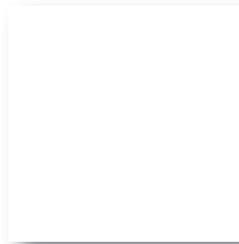
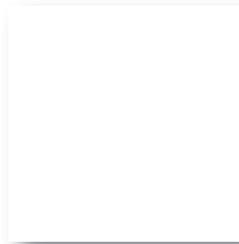


In my back yard: unlocking the planning system

Tim Leunig



POLICY PAPER

About the author

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■ Executive Summary

Britain's housing system does not work. Millions are badly housed, many cannot get on the housing ladder, while others cannot move to areas with more opportunities. Housing benefit and social housing subsidies cost taxpayers more than £16 billion a year.

The only way in which this dismal reality will be reversed is if the planning system is reformed to ensure more houses are built. This could be done from the centre: Whitehall could ride roughshod over local opinion, and simply order an increase in building levels. But it could also be achieved locally, by giving local authorities an incentive to accept development, and the right to say no to proposals they do not want. The best way to do this is to allow local authorities to capture most of the – massive – uplift in values that comes when land is first zoned for development. The value of one hectare of land rises 400-fold in the south east when planning permission is given: a hectare of agricultural land is worth £7,410, while the same hectare with planning permission for housing is worth £3.32 million.

There have been many ways suggested to achieve this – enhanced planning gain supplements, betterment taxes and so on. None of them are compelling. This paper suggests that the best way to establish the value of planning permission and to capture it for the local community is to use well designed auction mechanisms, repeating the successes of the 3G mobile licenses sale.

In the first stage local authorities would invite offers from landowners, whereby landowners state the price at which they are happy to sell their land. It seems likely that most farmers would be willing to sell their farm for five times its value, just as most homeowners would be delighted to sell their homes for five times fair value. The council would then choose which, if any, of the land offered they would like to see developed, would grant that land planning permission, and auction it to developers.

The successful bidder would pay the landowner the price the landowner had set *ex ante*, and the additional money would go to the local authority. In essence, the local authority is able to capture almost all of the difference between the agricultural value, and the value with planning permission, which amounts to around £3 million a hectare, or £85,000 per house. In urban areas, the scheme would also encourage the reallocation of land from industrial to residential use: here the gains to the council per hectare are even larger.

For the first time, councils would have a strong incentive to encourage development in their area. This would lead to more homes being built. At the very least house price rises would be slower. The expectation that prices will stop their giddy ascent should soon reduce speculative pressure.

In the medium term, more people will be able to afford a place of their own, in a place they want to live. This will reduce the cost of building social housing and funding housing benefit, ensuring that a greater number of people in the social sector can be better housed and/or the housing budget is reduced.

The knock-on effects will be positive. More people will be able to move to areas with greater opportunities, increasing direct and indirect tax revenues and reducing unemployment and benefit spending. With less need to cool a frothy housing market, the Bank of England will be able to keep interest rates a little lower over the economic cycle, encouraging investment, as well as making life easier for those with mortgages.

■ Introduction

Britain's housing policies meet neither the needs nor the aspirations of the country today. Many people struggle to get on the housing ladder or find a house suitable for their family. Some would like to move area, but cannot because of regional price differentials. Many find mortgage or rent bills crippling. The cost to the taxpayer of housing benefit spirals ever higher.

The only long term solution is for more houses to be built. This paper sets out a way of harnessing the power of well-designed auction mechanisms to give local communities a genuine incentive to support new housing developments. The scheme is fundamentally liberal: landowners can choose whether or not to sell their land for development, and at what price. Government would no longer force local authorities to accept new housing. Instead, communities would decide for themselves how much – or how little – of the land offered for development should be built on. Before describing how this system would work in more detail, the paper first sets out the symptoms of the problems with the existing system, before examining the causes and finally considering the possible solutions.

The British planning system

Prior to the 1947 Town and Country Planning Act, development in Britain was essentially *laissez faire*: if you owned the land you could, by and large, build on it. Subsequently, development has required state permission. The system has changed only incrementally over the past 60 years.

National government assesses the likely number of future households, and decides where they should be built. It then allocates local authorities targets for the number of new homes. The council produces a five year plan, which sets out what land can be developed and in what ways (housing, industry, and so on).

A developer then asks the council for planning permission. If the proposal is consistent with the development plan, councillors (on the advice of officers) will normally give permission.

This system no longer ensures the housing stock is expanding fast enough to meet rising demand. National government tends to underestimate the pace of household formation. Local authorities often view their housing allocation as a maximum target, and under deliver. Nor is the system responsive: if there is a rise in housing demand, there is no means to encourage or coerce councils to provide more housing. Last year 53,000 more households were formed than houses built, or, to put it another way, only three houses were built for every four households created.¹

1 Council of Mortgage Lenders, 'Market Commentary', January 2007.

1 The problems

Symptoms of a failed system

Symptom 1: A million families on housing waiting lists, with many more in unsuitable housing

Sarah Teather MP recently wrote that: “The heart-wrenching stories of poor housing and its crippling effects on young people’s education, mental and physical health, social development and family stability have had a more profound impact on me as a new MP than almost anything else.”² More than one in 30 households are on the waiting list for social housing.³ The number in temporary accommodation has doubled since 1997, and now approaches 100,000 families. Many will never reach the front of the queue, nor will they be able to afford appropriate private housing. More than 200,000 people are in hostels, temporary accommodation or sleep on the streets. The same number are sharing a house or living as “concealed” households with other family members. Over 200,000 households are resident in overcrowded local authority and social housing accommodation, while a further 150,000 families with children in social housing are living above the ground floor. Since many in need do not register on social housing waiting lists, these figures almost certainly underestimate the true number of badly housed people in the country today. A recent survey found that in London alone, 800,000 people live in overcrowded conditions.⁴ Furthermore, even when households have appropriate sized housing, it is often in poor condition. Although the situation has improved over the last decade, around 30 per cent of all houses in Britain still fail to meet basic decency standards.

2 S Teather, ‘Education: expanding opportunities, increasing mobility’, in J Astle et al (eds), ‘Britain after Blair: A liberal agenda’, Profile/CentreForum, 2006.

3 K Barker, ‘Review of Housing Supply: Final Report’, HMSO, 2006.

4 BBC Online, ‘Overcrowding epidemic in London’, 21 November 2006.

Symptom 2: high house prices

Over the last decade the average house price in Britain has almost trebled, rising from £62,000 to £179,000. Earnings have risen less than half as quickly. As a result, the average cost of a house relative to earnings has almost doubled in the past decade, and now stands at six times average income. In London this rises to nine times.

The spiralling cost of housing is extremely bad news for those seeking to get on the housing ladder. Despite buoyant labour markets and high levels of employment, the number of first time buyers is lower than at any time in the past decade and little over half the number in 1999. High costs delay as well as deter potential buyers; in the past ten years the average age of first time buyers has risen from 31 to 33.⁵

Symptom 3: Very high levels of debt

The amount of outstanding mortgage debt now stands at over £1 trillion. Mortgage debt has risen rapidly relative to GDP, increasing by more than a third in the last decade to stand at 72 per cent in 2004.⁶

Mortgage companies have responded to high prices by offering much larger advances. These can reach as high as five times joint incomes, twice the level of a decade ago. Regulators have expressed concern about this new practice. The Financial Services Authority, for example, comments: "The move towards higher income multiples on mortgages prompts us to ask whether these sales will be appropriately controlled to ensure that they meet the affordability and other responsible requirements that we impose."

High levels of debt leave borrowers financially vulnerable to small changes in interest rates. A 1 per cent rise in interest rates is equivalent to a cut in disposable income (that is post-tax and post-mortgage) of around 20 per cent for someone with a 'five times' mortgage. Since inflation rates are low, this debt will not become significantly easier to service as time goes on, as would have been the case in the 1970s and 1980s. Mortgage debt will remain a millstone for many well into the future.

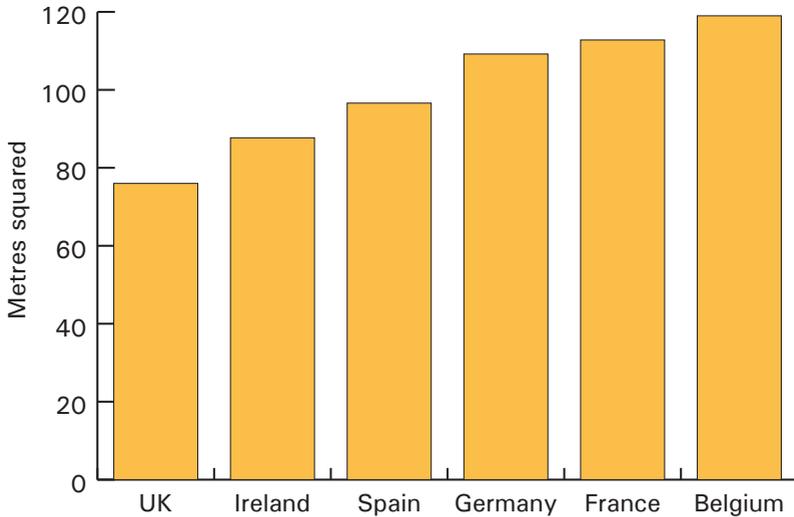
5 M Balen, 'Land Economy', Adam Smith Institute, 2006.

6 P Zhang, 'A trillion pound success story', Council of Mortgage Lenders, Housing Finance, Issue 06, 2006.

Symptom 4: Cramped houses

House sizes have traditionally been similar across Europe. The average house size in the UK is within 5 per cent of that in Ireland, Spain, France, Germany or Belgium, reflecting the fact that family size and income are similar across all of these countries.⁷ But new houses in Britain are much smaller than those in any of its neighbours due to high prices – around a third smaller than in Germany, France, and Belgium. Indeed, new homes in Britain are 10 per cent smaller than the existing housing stock: the UK is the only country in Europe where houses are getting smaller rather than larger over time.

Average house sizes in selected EU countries



A Evans and O Hartwich, 'Unaffordable housing: Fables and myths', Policy Exchange.

Symptom 5: Intergenerational housing poverty

The typical first time buyer now receives over £17,000 from their parents towards their deposit.⁸ Children in families which cannot raise this kind of sum are finding it increasingly difficult to buy. There is a real risk that the property ladder will increasingly become accessible only to those with affluent parents.

7 A Evans and O Hartwich, 'Unaffordable housing: Fables and myths', Policy Exchange, June 2006.
 8 MORI Social Research Institute, 'Homeowners: Sons and daughters', Joseph Rowntree Foundation, March 2004.

Symptom 6: Higher interest rates for all

Interest rates are higher in Britain than in most major world economies. British base rates are currently 5.25 per cent, the same level as in the US, but significantly higher than the euro-zone's 3.5 per cent base rate. Even at the lowest point of the most recent economic cycle British interest rates were 3.5 per cent, compared to US and European lows of 1.0 per cent and 2.0 per cent respectively. The problem of high rates in Britain is structural rather than cyclical, and the housing market is partly to blame.

Rising house prices make homeowners feel richer, and have thus pushed up consumer expenditure. That in turn leads interest rates to be higher than they would otherwise have been, to prevent the economy from overheating. Higher interest rates lead to lower levels of business investment. All economic commentators agree that if house prices had grown at a slower pace over the last decade, interest rates would have been lower, business investment would have been higher, and Britain would have had a better balanced economy. Some senior policymakers privately estimate that the surge in house prices has increased the base rate by 0.5 per cent over the last economic cycle.

Symptom 7: Higher unemployment, more poverty

Regional house price variations make it hard for people to move in search of better opportunities. In particular, it is difficult to move to the south east. Furthermore, many people in the south east are reluctant to move away, because of concern they will be unable to afford to return. As one study concludes: "High house prices choke off migration."⁹ This leads to people becoming 'trapped' in areas where their skills are less useful, and in which they have lower earnings.

Symptom 8: Higher taxes for all

Treasury figures show that Britain spends £14.7 billion a year on housing benefit, and an additional £1.4 billion in subsidies for social housing, equivalent to over 4p on the basic rate of income tax. In addition, Section 106 agreements (see box page 16) between developers and local authorities, used to create

9 A Murphy et al, 'Housing market dynamics and regional migration in Britain', CEPR Discussion Paper 5832, 2006.

social housing, are a disguised tax in that they represent the state taking an item of value from developers. The total cost to the taxpayer substantially exceeds £16 billion a year.

Symptom 9: 'Intermediate' tenures disliked by occupants

There will always be people who need state provided housing. But, in recent years, the state has sought to mitigate the rise in houses prices by making provision for specific groups of public sector workers. It is highly questionable whether the state should decide where people such as teachers should live. Privately, the 'Zone Agents' responsible for allocating key worker housing suggest that many schemes have difficulty finding key workers who want to live in the accommodation provided. People want to choose where to live, not have the state choose for them.

The underlying causes of failure

The housing market is, in essence, like the market for almost every other item in the world. If demand exceeds supply, prices rise. If supply exceeds demand, prices fall. If we allow more houses to be built, at the very least the pace of price rises will slow. There is, however, one way in which housing is different: home ownership, whether by owner-occupiers or by landlords, is an investment. If policies and economic conditions are such that prices are expected to rise in the future, they will rise now, as people seek to buy ahead of the price rise, and vice versa. This means that credible announcements of reform can impact on house prices before the new policy is fully implemented, and certainly before homes are built.

In the medium term, house prices will rise by more than earnings if the number of newly built houses is less than the number of newly formed households. Although the UK population is not rising particularly quickly, there are a large number of factors leading to an increase in the number of households. People are living longer, and more elderly people are living independently, often in the 'family home'. Younger people are delaying the age at which they marry or settle down, and more wish to live away from their parental home prior to marriage. Relationship breakdowns have also contributed to the rise in the number of households. In addition, growing numbers can afford a second home.

Greater longevity and higher incomes are cause for celebration. There is little politicians can or should do to try and slow down most of the factors behind the rise in household formation. But if Britain continues to build homes at a rate below that of demand, prices will become even more unaffordable.

The average household size fell from 2.4 in 1996 to 2.34 in 2001 and is expected to reach 2.15 by 2021.¹⁰ The government estimates that it needs to build 150,000 to 175,000 houses a year for house prices to remain stable relative to earnings. In fact there are reasons to think that these estimates are too low. The government has greatly underestimated the number of immigrants from Eastern Europe, while the rapid rise in top end earnings is fuelling greater demand for second homes. Both of these will have obvious knock-on effects on overall price levels.

Britain is currently building far fewer new homes than the number necessary to stabilise house prices relative to income, let alone to make them more affordable. If nothing changes, all of the symptoms set out previously in this chapter are likely to worsen over the coming decades.

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M Balen, 'Land Economy', 2006.

■ 2 The solutions

In essence, the solution is simple: build more houses. This is the conclusion of the Barker Review which sought to “achieve improvements in housing affordability in the market sector”. Kate Barker stated that: “I do not believe that continuing at the current rate of house building is a realistic option, unless we are prepared to accept increasing problems of homelessness, affordability and social division, decline in standards of public service delivery and increasing the costs of doing business in the UK – hampering our economic success.” The report suggests raising the number of private new builds by between 70,000 and 120,000 per year, with a further 17,000 to 26,000 social houses per year.

However, one major obstacle stands in the way of a much needed increase in the rate of housebuilding - NIMBYism (‘Not In My Back Yard’). This term, popularised originally by the then Secretary of State for the Environment, Nicholas Ridley, has become a term of abuse. In fact, NIMBYism is perfectly rational. No-one wants a development in their back yard, and Nicholas Ridley himself opposed a housing development near his home. Councils understandably feel pressure to respond to the views of local residents resisting having houses built in their area. This leads central government to try to impose new developments from above, and local councils to drag their feet in delivering the centralised plan.

Unworkable solutions

The state as builder

One option is to have a big social house building programme. The state could simply build the 948,000 homes that the Barker report identifies as needed by 2021. But the cost is prohibitive: it currently requires a subsidy of £70,000 per social house.¹¹ Even

11 K Barker, ‘Review of Housing Supply’, 2006.

without any cost escalation, that would mean an annual subsidy of £4.7 billion a year, every year between now and 2021.

Nationalise planning

This option is the centralisers' choice: Whitehall decides where the houses are to go and forces local councils to provide the land and planning permission. This idea may appeal to those who cling to the belief that the man in Whitehall knows best, but not to liberals. It would ride roughshod over local communities.

Introduce a planning gain supplement

The Barker Review recommended introducing a (small) planning gain supplement to replace the existing Section 106 agreements (see box page 16). This would be a fee that developers would have to pay when planning permission is granted. While the current fees – Section 106 agreement money – is supposed to be related to the cost of providing additional infrastructure, the level of the planning gain supplement would be related to the rise in value of the land concerned. Barker sees the revenue as being of the same size as the foregone Section 106 money. This is essentially a small 'betterment tax', a tax on the increase in the value of land that occurs when planning permission is granted. The revenue would accrue to the local authority.

There are a number of practical objections to this idea. First, under the current system the value of land may not increase when planning permission is granted. If the land is listed in the development plan as suitable for development, then its value will already take into account that planning permission is very likely to be given. As a result the value will not increase, or increase only by a very small amount, when permission is actually given.

Second, it is often the case that the land has been owned by the developer for some time prior to planning permission, and will not be sold until the development is complete. In those cases it is hard to calculate the value of land before and after planning permission is given, and thus hard to agree the basis on which the tax will be levied. At the very least, introducing a planning gains supplement is a recipe for long – and expensive – negotiations over each and every piece of property.

Third, if the betterment tax is only the same in value as the foregone Section 106 agreement money, the scheme provides no additional incentive to local authorities to favour development, since they will be on average no better off under this system than under the current one.

On the other hand, if the betterment tax is significantly larger than the value of the Section 106 agreement, developers could simply refuse to seek planning permission. It could be financially advantageous for developers simply to wait until the system changes in the knowledge that only their land is earmarked for development. The problem is that the plan effectively prevents any other land being developed in lieu of the land being held back. Betterment taxes have been tested without success in Britain in the past. There is no reason to think that they would work better in the future.

Section 106 Agreements

Section 106 payments are made by developers to local authorities as a condition of planning permission. These payments are supposed to cover the costs to the council of providing infrastructure, such as extra school places, bus services to offset additional traffic and so on. But as a proportion of the total extra value realised from development, these payments are trivial and provide little incentive for development. Furthermore, as one study concluded: "These agreements have high transactions costs associated with them and are very imperfect."¹²

A liberal solution that will work

At present there is one group who frequently favours development – those who own a house with a large garden, or farmers on the edge of a town. These landowners are often delighted to see new development – land with planning permission is worth many times the value of land without. Of course, they do not like the development per se, but the compensation is more than sufficient to make up for any detrimental side effects of extra houses in their backyard.

This points to a way forward: if communities as a whole could capture the value of the planning permission that they grant,

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P Cheshire and S Sheppard, 'The introduction of price signals into land use planning decision-making: a proposal', *Urban Studies*, 42 (4), 2005.

local people would be fairly compensated for development. This would provide an incentive to support rather than oppose new homes. Top down targets could then be dispensed with: once local people, rather than individual landowners, capture the benefits of development it will be for them to choose whether they want development, and to what extent.

The most successful experience of government extracting rents in recent times has been the auctioning of the 3G mobile licences in 2000, from which the British government raised £22.5 billion. That success can be attributed largely to a well-constructed auction design. This paper proposes to apply the lessons from the 3G mobile phone auctions to the planning permission process. The aim is to use an auction mechanism to generate sufficient revenue for local authorities that local people will want more housing in their area.

The current planning system does not allow new entrants, that is, does not permit other landowners to undercut those whose land has planning permission. From the moment the council decides which land shall be converted from (say) agriculture to (say) housing in its development plan, the owners of that land become monopoly providers. This policy hands all of the cards to the landowners who happen to own the land designated for development. In the South East of England, for example, agricultural land is worth £7,410 per hectare, with residential land worth £3.32 million.¹³ The owner of an average sized 57 hectare farm could thus make a windfall gain of £189 million from development. Although some of that gain will come back to central government via capital gains tax, none of it accrues directly to the local authority.

Once land for development is chosen, the council enters into complex Section 106 negotiations to get specific planning applications approved. To make the local council favour rather than oppose development, it needs to secure a sufficiently large proportion of the windfall gain for itself in order adequately to compensate local people – with better services or lower taxes – for their dislike of additional developments. The current system does not do this: development plans effectively give away to landowners the value created by the local community from the planning system.

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Valuation Office Agency, 'Agricultural land and property', Property Market Report, July 2006.

The proposal in detail

A two-part auction system for development land would work as follows: in the first part of the auction, individual landowners would set the price at which they are happy to sell their land for development. The council then decides which, if any, of that land should be developed. In the second part, the council auctions the right to buy these pieces of land, now with planning permission, to developers. The council profits by the difference between the values of the two bids. The right to develop is conditional on the council receiving an acceptable bid. If it receives such a bid, the successful bidder can buy and develop the land. If the council does not receive a sufficiently high bid, the land is not sold, and the right to develop lapses.

Stage 1: Offers by landowners

Rather than having a periodic development plan, councils would have a periodic two-part auction. In the first stage, they would invite every landowner in their area to offer their land for development at any price of the landowners' choosing. This is a liberal system, devoid of compulsion. No landowner is compelled to offer or sell their land, and, if land is sold, the price paid will always be the price set by the owner. It is thus compatible with standard liberal interpretations of property rights and the sanctity of title. But offers to sell would be legally binding, and would be valid for a certain pre-set period. In effect they give the council a 'call option'; the right to buy land at a given price for a particular period of time, say, one year.

Stage 2: Decisions by councils

The council would then examine all the offers of land, and carry out a 'local plan' style exercise to decide where and how to develop. Nationally protected areas, such as sites of special scientific interest, would remain in place. But national governments would no longer issue binding development targets for local governments. The only exceptions would be, as now, for items of national importance, such as ports, power stations, and airports. The local council would take into account all of the standard planning criteria, including environmental and social considerations. It would also consider the price offered by the

current landowner, and the price that a developer is likely to be prepared to pay; the difference is the profit for the local community. This system would give the council an incentive to permit more profitable higher density developments. Nearby residents could, as now, object to the development or to its scale. However, residents would also have to think about whether their dislike of the development actually outweighs the benefits to the local community – in terms of better local services and lower council taxes.

Stage 3: Allocation to developers

Once the council decides which land is to be developed, it can begin the second part of the auction process. The council would auction the call options for land it is willing to see developed. Winning such an auction would give a developer the right to buy the land from the original landowner, at the landowner's chosen price, and then to develop it in line with the council's plan. Since the council is auctioning the right to buy the land, the council never itself owns the land, nor, by definition, can the council make a loss, as it has no outgoing costs.

Councils would set a reserve price: if the winning bid was lower than the reserve, the land would remain undeveloped. Reservation prices are important for two reasons: first, they would ensure that land is not developed if the amount that developers are prepared to pay to local people is too low to compensate them for the disamenity value. If the council allows too much development at too low a profit, or does not allow enough development when developers are prepared to pay large sums, the voters can make their views clear at the ballot box. Second, giving the council the right to reject all bids would make it harder for developers to collude – if they all enter low bids, none of them will win.

Stage 4: Development of land

Development would then proceed in the normal way, with developers having to submit specific plans to the council for approval. As at present, approval would be granted so long as those plans were in line with the overall development plan set out at the time of the auction. There would, however, be no Section 106 negotiations or payments. This gives developers the certainty at the second stage auction that they will not have

to make additional payments to the council. That certainty is valuable, and should result in higher average prices in the auction. In addition, abolishing Section 106 negotiations will speed up the development process.

An example of how this scheme might work

Since, under this scheme, councils are free to choose the level of development, it is impossible to predict how many houses will be built. However, as the Barker Review makes clear, even under the current annual quotas system it is still remarkably hard to forecast how many houses will actually be built in any given year. Nevertheless, there are good reasons to believe the number will substantially increase since councils and local people will have, for the first time, a significant incentive to allow development.

A hypothetical example shows how the process would work. Horsham District in Sussex is around 53,000 hectares with a population of 125,000. There is high demand for houses in the area, and developers would welcome the chance to build there. The council decides to allow 5,000 houses to be built. This would raise the current housing stock by about 10 per cent – representing a fairly high level of development. Assuming 35 houses per hectare, and sufficient space for new infrastructure, the council would be looking at developing around 200 hectares in total. This is less than 0.5 per cent of the total area of Horsham district, and less than 1 per cent of the undeveloped area in Horsham district.

There will be places in the district that the council does not want to see built on, as well as protected sites of special scientific interest and areas of outstanding natural beauty. But much of Horsham District – including large areas of green belt – would be perfectly good locations for new towns or villages, in addition to the usual policy of expanding some or all of the existing towns. There are good reasons to think that many, if not all, landowners would be prepared to sell their land for five times its current value. For a typical farmer with 57 hectares that would represent a windfall profit of £1.69 million on top of the undeveloped value of the land of £422,370 (taking the undeveloped value of the land as the south east average of £7,410 per hectare). The council would select the sites that it believes are most appropriate to be developed. The proposed site of 200 hectares is not a large

area, and it could be that the council requires the land of only one large farm for development as a new town. Alternatively, the council could accept bids from the owners of adjoining land, or from diverse sources so that new villages are created, or existing towns and villages expanded.

The council could expect to auction the right to buy the 143 hectares of land on which housing will be allowed for around £3.32 million per hectare, thus making a profit of £469 million (the landowners receive £5.3 million). That is sufficient to reduce the council tax in Horsham to zero for six years. Every Member of Parliament, every council, and every landowner knows that council tax is unpopular. It is surely likely that a politically astute council would allow houses to be built on a well-chosen area equal to less than 0.5 per cent of its district if that allowed them to abolish council tax for such an extended period of time.

This simple piece of political arithmetic reassures us that, under this system, NIMBY local councils will become IMBY local councils, because their voters will want them to become so. Those living close by may still object, but now the council has to weigh their objections against the possible gains to the community as a whole.

Challenges and objections

Can the council expect to receive offers of land for just five times agricultural value?

Yes: if the number of potential sellers is high and the number of buyers is low, the price will also be low. In this case every single landowner in Horsham is a potential seller, and the number of buyers is one, the council. Many landowners would be delighted to sell their land for two to five times its current value.

How can the council increase the number of sellers?

First, by making it quick, cheap and easy for landowners to offer land in the first stage of the auction. The council would send every landowner in the district a map of their property (available from the Land Registry). The landowner would simply have to draw around the land that they were prepared to sell, and name their price.

Second, the council should allow the owner to put restrictive covenants on the land. A farmer might be prepared to see some of the farm redeveloped, but only if the redevelopment met certain criteria, perhaps as a village of two storey houses, but not as a tower block, or perhaps with houses but not heavy industry. Alternatively, restrictions might be aesthetic: for example, admirers of Poundbury (the new village development near Dorchester endorsed by the Prince of Wales) could offer land so long as similar design standards were met. Landowners are more likely to offer their land for development if they have such rights.

With more land to choose from, developments are likely to end up in more suitable locations. With more offers on the table, the process is likely to be more profitable for the local community. Indeed, landowners will place a sensible price on their land in the knowledge that there are lots of other potential sellers. As a result, it is plausible to imagine that a council prepared to see development in a reasonable range of locations would be offered land at a 100 per cent premium over agricultural values, and implausible in the extreme to imagine that it would have to accept offers of more than five times the value of that land.

How can the council structure the auction to induce landowners to offer land at low prices?

The price set by the landowner would not be negotiable: the auction design is therefore similar to a sealed-bid auction. These have been shown to encourage entry, since the process is easy for the would-be entrant, and (unlike a traditional ascending auction) new and inexperienced entrants cannot simply be beaten by a £1 better bid by a landowner who “knows the system”. The sealed-bid element also discourages landowners from being too greedy. If they demand too high a price, then they are likely to be undercut by someone else, and the council will not choose to allow their land to be developed.

Can the council expect to sell the land for £3.32m per hectare?

Yes: this is the value that land with planning permission is currently being sold for in South East England. In fact, since under this scheme the developer would no longer have to pay Section 106 fees to the council, the most likely price would be higher than this by an amount equal to the level of Section 106 payments.

The best method of auctioning the land to developers is likely to vary from place to place. So long as there are many potential developers, and only a limited number of land parcels, a standard auction should suffice. Where the number of potential bidders is likely to be low, the council would need to ensure that the strategies that made the UK 3G auctions so successful were used. The auctioneer must ensure that the bidders risk failing to buy any land if their bids are too low. It can do this by allowing one bidder to win more than one, and perhaps all, of the plots of land available, so that developers who underbid can end up with no land at all. In extreme cases this can be achieved by using the Anglo-Dutch auction system developed for the 3G auctions, whereby a traditional 'Sotheby's' open-English auction is used to reduce the number of bidders to slightly more than the number of plots available, after which sealed-bids are used to determine which of the remaining bidders wins. This is a particularly effective way of raising money in a situation in which there are a limited number of items for sale and a limited number of purchasers.

Will the scheme work in urban areas?

Yes: urban areas are made up of residential and non-residential land, just as rural ones are. With the exception of retail space, almost all non-residential land – factories, warehouses, and so on – are valued at far lower levels per hectare than residential land. Indeed, the absolute price difference between industrial and residential land in many cities is greater than the price difference between agricultural land and non-agricultural land in rural areas. As a result this system can be used in urban areas to decide which non-residential land should be converted into residential areas.

Will current landowners sit on land, in the hope that the scheme will collapse?

No: the only way that the scheme would collapse is if all landowners boycott the scheme. Since the vast majority of landowners have no chance of seeing their land increase in value under the current system (since only the few who own land which the council designates for development see the value of their land increase), the vast majority have an incentive to see the new scheme succeed. There is no reason to expect them to refuse to participate in the first part of the auction.

Can landowners or speculators collude to force the system to fail?

Landowners or speculators could try to collude to force the price up. But there are a number of reasons why such collusion is unlikely to be successful. First, collusion is illegal and the penalties severe, including prison sentences for those involved. Second, collusion is always difficult when there are a significant number of suppliers. The more suppliers there are, the greater the chance that one will renege on the cartel agreement. Imagine that there are 26 landowners, A to Z, who value their one hectare plots at £37,000 (A) rising steadily to £370,000 (Z). If the council wants to allow one hectare to be developed, the obvious result in the absence of collusion is for A to win the first stage of the auction with an offer to sell for £37,000. The rest of the land remains undeveloped.

Imagine instead that Z persuades all landowners to offer their land at £370,000. What will happen? First, the council may decide to allow no land to be developed. In that case the cartel fails. No-one would have an incentive to join that cartel (since no-one would be made better off), and A has an incentive to break the cartel if formed, since A prefers to sell at £37,000 than not sell at £370,000. Second, the council may still accept a £370,000 bid – choosing one of the bids at random, since they are all of the same value. Landowner Z gains from the cartel – he has a chance of winning the bid which he otherwise would not have. The other landowners, knowing that they have only a one in 26 chance of being successful, all have an incentive to undercut the cartel. If you think everyone else will offer land at £370,000, and that the council will accept the lowest bid, your best strategy is to offer your hectare at (say) £300,000. After all, £300,000 in the hand is better than a one in 26 chance of £370,000. But knowing that at least some other bidders are likely to offer their hectare at £300,000, the same logic says that it is worth offering your hectare at £250,000, and so the process continues. Finally, for landowner A, who is genuinely happy to sell the hectare for £37,000 it is better to have £37,000 for sure, than, say, a half chance of selling at £50,000. So long as there are a reasonable number of sellers, and very few items will be bought, sealed-bid auctions are extremely good at producing low prices.

What about landowners who want to develop their own land?

Landowners, whether farmers, developers or companies, may wish to build on land which they own but which does not yet have planning permission. As noted earlier, landowners should be allowed to place any conditions they wish on their land during the first stage of the auction. In these cases the original owners would stipulate that only they should be allowed to buy the right to develop in the second auction. Clearly that means that they are the only bidder. In this case, the landowner would enter a sealed-bid, as usual. That bid would then be compared not only with the council's reservation price, but with the average price paid in the auction going on at the time for similar land. If the bid is too low, development would not be allowed. If the bid is sufficiently high, the development would be allowed. The District Auditor and the Valuation Office can be approached for guidance if the piece of land in question is unique to that area.

What about extensions, and other small developments?

Small changes to properties would be allowed as they are at present.

What about development opportunities that only occur between rounds of development auctions?

Councils should be allowed to consider smaller developments between rounds. For example, a council could consider a change of use application if a large derelict house was sold to new owners who wanted to convert it into flats. The price that would be payable would be set by reference to prices in the previous auction round, and to price trends in the neighbourhood.

What about existing planning permissions?

These would be respected.

Concreting over the countryside

Any advocate of house building will be accused of wanting to 'concrete over our countryside', as though this were uniquely bad for the environment. Nothing could be further from the truth.

Much of the countryside is intensively managed – British agriculture has some of the highest rates of fertiliser and pesticide use in the world. Many farms are ecological deserts. In contrast, the Sheffield University study on biodiversity found that, unlike intensively managed farmland, ‘gardens are brilliant for wildlife’, and, remarkably, that British gardens have greater biodiversity than tropical rainforests.¹⁴ The same is true for birdlife: while “wildlife in the wider countryside has collapsed”, gardens can and do provide everything that many birds need over their complete lifecycle.¹⁵ The environmental case against house building has been greatly overstated.

The global environment

Housing is a major contributor to global warming, and new housing locks the economy into the environmental standards of the time the house was built for as long as the house remains standing. In short, it is important to design houses well, and to make sure that they are appropriately well-insulated. However, building regulations can be implemented and enforced equally well under both the current and proposed planning regulations. But, insofar as cost is a major obstacle to improving energy efficiency, lowering the cost of housing relative to earnings makes it politically easier to improve environmental standards.

All of the gains will go to councils in the south east

Since the housing shortage is largest, and house prices highest, in the south east, this region will gain most directly from the scheme. But, as a result, house prices will become more level across the country, which means that those who own property in the south will lose relative to those in the north. Those in the south east are thus the biggest gainers and losers, and to some extent those effects will cancel each other out. Additionally, those living in the north who wish to move to the south but cannot afford to do so will be substantial beneficiaries. We have already noted that under this policy some industry is likely to move from the south to the north, increasing opportunities in the north. Indeed, Cheshire and Sheppard argue that introducing price signals into

14 K Gaston and K Thompson, ‘Evidence for significance of biodiversity and gardens’, presented to the RHS Conference, ‘Gardens: heaven or hell for wildlife?’, 2002.

15 A Evans, ‘Gardens: heaven or hell for birds?’, 2002.

the planning system “would, therefore, help to resolve the so-called north-south divide.”¹⁶ All regions will gain from the fall in housing benefit costs borne by central government.

There will be a glut of unwanted houses

Even if the UK were to double the number of houses built each year, the total housing stock would rise by only 1 per cent. It is most unlikely that Britain would be flooded with unwanted homes, or that houses would become unsaleable.

16 P Cheshire and S Sheppard, ‘The introduction of price signals into land use planning decision-making’, 2005.

■ 3 The positive effects of the new system

The main effect of creating an incentive to release land for building would be to release more land for building. This will alter the dynamics of the housing market. As things stand house prices are likely to rise faster than earnings, and as a result people are prepared to pay a great deal more for houses now, in the belief that they will continue to increase in value. Once that assumption is altered, the incentive to buy now at any cost disappears. It is impossible to predict how this change in incentives will affect market sentiment – indeed the Barker Review was unwilling to make such predictions of the impact of their relatively timid set of recommendations. Nevertheless, we can make some tentative predictions about the likely impact of the scheme.

Prediction 1: Lower house price growth

The launch of a new system that would lead to more houses being built should slow house price growth, and perhaps even reduce prices over time.

Prediction 2: The cost for housing support to taxpayers will fall

A fall in house price growth or a fall in house prices would significantly lower the housing benefit bill. It would do so in two ways. First, the cost of housing benefit moves in line with rents, which, in turn, are partly related to house prices. Second, the demand for social housing varies with the cost of private housing. When private housing is expensive, more people need social housing and vice versa. This means that the government has to spend less money building social housing, and/or can use some of the currently planned social housing to house some of those who would otherwise be homeless.

Prediction 3: Council tax will be lower and/or local services will be better.

Since councils would directly benefit financially from this system, they would be able to cut council tax and/or improve local services.

Prediction 4: The young and the poor will benefit at the expense of the old and the rich

The boom in house prices has transferred wealth from the young and the poor, who do not own housing, to the old and the rich, who are more likely to. This policy would reverse some of that process, and so represents a transfer of wealth from the affluent (current land- and homeowners) to the less affluent (those who own neither). In general this is to be welcomed, although inevitably there is a risk that a limited number of people who have overextended themselves will lose out.

Prediction 5: Interest rates will be lower over the economic cycle

Lower house price growth – or house price falls – would lead to lower interest rates. This is good for industry in that it encourages investment. It is also good for all existing mortgage holders, and makes it less likely that homeowners would be caught in financial difficulties.

Prediction 6: House price volatility will be lower

The current system does not result in more land being released when house prices are high. The new system would create an incentive for councils to release land for development. This incentive increases when house prices are high, and falls when house prices are low. For that reason the system would help the market to avoid positive and negative bubbles, since changes in demand would result in a change in supply, rather than price. The system would be self-regulating, in that if house prices fall, local councils would not be able to make significant profits and would, therefore, not want to permit further development.

Prediction 7: Regional house price differentials will be reduced

Higher house prices in the south mean that local authorities in that region would have a greater incentive to allow house building. This, in turn, would reduce house price differentials, although given current trends these are likely to remain substantial for a considerable period of time.

Prediction 8: More jobs will move out of the south east

Some industry will move away from the south east. Once industrial land can be converted into residential land, some industry is likely to move out of the south east, and towards areas of higher unemployment, reducing the north-south divide.

Magnitudes

In the long run, the constraint on the supply of houses is the supply of land. This scheme would relax but not eliminate that constraint. The supply of houses would be held back in the short to medium term by a shortage of builders. This has the advantage of easing the transition away from a system of significant and sustained price rises to one in which house price rises are lower. In short, it is not physically possible to cause the market to collapse through a sudden glut of new developments.

The socially optimal number of additional houses is large. Barker has estimated that the backlog of households in need of social housing in England alone is 948,000. In fact, this measure understates the number of houses needed, in that it excludes all those in unsuitable housing but not on the waiting list.

Barker also notes that even if house prices grow at 2.4 per cent above inflation – in line with earnings – the number of people unable to afford market housing, and therefore in need of social housing, will grow at 7,000 households per year for the next 20 years. Were that to happen, by 2021 an additional 140,000 households – the equivalent of a city the size of Nottingham – will be unable to afford their own housing. Current house price inflation is, of course, far higher than this figure, so as things stand, even more people will end up poorly housed. Last year, for every increase of four households in England, only three

houses were built.¹⁷ This implies that in 2006 alone 53,000 additional households – the equivalent of a town the size of Carlisle - became homeless.

That should be unacceptable. The pace of housebuilding would need to rise by a third just to ensure that overcrowding and homelessness do not become worse, and that affordability remains at current levels, with house prices growing in line with earnings.

A better alternative might be for house prices to remain stable over the next two decades. This would have a massive effect on affordability. After 20 years the cost of houses would be similar to the cost of building houses, with land representing a relatively trivial component. If we assume that inflation averages 2 per cent and earnings grow at 2.5 per cent a year in real terms, then affordability would improve dramatically: in that scenario the average house price in 20 years time would be 2.5 times average earnings, rather than the current six times the average.

That alone, and without any additional subsidy, would remove around 1 million people from the housing waiting lists.¹⁸ Some on the backlog would now be able to afford housing, while others currently in social housing would be able to move into private housing, freeing up social housing for those who remain in need of it.

17 Council of Mortgage Lenders, 2007.

18 K Barker, 'Review of Housing Supply', 2006.

■ Conclusion

This paper sets out a radical way in which we can reform the land use planning system in Britain. The proposed system is liberal in that it abolishes top-down national government targets and instead allows each and every local community to decide on how much development should be permitted in their area. By giving them an incentive to allow development, in the form of the uplift in value of the land on which planning permission is granted, the system will change NIMBYs into IMBYs, and lead to more, not less, development. Increasing the amount of housing that is built will lower the cost of housing and make a real contribution to social justice. More people will be able to afford a house that is appropriate to their needs. And all of us, as taxpayers, will benefit as the cost to society of paying housing benefit is reduced.