LSE Spatial Economics Research Centre

Monday, 17 August 2009

New homes are too small

CABE are talking about new homes. According to a new survey they are too small and CABE are suggesting that it is all the fault of developers: "Housebuilders often protest that people won't be able to afford houses with more space. In fact, the barrier is the profit margin that publicly limited companies feel obliged to make. By building the smallest homes in Europe, they're not giving people the choice. Homebuyers deserve well designed homes that allow them to choose how they live."

The solution, according to CABE chief executive Richard Simmons?: "We need local planning authorities to ensure much higher space standards befo giving developments the go-ahead"

I am completely baffled by this. We have a planning system that strongly restricts the supply of land for housing (especially in places where people wa to live). This drives up land prices - upwards of £8m per hectare in the most popular parts of the South East - which, in turn, tends to reduce the size o houses (because you have to buy the land before you can build on it). Additional land use regulation - in the form of density requirements and brownfie restrictions further compound this effect (the former directly; the latter because remediation costs mean that you need to get a higher return per unit th if you build on greenfield). In other words, our land use planning system unintentionally generates huge incentives to build small houses with small gardens. [i.e. "Rabbit hutches on postage stamps"]

And somehow the solution to this is to have yet another piece of the planning apparatus which refuses planning permission unless developers build houses of a minimum size? It clearly won't solve the problem. But, if even partially implemented, it would presumably mean less houses and higher house prices. Not sure that this will help in meeting government objectives on "affordability" ...

Posted by Prof Henry G. Overman on Monday, August 17, 2009 G+1 Recommend this on Google

5 comments:

Tim said...

According to the CABE press release, 35% of kitchens are not big enough for a toaster. I have just measured my toaster: it is 38cm wide x 11cm deep x 19cm tall. Are we really to believe that 35% of kitchens have less than 0.5 sq of worksurface?

These findings "are not only nonsense but self-evident nonsense" to quote Keynes.

18 August 2009 at 10:02

Jim said...

I hear what you're saying about regulation and I don't necessarily support the drive for high space standards, but won't land prices be highest in areas of highest productivity and density anyway? I find it hard to believe that we will ever build enough homes in the green belt to make new family-sized houses built in inner London cheap and affordable, so aren't we stuck with flats in those kind of areas?

18 August 2009 at 21:53

Tom said...

Great post - an obvious point to most economists, but clearly not appreciated by everyone.
Jim - I think you're right that there will always be people who will choose to live in flats in highly productive cities like London. But if we built some more houses on the urban fringe or greenbelt, there would certainly be some people who would choose to live outside and commute in.
So I think that we wouldn't end up with quite so many people in such small spaces.

21 August 2009 at 11:10

Anonymous said...

One of the points that CABE were trying to raise is that the ownership structure of the main developers (being stock market listed) adds an extra layer of cost - in expected profits - that means that they cut back on size of units.

The UK has a building sector that is characterised by being dominated by a pool of 5 extremely large housebuilders, all of whom are stockmarket listed, all of whom expect extremely large profit margins, all of whom make shoddy - and small - products as a result.

I was at an event where I overheard a representative from the House Builders Federation admit that they expect a profit margin of around 30 to 40%. A key area where these profits are squeezed from is in reducing the amount of land per unit.

Depressingly these same builders behaved extremely recklessly during the boom (loading up via high levels of debt exposure on top dollar land prices at the top of the boom), but are now being bailed out by both lenient creditors and the government (which is channeling large amounts of funding into house builders via a restructured HCA funding system and seeking ways for builders to avoid price realisation on top dollar units by offloading it via government backed shared ownership 'first time buyer' schemes - notably the HomeBuy Direct programme).

You would have thought one of the few upsides of the crunch would be to let the market punish a model of development that didn't work for consumers and produced some of the worst products in Europe and that this would let government restructure the sector so that it didn't have such a large capture of land value uplift for the short termism of the stock market.

But instead we have left it intact as central government feels hostage to these builders to deliver the numbers (there has been a severe case of institutional capture at CLG).

You'll be glad to know their share prices have performed impressively this year though.

Although I know Geographers aren't that strong on political economy, you would have thought you could spot when someone is getting screwed?

17 November 2009 at 12:27

Tim said...

"Anonymous" is half right, we are being screwed, but the builders are not the (root) cause.

Clearly developers may aim for high profits. So do Tesco. But developers they do not make 30-40% a year at all often, although they will make 30-40% on some sites in total. But that is in part because they have to sit on land for a long time, pay for options on land on which they hope to get planning permission on day, etc.

If you make 30% on a site, but it took 6 years to develop, then 30% total means 5% a year. In that context the issue is that the planning system adds time, and developers (and the pension funds that hold their stock) therefore require a return on the long period in which they are forced to hold land. Anon is write that we are being screwed, but to a large extent we are being screwed by the planning system.

As an example, the Westfield shopping centre in Shepherds Bush opened in Oct 2008. Chelsfield, the developer, already owned the site in Oct 1996, when I moved in to an adjacent street, so to my knowledge they had to sit on that land for at least 12 years - and perhaps more - while the planning system ground its way slowly forward (CPRE for example, requested a judicial review - the idea of Shepherds Bush as rural amused locals at the time!). Given the risks involved that the project would never happen, or be dramatically scaled down, or that the world would have changed by the time it was open, I don't think that anyone would dispute an 8% annual return - and 1.08^12 means a 150% return over 12 years.

The second way in which the planning system screws the end user is because land banking is the key to success, which in turn favours big builders (from memory this point is in Barker 2, which I still think reads pretty well, all things considered). And land banking comes because the planning system is semi-predictable, provided that you can wait long enough. In short, we need a planning system that allows other firms to enter much more easily. The community planning auction system that I proposed (google Leunig centre forum to find it or google Leunig Davey on the FT site for a shorter version) would achieve just that.

For my money it is not that a bigger selection of builders will bid down costs (although they might) it is more that a bigger selection of new entrants will do things differently, and variety is welfare enhancing.

18 November 2009 at 09:13

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