

By  
 Kevin Nicholson,  
 Beverley Hawkes,  
 Chris Knight  
 & Zoe Hatherley

## CONSISTENCY IS VITAL IF REGULATION IS TO WORK IN LINE WITH HOUSING POLICY

*Regulation of the housebuilding industry is increasing, as the Government tries to balance the need for more (and more affordable) housing with the preservation of the environment. But some of the regulations, particularly those arising from the tax regime, conflict with these laudable aims.*

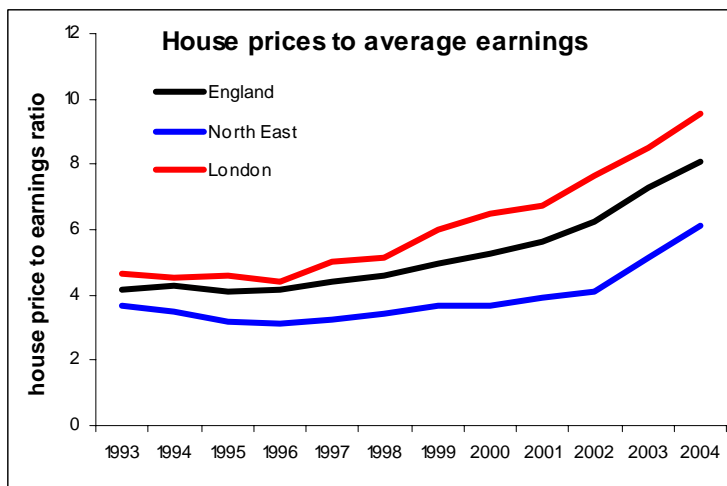
In its latest five-year plan for the housing sector, the British Government aims to ensure the provision of a decent home for every household at a price it can afford. The Government recognises that we all need a roof over our heads, but the acute shortage of housing stock and soaring prices have made this increasingly difficult.

Some 155,000 new households are formed every year, and the figure is rising; by 2021, the annual rise in the number of new households is projected to reach nearly 190,000. Yet the country's net housing stock is growing by an average of just 120,000 a year – a shortfall of nearly 23%. Internal migration has exacerbated the situation; while people are clamouring for homes in the South, there is little, if any, demand for an estimated 850,000 homes in the North and Midlands.

### The effects of inflation

The mismatch between supply and demand has contributed to rampant inflation. Between 1993 and 2004, house prices grew much more rapidly than earnings – particularly in London, where the ratio of house prices to earnings has doubled over the past decade (see Figure 1).

**Graph 1:**  
 House prices to average earnings.  
 Source: LFS, ODPM



As a result, bricks and mortar have become the biggest assets many homeowners possess; according to a report recently published by Shelter, housing now accounts for 40% of all personal wealth, up from just over 20% in 1975. But some people have been priced out of the market altogether. 30% of households do not own the properties they live in – and social attitudes surveys suggest that many of them would prefer to do so, if they could.

Soaring house prices have also pushed up the cost of renting and

increased the level of homelessness. In London, for example, average rents are now 65% higher than they were ten years ago. And in her final report on the country's housing supply, published in March 2004, Kate Barker noted that the number of people living in temporary accommodation had doubled during the previous eight years.

### The need for regulation

In short, housing (or lack of it) is an issue that affects everyone, but so is the way in which the world's resources are used – and the housebuilding industry has a massive impact on the environment. Domestic households account for about 30% of Britain's energy consumption and 27% of its carbon dioxide emissions, while the construction process generates 70m tonnes of waste each year. It is therefore only right that the housebuilding industry should be regulated – like the automotive and aircraft industries and any other sectors that have a major bearing on the global environment.

Moreover, the interests of Government, housebuilders and the local authorities responsible for implementing the planning guidelines are by no means identical. The Government wants to fulfil its social and political agenda; the housebuilders want to make a profit; and the planners want to preserve the nature of the communities they oversee. Balancing these sometimes-conflicting social, commercial and cultural imperatives is essential.

### The increasing regulatory burden

But how has regulation of the housebuilding industry actually worked? Planning Policy Guidance Note 3: Housing (PPG3) – the single most important policy document influencing issues like the availability of land and building densities – is due to be revised this summer, as the Barker Report recommended. We shall therefore confine our comments to other forms of regulation, and here there is both good and bad news.

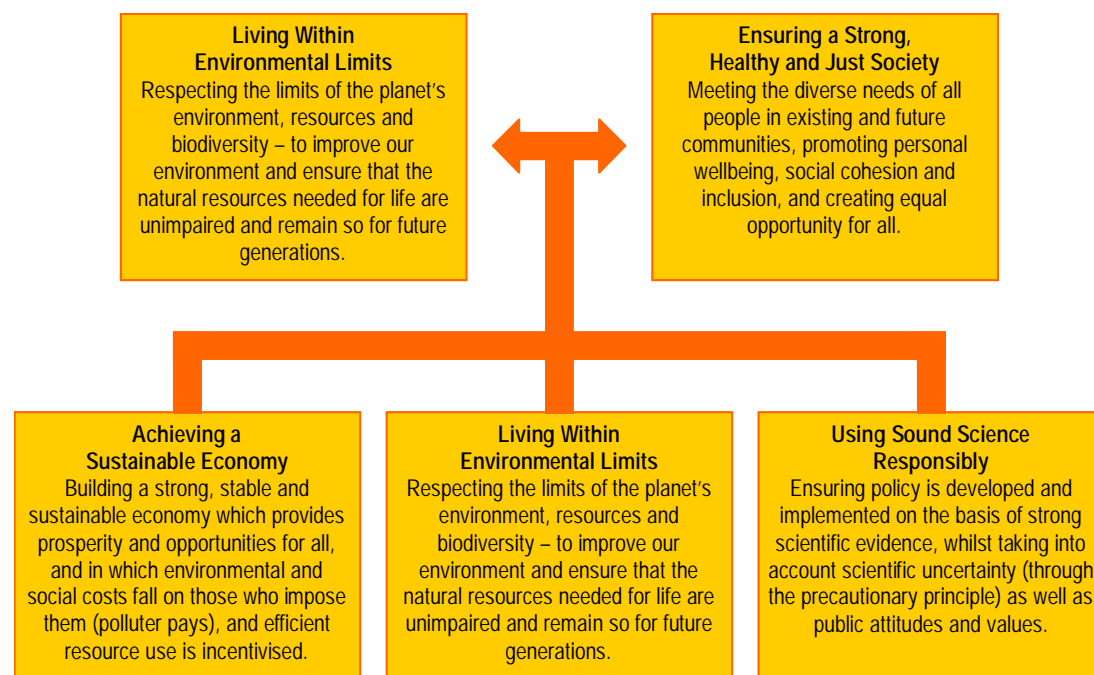
The Government is clearly making strenuous efforts to promote the development of affordable and sustainable housing. Some of the regulations it has recently introduced should also make life harder for “cowboy” builders and eliminate the sort of practices that have given such builders an unfair advantage over those that comply with the rules. That said, the regulatory burden is growing and a number of regulations, particularly, those arising from the tax regime, do not seem entirely consistent with the Government’s avowed aims.

**The Construction Industry Scheme:** One of the clearest instances of the way in which the regulatory burden is increasing (albeit for good reasons) is the new Construction Industry Scheme, which is due to come into force in April 2006. The housebuilding industry has traditionally relied on a large pool of self-employed labourers and craftspeople, but the Inland Revenue maintains that they cannot be regarded as self-employed when they only provide their labour and work under the direction and control of a site manager. Since all employers have to pay National Insurance Contributions (NICs) on their employees’ earnings, this will effectively increase the industry’s labour costs by 12.8%.

Furthermore, under the new scheme, all housebuilders will have to produce a monthly return confirming the self-employed status of every subcontractor who works for them. Where a dispute over status occurs, they may also be required to pay back tax and NICs for anyone who is subsequently deemed to have been an employee.

In fact, most of the large housebuilders have already put their “labour-only” subcontractors on the payroll and are scrupulous about treating employees as such. It is the “cowboy” operators at the bottom end of the market that typically fail to comply with the rules. The new scheme is thus welcome in one respect; it should prevent such builders from exploiting the savings they make by evading payment of NICs to undercut more law-abiding rivals.

However, the scheme has several other, less desirable consequences. It has been trumpeted as a way of reducing the burden of compliance for the industry – and it is true that there will no longer be certificates, vouchers and annual returns. But since contractors will have both to verify the status of the subcontractors they hire and to complete a monthly return, it is likely that the overall administrative load will go up rather than down.



**Figure 2:**  
*The guiding principles of sustainable development*  
Source: HM Government, *Securing the Future: Delivering the UK Government Sustainable Development Strategy*  
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There are legal implications, too. If a housebuilder goes through a downturn, for example, it can manage its costs by reducing the number of subcontractors it engages. Conversely, it cannot make employees redundant without incurring statutory responsibilities such as redundancy payments based on length of service. And if it employs an individual whom it has formerly hired as a subcontractor without any break in service, the courts could rule that there has been an implied employment contract between the two parties for many years. Such complications might be avoided if there were a hiatus, but that in turn would deprive the company of the subcontractor’s skills and the subcontractor of his livelihood for the duration of the break.

**The rules on sustainable development:** This is not the only way in which the regulatory burden is growing. The Government has released a slew of policy documents promoting the creation of “sustainable communities” (see

Figure 2). The key components of its programme include greater brownfield development; the renovation of rundown and deserted stock; better use of building materials; construction of more energy-efficient dwellings; and quotas for the provision of affordable housing or other social amenities.

To this end, the Government has systematically tightened up the planning guidelines and building regulations. In November 2000, for example, it decreed that 60% of all new homes should be built on brownfield sites. In 2002, it made Part L of the building regulations concerning the conservation of fuel and power more onerous, as part of a move to raise the average level of energy efficiency in domestic dwellings by 20% by 2010. It plans to amend Part L again later this year, has undertaken to review the building regulations every five years and is exploring the scope for including a standard on water conservation.

Other changes are afoot. As a member state of the European Union, for example, Britain is committed to incorporating the Energy Performance of Buildings Directive in national law by January 2006. This requires, amongst other things, that minimum energy performance standards are set for all new buildings, including residential property, and that energy performance certificates are provided whenever ownership or tenancy of a building changes.

In its latest policy document, *Securing the Future*, the Government also announced that it is drafting a voluntary Code for Sustainable Buildings in conjunction with the industry, which will establish best practice in using key resources such as energy, water and materials and managing waste. The Code will be rolled out next year, and will ultimately be extended to cover major refurbishments of existing stock as well as new buildings.

Certain local authorities are keen to take an even tougher stance. The draft Supplementary Planning Guidance on Sustainable Development and Construction for the London Plan contains a list of "preferred" standards, some of which are very demanding indeed. The Mayor would like, for example, to see all new properties built on brownfield land, with 75% of the timber used in their construction sourced from sustainable forests; designs that restrict water consumption to less than 25 cubic metres per bed-space per year; and the provision of recycling facilities for at least 35% of household waste, rising to 60% by 2015.

These standards are not mandatory, but it seems reasonable to assume that developers which incorporate some or all of them will be more likely to get planning permission than those which do not, especially where two or more companies are competing to develop the same site. Thus, even though the standards are not strictly regulations, they could still become de facto requirements. They are also an indication of the direction in which the regulation of the industry is moving.

Of course, ensuring that every company complies with the rules is another matter. Adherence to Part L of the Building Regulations is not monitored, for example, with predictable results. In July 2004, the Building Research Establishment reported that more than a third of the properties it tested did not conform to the standards on air tightness. Similarly, a survey recently conducted by De Montfort University found that 98% of new homes failed to display an energy rating, as the law demands.

**New financial requirements:** However, other forms of scrutiny are increasing. From 2006, all listed housebuilders will have to produce an operating and financial review that describes any material social or environmental risks they face – whether these arise from the composition of their land banks, a shortage of key skills, a poor health and safety record or anything else. The EU Modernisation Directive will introduce comparable requirements for large private companies. They will have to provide a "fair review" of their performance, and the "principal risks and uncertainties" they face – including "information relating to environmental and employee matters", where appropriate. Institutional investors have also begun to pay more attention to the industry's environmental performance; US investment bank Morgan Stanley recently put out a briefing note on corporate and social responsibility in the housebuilding sector – a sure sign of its growing importance.

### **The absence of a coherent tax strategy**

The regulatory burden is increasing, then, in the sense both that there are more regulations and that some of those regulations are making housebuilders more accountable for themselves. Yet certain regulations are hardly consistent with the main planks of Government policy – more housing, more affordable housing and better environmental protection. Nowhere is this more evident than in the tax regime.

**Stamp Duty Land Tax:** We have already discussed the financial impact of the Construction Industry Scheme, but several other taxes have also had an inflationary effect. In 1997, for example, the Government changed Stamp Duty from a flat rate of 1% on all homes worth over £60,000 to a variable rate of between 1% and 4%, depending on the value of the property. The revised Stamp Duty Land Tax (as it is now called) has proved a very successful way of swelling the Government's coffers, with revenues up from £1.5 billion in 1997-1998 to £6.3 billion in 2004-

2005. But it has made many homes more expensive – particularly those in London and the South East, where demand for housing is highest.

The latest revision of the rules seems equally counter-productive. In his last Budget, Chancellor Gordon Brown raised the threshold to £120,000, at the same time that he summarily removed the special exemption on property transactions in disadvantaged areas. This move has had a minimal impact on residential sales in the South East, where it is now almost impossible to buy a home for less than £120,000. However, it has added 4% to the cost of all but the smallest land acquisitions in disadvantaged areas.

**Value Added Tax:** There are similar anomalies in the rules regarding Value Added Tax (VAT). New houses are currently zero-rated, and two new reduced rates of VAT for the installation of low carbon technologies were introduced in the April 2005 Budget. Yet refurbishments incur the full rate of 17.5% – a distinction that conflicts with the Government's policy of improving rundown and deserted stock. It discourages homeowners from maintaining their homes in a good state of repair and housebuilders from renovating old properties, even though this is sometimes more economical than building from scratch. In an experiment recently performed for the television programme *Tonight with Trevor MacDonald*, for example, a Victorian terraced house in Liverpool was modernised for only £6,000 more than it would have cost to demolish, let alone to replace.

**Development Profit Tax:** The much-mooted Development Profit Tax could likewise have an inflationary effect, should the Government ever decide to implement it. The Barker Report recommended taxing the windfall gains that arise with the grant of planning permission, on the grounds that it would encourage housebuilders to release a larger part of their land banks for development and generate revenues that could be used to benefit the community more widely. However, it cautioned against setting the tax rate at too high a level, since that could drive up house prices.

**Environmental tax breaks:** So much for some of the key taxes affecting the nation's housing supply, but what about tax breaks? Here, too, the Government's strategy is somewhat at odds with its stated aims. It has introduced several forms of relief intended to foster the efficient use of resources and discourage practices that damage the environment, but they are difficult to claim and very restricted in scope. One such instance is land remediation relief.

Housebuilders can claim tax relief on up to 150% of the costs they incur in cleaning up land they have acquired in a contaminated state. But the relief is only available to companies, not to individuals or partnerships. It only covers the cost of removing harmful or potentially harmful pollutants, so it excludes the remediation costs associated with prior uses such as mining, where mineshafts must be filled. And it only applies when the houses have been sold – which, given how long it takes to develop a large site, means a wait of as much as a decade before the tax break can be claimed.

The relief on the renovation or conversion of vacant or underused space above shops and other commercial premises to provide flats for rent is equally hedged with restrictions. A property only qualifies if it was built before 1980; has a maximum of five floors; the upper floors were originally constructed for residential use; and those floors have been empty or used solely for storage for at least a year. Very few buildings fit such criteria. Stringent conditions also apply to the conversion work that is performed. Each new flat must, for example, be self-contained, with external access separate from the ground-floor premises; it must have no more than four rooms, excluding a kitchen, bathroom and hallway; and it must not form part of a larger development scheme. However, such tax breaks are not very attractive because they benefit such a small number of housebuilders.

## Conclusion

Clearly, it is essential that the population be properly housed at the same time that the environment is preserved for future generations – and the Government has certainly made substantial headway in this respect. Between 1997 and 2003, development on brownfield land increased from 56% to 67%; 19,000 hectares were restored to the greenbelt; and the number of social homes falling below basic standards of decency was halved. But, if it is to fulfil its promise of "homes for all", the Government must also ensure that its strategy for building, refurbishing and selling property is reinforced by a consistent regulatory framework. Its current efforts are reminiscent of that well-known expression so beloved by teachers: "tries hard but could do better".

*Kevin Nicholson is UK Head of Private Companies at PricewaterhouseCoopers; Beverley Hawkes is a Manager in the Human Resource Services practice; and Chris Knight and Zoe Hatherley work in the firm's Sustainable Business Solutions team.*