Community land auctions
working towards implementation

November 2011

Tim Leunig

CENTREFORUM

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“Tim leunig’s proposals would be a major step forward to solving land supply problems and give the community a real incentive to welcome development”

— **Sir Stuart Lipton**
Deputy chairman of Chelsfield Partners LLP
and founding chairman of the Commission for
Architecture and the Built Environment (CABE)

“Innovative and essential”

— **Martin Wolf**

“The economics are clear that Britain needs more houses, but reforms to the planning system have been consistently blocked by politics. Tim Leunig’s proposals show how to cut the Gordian knot.”

— **John van Reenan**

“In real terms the Swiss have had stable house prices for 40 years; Swiss local authorities get real tax incentives to encourage them to allow building. The Swiss also have a strong economy. Tim Leunig’s highly original but simple idea could inject real incentives into house building in Britain. Maybe our economy could become more Swiss!”

— **Paul Cheshire**
LSE

“Were it not for arbitrary planning constraints, Britain would get the house building it desperately needs. Tim Leunig’s pathbreaking work shows how to remove the planning logjam without providing unearned windfall profits for existing landowners.”

— **Chris Giles**

“Tim Leunig makes a compelling case that Community Land Auctions are both desirable and feasible”

— **Professor Paul Klemperer**
Leading UK auctions expert

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"The best idea for growth"

— **Sam Brittan**

"Land auctions are a radical way to change the community's incentives toward accepting development. They have now been discussed for several years - it's time to test their practical value"

— **Kate Barker**
Chair of the UK Government Barker Review of Housing Supply, non-executive director of Taylor Wimpey plc

"In the UK, all methods of expressing economic preferences on land-use planning issues are completely excluded by our planning system. This has disastrous results from the point of view of those who cannot afford housing and unsatisfactory results from the point of view of preserving environmental amenities. This proposal is an important attempt to rectify this long-standing defect."

— **Professor Philip Booth**
IEA

"Tim Leunig's analysis is typically excellent. He has played a key role in highlighting current planning failure."

— **Alex Morton**
Policy Exchange

"A major step forward in making us a better housed nation"

— **Professor Stephen Nickell**
Office of Budget Responsibility and former head of the National House Planning Advisory Unit

"Britain's housing shortage clearly needs some radical solutions. Dr Tim Leunig always argues his case very powerfully, and in this instance makes innovative and challenging proposals about how the problem could be solved."

Trudi Elliott CBE
Chief Executive of the Royal Town Planning Institute

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About the author

Tim Leunig joined CentreForum in January 2011, from the London School of Economics. As well as his academic work, he has served on the academic advisory board to the Barker Review of Land Use Planning, co-authored a research paper for the Eddington Review on transport and the economy, and has written widely in the press and for think tanks on planning, housing, transport, pensions, university access and economic issues more generally.

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Executive summary

House prices in Britain are high, whether measured by historical or international standards. High house prices also mean high rents, and that in turn means a very large bill for housing benefit.

The last 25 years have seen a significant rise in the number of households – by around 1% a year. In addition we have become richer, and falls in interest rates since the mid-1990s make mortgages more affordable. In a rational world this combination would lead to a lot more houses being built. The planning system has not delivered this. As a result the prices of existing and new houses have risen sharply.

The only way to make houses more affordable is to increase the supply of new houses. The old system of top-down targets has proven a failure: the regional spatial strategies did not deliver the houses we needed. Instead the coalition government wants to create a system whereby local authorities will have an incentive to permit development, so that local communities will choose to support, rather than oppose, development.

Community land auctions are part of that set of incentives. The Chancellor of the Exchequer announced in the 2011 Budget that the government will run a pilot to test the feasibility of the idea.

At present, and particularly in the South East, where house shortfalls are most acute, there are large financial gains when land is reallocated from agricultural or industrial use to residential use. In some places the value of agricultural land rises more than a hundred fold when the planning allows it to be used for housing. A small part of that gain accrues to the council, via community infrastructure levies and 'Section 106' planning agreements, but the bulk goes to the original landowner, and the land agent or developer who optioned the land and successfully guessed what would happen. Because the bulk of the gains do not go to the local community, the local community generally opposes development. There is little in it for them.

Community land auctions are akin to competitive tendering. The local authority invites offers of land, and accepts those that are good value. Good value is a combination of price and appropriateness for development, where the latter incorporates both sustainability criteria, as well as desirability for the final purchaser. The council grants planning permission, and then re-auctions the land that it accepted for development, keeping the difference in value.

There is lots of land in Britain that could be developed, and local authorities want to see only small amounts developed. Lots of potential sellers mean that prices of land that the local authority accepts are likely to be low. Equally, when the local authority comes to sell the land to developers it is the only seller, and there are many potential purchasers. This means that it will receive a full price for the land.

Using figures supplied by a major volume housebuilder, and confirmed in conversation with two other housing insiders, we estimate that councils in the greater south east would typically receive around £45,000 per house built. This is a dramatically greater incentive than local authorities have had before, and makes it much more likely that communities and local authorities will support, rather than oppose, development.

'Community land auctions: working towards implementation' updates Tim Leunig's 2007 CentreForum publication 'In my back yard: unlocking the planning system'. This publication sets out the basic idea more fully, and answers the concerns that people have expressed about how the system would work. It sets out why government can be confident that the proposed pilot is worth running, and why this policy is likely to be an effective part of a planning system that balances people's desire to have somewhere decent to live, with the need to use planning to deliver sustainable communities and a sustainable environment.

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1 Introduction

The planning system is not working. It is not delivering the houses that people in Britain want and need, in places that they want to live, at prices that they can afford. This harms those who are badly housed, and reduces economic growth. Nor is the current system popular: people perceive that they have no say in what happens to their area, and that houses are foisted on them by inspectors following edicts from Westminster.

Here we set out the evidence that the current system has failed, explain why it has failed, and show how a system of "community land auctions" would be more effective. We can reconcile both the need for more housing and the right of local people to control what should be built locally.

This paper builds on an earlier 2007 CentreForum paper, 'In my back yard: unlocking the planning system', which set out the basis of the idea proposed here. This paper goes further in two senses. First, it reviews the recent evidence in the housing market. Second, it uses evidence from one of Britain's major house builders on the economics of house building to demonstrate just how well the scheme would work in practice.

The insight on which this paper is based is that the value of land increases dramatically when it stops being used for agriculture and starts being used for residential land. The same is true for industrial land converted to residential use in many urban areas. That 'uplift' in value, if captured for the local community, is quite enough to persuade people to support more housing locally. The value of agricultural land is typically £15,000 or less a hectare, whereas residential land is worth £4m a hectare in a high demand spot such as Oxford.[1] Even taking into account

1 www.voa.gov.uk/publications/property_market_report/pmr-2011/pmr_2011_accessible.pdf

that some of the land would need to be used for roads, open space and community facilities, the gains to society from allowing building are large. Some of these gains are captured by the current, complex system of Section 106 payments, and 'community infrastructure levies', but, as we shall see, there is plenty of scope for local communities to gain much more than at present, and in a less costly and more transparent manner. If they are able to do so, then the incentives to allow development increase, and the amount of development that occurs will increase as well.

2 Why we need change

The biggest symbol of the failure of Britain's planning system is the huge rise in the ratio of house prices to incomes. In recent years house prices in Britain have been higher, in absolute terms, in real terms, and relative to incomes, than ever before. Decent housing is, as a result, an unaffordable aspiration even for many in steady employment.

It is worth setting out just how much house prices have risen since the mid-1990s. House prices have risen faster than inflation, and faster than median earnings. In 1993, the average house cost 5.4 times median household income; by 2008, the average house cost 9.8 times median income.[2] Since then both house prices and incomes have fallen, and houses remain unaffordable to many who would be able to afford housing in most other countries given their incomes. Even though interest rates and mortgage rates fell over this period, fewer people than ever before can afford to buy a house. The rise in prices is given in Figure 1, taken from the Financial Services Authority.

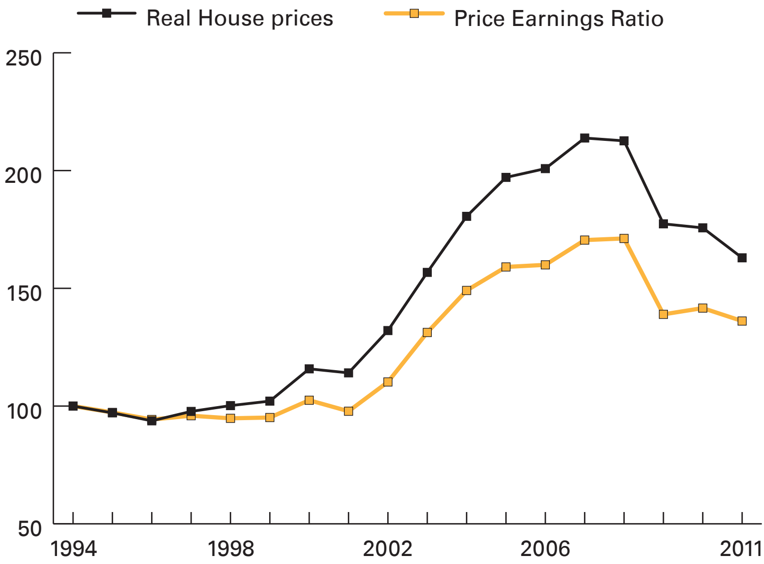
Why are house prices so high?

Housing is expensive in Britain because the planning system does not release sufficient land when demand is high. This means that rises in demand – caused by increases in the number of households, increasing affluence, or falls in interest rates – are translated into higher land prices, rather than increasing the supply of land available for housing.

The failure of supply to increase when demand is high is evidenced by the rise in the price of land relative to house prices over the last twenty years, and by the relatively high level of

2 www.lloydsbankinggroup.com/media1/economic_insight/halifax_house_price_index_page.asp

Figure 1: House prices and other core economic variables, 1990-2008



Source: www.fsa.gov.uk/pubs/discussion/dp09_03.pdf p 17

land prices in those parts of Britain where demand for housing is highest.

Figure 2 shows the rises in the real value of land and housing costs since 1993 in the South East, the area in which house prices have risen most strongly. As we would expect, the land price index is more volatile than the house price index. But what really stands out is that the land price index rises much more sharply. Between 1993 and the peak in 2008 land prices rose by almost three times as much as house prices in real terms. The rise in land prices accounts for the majority of the rise in house prices between 1993 and the 2008 peak. Since then land prices have fallen back somewhat, but remain high relative to house prices.

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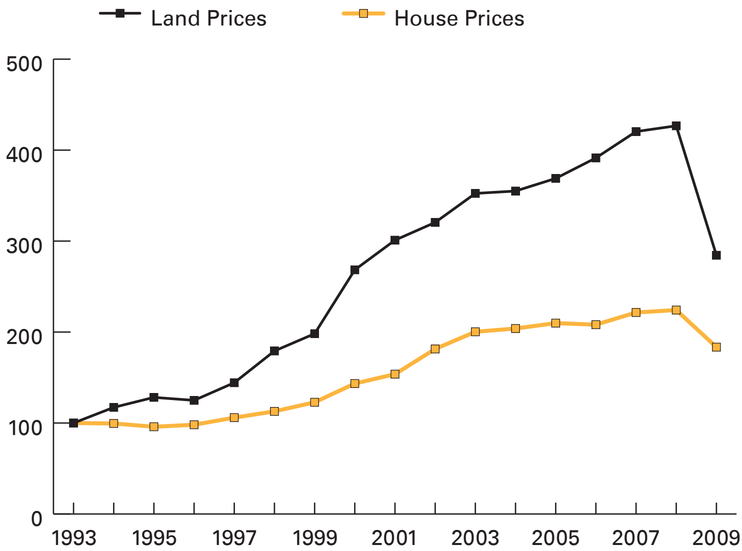
Figure 2: Land and Housing Prices in South East England



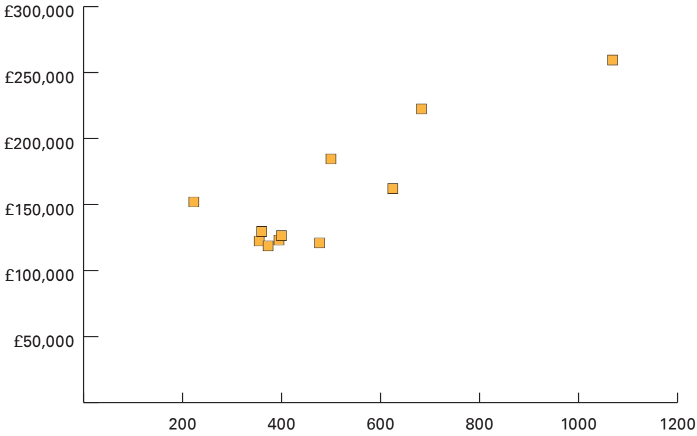
Notes: Halifax "All Houses (All Buyers), Seasonally Adjusted - Quarterly Data" available from www.lloydsbankinggroup.com/media1/economic_insight/halifax_house_price_index_page.asp. Land prices are Valuation Office Agency residential land prices, available from webarchive.nationalarchives.gov.uk/20110320170052/http://www.voa.gov.uk/publications/property_market_report/pmr-jul-09/residential.htm#residential_land_index. Until 2003 these were collected on a spring/autumn basis; since that date they have been collected on a January/July basis. This chart reports the spring and January land price numbers, which are compared to the average of Q2/Q3 and Q4/Q1 house price numbers respectively. Land prices per house assume 40 houses per hectare.

We can also plot residential land prices against house prices, for different regions of the UK.

Figure 3 shows that house prices are higher in areas where land prices are higher and vice versa. A simple regression of house prices on land prices shows that variations in land prices account for 71% of the variation in house prices between regions.[3] This is a remarkably close result given that we are matching the land prices in a limited number of locations with house prices in the area as a whole. The overwhelming reason why houses are

3 As measured by the adjusted R^2. Land prices have a co-efficient of 177 and a t-statistic of 5.0, demonstrating the power of land prices to explain house prices.

Figure 3 The relationship between land prices and house prices in Britain today



Sources: Land prices: Valuation Office Agency Property Market Report 2011; House prices: House prices: Halifax House Price Series, Q2 2011, all properties. Note that land prices are aggregated to regional level by taking a simple average of the prices for places within that region. The sample sizes are very small – typically two per region.

more expensive in some places than in others is because land prices are higher in some places than in others. This in turn is caused by the supply of land for residential housing being more constrained in some places than in others, relative to the level of demand.

The idea that high house prices are caused by high land prices, which are in turn caused by supply restrictions is not universally held. For example, high house prices – and high land prices – are sometimes seen as caused by a finance-driven bubble. The evidence for this widely held point of view is, however, weak.

1997-2007 is often seen as a period in which finance was more available than ever before. Although loan to value ratios of greater than 100% became (in)famous, such loans were always an exception. In fact, loan to value figures *fell* after 1997. In the 15 years prior to that date, the proportion of mortgages that were for more than 90% of the value of the property was typically 35-45% of all mortgages, but this fell back after 1997, to around 20 per cent prior to the crisis.[4] On this measure, bank lending was becoming more rather than less prudent.

What is true is that banks lent hitherto unheard of multiples of income. As the Financial Services Authority note, "An LTI in excess of 3.5 times income that was mostly unheard of in the 1970s and 1980s became common practice in the run up to the crisis."[5] But high loan to income mortgages are not evidence of imprudent lending, provided that the borrowers are carefully selected. There is good evidence that banks were selecting people who received these loans carefully. The FSA reports that default rates for loan to income ratio loans above 3.5 are lower than for traditional loan to income ratio loans of less than 2.5.[6]

The general prudence of bankers can be found in data on arrears. The number of people in arrears with their mortgages has risen during the recession, from a low of 0.36% in 2004 to 1.41 per cent in 2009, since when it has fallen back significantly.[7] Similar figures apply to repossessions, which rose from 0.07% of mortgages in 2004 to 0.42 per cent in 2009.[8] These figures are low by historical standards: the early 1990s recession saw arrears and repossession rates peak at 2.55 per cent and 0.77 per cent respectively.

The only exception to this generally prudent picture is the advent and expansion of self-certified mortgages, in which the mortgage company did not verify the borrowers' income. These grew to represent 45 per cent of mortgages immediately prior to the crash, and do have higher default rates. That said, the FSA found that over 97 per cent of self-certified mortgages are not in default, so clearly the majority of self-certified income mortgages had other controls, such as maximum loan to values or employment history. This illustrated that the people receiving the loans were largely plausible borrowers.

Recent house price movements also undermine the idea that the previous rises were a short lived bubble. By definition, bubbles pop and prices collapse when finance disappears. This is what happened in the US, where house prices are more than 30%

4 www.fsa.gov.uk/pubs/discussion/dp09_03.pdf, p. 38
5 www.fsa.gov.uk/pubs/discussion/dp09_03.pdf, pp. 40-41
6 www.fsa.gov.uk/pubs/discussion/dp09_03.pdf, p. 41, exhibit 4.7.
7 www.parliament.uk/briefing-papers/SN00263.pdf
8 www.parliament.uk/briefing-papers/SN00263.pdf

lower than they were at their peak in 2007, despite GDP rising by 7 per cent since that date.[9] Mortgage finance has all but dried up in the UK – in the first quarter of 2011 mortgage approvals for house purchases ran at just 40 per cent of the equivalent number in 2007 – and yet house prices have not collapsed in the way that they have in the US.[10] British GDP is still around 4% below its previous peak, and yet house prices have fallen by only half as much as in the US. That house prices have not collapsed when finance became much harder to come by, and when GDP has fallen, demonstrated conclusively that any bubble element to the previous boom was tiny. It is also worth noting that house prices have fallen less in real terms than in the early 1990s.[11]

The econometric evidence also supports the 'supply-based' understanding of housing costs. The National Housing Planning Advisory Unit used the University of Reading econometric model of housing affordability to set out the key determinants of house prices. They found that the following relationships hold in the long run:

1. If real incomes rise by 1 per cent, house prices will rise by 2 per cent;
2. If the number of households rise by 1 per cent, house prices will rise by 2 per cent;
3. If the housing stock increases by 1 per cent, house prices will fall by 2 per cent;
4. If interest rates rise by 1 per cent, house prices will fall by 3 per cent.

The second and third rules are essentially two sides of the same coin: house prices are determined (in part) by the ratio of households to the number of houses. A rise in the number of households is thus the exact opposite of a rise in the number of houses, and the two have opposite effects of the same size. A 1 per cent rise in the number of households, accompanied by a

9 www.standardandpoors.com/indices/sp-case-shiller-home-price-indices/en/us/?indexId=spusa-cashpidff--p-us

10 www.bankofengland.co.uk/statistics/li/2007/apr/index.htm#tables compared with http://www.bankofengland.co.uk/statistics/li/2011/apr/tableC.xls

11 Halifax House Price index deflated by the retail price index (ONS series CHAW and CZBH) www.lloydsbankinggroup.com/media1/economic_insight/halifax_house_price_index_page.asp ; http://www.statistics.gov.uk/statbase/tsdataset.asp?vlnk=229&More=N&All=Y

1 per cent rise in the number of houses, would therefore cause house prices to remain the same, assuming that incomes and interest rates remained constant.

Incomes matter because people who become richer over time want to live in bigger houses, and buy additional houses, just as they want to go to the theatre more often, take more holidays and so on. Since society is getting wealthier over time, this means that house prices will rise even if the number of households does not increase, unless the number of houses increases at the same time.

Here is the nub of the reason why house prices have increased in recent years: we seek to plan for 'need', not demand. Need in turn is based on projections of household numbers, which in turn are based on projections of births, deaths, divorce, remarriage, age of leaving home, immigration, and so on. Therefore, even if we were to build enough houses to cover the estimates of the increase in housing need, therefore, we would see house prices rise because our incomes have risen and with it our demand for housing. In fact, Britain did not even manage to build enough houses to match housing need – the shortfalls between 1993 and 2008 vary between 52,000 and 104,000 per year.[12]

The effects of high house prices

High house prices have effects in the short, medium and long term. In the short term, high and rising house prices hit those who do not currently own a house. This group is made up predominantly of the young and the less well off. Those who own a house generally gain as the asset that they own increases in value. Home owners are generally older and better off. Rising house prices therefore transfer wealth away from younger and poorer people towards older and better off people.

Of course, not every young person is affected equally. Some can borrow money from their parents. Some inherit or are given money towards a house. Inheritance means that (almost) any level of house prices are sustainable in the long term, because wealth cascades from one generation to another. But high house

12 DCLG 2004 England household projects used as the base line, increased pro-rata to UK level. Quoted in england.shelter.org.uk/__data/assets/pdf_file/0003/142473/Homes_for_the_Future_amended_Feb_09.pdf, and compared with http://www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/housebuilding/livetables/ Table 241

prices divide societies at birth, between those who will inherit and be able to afford a place of their own, and those who will do neither. This sense of social division at birth should please no government committed to social mobility.

It is not only those buying a house who suffer from high house prices. The cost of renting in the private rented sector is closely linked to the cost of purchasing a house. This connection was less clear between 1997 and 2005, as the sustained fall in interest rates led to a change in the underlying ratio between rents and house prices. This reduced the effects of rising house prices on renters, although renters have been hit more recently by relatively large rises driven by the underlying scarcity of houses. High rents are a particular problem for the young, who are most likely to be in the private rented sector.

People in social housing also suffer from high house prices. The high cost of buying or renting a house in the open market means that the number of people leaving social housing for the market sector has fallen dramatically. This in turn means that far fewer social houses become available each year for new tenants, putting pressure on some of the most vulnerable households. This lack of outflow is the primary reason for the shortage of new lets in the social renting sector.[13] This has been compounded by the failure to replace the stock sold off under the 'right to buy' legislation. In the short term right to buy sales do not increase waiting lists – the same person is living in the same house. But many of the people who bought in the 1980s were in their 50s, and a significant proportion of the houses bought would have become available to other tenants by now, had they remained in the social sector.[14]

The high cost of housing means that people economise on housing. New houses in Britain are smaller than those that are being built elsewhere. Here the contrast is not only with the United States, or Australia – land abundant societies where the detached house and large plot have always been the norm – but with all of our European neighbours. New houses in Britain are smaller than those in any of the EU-15 nations. Our new houses average 76 m^2, compared with a range of sizes from

13 Hills, Ends and Means, pp. 144-5
14 Hills, Ends and Means, pp. 146-7

82 m^2 in Portugal to 137 m^2 in Denmark. Obvious comparators such as France, Germany and Belgium average 113 m^2, 109 m^2 and 119 m^2 respectively. Nor is it that Britain is building flats for single people, while others are building family houses owing to differences in demand. The average room size is also notably smaller in Britain. Our newly built houses have rooms averaging 15.8 m^2, whereas the range in Europe is from 16.9 m^2 in Ireland to 39.5 m^2 in Greece. All of the EU-15, excepting only Ireland, Portugal and Spain, have room sizes in new houses at least 25% bigger than in the UK.[15] One of the prices of high housing costs is that we live in shoeboxes. We are getting richer, and yet our houses are getting smaller and pokier. That makes no sense.

Finally, we all suffer from high house prices via the benefits system. The need for housing benefit is real in Britain, given the level of rents. The housing benefit bill is currently around £21.5bn per year – which means every household not receiving housing benefit is paying more than £1,000 a year in taxes just to cover housing benefit alone.[16] The recent reforms aim only to stabilise the bill rather than to cut it. The only sustainable way to reduce the burden of the housing benefit bill to taxpayers is to cut housing costs, so that housing benefits fall as well.

A better system would have seen more houses built in response to rises in household numbers and incomes, and to falls in interest rates. Under that scenario there is no reason to think that house prices would have risen to significantly greater than the cost of construction, including site preparation. Had house prices kept pace simply with inflation since, say, 1993 then a typical house outside London would now cost £103,200, rather than £160,500.[17] In that context a three bedroom terraced house would retail for around £75,000 – bringing decent housing into the reach of many.

15 Hartwich and Evans 'Unaffordable housing: Fables and Myths', p. 24 www.policyexchange.org.uk/images/publications/pdfs/pub_38_-_full_publication.pdf, based on EU data.

16 research.dwp.gov.uk/asd/asd4/index.php?page=hbandctb_expenditure

17 Halifax House Price value for February 1993 indexed to ONS RPI all items series CHAW

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3 How to increase the number of houses built

New housing is not, in general, popular with existing voters. The National Trust, for example, speaks for many in its firm opposition to the government's proposed changes to the National Planning Policy Framework. Its chairman, Simon Jenkins, has written in the Guardian that the changes are "a straight developers' ramp", which will cause the "most astonishing change to the face of England in half a century". He argues that "for the unprotected countryside to become the lasting victim of the credit crunch is tragic", while for good measure describing Vince Cable as "a rightwing nutter". He concludes that "litigation and direct action will be conservation's only defence".[18]

It is possible to argue that it is not the quantity, but the type of development that is unpopular. This approach argues that local people will vote for development, in sufficient quantity, provided that it is the right sort of development, sympathetic to the needs and views of existing local people. While it is clear that people will prefer nice developments to nasty developments, it is not at all clear that they prefer nice developments to no development at all. Indeed, the evidence is to the contrary. The current government abolished regional spatial strategies immediately on entering office. The result was that many local authorities cut back on the number of houses that they will allow to be built. A survey by BNP Paribas found that local authorities were six times as likely to cut housing numbers as increase them, with an average change of more than -20%. The biggest falls were in the South East.[19] The evidence is that, all other things remaining equal, most

18 www.guardian.co.uk/commentisfree/2011/jul/28/localism-bill-sacrifice-countryside-market
19 www.realestate.bnpparibas.co.uk//pages/download.php?s_wbg_menu=0&s_document=http://www.realestate.bnpparibas.co.uk/_protected/etudes_sectorielles/housing_the_nation_summer_2011.pdf

communities prefer no development to development. Localism without incentives is simply a charter for widespread nimbyism. We cannot expect to see more houses built by simply wishing that it would happen. There are good reasons for NIMBY behaviour. Either local people in local areas need to be compelled to accept more housing, or given incentives to accept it.

There are two forms of compulsion. One is for the government to mandate increased building and back that command with effective sticks to ensure the houses are built irrespective of what local people want. Alternatively, compulsion can take the form of the government granting developers the right to overrule the planning system, at least under some circumstances. Finally – and most convincingly – the government can construct a set of incentives that make allowing development very profitable to local communities in areas of high housing demand.

Although we think of planning as a local government issue, national government is sovereign in Britain, and has the ability, both in law and via the financing of local government, to tell local government what to do. This, in essence, was the approach used by the previous Labour government. The government set out a methodology to assess so-called 'housing need'. Regions then had to apply that methodology, and construct 'regional spatial strategies'. Local government in turn had to produce local plans (which went under a myriad of names) that had to conform to the regional spatial strategies, which themselves had to confirm to national guidance. In short, national government was in the driving seat, and could, at least in theory, alter the number of houses built by changing the criteria of how housing need was assessed.

Of course local government had a role, but all too often that role seemed to be to slow things down. Local people were not in favour of development, which seemed to be – and was – mandated from above. Local authorities could argue that a neighbouring authority should take more of the region's housing, or could offer up land that was very unappealing to developers. The reality was, therefore, that the government's targets were never hit.

If government wanted to return to this top-down, centralised, command and control approach, it could do so more effectively than in the past. A method based on sticks needs to have sticks to wield. The obvious one is local government finance. The government could simply state that some significant part of the grant that an authority gets from central government is tied to the local authority delivering a certain number of new houses. This could either be the number agreed through a plan led, regional spatial strategy style exercise; or it could be more brutal: the government could simply tell every local authority to increase the stock of housing by at least 1 per cent a year in order to receive their revenue. If enough finance rests on hitting the target, the target will be hit.

This approach would work at one level, but it would also be unpopular. We know that local people do not like having housing forced on them from above, and it is likely that an aggressive, plan-led, centralised system would have MPs postbags bulging with letters of protest. Such an approach would also be contrary to the localism agenda rightly being pursued by the current government.

The second approach is to use the market. Market signals are clear: build more houses, build them predominantly in the south-east, and particularly in an arc immediately outside London from Hemel Hempstead and Aylesbury, south and west through Reading, Guildford, Reigate and on to Sevenoaks, as well as in London and other property hotspots. The very high price of property in such places tells us that people really want to live there. There are two ways in which such a market based system could work. First, we could simply return to the pre-second world war system in which ownership of land conveyed the right to build on it. Planning permission would simply not be required. Were we to do that, we can be sure that many, many houses would be built, particularly in the south east, because the value of a house in such areas greatly exceeds the cost of construction.

Nevertheless, we have a planning system for good reason. There is more to constructing stable, functional communities than simply allowing the market to build what works for individual developers and purchasers. Housing has externalities – we need schools, hospitals and other facilities to go with the houses. Building additional houses can increase pressure on roads, and cause congestion for others. The layout and density of housing hugely affects our environmental footprint – American style 'exurbs' mean that every adult in every house needs a car to do anything at all, with all the carbon emission implications that entails.[20] In contrast, a well-constructed suburb makes for viable local shops within walking distance. Public transport too needs a critical mass of potential customers to be effective. Letting the market rip would bring down house prices, but would do so at a terrible cost.

For those reasons a more sensible pro-market policy would be to return to the pre-1988 system. Prior to this date, rises in the value of housing counted as evidence of housing need, and local authorities were obliged to respond accordingly. If local authorities failed to release additional land for development when prices rise, developers were able to appeal to government on the grounds that the local authority was failing in its statutory duties. In such circumstances, national government would then allow development on the land brought forward by the developer. Knowing this, the local authority would plan to release more land in advance, so that it could control what land was developed, even if not the quantity of land that was developed. In reality a lot of development did go to appeal, and local communities felt that housing was forced on them.

It would be perfectly possible for Britain to return to this system. In some sense, the newly announced "Presumption in favour of sustainable development" is just that. Under the new system, so long as the development is sustainable (a somewhat ill-defined term in practice), permission must be granted. Nevertheless, we need to appreciate that this change may well be wildly unpopular, since it would, once again, see local planners and local politicians saying to local people: "We do not want to see this land developed, and there is nothing in it for you, but we have to, because if we don't, the developer will appeal to national government and they will win". This is not localism as most people understand it. Such a system would also lead to huge windfall gains from people who were suddenly able to develop land that they could not develop before.

If localism is to be successful, local people need to have incentives to counterbalance, or better still outweigh, the

20 Edward Glaeser 'Triumph of the city'

natural and rational nimbyish tendencies that we see in so many places. The government has recognised the importance of incentives, and has created the "New Homes Bonus". Local authorities that allow new housing to be built will receive a grant from central government equal to six times the council tax of every (net) new house permitted. Thus a council will typically receive around £7,000 for each new house permitted, albeit spread over the following six years.[21] Local authorities are allowed to regard the New Homes Bonus – and all other financial incentives – as 'material' when deciding whether or not to grant planning permission. This means that it is legal for them to decide to permit development because of the financial gain. The government is currently making this explicit in law.

The evidence is that this incentive is simply not large enough to persuade local authorities to allow more housing. The new homes bonus was announced at the same time that the regional spatial strategies were abolished. Since then, as we noted, there has been a net fall in the number of houses for which local authorities expect to grant planning permission. Elected officials and local authority planners believe that £7,000 is insufficient to cover the costs associated with development, and to outweigh nimbyist sentiment.

The current government is rightly committed to localism in planning. The previous centralised system did not deliver the houses we needed, and was not popular. We should not countenance a return to such an approach. To make localism work we need real incentives. If those are sufficient, localism will deliver the houses people in Britain need. If they are not, localism will not deliver what is needed, houses prices will rise, more people will be badly housed, and the benefits bill will continue to rise.

The incentives meet a number of criteria. First, they should not cost the Exchequer (much) money. This is particularly important given the current fiscal constraints. Second, the incentives must be greatest in areas where we most need new housing. Third, they must be self-regulating, so that we get neither too much

21 www.communities.gov.uk/documents/statistics/pdf/1289026.pdf. They receive additional payments of £350 a year for social housing. Payments are also made if houses are brought back into use, and for conversions. The payment due is calculated on net additions, that is, having subtracted any houses demolished, merged, or now uninhabitable.

nor too little housing. In particular, they will be greater in periods in which we most need new housing, and smaller in periods in which we least need new housing. Fourth, the commitment to localism means that once the incentives are in place, they should allow local areas complete discretion as to how much housing to allow. Community land auctions meet these criteria.

Community land auctions are based on three independent foundations. The first is that the value of land rises dramatically when land is transferred from agricultural to residential use. The same is true in many locations when land is transferred from industrial or commercial to residential use. This uplift in value can serve as the basis for an incentive to local people to support development. The extent of the uplift in value is closely correlated with house prices in different areas, and thus with the need for new housing.

The second foundation is that monopolies are profitable. Since the local authority is the only body who can grant planning permission, it should be simple to construct a planning system in which the council finds granting planning permission very profitable. There are many places in any given area that could be developed, and there are many potential developers. But in each area there is only one council. In such circumstances any economist would predict that it is the council, not the landowner or the developer, who will make most money.

The third foundation is that auctions are an effective mechanism for establishing value in an open and transparent manner. We have seen this in the case of the British 3G mobile phone auctions, and we have seen it more recently in the case of the Bank of England's Quantitative Easing auctions.

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4 How community land auctions work

Community land auctions are designed to replace the way the current planning system plans for new housing.[22] The local authority would begin by announcing widely that it was going to hold a community land auction. It would invite every landowner to state the price – if any – at which they would be willing to sell some or all of their land for development. All existing national constraints on development would remain – sites of special scientific interest, areas of outstanding natural beauty, and so on. The location and extent of “green belt” land is best determined locally, although government could continue to set this centrally if it prefers. Landowners wishing to offer eligible land would detail the land offered, and the price required. Landowners are free to set any price they like, and they are free not to offer their land at all. Of course, the freedom to set a high price is constrained by economic reality: a high price makes it less likely that the council will select their land for development.

Any landowner wanting to offer land would simply have to describe the piece of land offered, the price requested, and any constraints that they wish to impose on subsequent developments by a date set by the local authority. By making an offer, the landowner would grant the local authority the right to buy the land at that price, for a set period of time, say eighteen months. In effect the landowner is granting the local authority a call option on the land in question. All offers would be submitted in sealed envelopes.

At the end of the first auction, the local authority would open all the envelopes, in public. It is important that this is public so that everyone can see that the process is fair and transparent.

The local authority would then consider which, if any, offers it wishes to accept. As we have noted, any land that is barred from

22 Existing planning permissions would be respected. The existing system would remain for alterations.

development in law would be excluded. More generally, local authority planning officers would take into account all of the existing planning criteria. They would ask whether a particular piece of land was suitable for sustainable development. Issues such as transport links, availability of schools and other services, proximity to employment and so on are all important. Equally, they would look at the availability of necessary services, such as water, sewerage and electricity, or at the likely cost of providing them. And they would look at two prices – the price that the current landowner has set for the land, and the price that the land would command were development to be allowed. Local authorities would be able to provide the necessary infrastructure, or to require the private sector to provide it.

It is worth being very clear about the role of the prices here. It is not the case that the local authority will always allow development on the lowest price land. Nor is it the case that the local authority will always allow development on the land on which it is likely to make the greatest profit. Rather, it will engage in an exercise akin to "best value", a concept well understood in local government circles. In short, it will take into account quality (the suitability for development) as well as price (the likely profit to the local authority).

The local authority would then hold a second auction, offering the options granted by the landowners. Bidders would bid for the right to buy the land that the authority had selected for development at the price named by the original land owner. Bidders would consist of potential developers or financial organisations that see the land as an investment. The best form of auction would generally be by sealed bid, with bidders allowed to place conditional bids in the form of "I wish to bid for lot A only if I did not win lot B". Allowing bids of this type increases the number of likely bidders, and so raises the average selling price. Bids would be made under the "second price" rule.[23] The local authority would be able to place conditions on what the land could be used for, an issue we will return to later. The local authority would set a reservation price, to take into account additional costs borne by the authority, and to make

23 This means that the winner is the person who bids the highest price, but the price that they pay is that of the second highest bidder. This is akin to a traditional "open-cry" auction, in which the winner has to bid a token sum above the maximum bid of their nearest rival. Knowing it is a second price auction encourages bidders to bid more fully.

accepting development politically attractive. The local authority would be able to use the profits made in any way it liked. In particular it would be able to increase spending or cut taxes, without restriction.

Community land auctions are very straightforward, and well within the competency of the different groups involved.

: 5 Optimal strategies

Here we investigate the optimal strategies for those involved in community land auctions. It is important to understand these optimal strategies, since the system will only work if it is compatible with the optimal strategies of all of the separate groups involved. In short, we cannot rely on altruism, but must instead ensure that the proposal works when people act in their own self-interest.

Optimal strategies for the original land owners

Clearly there will be a spectrum of prices at which people are willing to sell their land. There are people who have no wish to sell at any price. They enjoy living, working, or farming where they are and are not interested in changing their lifestyle. Such people will not offer their land.

At the other end of the spectrum there will be people who plan to sell their land in any case. They may have reached retirement and have no family to pass their farm or business onto. These people would prefer to sell in a community land auction at a modest premium over the market value that they will otherwise receive. Similarly, there will be people whose farm or business is simply not very profitable. They too would be happy to sell out at a moderately higher price than they would otherwise receive. Again, there will be others who are making a decent return, but who would be happy to sell out on the grounds that getting more than the market value would allow them to buy a bigger and more profitable farm or business elsewhere. Investment landlords, such as the Church, Oxbridge Colleges and investment funds will fall into this category: receiving, say, twice fair value for a farm that would never otherwise have received planning permission, and which is otherwise earning only a normal rate of return represents an excellent opportunity.

Farms in England average a little over 50 hectares, and are worth around £1m, plus the value of the farm house. Receiving twice fair value for the land means a windfall profit of £1m, and receiving five times fair value implies a £4m windfall. It is easy to imagine that many farmers would be tempted by such sums. A £1m windfall is a significant sum, and would represent a great retirement lump sum, or a successful exit strategy from a farm that was not doing particularly well. A £4m windfall would allow a keen farmer to buy a much bigger farm, and allow a radical increase in output and profitability. Windfalls of £1m or £4m are large sums for almost any individual. But these numbers mean that the local authority will be able to buy land at £30,000 - £75,000 a hectare, modest figures compared with their final value.

Clearly landowners wishing to sell would like to get as high a price as they can. But their ability to get a high price is constrained by the existence of other people who own land. One piece of land, of course, is not a perfect substitute for another, and so some landowners will be able to name a higher price than others while remaining competitive. There are three reasons why a landowner may be able to name a higher price: the cost of development, the value of the land for development, and the local authorities planning preferences. For example, the owner of land with good utility provision in place will be able to ask for a higher price than an owner without utilities in place, to the extent of the cost of providing equivalent infrastructure elsewhere. Equally, if a landowner knows that houses built on their land would sell for more than houses built elsewhere – perhaps because their land is in a convenient position for commuters – they will be able to ask for more, safe in the knowledge that developers will in turn be willing to pay more, so that the council's margin is unaffected. Finally, if the landowner believes that the local authority has a preference to see more development in their area than in another, they can name a higher price in the belief that the authority will accept a lower margin.

That said, almost every district will have a large number of potential places on which housing could be built. This is particularly true in areas where local authorities are willing to see new towns or villages created, or are willing to see any one of a number of smaller towns or villages grow. Indeed, even when a local authority does have a geographical preference as to where development takes place, it has a strong incentive to state that it is open to a range of possibilities, so that all landowners fear competition. Many people buying a car imply that they would be as happy with a Ford as a Vauxhall, in order to get a good price on the Vauxhall they were always going to buy. It is the same here. A sensible local authority will make lots of noises about being willing to consider developing in a range of places, in order to ensure that no landowner believes they can get away with naming a high price. Equally the local authority should make it clear that it is willing to see no land developed if no land is offered at prices that make sense to the local community.

The optimal pricing strategy for sellers turns out to be pretty simple – give or take, they should name the price at which they are happy to see their land bought in eighteen months time. That will be higher than the market price, since they will not receive the money for eighteen months, but in many cases it will be a price that bears a clear relation to the standard market price, given the land's current use. Sellers have the right to seek advice on valuations, but it is not legal to collude with their neighbours to set a common price.

The second decision that landowners have to make is whether to place any covenants on the land. This system is built on respecting property rights, and as such it is legitimate for landowners to place constraints on what their land can be used for, were it to be bought. Placing constraints on the use of the land will, in general, lower its final value, since the constraints restrict the freedom of the ultimate owner. That in turn makes it less likely – and perhaps much less likely – that the land in question will be chosen for development. This means that the initial landowner has a strong incentive not to place conditions on the land unless they are really important to the initial landowner. Prince Charles has the right to include a covenant that stipulates a style of architecture, a religious group or individual could require a place of worship as part of any major development, and so on. It is much more likely that smaller developments will see constraints inserted by the initial landowner: for example, someone selling part of their back garden may state that the land could only be used for houses rather than flats, or that no windows may overlook their remaining garden.

Optimal strategies for local authorities

The optimal strategies for local authorities are also straightforward. At the first stage they need to persuade every landowner that they have a chance to sell their land for more than they would otherwise receive for it. The local authority does not want landowners to think “they will never be interested in my land, so I will not participate”. The authority’s message has to be that it costs nothing to enter, and that at least one person will gain a windfall of say £1m. They also need to make it very easy for landowners to offer their land. It should be a simple case of drawing a boundary on a map, or giving a title deed reference number, and naming a price.

The second stage is the planning round. Here the optimal strategy is again straightforward. The authority should eliminate all land that has not been offered, or which is banned from development under national legislation. It should then carry out a planning round, along the same lines as at present, but taking into account price as well. In reality it is likely that some land can be excluded from serious scrutiny, either because the land owner has named a clearly uncompetitive price, or because the land offered makes no sense in planning terms, or some combination of the two. Nevertheless, the authority also has an incentive to be open minded about what land could be developed, not only to maximise its returns in the short run, but to encourage landowners to offer land again in the future.

A planning round is not a decision, but a recommendation. The planners will say which land is appropriate for development, but cannot take the decision. That is for elected councillors. But the planners will, in essence, have ranked the different possibilities. The principal decision that councillors have to make is, therefore, to decide how far down the ranking to proceed. One vision would be to allow very limited or even no development. An alternative would be to allow a huge amount of development, and make a huge profit for local people, which could be returned in cash, via lower council tax, or in the form of better local services.

The local council could simply make that decision. They have a democratic mandate, secured at the previous election, and so have some right to make that decision. An alternative would be to have two options (one of which could be to allow no or only limited development), and put it to a local referendum. But the best alternative would be to time the community land auction so that the planning round is completed shortly before a set of local elections. This would allow the political parties, and other groups such as residents' associations to put forward their vision for the local area. This would cover both the amount of land that would be permitted for development, and what would be done with the money raised. People would vote, and the result would have immediate democratic legitimacy.

After the election, land that the newly elected council was willing to see developed would be auctioned. In some cases the council might be willing to accept very low bids – for land that is currently an eyesore, for example. In other cases the council might have a very high reservation price, that is, it would only be willing to see the land developed if the financial gain to local people was sufficiently high.

As a democratically elected council, councillors have the right to decide not only how much land should be developed, but which land. That right is not, however, unfettered. This is because of the general duties of care that apply to all elected officials. Imagine that two pieces of land are offered, both at the same price. One is clearly more suited to development. Picking the other – because a friend owns it and wants the windfall, or because a councillor or council officer overlooks the former piece – would be unlawful and open to judicial review. Equally, we can imagine two pieces of land with similar suitability for development, but with different prices named by the original landowners. Picking the higher priced piece – against the advice of planning officers – would again be unlawful. There is no greater scope for corruption here than under the present system. Furthermore, since the original landowners stand to gain less, there is a smaller incentive to be corrupt.

The local authority has to decide which, if any, conditions to impose. Clearly they have to impose any conditions raised by the initial landowner, but they can also introduce additional conditions of their own. These could range from nothing whatsoever – at which point the new owner can do anything they like with the land, subject to the constraints imposed by the original landowner – to something much more draconian. They could, for example, require the new purchaser to go through the full panoply of a traditional planning application. This increases the risk for the developer – the plans that they have in mind may not get approved, and the land would then be worth less to them than they had envisaged. In addition, having to apply for planning permission in this way would delay work commencing, and that is costly for the developer. Imposing costs and additional risks on the developer will in turn reduce the likely price that the developer will be willing to pay in the auction. As such, the local authority has a financial incentive not to impose conditions unnecessarily.

A sensible strategy, therefore, would be for the authority to auction the land with a style guide that sets out the conditions under which planning permission would be granted automatically. This is the approach used in many other countries, such as the Netherlands. The authority could say that the land could only be used for residential use, with a maximum density, particular proportion of social housing, maximum heights, cycle lanes, environmental standards, community buildings, green space, and so on. Then the developers could get on and develop housing that they believe will sell well. That last point is important: even if no conditions are imposed, developers still face a very important constraint called the market. The more attractive their housing, the more likely it is to sell, and to sell for a high price. There is a hugely important role for building regulations, as well as ensuring an amount of community facilities and other non-market outcomes. But builders know what sells when it comes to houses themselves, and there are good reasons for authorities to give them a lot more freedom than at present.

More generally, the local authority has a strong incentive to behave in a professional manner in its dealings with developers. This means that the developer will bid more if the local authority is known to be an effective partner than if it is felt to be capricious or ineffective. That in turn creates a financial incentive for the local authority to behave professionally, reducing uncertainty. This is likely to be particularly important if the market has a considerable degree of uncertainty. Savills note that at the moment, “Demand for consented, relatively small, risk-free sites is strong and competition for these sites is fast pushing up land prices in some locations”, but nationally land prices are flat

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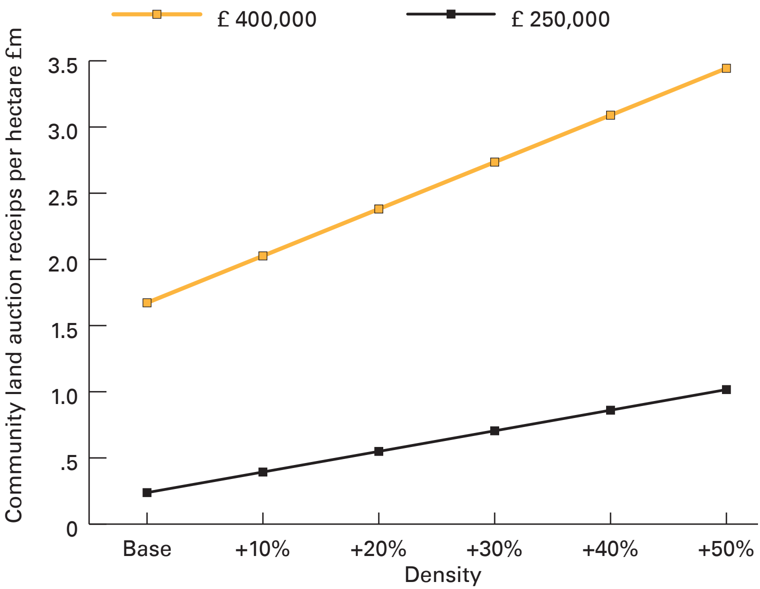
and demand is subdued.[24] A council that is able to offer plots that are closer to being "oven ready" will reap a rich reward in uncertain times. Reducing a developer's rate of return by 2 per cent, because the timescales and risk are reduced, increases the return to the council by about £4,000 per house.

The local authority should also think about the maximum amount of development permitted on any particular site. Allowing more development increases the value of a site to developers, and thus increases the amount that they are willing to bid. We can see this graphically in figure 4, which plots the relationship between density and receipts for two different levels of house prices.

Figure 4: The effect of higher density on community land auction receipts



Notes: the baseline is 50 per cent gross to net, with 40 houses per net hectare. 30 per cent are social houses of 900 sq ft, and 70 per cent are market houses at 1000 sq ft. "10% denser" means a rise in the total sq ft permitted of 10 per cent, all of which is taken to be market housing. For simplicity this is modelled as bigger houses, but more houses gives a similar result.

24 www.savills.co.uk/promotions/research.aspx?document=http://pdf.euro.savills.co.uk/uk/market-in-minute-reports/market-in-minutes---dev-land-jul-11.pdf?form=no#

The baseline scenario is a relatively low density suburban development. The denser scenarios are not particularly dense – Berkeley homes regularly build to a density of 35 per cent above this baseline for suburban developments. This is the density for their small Lincoln Grove development midway between Weybridge and Walton-on-Thames. This is not in any sense a "tower block urban density" but rather a suitable density for a suburban setting in an affluent area. The market makes it clear that such densities are acceptable: a 4 bedroom terraced house in Lincoln Grove sells for £715,000 and a two bedroom flat for £410,000. These prices, and the success of other Berkeley Homes developments more generally, show that developments of this density are attractive and that there are neither good planning reasons, nor good economic reasons, for councils to stand in the way of such densities. Urban developments can and are much denser still. Much higher densities, however, require radically different techniques: a twelve storey block cannot be constructed in the same manner as a three story building. Those different techniques then imply different cost structures which make it much harder to predict a developer's willingness to pay for the land.

The derivation of these figures will be set out shortly, but for now note simply that all councils will gain if they permit denser development. Note too that the gain is particularly large in places where housing is most valuable, and most needed. This is an important finding. It tells us that community land auctions create strong incentives for councils to ensure that land is used effectively. This is an important way in which we can prevent excessive amounts of countryside being used for housing, and can limit urban sprawl to efficient levels. We neither want everyone to live in a handful of skyscrapers, nor for Britain to become characterised by super low density places such as Phoenix, Arizona. Community land auctions create a financial incentive to support higher densities, but this incentive is constrained by the additional construction costs associated with very high densities, and with people's willingness to purchase properties in developments that are unacceptably dense. Community land auctions balances the pressures in each direction and delivers an appropriate level of density for society as a whole. The system is pro-development, but against unnecessary urban sprawl.

Granting developers more freedom will increase the financial returns to the local authority. If the developer knows when they are bidding exactly what they are able to do, and have some flexibility to respond to changing conditions over time, then they are more likely to bid for the land, and to bid a high price for it. Every time the local authority imposes something on the developer, the price that the developer is willing to pay falls. In short, the local authority has to pay the price of everything it demands. In economic terms, the externality is internalised – which is always an efficient outcome. If the local authority wants a lot of green space, or social housing, or zero carbon homes, it will have to pay for them in the form of accepting lower bids from developers. That is not to say that these things should be abandoned, but we will get better decision making if the prices and benefits of each of these items are considered explicitly by the local authority.

Local authorities also need to choose when purchasers are required to pay the fee to the council. Auctions generally work on the principle that you pay the price as soon as you win the auction. There is much to be said for this approach. In particular, it ensures that the council that allows the development gets the proceeds of its decision, and that the existing population who voted for the councillors who allowed the development get the benefits. Since developers are bidding for something of value, they will be able to raise the money to pay up front. They can borrow it from banks, issue bonds or equity. Equally, financial institutions or strategic land companies may bid, planning to sell the land on to developers over time. This would make sense when such groups have better access to finance than the developers.

The alternative would be for the council to state, prior to the auction, that the payments will be staged. They could either be staged with payments due on particular dates, or they could relate to the building out of the development. It would even be possible for the payments to be related to the final value of the houses built and sold.

There are advantages and disadvantages of delaying payments. One advantage is that it opens up the auction to potential developers who do not have, and will find it hard to raise, large sums of money up front. With more developers willing to bid in the auction, the final price is likely to be higher. That is good news for the local community. Second, allowing staged payments reduces the costs to developers, who might otherwise have had to borrow the money at high rates of interest. Reducing the financial costs of bidding will increase the bids that can be made by developers. The council will therefore receive more money if it can cut the developers' cost of capital. Third, if the payments are related to the stage of building, the developer has some insurance. If the market crashes, and the houses are not built, the payments are not made. This makes bidding less risky for the developer, and means that they will be willing to pay a higher price – eventually. Relating the payments to the council to the final selling price also reduces the risk to the developers, since this means that if they are able to sell the houses, but at a lower price, the council shares the financial hit with the developer. That is good for the developer, which is why developers would be more likely to participate in such an auction than in one in which they have to pay upfront, and in full.

Of course, allowing the developer to pay a proportion of the final selling price, rather than money up front, is not costless to the council. The council then has to delay using the proceeds, or borrow the money and pay interest itself. The council also takes the risk that the development will not go ahead, or that its share of the revenues will be lower.

The optimal auction design is likely to be site specific. Where the site is small, and relatively "oven ready" (that is, with all the necessary infrastructure in place), an upfront payment is most likely to be appropriate. In such circumstances there is relatively little risk to be shared, and the number of bidders is unlikely to rise if the council offers deferred or revenue related payments. In contrast, were a council to plan a new town, the payments would be so large that payment up front would be very difficult. Furthermore, since the development would take many years to build, the financing costs, particularly given the level of risk, would be large. In those circumstances, a council may well choose to accept a deferred element related to the final outcome.

Optimal strategies for land purchasers

Land purchasers have to make a simple choice: whether to bid for a piece of land, and at what price. This is the sort of decision that developers have to make all of the time, and is clearly within their competency. As we have noted, where the local authority is auctioning a large number of parcels, developers would be able to enter conditional bids. These take the form of the developer saying, for example, that they would like to buy parcel A at up to £1m or parcel B at up to £1.5m, but not both. Alternatively, a developer wanting a bigger site could bid for parcel A at up to £1m and parcel B at up to £1.5m, but with each bid conditional on winning both parts to the auction. These linked conditional bids have been shown to be effective in the Bank of England’s recent Quantitative Easing auctions.

: 6 Would community land auctions work?

Ultimately whether any policy idea works can only be found out by trying it. No-one had any idea whether people would buy shares in nationalised industries, or whether privatising them would work. Nor did anyone know whether council house sales, or stock transfer to housing associations, would work. The only way to find out was to try it. The same is true here.

There are, however, good reasons to think that community land auctions will work. The incentive mechanisms for all the different actors are clear and unambiguous. No-one is required to do anything particularly difficult. Existing landowners have to name a price at which they would be willing to sell their land. Councils have to consider the suitability of different pieces of land for development. Developers and financial institutions have to work out what developable land is worth.

All of these are straightforward. Most people can name a price at which they are willing to sell a particular asset. I, for example, am happy to sell my house for double its current market value. Councils already have to consider the suitability of land for development in order to produce local plans. Developers already have to assess the value of land, both as green field sites and as smaller plots that are 'oven ready'. Financial institutions already have to decide whether to buy land as an asset, and whether to lend to companies for whom land is a significant part of the asset base.

Experts believe that the system would work. Auction expert Professor Paul Klemperer is the author of 'Auctions: theory and practice' and was instrumental in both the 3G mobile telephone and more recent Bank of England Quantitative Easing auctions. He is on record as saying that the auctions proposed here are straightforward to operate. Kate Barker, in her "Review of Land Use Planning", argued that the government should explore community land auctions in more detail. Gideon Amos, former

Chief Executive of the Town and Country Planning Association, has stated that it is compatible with good planning outcomes.

Community land auctions have also been endorsed by both the Conservative and Liberal Democrat parties. Michael Gove endorsed the idea when he served in opposition as Conservative shadow housing minister. Edward Davey did likewise when responsible for planning for the Liberal Democrats, and it was later endorsed by their party conference. The Chancellor, George Osborne, announced in the 2011 Budget that it will "pilot a land auction model".[25] The idea is localist, and fits well with the ideologies of both parties.

Clearly, the ultimate effectiveness of community land auctions as an incentive mechanism depends on the amount of money that can be raised by the council running a community land auction. Broadly speaking, the council will raise an amount equal to the value of the housing finally sold, minus the cost of building the houses (including any infrastructure provision, and finance), minus the price required by the original land owner.

Build costs are a closely guarded commercial secret. I am therefore grateful to a number of people in the industry for sharing confidential information with me. One was a formal presentation of costs by a major volume housebuilder, and two other housing industry insiders provided a commentary on those figures. All of these briefings were 'off the record', and I will therefore quote no names here.

People within the industry have an incentive to present their industry as under pressure, with low margins, pitiful profitability and nothing left to be squeezed. For those reasons, the costs given here are more likely to overstate than understate the costs faced by developers. The costs listed here are set out in more detail in the appendix.

There are four costs to building a house: buying the land, making it ready for development, building the house, and covering overheads and profit.

The cost of land in the core South East – excluding areas very close to London, hotspots such as Oxford, and coldspots such as Hastings, typically amount to £24,500 per house.

25 2011 Budget, para 1.82 cdn.hm-treasury.gov.uk/2011budget_complete.pdf

The cost of making a site 'development ready' will vary dramatically from one site to another. They will be very low for small developments in areas with non-congested roads and nearby utilities with spare capacity. In that case a fee of £5,000 to the council to cover additional schooling and the like might suffice. In the case of a major new greenfield site the costs are obviously much larger, and we use a value of £35,000 for such sites, including section 106 and community infrastructure levies.

As a spot check, the costs of green field land and site preparation given here amount to £59,500 per house, or £2.38m per hectare. If correct, we would expect to find small parcels of "oven ready" land selling for this sort of price. Such land sells for £2.75m per hectare in Reading, a location with slightly higher house prices than the "core south east" for which our £59,500 figure is calibrated.[26] This strongly suggests that our costs for land and preparation are accurate.

It costs £100 per square foot to build the house itself, which implies around £100,000 for a medium sized three bedroom property. Social housing is 10 per cent cheaper. This is not because of lower build standards, but because social housing has more spacious rooms, and therefore fewer walls for a given floorspace. In addition, social housing is less likely to have ensuite bathrooms, and the developer does not have to provide white goods in the kitchens. Against that, DCLG stipulates higher environmental standards for social housing, to prevent fuel poverty and reduce carbon emissions. These currently add £3,500 to the total cost of a social house.

Finally, there are central overheads, marketing costs, and profits. Developers usually express these as a percentage of the final selling price. We take overheads to be 5%, marketing costs to be 3.5% in the south east and 4% elsewhere, and profits to be 16% on market housing and 12% on social housing. Marketing costs as a percentage are lower in the south east because the headline price is higher, and the return on social housing is lower because the developer has a guaranteed purchaser, and regular stage payments as the development proceeds.

These costs are broadly in line with, or slightly above, current market price data. Persimmon, Britain's third biggest house

26 www.voa.gov.uk/dvs/_downloads/pmr_2011.pdf, p. 12

builder, offers housing in Leicester at £201 per square foot.[27] Subtracting 25 per cent for overheads, marketing and profit leaves £151 for land, land preparation and building. Building land in Leicester is £41 per square foot built, and taking construction costs as £100 leaves £9 per square foot to prepare the site, and for any discounts to purchasers.[28] That is tight, and implies that either the costs that I have been given are overstated, or that achieved profit margins will be lowered than planned.[29]

Bellway Homes, the fourth largest house builder, offer the "Faceby", in Wallsend for £151 per square foot, or £114 after marketing, overheads and profits.[30] This leaves just £14 after construction costs to cover the purchase and preparation of the land, suggesting that either construction costs can be driven significantly below £100, or that this site is not even close to making the return that the developer sought when planning it, or some combination of the two. Taylor Wimpey's "The Ivy", in Sheffield, is selling for just £110 per square foot all in.[31] Since building land retails for £34 per square foot in Sheffield, it is hard to see that price as anything other than lossmaking, but it also suggests that the constructions costs that I have been given are on the high side.

The second potential challenge to the economics of house building is the provision of social housing. Councils often require developers to provide social housing at relatively low costs in order to be given approval to build market housing. This is particularly true for large sites. The regime for financing social housing has recently changed quite dramatically. Where social housing is required as part of the planning agreement, the developer will receive no grant from the Homes and Communities Agency, except in exceptional circumstances such as using badly contaminated land, or for social housing for people with particular needs. Offsetting the loss of grant is that the new "affordable rent" regime makes it possible for

27 "Shire Lifetime home" at their Blackthorn Brook development, www.persimmonhomes.com/blackthorn-brook-1833#siteplan, Rankings based on turnover, figures compiled by the British Social Housing Federation, June 2011.

28 www.voa.gov.uk/dvs/_downloads/pmr_2011.pdf

29 Another of Persimmon's Leicester developments has similar economics – the 540 sq feet one bedroom "Botham" flat includes £11 per square foot after land purchase, construction, overheads, marketing and profit. This has to cover the construction of common parts to the flats as well as the other aspects of site preparation.

30 Hadrian's Village site, www.bellway.co.uk/new-homes/north-east/hadrian-village

31 www.taylorwimpey.co.uk/newhomes/Yorkshire/TheCarriagesPhase2/TheCarlton/

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social landlords to pay a higher price for new social houses. The method of calculating the price of a social house is given in appendix 2, and gives a figure of £128,000 for the South East.

We can now consider the economics of a green field development in the South East of England. The details are given in table 1, and in more detail in the appendices. We work on the traditional basis that 50% of the gross area of the site can be used for housing, that the developer builds 40 houses on each "net hectare". Of those 40, 12 are social houses, averaging 900 square feet, and 28 are market, averaging 1000 square feet. The social houses sell to a housing association for £128,000 and the market houses for £275,000. The average revenue is therefore £231,000.

The initial costs per house are made up of land at £24,500, and land preparation at £35,000. Build costs are £100,000 for the market houses and £84,500 for the social houses. Marketing amounts to £9,600 per market house, while overheads and profits average £11,500 and £35,400 per house respectively. The average cost is therefore £209,000.

Table 1: the costs of constructing houses on greenfield sites in the south east (current system)

	Blended	Market (70%)	Social (30%)
Revenues	£230,889	£275,000	£127,963
Costs	£208,539	£226,875	£165,754
Of which:			
Land purchase	£24,500	£24,500	£24,500
Land preparation [a]	£35,000	£35,000	£35,000
Building	£95,350	£100,000	£84,500
Marketing	£6,738	£9,625	£0
Overheads	£11,544	£13,750	£6,398
Return	£35,407	£44,000	£15,356
Surplus	£22,350	£48,125	-£37,791

[a] includes section 106 and Community Infrastructure Levies

Figures include financing costs – see appendix.

Table 1 shows that even if no-one changes their behaviour, there is around £22,350 per house in surplus value for the council to gain through the auction mechanism outlined here. The developer would be willing to pay that sum in order to acquire the right to buy land for development for £24,500 a plot. Taking into account the developers need to finance the community land auction payment and the council would receive around £20,000 per house.

There are various reasons why this figure is clearly too low. First, the cost of land includes over £4,000 per house as the return to the strategic land developer, whose job in the current system is to identify land that when presented to the council will be granted planning permission, and a further £3,000 for the planning application itself. Under a Community Land Auction system the former role is essentially redundant, and the latter greatly simplified. If we eliminate the former, and reduce the latter to £1,000, we eliminate around £6,000 of costs. This allows developers to bid a higher price. Taking into account the financing costs, developers bids would rise to around £25,500 per house. This is a good example of how the government can reduce the wasteful burdens on market participants, and so lower costs in the industry. In the short run local communities get the benefit, in the long run the gains will go to consumers via lower prices.

Furthermore, the point of Community land auctions is to lower the price at which land can be acquired. Let us assume that suitable land can be acquired for £75,000, which is five times agricultural values. This lowers the cost of land to developers from the £24,500 that currently prevails to £3,750, based on standard density assumptions. Developers are clearly willing to pay £20,750 more for the right to buy land at £3,750 rather than at £24,500. Again taking into account financing costs this implies that the council will receive around £45,800 per house in community land auction receipts. More details of this calculation can be found in the appendix. Note that this is in addition to existing levels of section 106 and community infrastructure payments, and in addition to the £7,000 in new homes bonus. The community land auction is a much stronger incentive mechanism than either section 106 or the new homes bonus.

An additional gain to the community of £45,800 per house equates to £9.2m for a 10 hectare site, or £52m for a typical 57 hectare farm. These are large sums of money, and offer the potential to change the way local people view development.

: 7 Community land auctions over time and space

The relationship between house prices and auction returns

The figures that we have used here are based on one specific development in the south east. That particular development retails for £275 per square foot, and is located 2.5 miles from the station, which in turn is around an hour from the London terminal. There are many sites that would be potentially similar to this site, but there are also places where housing sells for more, and for less. House prices are the single most important determinant of the revenues that will accrue to councils from the community land auction system. The larger the prevailing house prices, the larger the gain to the community from allowing more houses to be built.

We can see this by calculating the optimal community land auction bid according to the level of house prices.

Figure 5 shows that the returns from a community land auction are much higher in areas where houses prices are high. This is what we would expect: community land auctions are a way by which the community can capture the rise in value of land when it is reallocated from agricultural to residential use. Agricultural prices do not vary dramatically across the country in absolute terms, but the value of residential land varies dramatically.

This has four important implications. First, community land auctions do not create financial incentives to build more houses in areas where housing demand is relatively weak. Broadly speaking there will be no incentive to create big new green field developments in areas where house prices are at or below the current average. There will be incentives to allow relatively small

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Figure 5: How the returns to a council vary with house prices: land auction proceeds per net hectare

developments in many such areas, where infrastructure and the like are readily available. Demand for housing is weak in areas where wages and employment are low. Since houses last a long time, it is good to create a system that does not incentivise local authorities to build additional houses in areas with poor economic prospects. Those areas will, of course, still be able to permit additional housing, and will receive the same returns in section 106 and New Homes Bonus as at present. But they will not receive additional incentives from the land auction.

Second, community land auctions create exceptionally large incentives to councils to allow development in places where demand is greatest. As figure 4 shows, the incentives to allow development are roughly two and a half times as great in areas in which house prices are £400,000 as in areas in which house prices are £275,000. Community land auctions create the incentives to build houses in the most economically dynamic parts of the country.

Third, the system has good properties over the economic cycle. When house prices rise, the incentive to the council to say yes to development increases. Similarly, when house prices fall, the incentive to say yes to development falls with it. This is exactly what we want: housing supply becomes responsive to changing prices. That will, in turn, moderate the extent of cyclical swings in house prices, although given that houses are slow to build, and never disappear, we should not expect house prices to remain constant over the cycle.

Finally, the system is self-regulating. As more houses are built, prices will fall, in line with any supply and demand analysis. We know from the National House Planning Advisory Unit model that prices will fall by 2 per cent if the housing stock increases by 1 per cent, all other things remaining equal. As prices fall, the incentive for councils to permit more development will fall as well. Indeed, since the local authority is gaining the surplus over building costs, the incentive falls relatively rapidly as prices fall – at a first approximation a £10,000 fall in house prices translates to a £10,000 fall in community land auction proceeds, given that the cost of construction does not fall. The system is inherently and automatically self-regulating because the incentives to allow development rise and fall automatically with house prices. In addition, developers will not bid for land if they do not believe that houses built there will make a profit. Again, this reduces the risk of overdevelopment.

Community land auctions in an urban setting

We now consider how community land auctions would work in urban settings. Until now we have assumed that it is possible to acquire land for £75,000 per hectare. That will not be true in urban areas, where industrial land prices are clearly higher than this. We can compare the values of industrial and residential land using data from the Valuation Office Agency to get a sense of where community land auctions will give the greatest incentive to build new houses on brownfield land. The results are given in table 2, with places ranked from the largest difference in values to the smallest.

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Table 2: The difference between industrial and residential land prices by place, per housing unit

Oxford	£75,000
Croydon	£67,500
Cambridge	£54,000
Cardiff	£53,250
Enfield	£48,750
Edinburgh	£36,250
Bristol	£32,500
Leicester	£29,500
Norwich	£29,375
Romford	£28,125
Plymouth	£27,500
Aberdeen	£27,500
Liverpool	£26,250
Newcastle	£26,125
Reading	£21,250
Sheffield	£20,875
Leeds	£19,000
Nottingham	£17,500
Manchester	£17,500
Wrexham	£14,750
Birmingham	£14,625
Medway Towns	£13,750
Glasgow	£12,000
Stoke	£11,875
Southampton	£6,875

Notes: The Valuation Office Agency gives prices per hectare. We convert them to prices per unit assuming 40 units to the hectare – an appropriate level for small sites in urban areas. This assumes a mix of houses and low rise flats, although in some cases denser developments will be appropriate.

It is not straightforward to move from these figures to the receipts that a local authority would receive from allowing such land to be converted from industrial to residential land via a community land auction. Industrial land is very heterogeneous.

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Some is very suited to residential conversion with good road access, and utilities provision. Alternatively the land may be contaminated, and need significant levels of remediation. In addition, the location will matter a lot. An industrial site in the middle of a residential area will clearly see a larger rise in value if transferred to residential use than will an industrial site in an industrial area.

These figures, therefore, cannot be taken as applying to any particular site in each town. Nevertheless, they tell us which councils are likely to have the highest incentives to allow land to be transferred from industrial to residential uses. As we would expect, the property hotspots of Oxford, outer London, Cardiff and Edinburgh score highly – inner London is not included in the data, but would surely rank highly as well. In contrast, the gains to local authorities from allowing conversions in Wrexham, Birmingham, Medway, Glasgow, Stoke and Southampton are much lower. This is as it should be: it is socially preferable to be supplying more housing in the first set of places than in the second, and the data suggest that some of that additional housing could come from allowing existing brownfield industrial land.

Development in urban areas is often characterised by the use of windfall sites. The classic example would be a factory moving to a new location, freeing up land that can be used for housing. Such sites are perfectly suitable for community land auctions – the owners of such sites are well-placed to propose such land for development. Community land auctions are, however, held only periodically, and there will be times when a windfall site could not have been predicted at the time of the previous round of auctions. In such circumstances the local authority will be able to grant planning permission, provided that a payment is made that is in line with those that prevailed at the previous round of land auctions, taking into account any changes in land values in the interim. Thus if the council made a profit of £50,000 per unit on one site in the previous auction, it would be able to grant planning permission for a similar payment outside of the auction mechanism. Note that although the council can accept a planning application in the way, it is not obliged to do so. In particular, the council would not want to allow this sort of application when the landowner could perfectly well have submitted the land in the previous auction round. The 'between rounds' mechanism is for whose availability for residential use could not have been predicted at the time of the auction.

8 Who wins and who loses?

Community land auctions will create winners and losers. Some win and lose in cash terms, others compared with what would have happened under the current system. The overall effect will be to see more houses built, particularly in areas where housing is expensive.

The first big group who gain includes anyone who does not currently own a house. As housing becomes more affordable, those who do not currently own a house gain. This is true for those who will buy a house in future, and for those who are renting. The first group will see the deposit that they are required to save fall, and their future monthly mortgage payments fall when they purchase a house. The second group will see rents fall, since if the cost of buying falls, the cost of renting must fall with it, or everyone will buy. Council and housing association renters also gain, for two reasons. First, as market housing becomes more affordable, some social renters will be able to move into market housing, including owner-occupation. This used to be relatively common, but became less common as the cost of market housing rose. Owner occupation remains the tenure of choice for council and housing association renters.[32] The second way in which this group gain is that as some people move out of social housing and into market housing, more social housing is freed up for those on the waiting list. It is not the number of properties in total, but the number that become vacant each year that determines how many people on the waiting list are offered a home.

The second big group of winners are those who own property but would like to own a bigger property. This would include those who want to move to a bigger property because their

32 Hills Ways and Means table 7.3, page 70.

family has grown or will grow, those who want to buy a second home, and those who simply like living in a bigger place. The cost of acquiring additional housing for all of these people will fall. Although their current house will fall in value, the cost to trade up will fall too.

The biggest group of losers are homeowners in the south east who do not plan to acquire additional housing. The author falls into this group. That said this group may still gain if they would otherwise, de facto, be obliged to support their children's entry into the housing market. We know that the 'bank of mum and dad' is becoming more common – many children simply cannot leave home unless their parents support them. In this case their parents are worse off in that house prices fall, but better off in that they are not required to give their savings to their children.

The second group of winners will be people who live in the South East, and whose councils allow housing to be built. Their councils will be able to offer lower council taxes or better services, or some combination thereof. They have chosen to accept more housing in exchange for the payments their community received, and as such the average voter, at least, is better off – although there will of course be a range of opinion locally.

The third group of people who gain are those who wish to move from areas with low house prices to areas with higher house prices. Under community land auctions, high house price areas will have a greater incentive to build more housing, and with supply increasing in those areas, the difference in price between areas will fall. This makes it easier for people to migrate from low housing cost areas to those areas that currently have higher housing costs.

There are two reasons why people may wish to do this. First, for work. We know that employment levels are higher in areas with high house prices. This can only partially be explained by differences in skill levels between people in different places. Moving area is a good way to find work. Wages are also higher in high house price areas, implying that productivity is higher as well. Allowing people to move to economically successful areas is a pro-growth measure: it will raise wages as well as employment.

The second reason that people may want to move is social. People wish to be near their families. At the moment people can move away from the south east much more easily than they can move towards it. This policy will reduce that asymmetry, and make it easier, for example, for grandparents to move to be near their children and grandchildren, if the latter have migrated to the south east.

The policy offers benefits to a range of different people. The gains in reduced council tax and better local services go in the main to people in the South East, whereas gains in new opportunities go to people outside of these areas.

Finally, everyone gains, in two senses. First, Britain will have more space to live per person. That is a good thing for living standards. Furthermore, greater land availability makes it more likely that houses will become larger, with larger rooms. Second, more housing means lower house prices and lower rents. This in turn lowers the bill for housing benefit. The House of Commons Library estimates that a 1% cut in rents leads to a 1% cut in housing benefit. A 10% rent cut in real terms therefore saves around £2bn a year, and a one third cut would save around £6.5bn. These are large savings for taxpayers.

There is, however, one very real group of losers: existing developers, and landowners who expect to make a fortune from the current system. Developers would lose in two senses. First, they often have considerable landbanks: land on which planning permission has been granted, or on which they expect it will be granted. If house prices rise, landbanks rise in value, and the gain goes straight through to the bottom line. If house prices fall, landbanks fall in value, and the loss goes straight through to the bottom line. Developers are rational to oppose community land auctions.

The second way in which developers will lose is that it will be easier for other people to enter the industry. At present, one of the key skills of being a developer is to second guess which land local councils will allow to be developed, and to option that land. That skill will no longer be required – the council will offer land to developers pre-approved for development. This makes it much easier for newcomers to enter the industry. There is potential for European builders to enter or for new British entrants to enter into the market. Finally, self-builders – in reality individuals who commission a local building firm – would find it easier to build their own house. This is bad news for incumbents, because entrants increase competitive pressures, and may well have successful new ideas that allow them to out-compete existing builders. From a consumer point of view, of course, new entry and increased competition is a good thing, driving standards up and prices down. Increasing the role of self-builders and small builders also has the potential to increase the quality of design, as fewer houses would be identikit standardised designs rolled out by large firms across the country.

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: 9 Objections to community land auctions

Not everyone is convinced by the merits of community land auctions. Here we set out some of the objections to community land auctions, and respond to them.

The problem is land banking, not planning.

Land banking refers to developers who purchase land, and then hold on to it, either before or particularly after receiving planning permission to develop it. In 2007 the Royal Town Planning Institute investigated the annual returns of the major builders and found that the top ten were sitting on enough land with planning permission to build around 225,000 homes.[33] This represents an average of 2.7 years supply of land, at the then current build rates.

Given that house prices vary over the cycle, a rise in land banking in a recession is to be expected. When values are low, developers may well do better to hang on to the land until prices recover, rather than build and sell in a downturn. In that circumstance land banking has positive effects, since it reduces downward house price pressures in the recession. Nevertheless, 2.7 years supply of land at the peak of the boom is a lot of land. We need to ask ourselves why developers want to bank land, but Ford does not bank steel, publishers do not bank paper, and chip shops do not bank potatoes. There are two answers. First, steel, paper and potatoes are always available, and land is not. Because the planning system is sclerotic, developers have to maintain land banks to avoid the risk of running out of land. Land banking imposes a cost on developers – they are forced to own an asset that yields nothing. For this reason the slow and erratic nature of the planning system raises costs, which will ultimately be passed on to the final consumer. That said, holding 2.7 years supply of land is a large amount, even given the

33 www.rtpi.org.uk/download/1708/Opening-up-the-debate-June-2007.pdf, p. 6, para 23.

planning system. The primary reason that developers hold land rather than developing it is that they expect land prices to rise in the future. Indeed, given the overall trajectory of land prices in the past twenty years, the surprise is not that developers hold land, it is that they ever develop it!

Community land auctions give councils a big incentive to allow more development. That in turn, via standard demand and supply analysis, will lower housing and land prices, at least compared with the levels to which they would otherwise have risen. As such, the incentive to bank land will fall. Land banking may be the proximate cause of low levels of housing supply, but it is a symptom of the underlying cause, namely that the planning system does not release enough land to prevent house and land prices rising.

One side effect of community land auctions is that, if they are successful, developers will have an incentive to develop their land banks relatively quickly. Once land banks change from being an appreciating asset to a depreciating one, developers will not want to hold them for longer than necessary. Land will become to developers what steel is to Ford, and what potatoes are to my local chip shop: an input into the supply chain that should be used as quickly as possible.

The existence of options means that the system won't work

Others argue that while the system might work in theory, the existence of options prevents it from working in practice. Options involve the landowner giving a strategic land company an option to purchase their land in the future, at a discount to the value with planning permission, if the strategic land company bears the cost and risks of getting planning permission. In the medium term community land auctions would mean that land owners would have no incentive to sign such contracts, as they would restrict their ability to enter, and potentially profit from, community land auctions.

In some cases the option will be unproblematic, in that it will expire in time. In such cases the original landowner can offer the land since they will have the full rights to sell it on the day of the second auction. In other cases the option will not have expired in time.

There will be cases in which the option will preclude the land being offered in the auction, unless the landowner and strategic land company renegotiate. Whether they do so depends on whether they think that the land auction system will last longer than the option. If they do, then their current agreement is essentially worthless, since it precludes the land from being developed. At that point it would make sense for them to sign a new agreement, which would allow the land to be put forward for development in the auction.

Clearly the existence of options means that some land will not come forward. But the only land that is optioned is that which developers believe will be successful under the current system. Since community land auctions give communities incentives to allow other land to be used for development it is unlikely that options will prevent sufficiently attractive land being offered.

By making options close to pointless, community land auctions essentially remove the raison d'etre of strategic land companies. In addition, in the short run it leaves them holding assets – options – whose values will have fallen dramatically and may be worthless. Some may try to sit out the process in the hope that it fails, but as all options are time limited, strategic land companies are sitting on expiring assets. In such circumstances it will often be better to play the new game than to wait for the option to expire and become worthless.

Community land auctions increase the role of the state vis-à-vis the private sector

Some people dislike community land auctions because they perceive them as increasing the role of the state vis-à-vis the private sector. Developers in particular argue that under the current system the private sector can be entrepreneurial in identifying sites that they can then persuade the local council should be used for development.

Developers are right that a particular function of the private sector would disappear, but second guessing the public sector is not a good definition of entrepreneurship. Community land auctions should be thought of as akin to competitive tendering, which is widely practised by government, and is seen as a pro-competitive, pro-market policy. In this case the local council needs something (land for development) and holds an open competition to find good land at good prices. It also wants houses built, and holds an open competition to decide who should build them.

Private sector developers will still have to decide which land to buy, what price to pay for it, what to build on it, and what price to charge. The role of entrepreneurship, properly understood, is undiminished. Indeed, there are incentives for local authorities to allow developers more flexibility in what they do with the land.

Community land auctions introduce greater levels of competition at two points. First, many current private landowners are currently shut out of the development system because they rightly perceive that their land will never gain planning permission. Far from reducing the role of the entrepreneur, community land auctions open up the possibility that far more private sector individuals will be able to engage, successfully and profitably, with the planning system.

Second, community land auctions will make it easier for new developers to enter the market. At present it is relatively hard for a new developer to reach critical mass, since they have to identify and option land, and get it through the planning system, prior to laying the first brick. Under community land auctions anyone could enter the auction, shortening the gap between entering the market, building and selling houses. That makes entry easier, and the market more competitive.

Community land auctions reduce the role of the state vis-à-vis the private sector

At the opposite extreme, some people think that community land auctions are a “free for all”, in which the state and good planning will go out of the window as councils think of nothing but the money that they can gain. Far from it. Unlike both the current system and the proposed “right to sustainable development”, community land auctions give a local area the absolute right to decline all development. All of the existing planning values, about creating good neighbourhoods, about sustainability, and so on remain and there is no reason to think that voters, councils or councillors will stop being concerned about these things. The only thing that changes is that planners can include the financial gain to the local community in their deliberations. With the creation of the New Homes Bonus the financial return to the local authority is already part of the new system of planning in any case, as a "material consideration". Only the scale of the incentive changes.

Although community land auctions increase the role of the market, the change is one of degree. That this is only a modest pro-market step has been noted by the libertarian Adam Smith Institute, whose executive director, Tom Clougherty, argued that land auctions were a step in the right direction, but that Britain "should be ripping up the Town & Country Planning Act and starting again."[34] We do not accept that analysis, and prefer incremental change. Community land auctions build on both the Town and Country Planning Act, and on the current Localism Bill, in a way that works with the grain of evolving British planning policy.

Community land auctions would be open to corruption

Community land auctions are much less vulnerable to corruption than the current system. Under the current system, land is designated as suitable for development via a reasonably opaque system, and the value of land designated rises enormously as a result. The current system is almost perfectly designed to foster corruption. In addition, section 106 negotiations are secretive and opaque, and again seem designed to facilitate corruption. There is, however, little evidence of corruption in the current system – local government officers do not seem to be prone to corruption, and controls within councils seem reasonably effective.

Under the Community Land Auction system, all offers of land are opened in public. Furthermore, the second stage of the auction would also be public. It would be possible for one landowner to try to bribe the council to choose their land for development – just as they could try to do so under the current system. But it would be much more obvious that something fishy had happened under the auction system if the council chooses a piece of land

34 www.link2portal.com/budget-2011-doubts-raised-over-community-land-auctions

that has been offered at a very high price. Community land auctions are a very open system, and very open systems are rarely prone to corruption. For that reason land auctions reduce rather than increase the opportunities for corruption.

Landowners would collude and land would be offered at correspondingly high prices

Collusion between landowners is unlikely. None of the standard textbook conditions for collusion are met. Collusion is most likely when there are a small number of players, contracts are repeated (so that each can win in turn), and goods are reasonably standardised. In this case there are a large number of potential sellers, and only one auction round at any one time. If all the potential land owners were to collude, and all were to name high prices, only one will be successful, and the others will be left with nothing. The others have, therefore, no reason to collude. Indeed, were 100 landowners to agree to collude, and each name a price of (say) £1m a hectare, it would make sense for one landowner to decide to offer their land at a bit less than £1m. Rather than having a 1 in 100 chance of selling for £1m, they would then have a very high chance of selling for just under a million. Of course all landowners will realise this, and all will name a price a little under a million. And all will realise this, and will name a price a bit lower still. And so it goes on, until the prices named are those below which landowners really would not want to sell. Collusion is also illegal, and the sight of all landowners naming the same price, or much higher prices than were seen in other areas, would soon have the authorities looking for evidence of collusive behaviour.

Some areas have only one landowner, so the auction will not work.

We have relatively little knowledge of exactly who owns Britain: there is no requirement to register land, and the ownership of much agricultural land is not recorded with the land registry. It is often said that some landowners own all of an area, and that may be true in some places.

A monopoly owner of land is in a better position to name a high price than competing owners. It is, however, hard to imagine that there is any place where one landowner is truly a monopolist.

For a start, there will be smaller sites in towns that could be developed as an alternative.

Let us imagine that the Duke of Norfolk, whose family seat is in Arundel, owns all of Arundel and the surrounding area. Clearly he will be in a position to offer land at a high price, safe in the knowledge that no-one else can offer land to the local Council. Let us assume further that there are no small sites owned by others that can be developed. Even in that situation there are three constraints on the price that can be charged. First, the final development must be profitable, or developers will not bid for the land and the Duke will receive nothing. Second, the development must be profitable enough for the local authority so that local people support rather than oppose development, or the local authority will decline all development, and the Duke will receive nothing. Third, so long as other areas have competing land owners, other areas will see development, which will have an effect on house and land prices in general. Land prices will fall in the medium term, so the Duke has an incentive not to be too greedy now.

Note that we can be sure that the price that the Duke receives will be lower than under the previous plan-led system, because the council can decline all development. Under a plan led system the local authority essentially has to allow development somewhere, making the Duke a monopolist. Under community land auctions he is still a monopoly seller, but the local community are not required to buy. As such the equilibrium price will be lower, although theory has no strong prediction as to how much lower.

Environmental impact assessments mean that councils have no choice in reality as to where to build and therefore have no choice as to what land to buy

European law states that all major new developments have to pass an environmental impact assessment prior to being authorised. The European law basis is Directive 85/337, (The Assessment of the Effects of Certain Public and Private Projects on the Environment) as amended by EC Directive 97/11/EC. The EIA system does not require the council or other body to identify the single most desirable site on environmental grounds, and allow development only on that site. Rather, "In a nut shell EIA is just an information gathering exercise carried out by the developer which enables a Local Planning Authority to understand the environmental affects of a development before deciding whether it should go ahead. The really important thing about environmental assessments is the emphasis on using the best available sources of objective information and in carrying out a systematic and holistic process. In theory this should allow the whole community to properly understand the impact of the proposed development.".[35] If the environmental costs are too large then development should not take place: that is true irrespective of whether or not community land auctions are in place. Community land auctions are perfectly compatible with EIAs.

Community land auctions require too much of the participants

Landowners

All that existing owners of land have to do is name the price at which they would be willing to sell their land, and list any covenants that they are imposing on the land. They would be able to hire surveyors or others for advice if they thought that was worthwhile.

Councils

The council has to decide which land should be developed. That is a very similar requirement to the existing requirement to develop a local plan. The burden on local councils falls in some ways, since councils could eliminate section 106 payments and all the accompanying administrative burden of negotiation and enforcement, knowing that reductions in section 106 payments will be compensated for by larger auction proceeds.

Developers

Developers have to decide what a piece of land is worth to them, and bid accordingly. They then have to build houses people want to buy, at prices they are willing to pay. These actions are well within the competency and experience of developers.

35 www.foe.co.uk/resource/guides/42_e_i_a_2010.pdf

10 How government can implement community land auctions

The Chancellor of the Exchequer announced in the 2011 Budget that the government would "pilot a land auction model, starting with public sector land".[36] A pilot based on public land is of limited benefit in evaluating the policy. It is not clear whether the owner of the public land, or the local authority would be auctioning the land. If it is the former, then the pilot will not reveal whether auctions give councils and communities an incentive to be keen about development. If it is the latter then it is not clear why the public sector body would want to "give away" the value to the local council. In neither case will it reveal information about the willingness of the private sector to offer land at reasonable prices.

In general all major policy changes should be piloted and evaluated. In this case, however, a pilot may lead to different behaviour to a permanent scheme. In particular, landowners who think that their land would be chosen might well decide to "sit out" the pilot, hope it fails, and then reap the high rewards that are currently available. Many landowners have long time horizons, and would be capable of doing this. Against that, landowners who think that their land will never otherwise be chosen will see a pilot as the only way to make any money, and may well offer it for remarkably low prices, on the grounds that they only have one shot in this game. In neither case will the system accurately reveal the information as to participants likely behaviour in a permanent scheme.

A better approach would be to make the system permissive. This means that local councils will be able to choose between the current system and the community land auction system.

36 2011 Budget, para 1.82 http://cdn.hm-treasury.gov.uk/2011budget_complete.pdf

This has two advantages. First, landowners are more likely to believe that the system is here to stay, and not behave in the particular ways that might occur in a pilot. Second, making the system permissive makes it more likely that a selection of places will try the idea, giving a stronger evidence base on when it is most effective.

The legal position is, at best, unclear. Nevertheless, the government is explicitly legislating that councils may view receipts from development as “material” in deciding whether a particular scheme should go ahead. It may be that this is sufficient for a local authority to enact a system of community land auctions, on the grounds that the current system offers a lower return for the community, and can, therefore, be rejected on the grounds of financial materiality.

11 Conclusions

Community land auctions are a viable alternative to the current planning system. They create an incentive for communities to support development by ensuring that a larger proportion of the gain from reallocating land from agricultural or industrial use to residential use is retained by the community that grants permission for the development.

We cannot be sure how many communities will respond to this new incentive or to what extent. The only way to find out, ultimately, is to pilot the scheme, preferably by making it permissive. This would allow those local authorities that believe that it is the right way forward to try it out for real.

In the long run Britain needs many more houses. Current estimates of need average around 230,000 for England alone, a comparison of this number with completion rates shows that the UK we fell behind by 1.4m houses between 1993 and 2008, even putting the recent collapse in house building to one side. Britain needs to build around 400,000 houses a year for a decade to cover future housing need and make good this recently acquired shortfall. Community land auctions give us a better chance of achieving this than either the old command and control system – which we know did not work – or that the new system embodied in the National Planning Policy Framework, which contains relatively small incentives and relatively small sticks. That is why the government is right to want to pilot this scheme, and why they should do so as soon as possible.

Appendix 1: The cost of building a house

This appendix sets out in more detail the costs given to me by people in the industry. The basic figures set out in Appendix table 1 were given to me by a major volume developer.

Appendix table 1: The cost of building a house

	Blended	Market (70%)	Social (30%)
sq ft per unit	970	1000	900
Revenues	£218,150	£275,000	£85,500
Costs	£220,593	£239,050	£177,525
Of which			
Land purchase	£24,500	£25,000	£25,000
Land preparation	£44,031	£45,300	£41,070
Building	£98,050	£100,000	£93,500
Marketing	£7,700	£11,000	
Overhead	£10,908	£13,750	£4,275
Return	£34,904	£44,000	£13,680
Surplus	-£1,943	£36,450	-£91,525

The figures relate to a specific 10 hectare development, with 50% of the site used for housing, and the other 50% for spine roads, community facilities, and open space, with the latter predominating. The development had 200 houses, 140 for open market sale, and 60 for social rent. The market houses averaged 1000 square feet, and the social houses 900 per square feet. The figures above are given per house, where "blended" is the weighted average of market and social housing.

Revenues

The market houses are taken to sell for £275,000, and the social houses for £85,500. The social housing figure was given to me at a time when the details of the new regime had not been announced. In summer 2010 developers worked on an assumption of £130,500 for social houses, and as appendix two shows, the new regime is likely to offer a return of about £128,000 per social house.

Costs:

Land purchase

The land price supplied by the developer is based on landowners receiving £100,000 per acre, net of all taxes. This equates to £343,000 per hectare, gross of CGT. Stamp duty is then applied to this figure, and VAT to the stamp duty, adding £16,000. It addition, the strategic land owner, who identified the land, takes a profit of 23% on that amount, and financing costs come to another 11%, making £490,000 per hectare in total. Assuming 40 houses per net hectare, and 50% net to gross, and the price becomes £24,500 per house, including the finance costs on land.

Land preparation

Land preparation covers site clearance and demolition, spine roads, off site works, and landscaping of major public open space, plus the provision of utilities, including water and sewerage, to the site itself. In addition, section 106 payments, and community infrastructure levies are included here, along with the financing costs that apply to these amounts. Together these amount to £42.30 per square foot, plus an additional £3,000 per house to cover the cost of putting together the planning application and supporting it through the planning process.

Building

Building costs are assumed to equal £100 per square foot. This covers everything that happens on the plot itself. The £100 is made up of £7 for site prelims (site management, facilities for construction workers, security, and so on), £8 for roads and utilities within the parcel, £70 for constructing the actual house,

£12 for fees and contingencies, and £3 to cover finance on these items. The financing cost is relatively small as the time lag between spending money on these items and selling the house is relatively short.

Marketing, overheads and returns

Marketing is 4% of the sales price, applied only to market housing. Overheads are 5%, and the required rate of return 16%.

Surplus

The numbers given above show that the scheme is not (quite) viable. The developer would try to re-negotiate a different deal with the landowner or council, or accept a lower margin. Accepting a lower margin is more likely if significant amounts of money have already been spent, and can be considered 'sunk'.

Commentary

Two other property insiders gave me their take on these figures. One argued that they were fairly stated, except that the land preparation costs, while not impossible, were higher than typical. A figure of £35,000 was suggested. This person also accepted my figure of £128,000 for the revenue from social housing under the new regime. Notice that because overheads and profits are proportionate to the final selling price, raising the selling price of social housing raises the overheads and financial returns as well, increasing the overall costs. This is a result of builders expressing their overheads and returns as a proportion of sales, rather than as a proportion of costs. On this basis the costs per house sum to £213,700, and the scheme is in surplus by just over £17,000.

The second insider was more aggressive, arguing for £30,000 for land preparation costs, £98.50 build costs per square foot, 10% less than that for social housing, 3.5% for marketing given the high level of prices prevailing in the area, 15% return on market housing, and 12% for social housing. Along with a price for social housing of £125,000, these imply a cost of construction of almost exactly £200,000, and a surplus of almost exactly £30,000.

We therefore have three sets of figures, with implied surpluses of around -£2,000, £17,000 and £30,000 respectively. For this paper we have taken £24,500 as the current cost of land, £35,000 as the cost of preparing land, £100 per square foot for the cost of building market housing, 10% less for social housing, 3.5% for marketing, 16% return on market housing, and 12% on social housing. Together these give costs of £208,500, and a surplus of £22,350. The final figures are given in the table below.

Appendix table 2: figures used in this report

	Blended	Market	Social
Units		70%	30%
sq ft per unit	970	1000	900
Total	970	700	270
Revenues	£230,889	£275,000	£127,963
Costs	£208,539	£226,875	£165,754
Of which:			
Land purchase	£24,500	£24,500	£24,500
Land preparation	£35,000	£35,000	£35,000
Building	£95,350	£100,000	£84,500
Marketing	£6,738	£9,625	£0
Overheads	£11,544	£13,750	£6,398
Return	£35,407	£44,000	£15,356
Surplus	£22,350	£48,125	-£37,791

These are the figures used in the text.

Appendix 2: The value of a social house

In recent years social housing has been built in one of two ways. First, housing associations would identify, buy and develop sites as social housing. These sites would usually be relatively small and urban, and would generally receive government grants from the Homes and Communities Agency. This system will continue.

Alternatively, when private sector developers request planning permission, the council can demand that a proportion of the houses built are social housing. This would be part of the "section 106" negotiations between the council and the developer. Given that social housing is usually unprofitable, there is a limit to the amount of social housing that a council can demand without making a site uneconomic. Under the previous system this housing could be eligible for HCA grants, but this is no longer the case except in exceptional circumstances. This might be, for example, when building on land that needs a lot of remediation, where the HCA might be willing to fund a share of remediation costs.

The council can still require that a part of the development will be social housing, and the developer will receive a price from a housing association. The government has set out the approach that housing associations should use when deciding how much to pay for housing in these circumstances, although it is for housing associations to calculate the actual numbers. In essence, housing associations can pay up to the net present value of the rental stream, less costs, that they will receive from the property.

The rental stream is based on the government's new "Affordable rent" regime, that is, rents set at 80% of market values. The exceptions are areas where rents are already higher than this, and in London, where housing benefit rules set lower maximum rent levels. In the case of the South East outside London, the 80% rule is likely to apply in a straightforward manner, and we apply it here.

Property prices in the South East average £206,767 and gross rental yields average 4.8 per cent, giving a gross market rental of £9,925 per year.[37] The "affordable rent" would therefore be £7,940. The Housing Association needs to subtract expenses from this. These include an allowance for voids, repairs, and management, including rent collection. Insiders tell me that allowing 2 per cent, 5 per cent and 6 per cent respectively for these three figures is plausible, with an additional 2 per cent margin of error, to make 15% in total. Social let voids are much lower than private lets, because there is always a long waiting list for social tenancies. The figure for repairs is low because the house is new build, and therefore the bills for the first 5-10 years, at least, are low, and big expenses – for example, to bring the home up to the decent homes standard, or for retro-fit insulation – are never going to be necessary. The net rental stream is therefore £6,749.

This rent increases by RPI + 0.5% per year, reset to 80% of market rent when a new tenant replaces the existing one. It is very hard to predict the extent to which resetting rents to 80% in, say, 10 years time will raise rents over and above the RPI + 0.5% by which they would otherwise have increased. We therefore assume that rents will simply rise by inflation plus 0.5% at all times. In any case, only 1.5% of social tenants leave the sector each year so this assumption is not particular crucial.[38]

The government has set the Bank of England a target of 2.0% for CPI, and expects RPI to exceed CPI by 0.9 per cent.[39] We therefore assume that RPI averages 2.9 per cent, and thus that rents rise by an average of 3.4 per cent in nominal terms.

We then sum the future rental stream, over the next 30 years, in line with government guidance, and discount future rent at 6.5 per cent a year, a relatively high rate that is supposed to reflect the cost of capital of housing associations. Housing associations

37 www.landreg.gov.uk/house-prices, www.thedigitalpropertygroup.com/wp-content/uploads/2011/05/FindaProperty_Rental_Index_Q1_Mar_111.pdf
38 Hills, Ways and Means, p. 51, figure 5.9
39 www.dwp.gov.uk/docs/cpi-private-pensions-consultation-ia.pdf

are held to be in the private sector and thus cannot borrow money at the low rates at which government can borrow money.

On this basis, a housing association would be willing to pay £127,963 for an average new build housing association property.[40] This figure is in line with the grant plus sales price that developers expected to receive last year – £50 in grant and £95 in sale price per square foot, or £130,500, suggesting that the government's policy change will neither help or hinder the social housing sector in the South East.

This figure is probably an under-estimate for this particular site. First, it is based on market housing valued at £226 per square feet – the average for all of the South East, rather than £275 per square foot in this particular site. Second, RPI is currently above 5 per cent so rents can rise by considerably more than the 3.4 per cent used here, at least in the short term. Given that net present value calculations give more weight to near-term rent rises than to those in the distant future, this means that the projected revenue stream based on assumed RPI of 2.9 per cent at all times is too low. Third, the current level of inflation shows that the Bank of England behaves asymmetrically in its treatment of inflation. It is unwilling to see CPI inflation become too low, but is willing – if reluctantly – to see it rise to over 4 per cent a year for some time. For that reason RPI inflation is likely to average more than 2.9 per cent – it will average 2.9 per cent in good times, but be higher in bad times. Using an average of 3.4 per cent for RPI would imply a price of £136,000 as a suitable bid. Finally, the developer can sell the social housing to the particular housing association who bids most aggressively. The figures here are those that a conservatively run housing association might use. The highest bid, however, will come from the housing association that is most confident that they can keep voids and management charges low, repair properties efficiently, raise finance cheaply, as well as believing that inflation will rise a little faster than others believe.

There is one extra consideration worth noting. The new law precludes grant for section 106-mandated social housing except in exceptional circumstances. There is, however, nothing to stop a

40 The full details of the calculations can be found online, at www.centreforum.org/howmuchshouldasocialhousecost

council mandating lower levels of social housing than previously, claiming that a higher level would make the development unviable, and then requesting HCA grant for additional social housing units. At that point the developer will receive grant as well as the £128,000 sales price. Local authorities will have an incentive to do this, while using the section 106 negotiations to gain more money for, say, local leisure facilities. This would again improve the viability of schemes and the corresponding community land auction bid that a developer can make while remaining profitable.

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