have about housing supply is this

long-term position on land. If I was a housing developer at the moment, I would be extremely cautious, because I do not know what my future land price is and I do not know what my future demand is.

Q231 Melanie Onn: Mr Farmer, your report said that the construction industry was incredibly fragmented and it was leading to the system being inefficient and stifling progress. If that lack of integration is a significant issue, do you think that the very fact that local authorities now are setting up their own development companies, enabling building to take place within their own areas, is going to replicate in the public sector some of those issues that the private sector is seeing? There does not seem to be a great deal of communication between local authorities on a regional or national basis.

Mark Farmer: It is a good point. There is a chance that the fragmentation we have seen in the construction supply chain is mirrored in the sponsoring client-developer world, particularly in the public sector and local authorities. One of the themes that comes out of my review is the need for aggregated thinking and to try to create borrowed scale by thinking on a bigger scale. If that is through programmatic delivery of people coming together in consortia, or large-scale investors or sources of money that are deployed into the construction industry, that enables the construction industry to see it as a different type of client.

All too often the construction industry deals with a project at a time. It is all very tactical. It is project-led. We need more joined-up thinking from clients, whether that be housebuilders, developers, local authorities, unitary authorities or devolved government areas, such that scale can be aggregated, such that the nature of the opportunity is seen more strategically. The biggest problem we have is short-term thinking in the industry, which is linked to short-term demand planning. If local authorities could start talking to each other, and there is a geographic bias to how the construction industry works, you can unlock an opportunity such that people could start looking at what their construction demands are in terms of a grouping of local authorities. There are discussions that I am certainly having trying to promote that kind of thinking. It is quite difficult and that is just human nature, to an extent.

If people can see the bigger picture, there is the possibility of driving a different competitive advantage for the construction industry driven by economies of scale. It is a really interesting point and it is an important point. Going back to certainty, certainty comes particularly when you start to bring in the idea of innovation, investment into factories and different types of construction working. You need scale. The scale will not come from fragmented clients working in isolation. You need to try to conjoin clients or have large-scale clients like institutional funds, large-scale registered providers, the HCA or whatever it might be—thinking strategically at a national level—that creates a different type of client for the construction industry.

Q232 Melanie Onn: Do you think there is a risk that councils will be wasting

public money if they continue to operate in siloes?

Mark Farmer: It is all relative. If they operate tactically within their own local authority areas, they will get best value as defined under public procurement, but there is a missed opportunity. There is an opportunity cost to being able to better that by thinking on a larger scale. That will only come through in local co-operation. You need to try to break down the barriers around how you can start thinking collectively.

In London, there are some interesting models starting to be deployed where shared services agreements are starting to get London boroughs to think outside of their own LPA areas, and that can include construction procurement. The same applies in the registered provider sector, in the social housing sector, where we have seen examples where housing associations are starting to collaborate to look at sharing their development programmes such that they can then engage with the construction industry with a larger volume pipeline, drive a much better deal with the construction supply chain and potentially initiate the innovation and the investment that we need, because there is a large scale against which to plan that investment.

Q233 **Melanie Onn:** On the economies of scale, when it comes to the public sector, they do not seem to have been well served by the idea that economies of scale will benefit them. If we look at the national health service or local authorities, they have been sold a bit of a duck. Is that going to happen within the construction industry as well? I will explain later what "sold a duck" means.

Mark Farmer: The conditionality on what I have said is about driving innovation. There are interesting opportunities around how public authorities or local authorities, in terms of local planning authorities, start talking together to raise the scale of their combined development pipeline. You then bring in this whole agenda around innovation. Innovation should be done for the right reasons, which is driving a better outcome in terms of cost, time and quality, but it is a numbers game.

You need to have critical scale. From my perspective, there is always a risk around innovation. On your point about reference to other sectors where perhaps it has not worked out, nothing is gilt-edged. But if you look at the construction industry's performance today, it cannot be any worse.

Q234 **Mr Mark Prisk:** Infrastructure has been given two important elements you have all talked about: namely, long-term financial certainty under the National Infrastructure Commission and a streamlined regulatory framework for how they are dealt with through the planning system. Should that characterisation, that policy environment, therefore be applied to large housing projects, for example garden villages? Is this something where Government should say, "We think these are strategic projects, like a bridge or a railway," and therefore intervene by speeding up the planning process and making sure there is a clear long-term funding pattern for the proposal?

Professor Michael Ball: Speed up the planning process, by all means, and identifying particular areas where housebuilding has generally become acceptable, and then letting much weaker rules operate within those areas, is very important. That is one of the recommendations I made in my report of 2010 to the Department for Communities and Local Government. That is very important.

I still worry about using public sector money to underwrite a lot of what is essentially real estate development. It is very high risk and you end up inevitably favouring one group over another if you have a market type of context. Both on the grounds of the risk to public expenditure and the fairness of the types of process you are operating with, it becomes far more difficult.

With infrastructure, it is clear you are going from A to B, and then you procure it in the best possible way, but if you are doing housing you do not want the Government to, in some sense, underwrite the whole lot and pick who is going to be doing the building. You want the market to be able to do that. Yes on the land side; I am not so sure on the finance side.

Mark Farmer: There is a role for how strategic housing schemes can be viewed differently, certainly more akin to infrastructure-type projects. It is one of the findings in my review: that we need to think about housing long-term, apolitically and across parliamentary cycles if we are going to get anywhere in terms of improving numbers. The problem, if you look at infrastructure, is that most of what happens is either wholly or partly Government funded in the regulated context. You have certainty that there is going to be end demand use in terms of income, and there is regulation around what the income will be, whether it is the utility sector, rail fares or whatever.

In the housing and real estate sector, you have the variability that has just been referred to. If you are going to have a garden village-type concept, it is still going to be significantly led by the private sector and it is going to be subject to the vagaries of the real estate market around end demand. Again, going back to the comments I made at the beginning, there is the ability to influence the right policy environment, but the interventions need to be safe in terms of making sure the taxpayer is protected and the end outcome is not one that saddles the taxpayer with a burden. It is all about prudence.

Philip Callan: The garden villages and beyond have a major role to play. It is the issue in terms of unlocking those sites. It is all around certainty. If you take Barking Riverside, where we are looking to build, the expectation is that 10,000 to 12,000 homes might get built. I did a review of that site in 2006. It has not been brought forward at any great speed because it is a market-led scheme. You need certainty.

From the Government's perspective, the balance is that if you put some certainty into that by purchasing some of those properties and you speed up the process, there are many benefits for you to have in those

circumstances. What we are saying in the fund is that if you go down that route, the £10 billion is matched by £2.4 billion of economic impact in the first year.

Q235 **Chair:** If I may cut across what Professor Ball has said to us so far, if we look at success of the new towns where we actually got houses built, we did a lot by intervention. We compulsorily purchased land at existing-use value, not at future-use value, and the public sector putting the infrastructure in allowed private development, where appropriate, to take place.

Professor Michael Ball: The new towns were mainly public sector housing for a very long time. It was only the last few that were not. The new towns happened at a time when there was an awful lot of public housebuilding. The success of new towns, whether one likes them or not, is very much associated with that era. We are no longer in that era. A worry within this context again is that the Government invest a lot of money and then things do not happen because of market changes or whatever. All the risk is being taken by the public sector in a context where you would normally expect the private sector could and should carry the risk.

Q236 **Chair:** Do you seriously think that anything on the scale of new towns, garden cities and garden villages could possibly develop without significant up-front public sector commitment?

Professor Michael Ball: No. It is the housebuilding we are talking about, not the infrastructure and the underlying nature of the town. If you had somebody come in and do a big land development scheme, which again happens in the US and Australia and other places, and essentially make clear that this would work and win, you could then get the private sector building the homes if you required. You could similarly have social institutions coming in and setting that up, but you would not need to have the public sector building all of the houses. That would be a very large amount of the public sector and not particularly necessary.

Q237 **Helen Hayes:** Sticking to that theme of the role of different parts of the sector in the housing market, is affordable housing a more stable investment prospect for developers? When it is properly funded and resourced, does it play a role in stabilising and evening out the bumps there can otherwise be in the private part of the market? Everyone is nodding.

Professor Michael Ball: Unfortunately, no. Naturally, the people who are economically struggling get hit badly by economic turmoil. If there is a recession or interest rates change or anything like that, those people will tend to be highly vulnerable.

Q238 **Helen Hayes:** Which people?

Professor Michael Ball: This is in terms of affordable housing. Affordable housing is used in so many different ways, but if it is just in terms of a house somebody can afford and they are paying the rent for it, they are much more vulnerable. If affordable housing is the state

providing and subsidising the housing to 100%, that is clearly a very different model. It is the traditional social housing model we have had.

Was that less risky for housebuilders in the past? The answer is no, because public expenditure tends not to carry on on a very steady basis. When there were high levels of public expenditure and economic problems were reached, you got very substantial cuts in capital programmes, and housing was part of those capital programmes. Historically, even on the public sector funding side, you cannot say it is more certain.

Mark Farmer: If the question is about smoothing the bumps around the construction output in our country, the answer to that is yes, from my perspective. I see affordable housing as a countercyclical policy tool. Particularly with the dependence we have at the moment in the UK around private for-sale housing, the fluctuations that stem from macroeconomic conditions and other issues mean that the industry has probably never been more synchronised, particularly as the registered provider model has also now adopted a cross-subsidy model and is reliant on for-sale housing. We have a massive risk around the bumps or the boom-and-bust cycle that our industry follows being even more amplified than we have seen in past times. This is all about timing.

It is important to have a well-timed, stepped-up commitment to affordable housing in a way that smooths a downturn, perhaps, in private for-sale, alongside what I previously suggested is an acyclical private rented market, to stimulate the institutionally backed build-to-rent sector, where the rental velocity is a lot more agnostic than sales velocity, which is linked to an ownership cycle. That kind of integrated housing policy, again, comes back to certainty. It gives the construction industry more certainty. You get housing delivered, as opposed to being dependent on the private sector and driving down into a downturn. It is about timing: how you push and pull the levers in the right way at the right time.

Philip Callan: It has been a very useful tool. It now struggles to be so, because you have moved from a grant-based environment, where maybe half the cost of a house was covered by grant, to a situation 18 months ago where you were probably down to 10% of the cost being covered by a grant. Therefore, as Mark said, associations have moved much more into a developer market to provide that cross subsidy. You can intervene, but in a market turning down you would need to intervene with more public subsidy in those circumstances.

There are two crucial things to note. First, even when you have had that intervention, we have been bouncing around 160,000 homes a year. We do not get beyond that point. Secondly, disagreeing with the professor, regarding the public building we did in terms of new towns and so on, when we were building homes in the 1950s and 1960s they were subsidised through 60-year money. The rents were not subsidised. Often when people moved into their new council property, they were paying more for their council property than they were paying in the

private sector. Let us not misunderstand what that provision was at that time.

Q239 **Helen Hayes:** Building on that discussion, can I ask each of you to set out what you think the role for housing associations and local authorities is and should be in delivering the homes that the country needs?

Philip Callan: Housing associations play an absolutely crucial role. They now have 3 million properties. Typically, you look at an association and they will house one in 10 of the people who live in a town or a city. They are crucial providers of accommodation and they are extremely financially secure organisations, driven by good leadership and governance but also by regulation, which has ensured that they operate in an appropriate way.

They are very much enabled now to provide more homes. That is why we are promoting them as being the key part to get this fund under way. They are skilled in terms of managing homes, building communities and building successful places.

Mark Farmer: I would reiterate that. The registered provider housing association set has a massive role to play. It is effectively a dormant capability that needs to be re-energised through the right support. The challenge is, as Philip said, because of the cross-subsidy model, if you want to intervene and manipulate, there is probably going to be more public subsidy involved. Irrespective of that, the housing association sector has a key role to play in promoting innovation. The model is one where it is not just about development; it is retaining the asset and managing the asset. It is a mixed-tenure approach, where there will be some for sale, some for rent and some for shared ownership and intermediate.

The absorption rate and the desire for speed of delivery is probably higher than in the volume housebuilder sector, where you are back to this constraint around sales velocity. Some of the larger registered providers have very large ambitions, increasingly so, as we see M and A activity in the RP sector. If you combine that with innovation, there are massive opportunities. You saw the announcement in December regarding the Spanish-Chinese consortium alongside Your Housing Group from the north-west. I can see the opportunity for more of those kinds of deals, where you get RPs' joined-up thinking with new innovators coming into the market to access and underpin large-scale development programmes building differently.

Professor Michael Ball: I do not think we were disagreeing about subsidies in the 1950s and 1960s; they were definitely there, and the public expenditure accounts tell you a lot about them. But it raises a point that links into yours: if you subsidise something, that does not make it cheaper. In the end council tenants were paying higher rents than the private rented sector—and were having better quality, so I am not arguing it was necessarily a bad thing. But there were subsidies

involved in the construction of those homes. I do not think we are disagreeing over that.

This point about subsidies is very important, though. There are essentially two fundamental points we have to say about the role of local authorities and housing associations. One is whether that means a particular tenure, and therefore whether they are going to build, say, simply around the social affordable area, or do you mean that in terms of housing associations now, they are building for sale and building for rent? In some sense, they are doing something parallel to the private sector. That is a strategic question and, to a certain extent, I have already answered that. I do not think they have the capabilities to do that and they should not have the capabilities to do that. Concentrating on the affordable social sector is a specialist activity. That should be their prime focus and they should avoid risks around that.

The second thing is whether you can bring in social and housing association activity when the private sector does not want to build anymore—in other words, in a downturn. Is that another sensible, good role for the public institutions and the social instructions? It seems obvious in principle that is a good idea, but there is one big problem: it takes a long time to get housebuilding up and running. By the time you have got it up and running, the problem itself might have gone away. We are talking about a number of years.

In the context of a recession like 2007 and 2008, it was clearly a good idea to try to stimulate housebuilding. In fact, more should have been done then than took place, in my opinion—by whoever. If you are going to get into a much shorter recession, you might find a timing problem. You have to be a very good forecaster to be able to say, “Oh look, next year we should bump up public expenditure because the housing market is going down.”

Q240 Helen Hayes: Is that not an argument for a policy framework that enables housing associations and councils to make a stable contribution to building the homes we need so that provision is there to ride out the downturn?

Professor Michael Ball: Yes, but then the question is: what level? We get back to my first question: what role should they be doing and what mix of tenures do we want in this country? That is a consumer question as well as a policymakers’ question. How do people want to live? What are their aspirations?

Q241 Helen Hayes: Thank you. Finally, it seems that there is a broad consensus around the role of build-to-rent and a more professionalised private rented sector supported by institutions. What should the Government be doing to encourage institutions to invest in the private rented sector in that way?

Professor Michael Ball: I am terribly sorry, but I am a bit of a dissenter from that view. I say that for two reasons. If you look around all the rental markets in the world, apart from Switzerland there are very

few where large-scale institutions play a major role in the provision of rental housing. We are low in this country, but it is by no means clear that the large-provider model is the one that somehow should become the norm. It happens in Switzerland because of tax arrangements and a variety of other things. There is a whole variety of reasons, but that is one of the factors. I would question also whether you necessarily get better quality with large-scale providers. There is no clear evidence. We would like to believe that, but the evidence is not there that that is always the case.

There is a problem there. Again, it is up to the providers to say which is best, because the one that is best will make the most money and will take the market share. It is not up to the Government to decide which group should be subsidised and supported so that they take the market share. There is no infant industry-type argument here—that we have not had it before, and therefore we need to support it. I do not think that is a very strong argument. Yes, if large-scale build-to-rent happens, terrific. It is great, because it means that consumers want it, this belief about quality is right and they can make money out of it, but it is up to the market to decide whether that is the case, not Government.

Philip Callan: These institutions have a key role to play, and if you look across the world you will see, certainly in Canada and the United States, a large number of routes that provide housing. They are very innovative. In Canada, you charge an inclusive rent that covers your heat and all your other utilities. You find that the people who provide that accommodation provide very economically run properties. They build effectively in those circumstances.

Institutions in this country used to be quite heavily involved in rented housing until after the second world war, and they moved out of that and moved into commercial because of regulation and intervention by Government. Our experience is that institutions would like to be involved. The product is not there. They are not ready. They are not natural developers of product, but they would be very happy to acquire product and run it, and run it extremely well. They have a long-term interest in the asset. They would want it to be appropriate. Anything Government can do to assist with that, and certainly around collective construction and what you might charge people in terms of acquiring a block of properties, might be something that could be done.

Part of the idea of the fund we are promoting is that you create a substantial pool of rented accommodation and also create a situation where there are many more developers who are producing rented accommodation that will stand the test of time, because in those circumstances an investor has to be in it for 25 or 50 years. Institutions have a key role to play.

Mark Farmer: I agree. Build-to-rent is a massively important sector. It is one that should be nurtured and incentivised by Government. One of the biggest reasons for saying that is the fact that it is fresh capital. We are going to increase housebuilding in this country and it is not going to

be all funded by the taxpayer; we need to find fresh capital. The biggest single source of fresh private money coming into the market is institutional finance for build-to-rent. £50 billion is a figure that has been talked about quite a lot. It is in that order. We are talking about tens of billions of pounds of fresh money. If you look at the US or north American multi-family housing market, it is quite clear that it has a role to play, and professionalization of that offer has something that is different from your small-scale landlord buy-to-let market. They should coexist.

It is absolutely right that one does not cannibalise the other. There is invariably going to be an element of people making choices. As has been said, the market will decide what is right and what is wrong, but in this phase of the UK market, where it is an immature and growing sector, it should be given all the support it can. My overlay on that is that, again, alongside the housing association sector, it is an ideal candidate for promoting construction innovation. Look at the types of clients you have: well-funded, deeply capitalised, programmatic, large-scale developer/investors wanting to enter the market that are probably more amenable to looking at different models of construction delivery.

If you look at what Essential Living are doing in Greenwich, where there is a very well publicised scheme, it is going to be one of the biggest modular, volumetric offsite-build schemes, driven by the fact that they think differently and they are looking to replicate that approach potentially on other jobs. It has massive benefits for the construction industry as well as overall housing supply. It should be promoted.

Q242 **Kevin Hollinrake:** In terms of foreign direct investment into the UK market, the Committee went to see a scheme in Archway by Essential Living that is backed by an American pension fund, I believe. How important is that foreign direct investment to the UK housing market?

Mark Farmer: It is critical. In terms of the money flows that I was just referencing, the new capital coming into the institutionally backed build-to-rent sector is dominated by foreign investment. A big chunk of that is probably north American, because it is a market that a lot of the investors there are used to. They are more used to family markets. It is a mature market, they understand it and they see the opportunity in the UK. There is a very interesting piece here around the fact that people see the opportunity to replicate what has been done in their home markets, whether that is in Germany or north America. We should be grabbing that money with both hands.

The other angle around FDI is from the construction perspective. The number of new entrants into the traditional construction industry from overseas has been notoriously low, in terms of big players coming in and being successful in the UK market. Again, harnessing innovation, pre-manufacturing and different approaches to construction is the theme. We have the ability for foreign money to come into the UK. We have fewer barriers to entry, such that they can land with joint venture partners or alliances, build factories, employ British people and use

different approaches that perhaps they have used in their own markets, and use that as a means to access the construction industry in a much more user-friendly way than perhaps if they landed and needed to use an existing, traditional supply chain, which has not been proven to be successful. Foreign direct investment is critical for me in all sorts of ways in terms of funding the housing supply but also resolving some of our construction industry issues as well.

Q243 **Kevin Hollinrake:** Professor Ball, you are less convinced.

Professor Michael Ball: Yes. There are some interesting historical parallels in this respect. I agree with what has been said so far. The point is that in the housebuilding industry of the United States, a number of UK firms went over in the 1970s and some of them burnt their fingers, because one of the problems is that you need to know the local market very well. Some of them were very successful and in fact Americanised themselves and disappeared. That was the possibility of having a foreign entry into the US market.

As was mentioned, when firms have tried to enter the UK market in housebuilding, they have been very unsuccessful. It has not worked at all. You could say it is the peculiarities or uniqueness of the British, but there is another more fundamental reason than that, which is there is a much more plentiful supply of land in north America, which enables entrants to build up market presence in a fairly straightforward way. There is not within the UK. We face a fundamental competition problem in housebuilding.

Somebody suggested that I thought the market was very rosy at the moment. We need an awful lot more competition in the housebuilding market. One of the things that obviously would be of great interest is if foreign investment came in and could succeed within the housebuilding sector, and bring new and alternative methods. In order to do that, they need to build up very substantial land stocks in order to be able to build. At the moment, the chance of doing that is very limited. One of the barriers to entry that limits competition is the availability of land supply. Some consideration in that respect would then achieve two things: first, you get more housing; and secondly, you get a lot more competition, which we definitely need.

Q244 **Kevin Hollinrake:** I agree with that point. Putting land availability aside, yes, foreign direct investment could increase competition. Why not UK investment? We have massive pension funds here too: local government pension funds and big pension providers could be putting money into the private rented sector. Why not? Are the yields not sufficient? What is the problem?

Professor Michael Ball: There is an argument that was produced in a report by the Investment Property Forum last year that there is a funding gap. One of the problems about build-to-rent is that it is a very expensive operation to manage. There is a lot of talent turnover, buildings, taxation issues and so on and so forth. They would argue that

it is still not long-term profitable to have a very large build-to-rent sector. They were asking for a little bit of Government top-up to their returns in order to achieve this. Whether members of this Committee feel that is a good idea is entirely up to you, of course, but that was their request. That highlights one of the reasons we have not in the past seen a massive expansion in large-scale institutional investment.

Philip Callan: It is not profitable. If you talk to the institutions, they will say, "If I take a commercial portfolio, it will produce a yield of 6%. If I take residential, it will produce a net yield of 4%." It is not attractive in those circumstances, but they do not necessarily do a like-for-like comparison, because if I have a commercial thing and I have let it out for 15 or 25 years, at the end of that I have a significant capital investment. It may or may not have grown very much in terms of value, depending on the rental I can generate out of that commercial property. If I am in a residential property, on the other hand, certainly in the UK and certainly over the last 30 years, I have seen significant value growth. What they do not look at is that combination between the yield from the property from a rental point of view and the capital growth. If I did a combination of those two, what would happen?

Typically, across the country, I get about 10% out of a property. Either I get it through rent or capital growth, or a combination of the two. The big reason why the institutions and the local government pension funds and others are not investing—and typically your local government pension funds have a very low level of property in them at all—is because the product is not there. If we were providing significant blocks of rented homes, you would be able to sell them in the institutional market. We just do not do it as a trend. If I am a housebuilder and I can build and the market is working, I will sell it into the market as a whole. I will not produce a block of 400 apartments and sell it into an institution, because I am taking all that risk in terms of whether it is going to be sold at the end of that process.

But the institutions coming in have a fundamental role to play. I will give you one example in London. There is a scheme in Silvertown that has Fizzy Living as the market rented developer; it is a housing association partnership with a foreign institution. They are taking the first 400 homes that are built on that site. They are unlocking that site; because they are building the 400 homes, the 400 homes for sale will get built and the 400 affordable homes will get built. Institutions have an absolutely crucial role to play. It is about creating a situation where that product is going to be available for them.

Mark Farmer: To build on the role of UK institutions, probably the single most disruptive entrant into the market, certainly from a construction and supply chain perspective, is Legal & General. It is really important to know what they are doing around entering the construction manufacturing arena. It is going to be massively disruptive to the construction market in a positive way. It is going to shake things up and create a different delivery model. As an institutional fund, L&G are active

in the build-to-rent market through their Dutch PGGM joint venture, and they have looked at the construction delivery side of things and are dissatisfied with that, and they are looking to have their own means of delivery and access to the opportunity around innovation and large-scale delivery in a slightly different way from perhaps what others have done.

I would probably analogise what L&G are doing more to what is happening in the Japanese market. The Japanese housing sector is really interesting around how it has taken innovation in construction and industrialised it. It is the scale of what is happening in Japan that makes it highly effective and efficient. Going back to the skills and productivity debate, which is critical here, we cannot lose sight of this, particularly in the light of Brexit and the additional pressures we have in the construction industry. Productivity is crucial. Look at the productivity that the Japanese manufacturing industry is able to achieve in terms of pre-manufactured housing. It is about three times as efficient as traditional construction delivery.

- Q245 **Kevin Hollinrake:** We will come on to MMC in a second. In terms of foreign direct investment, what about the effects of a falling pound? Is that going to have a negative impact in terms of potential investment from overseas?

Professor Michael Ball: It will stop falling one day.

Kevin Hollinrake: It fell again today.

Professor Michael Ball: In that sense, it is a new game plan. In terms of long-term effects, no. One thing about foreign investment, which is probably outside the remit of our discussion here, is that there are a lot of foreign investors in properties themselves on an individual basis. If they are encouraged to rent those properties out, that might be a good thing, but if they are encouraged by the tax system here or in their home countries to leave them vacant, that might not be such a good thing. It is not the question of ownership that matters there but what is done with the properties.

- Q246 **Bob Blackman:** Do you think the Government should take tax measures to encourage foreign investors that have bought properties in the UK to rent them out?

Professor Michael Ball: Yes, I do.

- Q247 **Bob Blackman:** Thank you. Moving on, Mr Farmer touched on the availability of skilled individuals to provide the workforce we need for the building industry. What does the industry have to do? What do Government have to do in order to attract more people to work in this industry?

Mark Farmer: The scale of the issue is really important. My review was commenced pre-Brexit, so I was looking at something that was probably more of a demographic-led issue. What we have in construction is an ageing workforce; it is one of the most advanced in terms of its age of all the sectors in the UK. That suggests, based on census data and looking

at the level of new entrants to the industry, that we are going to lose 20% to 25% of our workforce over the next decade. With Brexit overlaid on that, whether that is a hard or soft Brexit, there are variations on a theme, but it is undoubtedly going to add more pressure to that. We might even be moving towards a situation where a third of our workforce is lost over the next decade or so, which, again, going back to my Japanese analogy, is what the Japanese economy has dealt with: a one-third shrinkage in its construction workforce.

Q248 Bob Blackman: You talked earlier about the reduction in the number of SMEs in the industry, which were then going into bigger firms. Is that then what happened? SMEs that were maybe working privately for themselves could not get the finance and then went into the bigger firms. Is it those people who are reaching the retirement age and saying, "I cannot sustain this as a job any longer"?

Mark Farmer: Yes. There has definitely been a moving around of where people are in the industry. We have a finite pool of resources that everyone is fishing in. People's work varies from, as I say, the repairs and maintenance, small-works jobbing sector at domestic scale, all the way through to working on construction sites at commercial scale or major infrastructure schemes. With the core trade skills, whether it be bricklaying, carpentry or whatever, there is a lot of crossover in terms of where people can work. There are some transferable skill sets.

Ultimately, what has happened over time is that, certainly as the SME sector has reduced, those skills have dissipated into other sectors, either down or up the value chain, if you like, in terms of the type of projects. Also, every year we have had more and more people leaving and fewer people coming in. It is a numbers game where we are facing a significant attrition rate. In answer to your question about what Government can do about it, there are two prongs to this, going back to the key themes of my report around skills and training and how they can play a part in creating the right environment for enhancing skills and training.

Part of that is already in play, with a review of the Construction Industry Training Board taking place, which is happening as a separate piece of work on the back of one of my recommendations. However, that alone will not solve our issues. That is more of an administrative question about how the industry funds its training and uses the levy grant system. The real point where Government have to play a part in changing the game, rather than the rules of the game, is in innovation. This is a productivity-led debate. Given the scale of the challenge we have around a declining workforce, we cannot, as I said earlier, recruit or retain our way out of the challenge of a reducing workforce. For me, that is all damage mitigation.

It is massively important that we get into schools earlier and start to influence people's thinking. I am talking about children who are 10 or 11 years old, not 16 to 18. We need to change their perception of the construction industry. My view is that you have to do the innovation piece first and re-profile what skills we need in the future. If we have a

modern, more productive industry that is a combination of traditional site-based working, artisan or “biblical” skills—whatever you want to call them—alongside more modern approaches, whether factory-based or hybrid but certainly digitally enabled, we stand more chance of attracting the youngsters. They are wanting something that is a bit more 21st-century, not necessarily something in the dark ages.

Unfortunately, parts of our industry still have that stigma attached to them, rightly or wrongly. We need to move the dial towards creating a different offer for youngsters. In doing that, not only are we increasing our productivity and are able to produce more with less, which I can say with absolute certainty we will have to do, but we stand more chance of increasing new entrants into the industry, because it is more attractive to them in terms of the mode of working. They are not necessarily on a cold, wet building site; even if they are going to be a bricklayer or a carpenter, they can do it in a factory, or they can do both. That is a really important part of the story.

Q249 **Bob Blackman:** If you go to a simpler, possibly less labour-intensive type of operation, does that not mean that you say, “You can pay people less money, because they are less skilled”? You do not need highly skilled people to do that. You can get anyone to do it. Is that not a risk?

Mark Farmer: The profile and type of skills you need will be different. They will be what I would term multi-skilled; there will be a lesser level of skill, but there would be a training that is required. The types of skills that go into a factory-based environment or a manufacture-led type of construction will definitely be different. For me, the reality is that we need that to take the pressure off the trained resource, of which we do not have enough. This is about a complementary approach, looking at the holistic numbers of what we have in terms of skilled, specialist labour, and we do not have enough of that.

We need to find a different way to be able to build more homes, reflecting the fact that we have declining resources. This is part of a rounded strategy around using innovation to redefine the skills that we need in the future, in the face of a massive threat around the sheer quantum of our workforce.

Philip Callan: The crucial thing is when. It is about taking out the vagaries of the market as it exists at the moment. What happened in 1992 when the market crashed? A lot of people moved out of the housebuilding industry and into maintenance, and they never moved back. Mark’s report is very thorough in terms of analysing what the issues are, and offsite production will be a key element of doing that, but at the moment you have difficulty in recruiting people into the sector, partially driven by people’s experiences. What happened to Bill, or Fred, or Mary? They are working in the construction industry and then they are out of a job. They are working in construction, and then they are out of a job. It is the cyclical nature of the market that creates the problem.

Back in the 1950s and 1960s, when we built all these homes, we went from building 150,000 homes to 300,000 homes in about 18 months. We were able to do that because there was a complete political agreement, across both parties, that we were going to build more homes. Once you have got that certainty into the market, you attract people in. People think, "This is a career I want to pursue. This is a career I want one of my children to pursue."

Q250 **Bob Blackman:** In the evidence that has been presented, you said 150,000 or thereabouts would be the maximum that could be built in any case. We know that we need to provide 200,000 homes a year just to stand still, but no-one has ever done it. I do not think it is a matter of political debate between different political parties about this. It is a case of saying, "Yes, we need to do it." Given that everyone knows we want to do it, what provides that stability and encouragement to the industry to do it?

Philip Callan: What provides that is providing a purchaser of those properties. What is missing in the market at the moment, and has been missing since the late 1980s, is somebody buying rented homes on a scale. You have had somewhere between maybe 15,000 and 25,000 social rented properties produced by associations, topped up by shared ownership, over the last 20 years. Since we stopped building scale rented homes, the market has not worked. You can plot the point when the market stops functioning, and it is when we stopped building rented homes.

Professor Michael Ball: I have a slightly different image of the industry. I can take the point about ageing, and it is very much the need to keep on sustaining the skills and thinking of new skills. All those sorts of arguments I am in total agreement with, but I cannot see the construction industry as being this thing that just has a group of people who work in it. In the UK and elsewhere people tend to come in and out of the industry on a very considerable basis. The reason for that is that a lot of the skills they have are shared elsewhere; they take place in many other sorts of industries—carpentry, for instance. You can run through an awful lot of the trades. Also, they might simply do something else. You can see that there is quite a lot of flexibility.

I do not believe there is a ceiling of 160,000. We can build as many houses as we want. Obviously there are macroeconomic constraints in terms of what we are talking about, but if we really wanted to get half the workforce in the country building homes, it would be a funny world, but I am sure the technologies that exist at the moment would make that feasible. A lot of the houses would not be very good, I would say, but the point is that there are lots of flows and there are flexibilities. There is not, in my view, a doomsday limit in terms of how many houses you can build or what will happen in the future. It is a much more gradual process.

In terms of techniques, the cost of doing housebuilding in particular ways will drive the change in techniques. At the moment, typically modern

methods of production are seen as creating situations where firms cannot time the sales as they want, or make the return that they would do using other techniques, but in the future that might well change, and then we will see a tip towards new areas.

I am sorry to keep on saying this, but it is not for Government to decide the best technology for building a home. I would not know, and I do not know how many people within Government would know. It is up to firms to make that decision themselves and to work out supply chains. That is not a criticism of what has been said by Mark Farmer, because he is talking about how you get that going in a dynamic. It is the process and way of understanding it, rather than seeing these massive disjunctures.

There is another point to make, which is that modern methods of construction only deal with a very small part of the housebuilding process. They are not about land assembly. They are not about design. They are not about raising finance. They are not about organising site sales. They are not about working out infrastructure, the layout of sites and putting in services, and so on. They are a part of the process, but only a part, and they need to fit in with all the rest.

Mark Farmer: Just to build on what Michael has just said, I agree that it is not a panacea. There are lots of other things that need to be dealt with, including the land and planning pieces etc. Michael touched on something around quality, and there is a really important part here about quality. You would have seen in the last week or two news of a quite well-known housebuilder that has had a problem with regard to quality. It has cost them their CEO. There is a growing feeling that traditional building in the housebuilding world is not delivering the quality that purchasers or renters are expecting in terms of the legacy of defects.

We are just on the tip of the iceberg in that regard. The pressures that the traditional trade workforce has had applied to it mean that we have substandard building going on at scale. We are building a legacy issue in terms of downstream defects and maintenance issues that is pretty serious. I do not want to overgeneralise, because there are a lot of people out there who are extremely well trained and very competent, but that is being diluted. The numbers imperative is driving people into the industry at an accelerated rate, potentially where the competence levels are not as high as they were. That is another reason for wanting to promote innovation and offsite solutions, where quality control and more certainty of outcome is really important.

Q251 **Bob Blackman:** Mr Farmer, in your report you mention Brexit, and no debate in this place is ever complete without mentioning the subject. This is an important issue in terms of the availability of labour. You suggest that that is not going to have much of an impact. What is your justification for that? I will tell you why I ask that: in my constituency I have, broadly speaking, about 8,500 Romanian citizens who have come here over the last three years, and almost all of them are in the construction industry. They have skills and capability, and they are working. There is clearly a requirement for them. If they choose to

disappear, presumably those skills and that availability of labour will disappear. Do you not think that will have an impact?

Mark Farmer: I am not sure my review says it will not have much of an impact. The point I was trying to get across is that most of my review is written pre-Brexit, and Brexit purely reinforces the fundamentals of what I was setting out regarding the demographic piece around an ageing workforce. It does not change what I was saying. The issue is we have a shrinking workforce. Brexit will overlay an additional level of risk, and there are two levels of risk there. One is definitely the fact that, depending what comes out post-Article 50, with border controls or ring-fencing of construction for special cases, or whatever it might be, we stand the risk of having reduced forward flows of EU migrant labour.

The secondary issue, which I am starting to hear anecdotal evidence of, is that the EU labour we have here already is having second thoughts as to whether it is staying. That is even more dangerous and insidious.

Q252 **Bob Blackman:** The consideration will be—and I think we have heard it from all the panel—that people work in a different way. They are not on PAYE. They are not necessarily employed by a company; they are effectively employed as agency workers in some guise or other. Particularly where there are immigration controls that say you have to have a job and skills, and you have to prove you have the capability before you come here, clearly that has a huge impact on this industry, in the way you have described it. Would you agree with that?

Mark Farmer: Yes, I would. Going back to the point about risk to existing workers here, one of the issues is obviously the currency-related impact. A lot of EU nationals repatriate some of their earnings back to family in their home countries, and overnight, or over the past few months, the value of that back home is a lot less. That is starting to influence decision-making around people's plans. There are lots of real dangers about how the Brexit impact can play out in construction. Construction has massive exposure to it. In London, 40% to 50% of the workforce is not necessarily EU but migrant labour. Nationally, it is somewhere between 10% and 15%. I was hearing from colleagues both in Wales and Scotland last week, and this is not an England issue but equally applicable in Wales and Scotland. Big infrastructure projects like the Swansea bay tidal lagoon that was in the news last week are at risk due to the Brexit impact around the availability of labour.

Q253 **David Mackintosh:** Do you think the industry is as efficient as it could be?

Mark Farmer: No—far from it. When we say “the industry”, there are obviously different component parts to that; you look at the development industry holistically. It is massively fragmented. The way in which value is generated through the value chain in development is distorted. There is too much bias towards land value creation rather than creating value out of building stuff. We are in a real economy. We should be focused on driving value out of doing stuff, not speculation, and that is an unfortunate part of what development has grown to be. It is about trying

to promote more value out of taking a raw piece of land and getting planning consent and seeing a land value uplift, as opposed to value driven by building something. That is an unfortunate state of affairs.

If you look at the construction industry, which is my area of specialisation, it is massively inefficient. The reality is that if you look at construction productivity relative to other sectors, particularly manufacturing, or automotive or aerospace, it does not compare in any shape or form. A lot of that is down to how the industry is shaped and the fact that construction is inherently site-based. It is subject to the vagaries of the weather and all sorts of very specific issues. However, the suggestion is that 50% of everything that is done in construction is waste, just to give you a flavour of how much there is to go for: 50%.

That is either reworking, where you are rectifying mistakes, defects post-completion, design that is not managed, construction activities that are not managed, or transactional interfaces. Because of the fragmentation of our industry, you have lots of subcontracting. Every time you have a transactional interface, someone is on-costing without necessarily adding value. It is massively inefficient.

Q254 **David Mackintosh:** Do you think builders of new homes for owner-occupiers have any incentive to build them as quickly as possible?

Mark Farmer: In terms of building for sale and owner-occupation, there is ultimately going to be a constraint around the sales velocity issue that has been spoken about already. I do not think there is any incentive for a housebuilder to flood one of their developments with unsold products. They will be absolutely driven by work in progress. The cash flow-based model they operate, particularly in the wake of the last downturn, where lots of them ended up with unsold inventory, will be driven by making sure that they carefully manage the rate of build and rate of completion against what they think they can sell.

The answer is I do not think there is an incentive to build as quickly as possible. You do see that in the rental market, where there is greater absorption ability, and in shared ownership to an extent as well, where there is greater demand for that. The speed at which the market can absorb new housing products will be skewed towards non-owner-occupied segments of tenures.

Q255 **David Mackintosh:** Finally, do you think there is enough innovation in the homebuilding sector?

Mark Farmer: No, absolutely not, for all sorts of reasons that I have already described. Ultimately, you could argue that it is part of the model that there is no incentive to innovate. The model is one that is about cash preservation; the level of capitalisation in the construction and housebuilding industries is very low. It is all about cycling money and cash flow. Going out and doing research and development, thinking differently, and looking at different ways in which you might deliver construction or product is quite low down the list of priorities.

However, in my discussions with some quite large housebuilders at the moment, there is a gathering of feeling about the quality issues I referred to earlier. There is concern about reputational risk and damage in terms of homes being delivered that are poor quality, and there is increasing concern about how that plays out in the media. Some of that is driving behaviour and the idea that maybe they need to think about a different way of delivery. Even if it is a negative reason for innovating, it may well be that we are on a journey where that can start to improve.

Professor Michael Ball: Is it possible I could make a couple of comments? The first one is slightly jocular, but it has some intent beneath it. I am an observer of the construction industry, not a member, and I look at other industries as well. One thing I observe is that it wins first prize for self-criticism. It brings out its weaknesses and discusses them in a quite considerable way.

Yes, the construction industry could do better, but there is no overwhelming evidence that the construction or housebuilding industry in this country is any better or worse than others in general. Clearly you can always pick on best practice in many areas, but you cannot expect your industry to have the best bits of best practice for everything. Yes, there is an efficiency issue, but the policy implications are essentially non-existent, unless you get down to specific issues.

Secondly, in terms of speed, we want in housing a high level of housebuilding, year after year after year. We do not want a sudden burst of housebuilding that somehow does the job and we can all sit back and relax. We want a much higher flow of housebuilding. Within that context, speed is not necessarily the overriding objective. It is getting up to a level and then sustaining that level. In other words, there are a lot of institutional and market relationships that we are talking about: the nature of the planning system, the link of private housebuilding to the need to have sales rates, and so on and so forth, which you will have heard a lot.

Those sometimes, and quite often, will militate against building at the fastest possible rate. The important thing, as I said, is to get up to that level of housebuilding, and if it takes two years or one year to build a house, it does not matter, as long as you have the same number coming out each year. In other words, it is the flow that matters. That is the important thing to concentrate on.

Chair: Thank you all very much for coming to give evidence this afternoon. It may have slightly differed from the earlier evidence of your colleagues, but nevertheless it is good for the Committee to hear different points of view. Thank you very much indeed.