

Institute for Public Policy Research



THINK SMALL, BUILD BIG

LESSONS FROM SME HOUSEBUILDING IN GERMANY

**Ed Turner, Luke Murphy,
Bill Davies and Charlotte Snelling**

December 2017

ABOUT IPPR

IPPR, the Institute for Public Policy Research, is the UK's leading progressive think tank. We are an independent charitable organisation with our main offices in London. IPPR North, IPPR's dedicated think tank for the North of England, operates out of offices in Manchester and Newcastle, and IPPR Scotland, our dedicated think tank for Scotland, is based in Edinburgh.

Our purpose is to conduct and promote research into, and the education of the public in, the economic, social and political sciences, science and technology, the voluntary sector and social enterprise, public services, and industry and commerce.

IPPR
14 Buckingham Street
London
WC2N 6DF
T: +44 (0)20 7470 6100
E: info@ippr.org
www.ippr.org
Registered charity no: 800065 (England and Wales),
SC046557 (Scotland)

This paper was first published in December 2017. © IPPR 2017

The contents and opinions expressed in this paper are those of the authors only.

The progressive policy think tank

CONTENTS

Summary	3
Key findings	3
Recommendations	4
1. Introduction	5
2. The position of SME builders in England	7
The ‘toxic triangle’ of challenges.....	8
Lack of available and viable land.....	8
Challenging planning system	8
Lack of finance	8
Discussion and outlook	13
3. The position of SME builders in Germany	14
The relatively strong position of German SME builders	14
To what extent does the ‘toxic triangle’ exist in Germany?.....	15
Discussion and outlook	19
4. Conclusion and recommendations	21
References	25

ABOUT THE AUTHOR

Ed Turner is senior lecturer and head of politics and international relations at Aston University, based in the Aston Centre for Europe.

Luke Murphy is a senior research fellow at IPPR.

Bill Davies was previously a senior research fellow at IPPR and supported this work in a personal capacity.

Charlotte Snelling is a research fellow at IPPR.

ACKNOWLEDGEMENTS

This research forms part of the joint project between Aston University, the Social Science Research Centre, Berlin, and the IPPR. We are grateful to Susanne Marquardt for her contribution to the report and for the feedback from Andrew Dixon and John Slaughter. We held a round table with specialists on the SME sector from the two countries, and have followed this up with desk-based and analysis, as well as relevant interviews. We are grateful for the financial support of the German Academic Exchange Service (DAAD) for this project, as well as the input of those who gave generously of their time at the round table or subsequent discussions, and who commented on an earlier draft of this paper.

Download

This document is available to download as a free PDF and in other formats at:

<http://www.ippr.org/publications/think-small-build-big>

Citation

If you are using this document in your own writing, our preferred citation is:

Turner E, Murphy L, Davies B and Snelling C (2017) *Think Small, Build Big: Lessons from SME housebuilding in Germany*, IPPR. <http://www.ippr.org/publications/think-small-build-big>

Permission to share

This document is published under a creative commons licence:

Attribution-NonCommercial-NoDerivs 2.0 UK

<http://creativecommons.org/licenses/by-nc-nd/2.0/uk/>

For commercial use, please contact info@ippr.org



SUMMARY

The small and medium-sized enterprise (SME) housebuilding sector in England has seen persistent decline over the past three decades, which is proving a major barrier to increasing housing output. The number of SME building companies is barely a quarter of what it was in the 1980s, and the share of output of SMEs is just half its previous level of 57 per cent of the market. By contrast, in Germany, the sector continues to hold a predominant position in housing development. This is a real problem – it is a major reason why Germany’s housing output has been consistently far higher than England’s, and why too many small and medium-sized sites in England are not being developed despite being appropriate for housing.

We diagnose a ‘toxic triangle’ of problems facing English SME builders, with mutually reinforcing problems stemming from the planning system, the land market, and insufficient access to finance. We then summarise the situation in Germany in each of these three areas, finding that in all, the German system performs far better. Overlaying these policy specifics, Germany has a far more localised and regionalised development market, which is beneficial to SMEs. There are important lessons for English policy-makers – even if the precise nature of German policy cannot be replicated, the German experience points to important pre-conditions for a successful SME housebuilding sector that need to be the focus of government policy.

KEY FINDINGS

There has been a catastrophic decline in the size of England’s SME housebuilding sector. This is not the case in Germany, where the SME sector dominates the housebuilding market.

- In England, the planning process works against SME housebuilders in several ways. There are significant ‘up-front’ costs to submitting an application – without any great certainty about its likely success – and cash-strapped local planning authorities may prioritise larger sites when formulating plans for their areas. In Germany, there is often greater certainty about whether the principle of development is acceptable, meaning that a developer can plan with greater certainty. Resourcing of planning departments is an issue in Germany as well as in England, however.
- The land market in England sees too few small sites come forward for development, again hampering the efforts of SMEs. SME builders are unlikely to have large land banks, the public sector has shown little interest in ‘parcelling’ large sites, and there is very little custom-build housing (which is of substantial interest to SMEs). In Germany, shortage of sites is also considered to be the biggest constraint on the activity of SME builders. Nonetheless, there are policy tools to prevent the ‘hoarding’ of land by those who do not intend to build it, parcelling of sites by the public sector is more common, and in particular custom-build housing plays a significant role.
- Access to development finance is also a major impediment to England’s SME housebuilding sector, which heavily relies on major banks. The availability of finance is strongly responsive to changes in economic conditions, as seen in the substantial contraction following the 2008 financial crisis. Government attempts to address this have been well intentioned but have often missed the target. In Germany, major private banks play a much smaller role in providing development finance than local savings banks, co-operative banks, and

regional banks. This strengthens the relationship between individual builders and their financiers, leading to lenders' decisions being taken on the basis of local knowledge rather than generic judgements about the sector, and also shows greater resilience to economic shocks.

- These issues are inter-related – for instance, the nature of the planning process in England and the land market compound the problem of lack of development finance. It would not be possible simply to ‘transplant’ the German model – which is rather deeply embedded in Germany’s economy and indeed wider society – into England. However, the areas where the German system works far better for SME builders can provide important evidence and input for English policy-makers.

RECOMMENDATIONS

Drawing on experience from Germany, we recommend to government a seven-point plan to give England the greatest prospect of revitalising its SME building sector, thus making a substantially greater contribution to housing output:

1. **Look to provide greater certainty for SME developers early in the planning process, and increase the volume of small sites coming forward for development.**
2. **Seek to provide greater clarity on developer contributions.**
3. **Provide robust support for custom builders in planning and in financing, and support a range of tenures.**
4. **Make increasing housing supply a clear objective of release of public land, and recognise the potential of SMEs to contribute to that.**
5. **Provide tools to local government to support build-out of land allocated for development, including a stronger role for local authorities in land assembly.**
6. **Have a clear objective of central government to ensure SME builders have sufficient development finance (monitored by the OBR), whether from the private or public sector, and regularly review the success of government-funded programmes.**
7. **Review the risks of Brexit to the SME housebuilding sector of Brexit and ensure that future immigration controls are not overly burdensome and unworkable for SMEs in the construction sector.**

1. INTRODUCTION

The decline in the number of SME builders and the scale of their output in England is widely acknowledged to be a significant problem, imposing a huge constraint on capacity in the development market (for instance, Lyons 2014; NHBC Foundation 2014; Walker 2016; HBF 2017; Dromey and Murphy 2017). This has also been acknowledged in the government's recent Housing White Paper, which stated an ambition to 'help this sector to grow and develop again' (CLG 2017: 47). It remains a simple statement of fact that the number of SMEs has plummeted since the 1980s:

'During the 1980s there were on average 10,000 SME builders (those building 500 units or less) delivering around 57 per cent of all output, last year [2013] there were around 2,800 of these builders active in the market, producing 27 per cent of new homes'

Lyons 2014: 23

This decline is not simply a product of the 1980s recession but also more recent economic shocks. The white paper notes that 44,000 new homes were registered by SME builders in 2007, dropping to just 18,000 in 2015, while the HBF pointed out that 'the largest companies have been responsible for around 90 per cent of volume growth since the [2008/09] recession', and that the housebuilding industry lost over a third of its companies in the 2007–09 period (HBF 2017: 14–20).

There are at least four good reasons why English policy-makers should want to address these problems:

- It is accepted that the dearth of SMEs is a serious constraint on capacity in the UK's housebuilding sector. Even an optimist would have serious doubts about the ability of volume housebuilders to contribute more than around 100,000 units to housing supply (a level not even reached in the boom years of 1988 and 2007), yet the white paper acknowledges a need for between 225,000 and 275,000 new homes per year in England (DCLG 2017: 9). At times, in order to maintain a flow of sites or due to the limits of what can be fully built out and sold in a short period, volume housebuilders will not build out all the sites to which they have access, whereas SMEs building smaller sites are more likely to want to complete these quickly (CPRE/Housing Foresight 2014: 9–10).
- On a related point, SMEs will be able to progress smaller (and potentially more complex) housing sites of little interest to larger firms, and therefore raise housing supply (reaching the sites other developers cannot reach!). For instance, in London, large sites make up two thirds of provision and have been shown to be slower to come to market and require greater upfront investment and infrastructure planning (Wilson and Brown 2016; Snelling and Davies 2017). SME builders can play a role in bringing a greater variety of sites to market for development.
- SMEs may help to provide greater variety in the market, specifically by offering options such as custom build and niche products like 'pocket housing'¹. This diversity could again drive supply, by adding to the diversity of the market and filling the gap left by volume house builders who (due to their business models) can only build and sell a limited number of homes (Lyons 2014).

1 Small one-bedroom units sold at a discount on the market rate, which is required in perpetuity.

- With Brexit, there are significant risks to the residential property sector, for instance around access to finance, but also skills (Dromey and Murphy 2017). Understanding the needs of SMEs at this juncture will be important if the sector is to maintain capacity and then grow, rather than decline further.

All the discussions referenced above point to a common diagnosis of the problems of England's SME sector (although with certain nuances) – what this report refers to as the 'toxic triangle', with three predominant and inter-related factors:

- A planning process which requires expenditure early in the process, before the principle of development has been established, necessitating the builder to take risk. Sometimes this critique is broadened to include difficulties engaging with local authority planning departments and regulatory requirements placed upon housebuilders.
- A land market which means insufficient small sites are accessible for development by SMEs.
- A banking system which fails to meet the requirements of SME builders and which is particularly prone to withdrawing funding during times of economic difficulty.

To this diagnosis might be added frustration at public sector disposals of land favouring larger organisations, a reliance upon a model of housebuilding where the major product is a home built by a housebuilder for sale which constricts the number of homes delivered due to their business models and the undeveloped nature of the custom-build (sometimes confusingly known as 'self-build') market in the England.

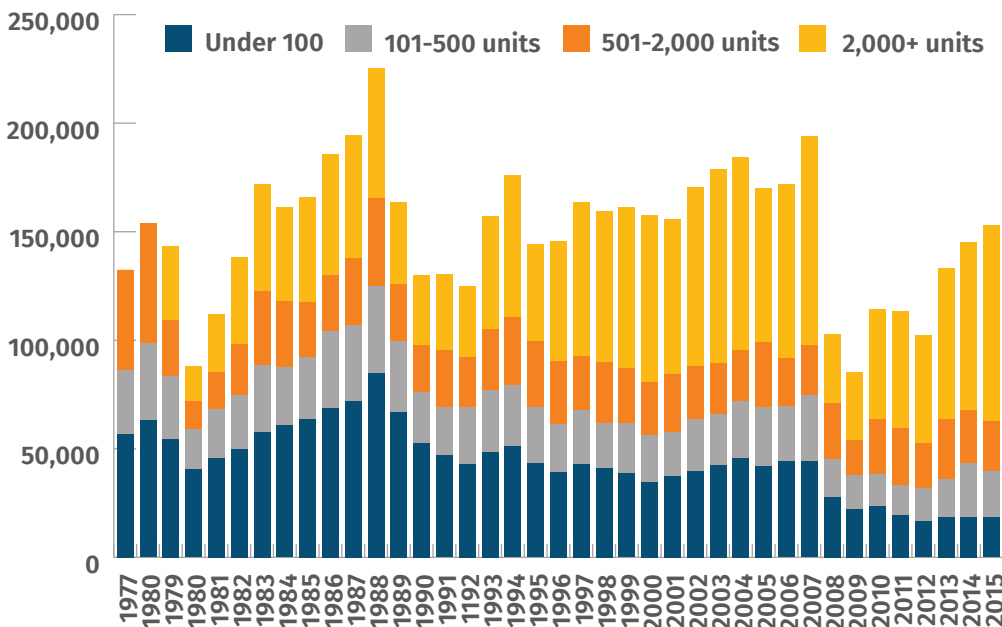
Yet although there is significant common ground between the various studies mentioned above on the nature of the challenges faced by SME builders, there has been relatively little comparison with markets where the sector is in a stronger position. Such comparison could help identify potential solutions, and at least give us pause to consider whether particular established practices should change. Germany, for example, provides an excellent such case. There, the SME sector remains significant, and capacity constraints on new housebuilding are barely present in Germany, in contrast to England. These were key findings of our interviews conducted during 2015 and 2016 with a range of relevant experts and practitioners.. Nonetheless, two of the three features of the 'toxic triangle' from the UK (insufficient numbers of appropriate sites becoming available for development, and difficulties with the planning process and regulatory requirements) are becoming evident in Germany.

2. THE POSITION OF SME BUILDERS IN ENGLAND

THE DECLINE IN SMEs

As discussed in the introduction, there has been a decline both in the number of SME builders and their share of overall housing completions:

FIGURE 2.1
Housing starts by size of developer, Great Britain



Source: Lyons 2014

As can be seen from the chart above, there were two key 'dips'. The first was in the late 1980s and early 1990s, when there was a significant fall in both levels of output and the number of companies. Even with the improved economic position of the mid-2000s, this failed to recover to its previous level. The second key 'dip' followed the global financial crisis of 2008/09 and associated recession. Two key lessons can be drawn from this: firstly, the SME building industry is particularly exposed to economic shocks, and secondly, it lacks the ability to 'bounce back', and once companies have folded, and workers have moved on, that capacity cannot be recreated when demand for housing picks up again. In each case, the HBF argues that the impact of the recessions was exacerbated by change to the planning system. In the early 1990s, it contends that the 1990 Town and Country Planning Act increased the onus on developers to ensure sites were identified in a Local Plan (HBF 2017: 18), thus lengthening the time and expense required to bring a project to fruition. In 2010, new provisions to prevent 'garden grabbing', or small

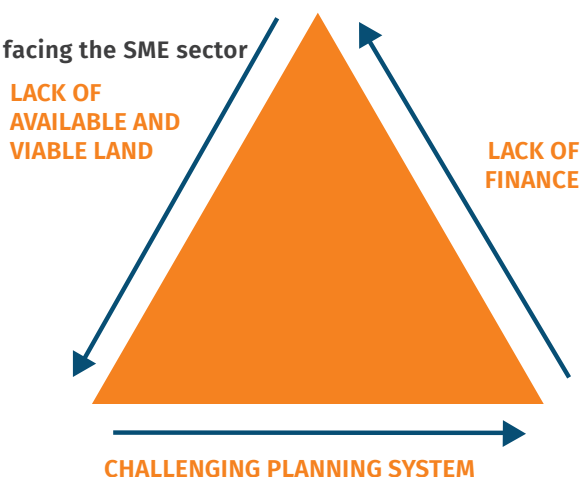
infill developments that were traditionally the preserve of SME builders and which generated a degree of public resentment, were introduced and exacerbated the sector's woes (ibid: 20).² This chart also shows that housing growth in the last few years has been delivered by larger housebuilders, and the position of SMEs has been almost entirely stagnant.

THE 'TOXIC TRIANGLE' OF CHALLENGES

There is a degree of consensus that the SME sector faces at least three inter-related areas of challenge (our 'toxic triangle' of problems) and these will now be discussed in turn. The identification of these areas comes from our review of the relevant literature and discussions with stakeholders: however, it is also supported by the most recent FMB survey of housebuilders (2016: 9) which found that the main constraints on housebuilders' ability to build more homes were 'lack of available and viable land' (named by 67 per cent), 'lack of finance to the company' (50 per cent), and 'the planning system' (50 per cent).

FIGURE 2.2

The 'toxic triangle' facing the SME sector



Source: Authors' own depiction

The planning process

In order to develop new housing in England, planning permission needs to be granted for the site in question. This may have a number of different stages:

- **Ensuring the site is appropriate for development according to the Local Plan** (a statutory document produced by the local district or unitary council, allocating land and setting local planning policies). In some cases, this might require active promotion of the site at the time of the Local Plan examination, if, for instance, a change from the allocated use is required. In some circumstances, the site will already be identified as appropriate for housing.
- **Preparation of a planning application.** At the very least, this will involve the engagement of relevant specialists, such as architects, and may also involve

² Specifically, planning guidance was changed so that domestic gardens would be treated as 'greenfield' land, and the National Planning Policy Framework excluded domestic gardens from the definition of 'brownfield', or previously developed, land. The loss of domestic gardens, according to the government at the time, led residents to have a perception that once spacious, green areas were being turned into a 'concrete jungle'.

pre-application discussion with the local authority (often charged separately) about what might and might not be acceptable on a site.

- **Submission of a planning application.** This can be split into an ‘outline’ application, to establish the acceptability of the proposed development, and then a later ‘reserved matters’ application clarifying details such as the precise appearance, access, and layout.³ The local authority will then decide whether the application is acceptable when considered against national, local and, if applicable, neighbourhood planning policy requirements, and if it is, will grant approval.
- **Conclusion of legal agreements and ‘discharge of conditions’.** Planning permissions may be contingent on the negotiation and conclusion of a legal agreement with the developer to make certain provisions which make a development acceptable (such as affordable housing). In addition, developments will normally be approved subject to certain conditions, and additional information will then be needed from the developer on how these are to be ‘discharged’.

Applicants do have the right to challenge the local authority at various stages of this process if they are dissatisfied. If a site is not included in a Local Plan, representations can be made to that plan’s examination; if permission is refused, the applicant can appeal to the Planning Inspectorate, which reviews the decision. An applicant could also appeal against conditions or planning obligations that seem unreasonable, and the government proposes introducing a new mediation process specifically for Section 106 agreements.

In all of this, there are several particular challenges for SME builders:

- Promotion of a site into the Local Plan is a potentially costly process with an uncertain outcome. It requires the submission of detailed information (especially if the plan is contrary to the wishes of the local authority), and the payment of relevant professionals who will draw together arguments (for instance, about the nature of the local housing market and extent of the housing need), and may include hiring a barrister for the examination itself. The process of producing a Local Plan can take several years, and such timescales and requirements for forward-financing are especially difficult for SME developers living ‘hand to mouth’.
- The extent of information required even for an outline planning application is potentially costly to produce, and the outcome is necessarily uncertain. The outcome can be ‘firmed up’, but engaging with the local authority prior to the submission of an application in pre-application discussion brings its own costs, with fees to the local authority and any planning consultants or architects who have been engaged.
- In producing local plans, there is a sense that local authorities often prioritise large sites over smaller ones for reasons of expediency (making greater strides towards allocating space for the necessary number of homes) and cost effectiveness (HBF 2017: 29). Walker (2016: 15) cites one local authority representative as stating that including all sites in the local plan would add two years to the plan-making process. This can serve to favour larger developers over smaller ones.
- The extent of developer contributions is uncertain – although the Community Infrastructure Levy provides a set tariff for contributions, the level of affordable housing to be provided ends up being the subject of negotiation (at least for sites of 10 or more units, since in most circumstances affordable housing is no longer required on sites below that size). This feeds back into

³ https://ecab.planningportal.co.uk/uploads/1app/guidance/guidance_note-outline_application_with_reserved_matters.pdf

land markets – purchasers of a plot of land can end up competing over who will be able to ‘squeeze’ most successfully the requirements of the local planning authority. In turn, this can lead to purchasers paying ‘over the odds’ for a site, and having to undergo complex and costly negotiations at the time of the planning application.

If a site is not specifically identified in a Local Plan, this need not necessarily prove a problem – it may be developed as a so-called ‘windfall’ site, provided it passes the tests set by planning policies. And indeed, ensuring that there is a positive and consistent approach to such proposals may be easier than asking local authorities to include numerous small sites in local plans.

An issue frequently identified is under-resourcing of local authority planning departments. The FMB, in its 2016 survey of builders, found this to be the single biggest cause of delays to consent being granted (FMB 2016: 14), while the Home Builders Federation agreed, and pointed to a 55 per cent reduction in funding of planning departments (HBF 2017: 29).

All in all, while accepting the need for a planning system to secure high quality development in the right locations, the English planning system is in several respects an inhospitable place for SME builders, compounding other challenges that they face.

The land market

A shortage of suitable sites for development is the second side of the ‘toxic triangle’ facing SME builders in England. As noted above, 67 per cent of SME housebuilders found that the lack of available and viable land was a constraint on building more houses – the most frequently encountered of all constraints.

This problem should be disaggregated. The first issue is that in local plans across the country, not enough land overall is identified to meet the housing need. Initial analysis has shown that the combination of the new standard methodology for identifying housing need and the housing delivery test proposed in the government’s Housing White Paper (DCLG 2017) would see 56 per cent of local councils needing to provide an additional 20 per cent buffer to their five-year land supply and another 12 per cent would have to set out an action plan (Lichfields 2017).

The second issue, as discussed in the previous section, is that smaller sites may not come through the planning process – the smallest are unlikely to be explicitly highlighted and (depending on local policies around the treatment of windfall sites) may be bound up with uncertainty about the likely outcome of a planning application. For instance, in London, large sites make up two thirds of provision and have been shown to be slower to come to market and require greater upfront investment and infrastructure planning (Wilson and Brown 2016; Snelling and Davies 2017). Small schemes, too, may be met with disproportionate amounts of local opposition (especially the case for ‘infilling’ schemes, which are more likely to have an immediate impact on neighbours than larger, self-contained sites). Indeed, it was this level of political pressure that led the government in 2010 to reclassify garden land as ‘greenfield’. Smaller applications are somewhat less likely to be granted by local planning authorities (according to DCLG data for the year ending 31 December 2016, 86 per cent of major and 82.8 per cent of minor applications were approved).⁴

⁴ Available at <http://opendatacommunities.org/slice?dataset=http%3A%2F%2Fopendatacommunities.org%2Fdata%2Fplanning%2Fdecisions%2Fmajor-and-minor-development-type%2Fall&http%3A%2F%2Fopendatacommunities.org%2Fdef%2Fontology%2Ftime%2FrefPeriod=http%3A%2F%2Freference.data.gov.uk%2Fid%2Fgregorian-interval%2F2016-01-01T00%3A00%3A00%2FP12M>

Thirdly, there is the question of whether sites are made available to those willing to build on them. Here, there is a need to distinguish between privately and publicly-owned sites. In the case of sites in private ownership, across the English housing market as a whole, there is strong evidence that some sites which are ready for development are not being brought forward. This has a range of causes: some are held in the pipeline by volume house builders; some are held 'under option' (where a developer purchases the exclusive right to build houses on a particular plot), often promoted by land agents; and others are retained as investment assets by those who do not intend to build.⁵ As Wainwright succinctly put it: 'Why would the successful buyer [of a field with permission for 100 homes] actually want to build those 100 homes, when it's more profitable to sit on the land for a while, then sell it on again?' In the same piece, Chris Brown, the Chief Executive of regeneration company Igloo, argued that, 'Developers can make much bigger profits by simply selling plots than building houses on them' (Wainwright 2017). Of course, some of these sites, on their own, would be too large for a single SME builder to contemplate building, but this might change with their sub-division.

In the case of sites in public ownership, there are also barriers to releasing them to SME builders. The Lyons Review (2014: 85–89) pointed to rather unimaginative practices in the public sector, often looking simply to release land to the highest bidder, rather than considering more imaginative approaches such as securing long-term returns on investment. And when large sites are released, a single sale will necessarily exclude SME builders. It would also slow down the actual development of houses. The Public Accounts Committee critically noted that:

'We questioned the Department on whether the actual building of homes – rather than the notional building of homes – was a criterion for the value for money of the [public land release] programme. After much prevarication, and reiterating that its target was to release land, not to build homes, the Department stated that "Building houses wasn't a criterion for the programme, so how could it be a criterion for value for money?"'

Quoted in Public Accounts Committee 2015: 9

This focus on selling land rather than getting homes developed mitigates against passing land to SMEs, despite the fact that they would most likely develop it quicker than larger housebuilders who could pay more but then have the capacity to 'land bank' and develop at a later date.

In 2016, the government set out its proposals to directly commission new homes on five sites, which could include some 'parcelling' to make sites available to SMEs.⁶ This ambition was part of the government's Accelerated Construction programme by Housing Minister, Gavin Barwell, in late 2016 (Building Magazine 2016). However, the benefit of these initiatives has yet to be realised, and another recent HCA announcement seemed to go in the opposite direction, with the suggestion that sites might be 'bundled' in order to expedite delivery – the precise opposite of parcelling (Inside Housing 2017).

Thirdly, whereas in much of continental Europe 'custom build' housing (whereby a plot of land is bought by a potential homeowner – often but not always from a public authority – who then commissions the construction of the new home – often from an SME) is very common, in the UK this phenomenon is rather small, accounting for around 7 to 10 per cent of new construction per year, according to the House of Commons Library (2017). This discussion (ibid: 6–7) noted constraints

5 A frequently-cited study by Molior for the GLA in 2012 found that 45 per cent of sites with permission for new homes in London were held by those who did not build, although later research has reduced that figure to 32 per cent of permitted sites (GLA 2014: 17).

6 <https://www.gov.uk/government/news/pm-the-government-will-directly-build-affordable-homes>

in particular around the availability of sites, but also around access to finance, the planning process, and regulation – a similar list of causes to the ‘toxic triangle’ faced by SME builders more widely.

Access to development finance

The third element of the ‘toxic triangle’ faced by SME builders is access to finance. Recent discussions and surveys (NHBC Foundation 2014: 6; FMB 2016: 10–12; HBF 2017: 42–46) pointed to several inter-related problems:

- A straightforward reluctance on the part of banks to lend to SME builders (combined with a tendency to contract lending sharply at times of economic downturn, and to benchmark the whole sector by the risk profile of its worst members).⁷ This also led to excessive interest rates.
- Insufficient loan to asset value ratios (often dropping below 50 per cent when the entirety of schemes were taken into account), and relying on equity from developers which was simply not available.
- Unrealistic conditions on loans (for instance, some sites would only be available subject to finance, but the finance would only be available once a site was secured).
- The loss of a local relationship with banks and the centralisation of their decision-making (in turn feeding into a problem of the whole sector being judged by the standards of the worst).

The withdrawal of finance after the 1980s recession was an important contributor to the rapid shrinking of the SME sector, and the same was true of the 2008 recession.

There is some evidence of improvement over the past few years, as might be expected given wider economic improvements. For instance, the 2016 FMB survey found that 16 per cent of builders found lending conditions had improved over the past year, compared with 8 per cent who found they had worsened (FMB 2016). In London, research for the GLA in 2014 was much more optimistic, finding that sufficient finance was available for small schemes:

‘Two years ago, schemes were chasing money. Now, money is chasing schemes. Effectively, there is now an unlimited pool of funding for schemes costing below £40 million as the limiting factor in the market is the number of schemes that can be invested in.’

GLA 2014: 4–5

However, the same report notes that most schemes have a loan-to-cost ratio of between 50 and 80 per cent, meaning that mainstream banks are not interested (they go for lower LTC ratios) and interest rates are 8 to 12 per cent plus 2 per cent fees. The London development market too, is significantly more buoyant than that elsewhere in England.

This is an area where government has sought to become more active. In 2014 it announced £525 million in the Builders Finance Fund for SME developer finance.⁸ Unfortunately, this was not a success, with just £1 million handed out in the first 18 months of the scheme (final figures are not yet available).⁹ Criticisms about the scheme included the maximum level of funding available (such that it did not really augment what commercial lenders would offer) and thresholds for support (CLGSC 2017). In 2015, government launched a ‘Housing Growth Partnership’ jointly with Lloyds Banking Group, with each contributing £50 million. The partnership

7 As communicated in private discussions with SME housebuilders.

8 <https://www.gov.uk/government/collections/builders-finance-fund>

9 <http://www.bbc.co.uk/news/uk-england-33659591>

is to provide equity investment of up to £5 million on schemes of £4 million to £35 million gross development value, which can be started within 12 months, and promises swift decisions. This project has not yet been evaluated. Most recently, £3 billion was allocated to the Home Building Fund, to be available to private businesses of any size to provide development finance (for up to five years) or infrastructure finance (for up to 20 years), at pre-agreed rates of interest. Again, no information is yet available on the success of this potentially significant intervention.

DISCUSSION AND OUTLOOK

The foregoing discussion identified the three elements of the ‘toxic triangle’ facing English SME builders. However, it is important to emphasise that these are inter-related. For example:

- if sites do not have planning permission, building projects are riskier, making it harder for a developer to obtain affordable finance
- if the planning process requires a lot of information at an early stage, that means a developer incurs costs at a stage before finance is available
- inadequate availability of small sites is related to the planning process as well as the land market and the approach of public and private sector land-owners.

The ‘toxic triangle’ is thus self-reinforcing, but in the same way, equally positive interventions in one area (for instance, earlier certainty in the planning process) could benefit another (availability of finance).

In each of these areas, the government has announced some plans for action (DCLG 2017). Greater transparency in the land market is proposed, as are tools for local authorities to require the build-out of sites. A new regime of ‘permission in principle’ is being introduced, whereby small sites in a ‘qualifying document’ will be deemed to have planning permission already, and only certain technical details will require subsequent approval, in order to de-risk the process for SMEs. Reforms to planning obligations have included restrictions on local authorities’ ability to require affordable housing on sites below 10 units. Significant financial support is to be made available through the Home Building Fund. ‘Custom build’ housing is to be promoted, and legislation has been passed to require local authorities to maintain a register of prospective self-builders, and to require local authorities to have regard to the register in discharging their functions, including in the planning process. There have also been repeated (if rather too familiar) statements of intent about the parcelling of public land before disposal. It is too early to evaluate the success of these emerging policy instruments, although it is positive that they acknowledge each of the elements of the ‘toxic triangle’ discussed here. In the November 2017 budget, further measures were outlined, including further financial guarantees and finance for SMEs, an expectation that 20% of housing supply will be on small sites, and making it easier to change the Community Infrastructure Levy (CIL).

In the current context, there is a significant new challenge. In particular, Britain’s decision to leave the EU risks unsettling financial markets (and thus potentially leading to greater risk adversity amongst lenders), and may also reduce capacity in the industry: restrictions on immigration by skilled migrants would quickly lead to a shortage in the workforce. Action to address the position of English SME builders is therefore especially timely.

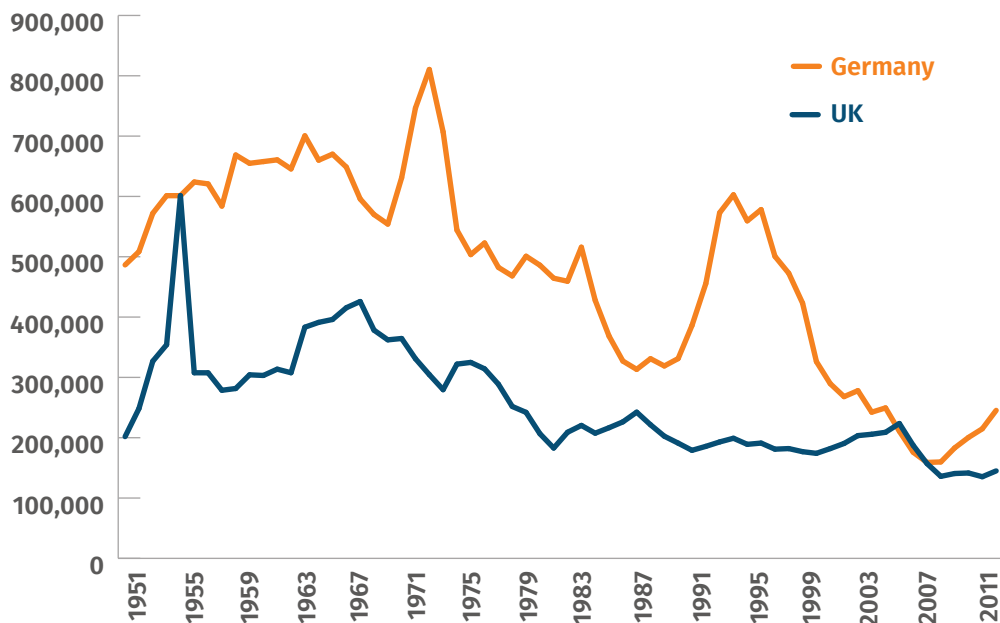
3.

THE POSITION OF SME BUILDERS IN GERMANY

THE RELATIVELY STRONG POSITION OF GERMAN SME BUILDERS

Since the 1950s, Germany has built more than twice as many homes as the UK:

FIGURE 3.1
New housing completions in Germany and the UK, 1951–2014



Source: Federal Statistical Office, 'Bauen und Wohnen, Table 9' (FSO 2015), DCLG 'Table 209: permanent dwellings completed, by tenure and country' (DCLG 2016a), DCLG, 'Table 241: permanent dwellings completed, by tenure, United Kingdom, historical calendar year series' (DCLG 2016b)

In our earlier work (Davies et al 2016), we note that, while by no means perfect, Germany's housing market functions better than that of the UK, with the gap between demand and supply significantly smaller, and price growth and fluctuations lower. We also tentatively suggested that this was, in part, linked to the stronger position of SMEs in the German market (ibid: 10).

Any attempt at a comparison between the position of SME builders in Germany faces an immediate problem: there is no national data available – akin to the NHBC data for the United Kingdom – about either the number of building companies or the proportion of output by SME builders.

However, there are several good reasons to think that the position of SME builders in Germany is significantly stronger.

Firstly, a study by the umbrella group Bundesverband Freier Immobilien- und Wohnungsunternehmen (BFW) found that in the seven largest German cities alone, there were 1,200 developers and builders active in the market (Beulich 2016). Moreover, it is clear that the market in Germany is a lot more localised and

regionalised than it is in the UK – we would therefore expect the overall number of firms to be far higher.

Secondly, much building activity is commissioned by individual households rather than companies. Take the year 2016. Table 3.1 below is compiled from 2016 data from the Federal Statistical Agency and covers new build flats/houses and major renovations.

TABLE 3.1

Building activity in Germany in 2016 by type of commissioner, according to number of units and percentage of all building permits issued¹⁰

COMMISSIONER	NUMBER OF UNITS	PERCENTAGE OF BUILDING PERMITS
Public builders	24,050	4.5
Enterprises	168,403	31.8
Housing companies	136,026	25.7
Real estate funds	3,803	0.1
Other enterprises	28,574	5.4
Households	167,705	31.6
Not for profit organisations	5,439	1.0
Total	530,197	

Source: <https://www.destatis.de/DE/Publikationen/Thematisch/Bauen/BautaetigkeitWohnungsbau/BaugenehmigungenBauherren.html>

Of course, not all building commissioned by households will necessarily be ‘custom build’, but the figure of 167,705 (number of households) includes 149,570 individual building or reconstruction projects, so a high proportion will be. We can safely assume that these projects are undertaken overwhelmingly by SME firms.

Thirdly, a recent government-commissioned report looking at development markets in a range of German cities found a dominance of ‘strongly regionally anchored SME family firms’, as well as companies in local authority ownership and housing associations; those reliant on capital markets were the exception (BBSR 2017: 81).

TO WHAT EXTENT DOES THE ‘TOXIC TRIANGLE’ EXIST IN GERMANY?

This discussion will look at each of the elements of the English ‘toxic triangle’ in turn, considering how the situation works in Germany and identifying points of emulation.

Planning

As discussed in chapter 2, uncertainty over the success of a planning permission is a major impediment to SME builders, who would be faced with significant amounts of expenditure at risk, especially if they acquire a site which is not designated in the Local Plan. In Germany, although this possibility still exists, a greater degree of certainty is provided earlier in the process, when a ‘binding land use plan’ is agreed by the local authority (Davies et al 2016: 14; Pahl-Weber and Henckel 2008: 80–83). At this earlier stage, the local authority has substantially greater discretion in deciding how to use its land, and many of the rather punitive mechanisms which erode local autonomy in England (in order to see sufficient land earmarked for development) are simply not present. However, the flip side of this is that, once the binding land use plan is in place, a developer who applies for a building

¹⁰ Full data is available at <https://www.destatis.de/DE/Publikationen/Thematisch/Bauen/BautaetigkeitWohnungsbau/BaugenehmigungenBauherren.html>

permit (a *Baugenehmigung*) and complies with the relevant requirements must see this granted. There is no appeal mechanism, but a failure to grant a building permit could be the subject of legal challenge.

Moreover, a process to allow for permission exists in built-up urban areas where no binding land use plan has been passed: here, paragraph 34 of the Federal Building Law allows for building to take place provided that 'in terms of the type and scale of use for building, the coverage type and the plot area to be built on ... [it] blends with the characteristic features of its immediate environment and the provision of local public infrastructure has been secured'.

In Germany, as in England, developers may be expected to make contributions to the cost of infrastructure, and indeed increasingly German cities are setting policy requirements. These can be incorporated into the building land-use plans; however, if development occurs in the unplanned inner area, they cannot be required, which gives local authorities quite a strong incentive to put plans in place. As noted in the foregoing discussion, in England the process for agreeing developer contributions can be a source of conflict and delay. In Germany, policy requirements for particular areas will be expressed more clearly, giving both the local authority and the developer a degree of certainty about what will need to be provided. This also impacts on land values, since a purchaser of a site with planning permission will be competing with others on the basis of making the required contributions, rather than their ability to 'haggle' and secure a reduction.

Of course, in Germany as England, the planning process can be the source of conflict. In particular, disagreement over the 'densification' of existing urban areas can be a significant source of conflict between developers, local authorities and local residents, and the designation of previous areas of open space can lead to major local opposition (witness the successful, binding referendum in Berlin to protect the Tempelhof Airport site from development in 2014). However, the process would appear characterised by a greater degree of consensus than it is in England, for a number of reasons.

Local authorities have more autonomy at the plan-making stage than they do in England, as well as a requirement to involve the public. This settles parameters for development, meaning that developers – large or small – are to a greater degree protected from arguments when permission is applied for. This can represent a win-win: local authorities enjoy a stronger hand in planning for their areas, while developers in areas covered by a binding plan enjoy greater certainty about what can be delivered. Secondly, there are powerful local incentives to support the development of new housing: not only can it provide new infrastructure, but local government finance is significantly more responsive – both in terms of grant and taxation income – to the inhabitants.

Nonetheless, there are still issues with the planning process in Germany. First of all, there remains a shortage of sites identified for building. This has been repeatedly identified as the single biggest obstacle to increased housing construction, and led to a squeezing out of builders of rented accommodation in favour of developers of higher-end flats (BBSR 2017: 86): since the returns from the latter are greater, their bids for sites are higher. Secondly, the process of gaining a building permit can be overly complicated, and at times developers resent what they consider to be arbitrary decisions taken by local officials, or the intervention of local politics; the involvement of local environmental agencies comes in for particular criticism (ibid: 89–90). Moreover, in our discussions with practitioners it was clear that the precarious financial position of many local authorities had led to a shortage of personnel in planning departments. All this presents a familiar picture to British observers.

In response to the shortage of sites, building law has been recently revised (see box below).

New provisions on ‘urban areas’

The federal parliament passed new provisions in 2017 intended to release more land for development in built-up areas. It amended building and planning laws, so that new ‘urban areas’ can be created, where commercial and residential uses can be mixed, density can be increased (including greater ‘in-filling’ of spaces between blocks of flats, and the addition of additional floors on buildings), and restrictions on acceptable levels of noise (for instance from neighbouring commercial uses) are relaxed. The law also allows for a ‘fast track planning procedure’, with less consultation and environmental scrutiny, to apply to small extensions to existing urban areas of up to 10,000 m², at the discretion of the local authority.

The land market

In Germany, there are important ways in which the land market works more favourably for SME builders.

First, there is greater clarity over planning obligations (discussed above) and the nature of development at the time a plan is settled, rather than waiting for the process of determining a planning application. This, and the absence of an appeals mechanism, mean that there is greater certainty over costs associated with development – and therefore less need to haggle over the nature of obligations, or for further purchasers to compete on who will be able to get the most concessions from the planning department.

Second, local authorities have a stronger record of ‘parcelling’ land for development (that is, dividing up larger sites), in ways which support SMEs, particularly custom-builders. In parcelling the land, the local authority may release individual plots to self-builders, and in rural areas that is an extremely common means of development (more so than construction of medium and large housing estates by a specialist housebuilder); for instance, in the south-western state of Baden-Württemberg, around half of all properties were commissioned by private households, although in its largest city, Stuttgart, the proportion was just 13 per cent.¹¹ An alternative in urban areas is to support groups of self-builders often actively supported through the provision of public land (see box below). Taken together, these measures point to a powerful contrast with England. It should be emphasised that self-building is not an alternative to ‘affordable’ housing – indeed, local authorities may feel that benefits include attracting relatively well-heeled citizens who wish to put down roots in the neighbourhood (a point specifically emphasised, for instance, in the guidance the state of North Rhine Westphalia issued to local authorities to support groups of self-builders [MWEBWB NRW 2010]). It does, however, represent an important market for German SMEs which simply does not exist on anything like the same scale in England.

11 http://service.stuttgart.de/lhs-services/komunis/documents/10362_1_Wohnungsunternehmen_dominieren_2013_Wohnungsneubau_in_Stuttgart.PDF

Building groups

Traditionally, custom build housing has been popular in areas where there is a good supply of sites. However, increasingly, 'building groups' (*baugruppen*) are emerging, especially in urban areas, to provide an alternative. There are a range of different types of building group – they may be 'bottom up', initiated by a group of friends or like-minded people, or they may be brought together, for instance by an investor. In some cases, there will be an emphasis on shared spaces, in other cases that will not apply. The group may commission the building project themselves, or they may engage a third party take on this role (often an architect); ownership at the end may be retained by a commonly-owned finance company or may be held individually (save for any common parts). The common thread though, is that a custom-built property is constructed for this group, extending the possibility of custom-builds to urban locations where they would otherwise not happen due to a shortage of sites.

The state government of North-Rhine Westphalia has recently promoted building groups to local government, pointing to them as a way of encouraging community-minded people to set down roots, and to the fact that the buildings commissioned are often of excellent quality. The city of Hamburg has reserved 20 per cent of publicly-owned sites for flats for building groups that are properly constituted and open about their finances (MWEBWB NRW 2010).

Thirdly, local authorities have powerful tools to support the parcelling of land. Even if they are not the initial owner of the site in question, they enjoy, in some circumstances, a 'first refusal' or 'pre-emption' right under sections 24 and 25 of the Federal Building Code, and pay either what another purchaser had offered, or the standardised market value of the land.

Fourth, local authorities also have the power to prevent speculative holding of land. As discussed in our other work (Davies et al 2016: 17; Turner 2017), there is provision for local authorities to introduce 'urban development measures' to assemble sites, parcel them and sell them to developers, pay for infrastructure and affordable housing, and then return any profit to the original landowners – the very threat of these serves as an effective tool to promote development. Moreover, an 'instruction to build' can be issued in areas where a binding land-use plan is agreed or in a built-up area (provided development is financially viable) – again serving as a 'use it or lose it tool' of the sort sometimes discussed in the UK. Recent work has, however, noted that there is a wide variation in local authorities' appetites to pursue such measures (Zur Nedden 2016).

Finally, there is an important point about the cost of sites for development. If a country is better at matching housing supply to housing demand (and indeed better at allocating sufficient sites – of whatever size – for development), then the price of sites for residential development will be lower. It is therefore to be expected that land values in Germany (outside particular 'hot spots' with a severe shortage of housing) will be lower, and therefore more accessible to SME builders.

This again is not to suggest that the German land market is a utopia for SME builders. Private developers are frustrated at their exclusion from some public land disposals in favour of publicly-owned companies. Moreover, the shortage of development sites in thriving areas discussed above has led to a raising of prices, which is squeezing out local companies. A growing phenomenon is that new entrants to the luxury housing market are driving up prices, sometimes even offering above the market value in order to gain a local 'foothold'. They may also erroneously overestimate likely returns, leading development to stall and land

to be sold on (BBSR 2017: 89). A further important point is that local authorities' capacities and experience play a role in whether more 'activist' interventions in land are practiced. While some local authorities have a long record of such measures, others are discouraged – either due to concerns over risk, complexity or because of the inevitable conflict (Zur Nedden 2016: VIII).

Finance

In this area, too, the contrast between the pictures in England and Germany is stark. It was noted above that in the NHBC survey, lack of project finance was viewed as the second biggest barrier to increasing housing output (behind shortage of sites). By contrast, in Germany, a recent survey of builders found that this was universally viewed either as being 'mainly irrelevant' or 'irrelevant' (BBSR 2017: 86). This partly flows from the different nature of what is being constructed. Since custom-build housing plays such a big role in Germany, large amounts of forward-finance for the housebuilder are not required, with the householder instead paying (sometimes supported by public funds, either from the national state investment bank KfW, or by the German states through their banks or investment arms).

Where development finance is required, however, the very different structure of the banking sector in Germany offers greater support to SME builders: a recent analysis of housing construction finance found that 29.8 per cent came from *Sparkassen* (locally-controlled banks), another 20.1 per cent from the network of 972 co-operative banks (which again are locally organised¹²), and 14.3 per cent from regional banks, with major commercial banks only accounting for 10.3 per cent of such loans.

As noted in the introduction to this chapter, the house-building sector in Germany is heavily regionalised – so, too, is its sources of finance. Locally-controlled banks and co-operative banks may well have established links with particular builders and companies, building long-term relationships, and thus easing access to finance. The role of banks in SME's success more widely is emphasised by scholars (Hall and Soskice 2001), and the housebuilding sector is an archetypal example. Indeed, one could expect the localisation of finance of the housebuilding sector to be *mutually reinforcing*, with local contacts providing access to development finance, as well as intelligence about sites, planning requirements, local expectations, and who the right contacts are in a local authority.

More generally, too, major banks were far less important than local banks and co-operatives to development finance in Germany, which helped to insulate SMEs from the 2008 recession. In contrast, their English counterparts were profoundly impacted due to their greater reliance on larger banks. The more restrictive mortgage market in Germany also reduced the impact of the recession on housing demand and thus on SMEs, as there was no sudden drop-off in the availability of mortgage finance, and therefore less of an impact on construction (Davies et al 2016: 21–22).

DISCUSSION AND OUTLOOK

The foregoing discussion of the situation in Germany suggests that each of the elements of the 'toxic triangle' faced by English SMEs is far less problematic in Germany. Moreover, there are two important, overarching themes.

The first is that the wider range of tenures built in Germany, and the importance there of custom-build housing, significantly reduces risk to housebuilders – who are more often commissioned to build, rather than building in the hope of selling

12 https://www.bvr.de/Press/Facts_and_figures

the property to an unknown purchaser, at an indeterminate price, following construction.

The second is the very significant degree of localisation in the development market. This operates on several dimensions – access to finance through contacts with local banks, access to sites through early local knowledge of their possible release (BBSR 2017: 89), and indeed knowing who the ‘go to’ people are in the local planning authority, as well as the precise nature of local requirements. This localisation naturally benefits SMEs, but it also brings risks. As the BBSR notes, a consequence is also a lack of transparency and a ‘closed shop’ of developers, impenetrable to new entrants to the market (ibid: 89). A reliance on an informal network of contacts also raises an obvious danger of corruption.

The previous sections on planning and the land market noted, too, that in the areas of access to sites, and also the planning process, frustrations are heard from German SME developers (albeit not on the same scale as their English counterparts). A further, major issue for German SMEs (related partly to planning but also to the wider regulatory context) is around build costs. These rose by some 36 per cent between 2000 and 2014 (BMUB 2015: 35), with a further 9 per cent increase anticipated with the adoption of new energy performance regulations.

The government launched a commission on this issue in 2014, which made a range of recommendations, including: standardisation of regulations between states and municipalities; acceleration of the planning process; disposal of public land according to the ‘best concept’ rather than the ‘highest bidder’; increasingly linear depreciation on new buildings from 2 per cent to 3 per cent; lowering real estate transfer tax rates (which are set regionally); and not increasing further energy performance requirements (ibid: 133–141). The perception among participants in our expert round table was that building costs were substantially higher in Germany than in the UK; but such claims need to be treated with caution: one participant suggested that the government commission's estimates were rather high (as part of an attempt to lobby for a lower regulatory burden).

There is a paucity of comparable data, but the most recent Turner and Townsend International Construction Market Survey actually suggested building costs in Germany were around €1,170 per m² for a detached or terraced house and €1,272 for a low-rise flat, whereas the equivalent costs in the south of England were £1,420/£1,940 and in the north £1,295/£1,630 (Turner and Townsend 2016). One reason why Germans are likely to be more sensitive to rises in construction costs is that, with the relatively low cost of development land in many cases, construction makes up a higher proportion of the overall cost than it does in England, where acquisition of development land will often be by far the greatest expense.

4.

CONCLUSION AND RECOMMENDATIONS

It is a relatively straightforward task to diagnose the problems faced by SME builders in England, and the case for the existence of the ‘toxic triangle’ of challenges to the sector is compelling. It is also clear that on each dimension (land, planning and finance) the German SME market enjoys more favourable conditions, and that, even without comprehensive data, German SME builders are in a far, far stronger position than their English counterparts.

Unfortunately however, this comparison does not give policy-makers a ‘silver bullet’ with which to remedy the position of English SMEs. There are at least two reasons for this. First, conditions for German SMEs are culturally, socially and historically embedded. For example, the strength of local co-operative banks is an important feature of the German economy, but cannot simply be transplanted, and if a report were to conclude, ‘to support English SME builders, you need to replicate the German banking sector’, it would stand little chance of gaining traction.¹³ Similarly, it would be difficult to ‘flick a switch’ and move to a German-style planning system with immediate, greater certainty about future uses of sites. Secondly, it is clear that an important reason for the strength of German SME housebuilders is that the system is localised, but part of that rests on the existence of *de facto* barriers to local markets for new entrants. It is implausible that English policy-makers would seek to render local land-markets less transparent, or encourage local authority planners to make their processes so obscure they could only be understood by ‘local insiders’, for example.

However, there are recommendations that can be formulated, drawing not on the precise nature of the German policy landscape, but rather on the functions that particular institutions fulfil. In fairness, in each case the government has identified some need for action, but (as discussed in chapter 2) measures intended to help SMEs have not always had anything like the traction anticipated, and so careful implementation and monitoring become at least as important as policy design.

Recommendation 1: Look to provide greater certainty for SME developers early in the planning process, and increase the volume of small sites coming forward for development

It is clear that uncertainty about how small sites will be treated in the planning process in England, compared to Germany, requires significant expenditure by SMEs. This leads to an unfortunate ‘chicken and egg’ situation – finance may not be available without planning permission, but the costs of securing planning permission are significant and may require loan finance. The new ‘permission in principle’ regime will assist in that regard, although local authorities may seek to set significant exclusions in order to protect their positions and the quality of developments. A sensible compromise would be to monitor the ‘permission in principle’ framework, give a clear steer to the planning inspectorate to minimise

13 A key argument of Hall and Soskice’s (2001) argument about *Varieties of Capitalism* is that there are synergies between different elements of coordinated market economies, of which the structure of the banking sector is just one. Trying to ‘uproot’ one element and transplant it into the context of a liberal market economy would lead to worse, not better, outcomes.

exclusions when Local Plans are examined – but allow local authorities to insist on high standards of design (of buildings and the wider ‘place’) – and give appropriate contributions to reduce the reasons why such exclusions would be sought.

It is also clear that there are some quite powerful incentives for local authorities to prioritise the inclusion of larger over small sites in their Local Plans, and we would recommend the NPPF is amended, quite specifically, to discourage this practice. This in turn brings with it some resourcing implications, and the government needs to ensure that planning departments are adequately resourced to include appropriate sites for development, whatever their size, in their Local Plans, and then to determine applications in a timely and efficient manner. Local authorities need to bear in mind that – as they are increasingly held responsible for the delivery of housing in their areas, rather than merely the allocation of sites (DCLG 2017) – having a favourable environment for SME builders will be significantly to their benefit. The government's proposal that 20% of housing should come from small sites may help address the focus on larger sites, though detail on how this will be implemented is, at the time of writing, not yet available.

Recommendation 2: Seek to provide greater clarity on developer contributions

In Germany, there is no right of appeal against the level of developer contribution required. And increasingly, local policies and binding, site-specific plans make clear, on a non-negotiable basis, what will be required of a developer in terms of infrastructure and affordable housing. This makes purchasers aware in advance of any requirements and avoids land values being inflated, followed by a period of haggling over development viability. Local authorities should therefore be supported to have clear but realistic plan-level policies on developer contributions, and government should allow these to bed in over time, in order that they are reflected in land values. As part of this realism, it may be appropriate for brownfield sites to be treated in a systematically different way (for instance, with different levels of CIL required).

To ensure that required planning contributions do feed into land values, we would welcome a clear statement from government that it does not intend to tinker with the framework for CIL and Section 106 over the next five years – to would allow policies to bed in, rather than have investors speculating on the possible impact of future policy changes. Here, the changes announced in the Autumn 2017 budget may prove unhelpful - the expectation that CIL can be amended more easily by a local authority in response to changes in the market will actually undermine the stability of the charge and make it less likely to feed back into land values.

Recommendation 3: Provide robust support for custom builders in planning and in financing, and support a range of tenures

It is clear that the far more developed custom-build market, in both rural and urban settings, is a significant boost for German SME builders compared to their English counterparts. The British government has endorsed the principle of expanding this sector with recent legislation, and sector expectation is of modest growth (House of Commons Library 2017: 16). To support this development in England, the government should give clear policy guidance in favour of appropriate land allocations (and consideration of the need for custom-build plots, as evidenced by local registers of interest). It should also consider the need for a public-private partnership (along the lines of the Housing Growth Partnership) to provide financing for custom-builders – including groups of custom-builders – since private sector provision is underdeveloped. The Housing White Paper (DCLG 2017) makes a strong case for supporting a wider range of tenures. This is to be supported for small sites as well as large, in order to allow more homes to be commissioned or pre-sold, rather than built for unknown future purchasers.

Recommendation 4: Make increasing housing supply a clear objective of the release of public land, and recognise the potential of SMEs to contribute to that goal

It was noted in chapter two that public land disposals have tended to focus on realising a swift capital receipt, and involved large sites (or even groups of sites), all of which serves to stymie SMEs, but also leads to slower build-out of housing. This delivers unsatisfactory outcomes for SMEs as well as wider housing markets. The objectives and delivery of the release of public land should be reappraised, so that there is a new focus on delivering higher supply. This would support parcelling (recognising the potential contribution of SMEs) and alternatives to up-front payment. Housing completion as well as land release should be monitored as part of this revised objective.

Recommendation 5: Provide tools to local government to support build-out of land allocated for development, including a stronger role for local authorities in land assembly

In the light of evidence that holding, rather than building out, sites which are ripe for development is a profitable and frequently-practiced activity – and one which is unlikely to be pursued by SME builders – it would be advisable for the government to carry out measures to help local authorities assemble land for development and confront ‘land hoarders’. This is mooted in the Housing White Paper (DCLG 2017: 25). ‘Urban development measures’, as practiced in Germany, provide a useful model in this regard, and could release more sites for development by SMEs. Under such a model, a local authority would be able to designate a particular area for development, and if proposals for development were not forthcoming, it would assemble sites, parcel them for development, secure contributions for infrastructure and then share out any remaining profits to original land-owners at the end. In extreme cases, a ‘requirement to build’, as can be issued in Germany (subject to meeting some quite strict legal hurdles) should also be considered. Proposals for local development corporations (ibid: 28) are also welcome in this regard, though these corporations would need to recognise the needs and potential of SMEs as deliverers of development.

Given the evidence in Germany that active interventions in the land market are only unevenly pursued by local authorities – and the sharp differences in capacity, experience and appetite to embrace innovative instruments among English councils – it would be important for the government, possibly through the Homes and Communities Agency, to make available expertise and project support to help such measures become a reality, where this is necessary.

Recommendation 6: Have a clear objective of central government to ensure SME builders have sufficient development finance (monitored by the OBR), whether from the private or public sector, and regularly review the success of government-funded programmes

In recent years, government has quite correctly acknowledged that SME builders need greater support with project finance, and has introduced several funds with the intention of assisting them. In Germany, there is less support for such government intervention because of the different and more supportive shape of the banking sector. This would be difficult to replicate in England, but it is clear that the German sector’s *function* should be emulated. The Home Building Fund is potentially the right instrument for this, but it needs to support a wide range of loan-to-cost ratios, in order to complement and not just replicate finance available from the private sector. The government should also review the potential for support from the British Business Bank for SME builders, and the responsibility of private banks – in which the UK government continues to hold a significant stake.

Given that previous well-intentioned policy instruments have failed to have the desired effect, it is important that the impact of such measures is continuously reviewed. An assessment by the National Audit Office of the Home Building Fund and other measures in 2018 would be timely and helpful in this regard.

In order to insulate the sector from financial shocks (which then have damaging pro-cyclical effect) the Office for Budget Responsibility should be asked to monitor credit availability to the housebuilding sector, including SME builders, to allow for the early recalibration of policy at times of economic downturn.

Recommendation 7: Review the risks of Brexit to the SME housebuilding sector and ensure that future immigration controls are not overly burdensome and unworkable for SMEs in the construction sector

There are important additional risks to the SME housebuilding sector from Brexit. In the case of possible financial stability, the measures proposed in recommendation 6 should go some way to mitigating the potential impacts to the sector of any reductions in the availability of loan finance. In the case of labour availability and skills, the government needs to put in place appropriate arrangements to avoid a sharp reduction in capacity in the sector (or increases in cost), and should review training and skills for the long-term.

A particular issue will be around arranging visas for workers from outside the UK. If all small construction firms are required to sponsor future employees, that is likely to prove an immediate, costly and unsustainable burden. Indeed, the ramifications of this would affect housebuilding by volume housebuilders (who rely heavily on smaller subcontractors in construction) as well as SMEs. One possibility would be to have some sort of public or private sector-led 'pool' arrangement, whereby the aggregate need for labour from outside the UK is assessed, and individual companies can then draw upon those who have been approved as required.

If these recommendations are undertaken, they will still not recreate in Birmingham, Barnsley and Bath the situation which exists in Bremen, Bonn and Baden-Baden – wholesale replication of the German context for SME housebuilders would be unrealistic and in some aspects undesirable. However, implementing these recommendations would go some way to addressing the three key elements of the 'toxic triangle' faced by SMEs, which have been such an important contributor to the woefully inadequate levels of housebuilding in England – and in turn secure the construction of homes desperately needed by future generations.

REFERENCES

- BBSR (2017) *Wohnungsbautätigkeit in Deutschland: Wer baut wo welche Wohnungen*, Bundesinstitut für Bau-, Stadt- und Raumforschung
- Beulich A (2016) 'German Builders', presentation to IPPR/Aston round table, London, 14 March 2016
- BMUB (2015) *Bericht der Baukostensenkungskommission*, Ministerium für Umwelt, Naturschutz, Bau und Reaktorsicherheit
- Building magazine (2016) 'Public land to be broken up for SMEs', *Building Magazine*, 5 October 2016
- Campaign for the Protection of Rural England [CPRE]/Housing Foresight (2014) *Increasing Diversity in the Housebuilding Sector: The Need to Re-establish Small and Medium sized Enterprises in Housing Construction*, Campaign for the Protection of Rural England
- Communities and Local Government Select Committee [CLGSC] (2017) *Capacity in the homebuilding industry*. <https://publications.parliament.uk/pa/cm201617/cmselect/cmcomloc/46/46.pdf>
- Davies B, Turner E, Marquardt S, Snelling C (2016) *German model homes? A comparison of the UK and German housing markets*, IPPR
- Department for Communities and Local Government [DCLG] (2016a) 'Table 209: permanent dwellings completed, by tenure and country'. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407556/Household_Projections_-_2012-2037.pdf
- Department for Communities and Local Government [DCLG] (2016b) 'Table 241: permanent dwellings completed, by tenure, United Kingdom, historical calendar year series'
- Department for Communities and Local Government [DCLG] (2017) *Fixing our broken housing market*, Department for Communities and Local Government
- Dromey J and Murphy L (2017) 'Building Britain after Brexit', in Lyons M, Murphy L, Snelling C and Green C (eds) *What more can be done to build the homes we need? The Lyons Edited Collection*, Institute for Public Policy Research: 95–103
- Federal Statistical Office [FSO] (2015) 'Bauen und Wohnen, Table 9'
- Federal Statistical Office [FSO] (2016) 'Building Activity', *Statistisches Bundesamt*. <https://www.destatis.de/EN/FactsFigures/EconomicSectors/Construction/BuildingActivity/BuildingActivity.html>
- Federation of Master Builders [FMB] (2016) *FMB House Builders' Survey 2016*, Federation of Master Builders
- Greater London Authority [GLA] (2014) *Barriers to housing delivery: update*, Greater London Authority
- Hall P, Soskice D (eds) (2001) *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, OUP
- Home Builders Federation [HBF] (2017) *Reversing the decline of small housebuilders*, Home Builders Federation
- House of Commons Library (2017) 'Self-build and custom build housing (England)', Briefing paper 06784, House of Commons Library
- Inside Housing (2017) 'HCA plans to sell accelerated construction land in packages', *Inside Housing*, 30 March 2017
- Lichfields (2017) *Insight Focus: Housing Delivery Test*, April 2017. http://lichfields.uk/media/3029/housing-delivery-test_insight-focus.pdf
- Lyons M (2014) *The Lyons Housing Review*, Labour Party. http://www.yourbritain.org.uk/uploads/editor/files/The_Lyons_Housing_Review_2.pdf
- MWEBWB NRW (2010) *Baugruppen und Wohngruppenprojekte: Ein Handbuch für Kommunen*, Ministerium für Wirtschaft, Energie, Bauen, und Verkehr des Landes Nordrhein Westfalen

- NHBC Foundation (2014) *Improving the prospects for small house builders and developers*, NHBC Foundation
- Pahl-Weber E and Henckel D (eds) (2008) *The Planning System and Planning Terms in Germany: A Glossary*, VSB
- Public Accounts Committee (2015) *Disposal of public land for new homes*, Public Accounts Committee
- Snelling C and Davies B (2017) 'Tackling undersupply in the capital and beyond in What more can be done to build the homes we need?' in Lyons M, Murphy Luke, Snelling C and Green Caroline (eds.) *What more can be done to build the homes we need? The Lyons Edited Collection*, Institute for Public Policy Research: 104–113
- Turner and Townsend (2016) *International construction market survey 2016*. <http://www.turnerandtowntsend.com/media/1518/international-construction-market-survey-2016.pdf>
- Wainwright O (2017) 'Britain has enough land to solve the housing crisis: it's just being hoarded', *The Guardian*, 31 January 2017
- Walker, A (2016) *Small is beautiful: delivering more homes through small sites*, FMB/LGIU
- Wilson R and Brown B (2016) *Going large: making the most of London's big sites*, Centre for London. <http://www.centreforlondon.org/publication/brownfield-sites>
- Zur Nedden M (2016) 'Vorwort', in von Einem, Eberhard (ed): *Wohnen: Markt in Schieflage – Politik in Not*, Springer: V–IX

Institute for Public Policy Research



GET IN TOUCH

For more information about the Institute for Public Policy Research, please go to www.ippr.org

You can also call us on +44 (0)20 7470 6100, e-mail info@ippr.org or tweet us @ippr

Institute for Public Policy Research

Registered Charity no. 800065 (England & Wales),
SC046557 (Scotland), Company no, 2292601 (England & Wales)

The progressive policy think tank