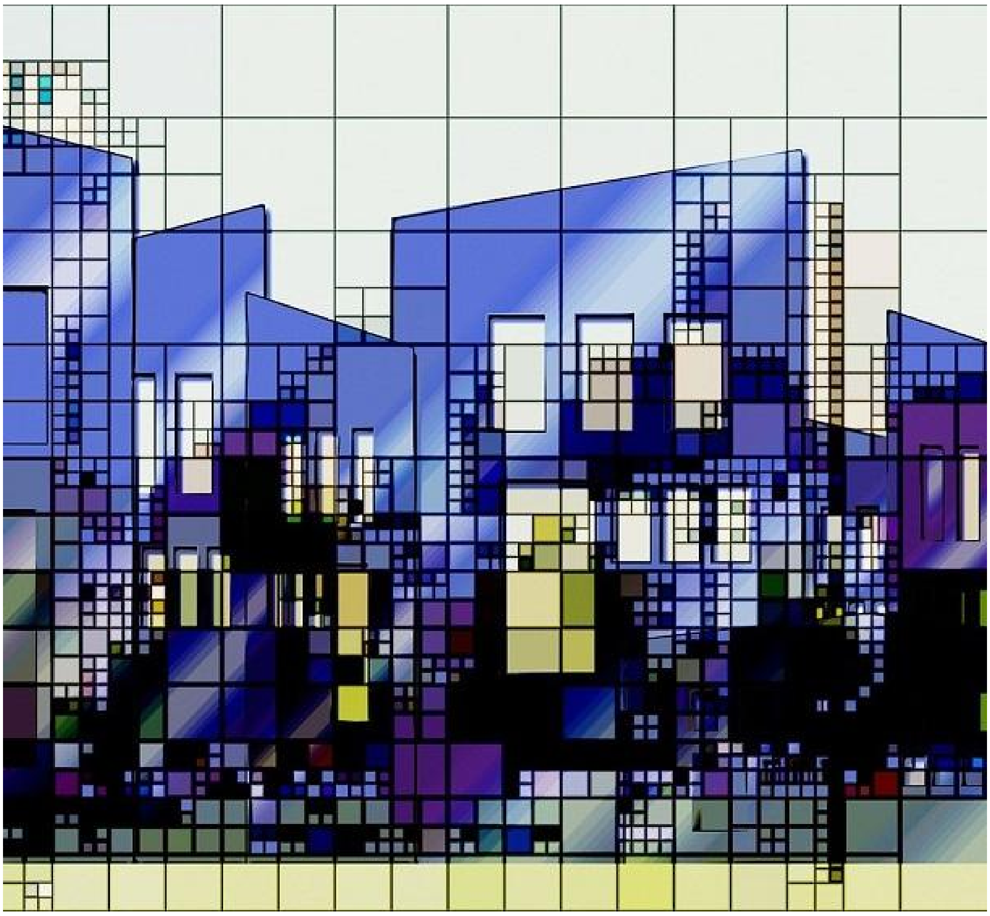

What Are the Realities of Building 300,000 New Homes in a Year?

As the new UK government identifies accelerated house building as a solution to two pressing political issues: a major housing crisis and the minimal rate of growth in the economy. Can the Government really deliver on its promise to build 1.5 million new homes in the next five years, and which issues are likely to impact the delivery of this challenging target.

Nick Hood, Senior Business Adviser, Opus Business Advisory Group

Among the first major announcements by the newly elected UK government was a return to mandatory housebuilding targets for local authorities and wholesale reform of the planning system. The laudable aim is to create 1.5 million new homes over the five year life of the current Parliament to address what is widely accepted to be a major housing crisis. By any standard, this is an ambitious objective. Can it possibly be done and what barriers face the housebuilding industry?

Historic trends

The 300,000 annual target was last achieved in 1969/70 when 306,860 new dwellings were completed. Back then, local authorities were major players and were responsible for building 135,700 of them.

Over the last 30 years, 2007 saw the highest total with 195,870 houses built by private housebuilders. Local authority activity had faded away to almost nothing by then, averaging only 1,763 completions a year during those three decades.

The Big Issue has published data[1] for 2023. This shows that private sector housing starts in England alone were only 116,290 homes, which was down by 18% on the previous year. This meagre outturn is increased to 171,693 when housing association and local authority starts are added and Scotland and Wales are included. Extra capacity was created through conversion of houses to multiple occupation and office re-purposing, but even so the final outcome was still significantly below the government's new annual target.

Where will the land come from?

The government's housing policy announcements have majored on reforming the planning system to free up more land for housing development, seeking to minimize the impact on the politically-sensitive green belt by focusing on the use of 'grey belt' sites, mainly on the edge of towns and cities.

The housebuilding community is steadfast in blaming the planning system for its failure to build more houses and there is no doubt that some aspects of planning need not only reform but greater resources if it is to operate effectively. It will remain to be seen when and if the promised 300 extra planning officers will materialize.

Nevertheless, an analysis[2] in December 2023 of the latest published accounts of the eight largest housebuilders by The Big Issue revealed that they held a total of 918,823 plots, an increase of 49% on 2018. At their then build rate, these land banks would support 11 years of housebuilding. Since then, market conditions have dictated a reduction in output sufficient to extend the period covered by their existing land through to 2040.

A significant proportion of these sites have already been granted planning consent. Indeed, the new Planning Portal Market Index has identified over a million homes in England and Wales given planning permission since 2015, but which have not yet been built. It is accepted that not all the land-banked sites are in the right place and that some will not be sufficiently profitable under the current difficult market conditions.

Who will build the houses?

No amount of available green belt, grey belt and brownfield land or planning reform will enable the construction of 300,000 homes a year if there is insufficient labour. Shortages have been endemic in the industry for many years as demographic, cultural and skills issues have hampered recruitment and retention. Our detailed report[3] in February 2024 examined these problems.

By common consent, there is a very substantial short and medium-term shortfall in skilled and unskilled labour, most estimates suggesting this is more than 200,000. In May 2024, The Construction Industry Training Board put a precise number of 251,000 extra workers needed by 2028, net of those leaving the sector[4]. Inevitably, this will lead to labour cost inflation as contractors bid up pay rates to attract and keep staff, threatening to trim profit margins for housebuilders.

Are housebuilders strong enough financially?

Our latest detailed report[5] into the construction sector in February 2024 found that while its finances were better than they had been fifteen months earlier, there were clear warning signs of financial vulnerability. More than a third of all construction companies were at significant risk of failure. In addition, insolvency remains an ongoing, long-term problem. The sector's business failures account for 17% of all formal insolvency filings despite it only generating 6% of GDP.

The stand-off between affordability and profitability?

There has been a serious problem over housing affordability ever since the cost-of-living crisis was triggered by the inexorable rise in inflation, which started in the late summer of 2021 and peaked at 11.1% in October 2022. This has been exacerbated by soaring interest rates, initiated by the disastrous Mini Budget in the autumn of 2022. At the same time, input cost inflation has savaged housebuilders' profit margins forcing them to raise prices. Most opted instead to delay starts on marginal sites, particularly in the first half of 2024.

Interest rates are just starting to ease off, but this will be a long and gradual process. Inflationary pressures are abating for house buyers, but there has been long-term damage to the disposal income available to meet housing costs such as mortgage repayments.

These opposing factors have created a commercial conundrum at the centre of the government's house building policy. Housebuilders are not charities and will not invest capital in building homes that they can't sell and there is no market for houses that potential buyers can't afford.

Mortgage rates are the key determinant in this impasse. Property research analysts, Quilter Cheviot have declared[6] that buyer affordability will not return to pre-2022 levels until rates fall to less than 4% and probably closer to 3%. On present trends, this will not happen for some time, maybe until the end of 2025 or even into 2026.

What about the infrastructure?

Not only is there a problem with building houses which buyers can't afford, but adequate infrastructure is vital element in buying decisions. Also, a lack of it can be the main concern of existing local residents who are accused of Nimbyism. Often, it's not the extra houses they mind, it's the lack of thought given to the strain on schools, GP practices, parking and roads or other transport links.

Early discussion within the housebuilding community since the government announcements has focused on this aspect, questioning whether local authorities and other relevant public bodies will be committed to ensuring that infrastructure considerations are considered alongside the planning reforms.

Can SME housebuilders cope?

Around half of the new home completions in 2023 were undertaken by smaller contractors, the SME housebuilders, rather than the volume site developers. The emphasis on 'grey belt' sites such as disused petrol stations or former pub premises will likely be taken up by these family owned and run businesses because the lack of economies of scale will put off the big housebuilders.

We looked closely at smaller contractors in our recent report into the construction sector, discovering that just under 50% of all construction businesses have total assets of £50,000 or less and more than 10% have total assets of £10,000 or less, which gives them little financial stability.

The average financial risk rating calculated by the financial health monitoring specialists, Company Watch for construction companies with assets of more than £1 million is 61 out of a maximum of 100, against the overall sector average of 42. But for the very smallest businesses, the health score is almost halved at only 31.

There is a very real risk that a rapid expansion in activity at these SME builders will lead to an even greater rate of insolvencies than the sector experiences already, as they discover too late that more work means having more working capital and that greater cash resources are essential to avoid potentially fatal cash flow crises.

What about the public sector?

The government's initial housing policy announcement made no specific mention of the role of housing associations and local authorities, implying that the whole burden of generating 300,000 more homes a year is expected to be shouldered by private housebuilders. This would require them to build almost three times as many units as they did in 2023 and approaching double what they managed at the peak over fifty years ago. If the public sector is to be encouraged (and suitably funded) to take part in achieving the housing target, the sooner this is made clear and the details announced, the better.

What next for housebuilders?

Despite the obvious enthusiasm of the government over housing, the rate at which houses are built is largely at the discretion of the major housebuilders, at least in the absence of the radical step of direct government intervention in the industry. Their Boards have a fiduciary duty to their shareholders to optimise profits and the value of their shares, which may be at odds with government policy.

Straight talking from both sides will be necessary to resolve these potential conflicts. These conversations will also focus on the issue of affordable housing, delivering more of which is a core objective of the government's housing approach, but which will dilute the sector's profitability.

For SME builders, the attitude must be one of caution and especially, avoiding over-trading from their limited capital base. For housing industry sub-contractors, the risks of over-expansion across the housebuilding industry are even greater. They are always the first to suffer when contractors run into problems, and many are perennially just one bad debt away from financial disaster.

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