

Subject: COMPETITION AND MARKETS AUTHORITY – Housebuilding Market Study

From: Richard Bacon MP

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I set out my interest in the establishing of a housing market that works properly – and the work I have done in this area, including the Review I undertook for the then Prime Minister published in August 2021 <https://www.gov.uk/government/publications/independent-review-into-scaling-up-self-build-and-custom-housebuilding-report> - the Bacon Review) – in my letter to the CMA of 20 March 2023.

I am writing with some specific comments following the publication of CMA working papers on 15 November 2023 which form part of your on-going study :-

Profitability of housebuilding

In Paragraph 1.3 (a) of its Planning Working Paper, the CMA posits as one possible explanation for the persistently poor market outcomes which have arisen in the housebuilding market that: *“despite increasing house prices, profit levels for building houses may be too low to attract more supply to the market, due to increasing costs to supply”*. I understand that the CMA may itself not regard this to be a sufficient explanation of what is happening, but nonetheless there are several points which must be clearly emphasised:

- housebuilding has been exceptionally profitable for some large housebuilders for several decades; to take one example, the Bank of England Residential Property Forum cited figures from one volume housebuilder, Persimmon, showing that a house sold for £225,000 yielded £75,000 of profit (if the CMA has not yet looked closely at the work of the Bank of England Residential Property Forum, I would recommend you to do so);
- the market for building houses can simultaneously be exceptionally profitable for some large players and yet so unattractive for smaller housebuilders that they are leaving the market entirely or thinking of leaving the market; various surveys over the years by the Federation of Master Builders confirm this trend; and as one experienced witness to my Review stated: “if we were starting out in business now, we would not start” (p.19 – the Bacon Review);
- consequently, something which should be true – i.e. that “super-normal profits” should relatively quickly be competed away by the normal operation of market forces – is not true; instead, in effect, what we have is “permanent super-normal profits”, which should be an oxymoron; and
- these structural conditions remain, notwithstanding that in the last couple of years volume housebuilders have faced genuine difficulties and a corresponding reduction in their profits, caused by a particularly serious combination of factors such as Covid, the war in Ukraine and the overdue but very sudden interest rate rises resulting from last year’s mini-budget.

Lack of Understanding

There is still a widespread lack of understanding as to what the chief problems are. The large volume housebuilders, for perfectly proper commercial reasons, are careful – in any given locale – not to build houses faster than the local market can absorb without adversely affecting local house prices (it was this phenomenon that was at the centre of the Letwin Review on build-out rates).

The government's Help to Buy scheme was launched in 2013 and for the last decade it has propped up demand for the small, expensive, often poorly-constructed and certainly not very "green" products of the volume housebuilders. Eventually it became too apparent to ignore that the volume housebuilders, having – unsurprisingly – taken advantage of the Help to Buy scheme to maintain overall levels of profitability, continued to build houses at a rate which – also unsurprisingly – suited their commercial interests, rather than at a rate which suited the wishes of the government. As a result, we even saw one Prime Minister making a major speech in a fruitless request to encourage housebuilders to "do your duty" by building more houses, although she did not make clear quite why any private sector business should be expected to flood the market with its products so completely that it would necessarily damage its profitability. Subsequent prime ministerial speeches to insurance conferences urging insurers to "do their duty" by selling more insurance – or to conferences of chemical engineers urging them to "do their duty" by selling more chemical engineering plant – have been notable by their absence.

In a properly functioning market, housebuilders would anyway be worried about cutting back on their rate of supply of houses for fear that customers would instead buy elsewhere. In the market for building houses as currently structured, they need not worry. The choice for customers locally will be limited to a couple of very similar suppliers who offer a largely homogenous product and whose chief concern is the same: to eke out the supply of new houses in a way that doesn't damage profitability. The result is that for the very item on which customers spend the largest proportion of their incomes – their homes – they hold the least consumer power.

The government recognises there are fundamental problems – and in February 2017 it published a White Paper "**Fixing our broken housing market**" (MHCLG Cm 9352) which sought to address them. The paper's most important statement was that "this is not a problem that will fix itself" but the government has not yet delivered solutions. Indeed, chapter two of the White Paper is entitled: **Building Homes Faster**, while actually we are now building homes more slowly. Chapter Three of the White Paper is entitled: **Diversifying the Market**, but the market for building houses is now less diverse. Given that the White Paper was published nearly seven years ago – more than a year and a half longer than it took to fight the Second World War – it is reasonable to conclude that the government has still not properly understood what solutions are required.

The obvious answer is a classic one – to lower barriers to entry and to increase choice.

However, this is not easy within the constraints of the current planning system. Indeed, many commentators point to the planning system as an important blockage. The retort by the planners to this point – that there are over 1 million extant but unbuilt-out planning permission "so it can't be the fault of the planning system" – ignores the overall systemic problem, which is that in the concentrated and largely uncompetitive market for building houses it makes perfect sense for large housebuilders to assure long-term profitability by acquiring large numbers of planning consents, and also options to acquire land that may one day be consented, while continuing to build houses when – and only when – it is sufficiently profitable to do so. The effective competitive threat to such market players that would arise from real consumer choice is almost entirely absent – and certainly not present at a scale which would require a change in behaviour.

Planning is certainly an important issue – and defenders of the planning system rightly point out that over 90 per cent of planning applications are granted. But both the critics and the defenders of the planning system miss the most important point. The reason that housebuilding companies have vastly reduced in number while growing hugely in size – and that the SME housebuilding sector has nearly been destroyed – is a direct consequence of a regulatory environment which is both exceptionally

complex and fraught with risk, so that the gaining of planning consents requires both very deep pockets and the ability to bear significant risks over very long periods of time.

In other words, over recent decades the planning system itself has played a significant role in hastening the concentration of the housebuilding sector; in effect, the planning system has morphed from a service to the whole community into a source of competitive advantage for large housebuilders. The concentration of most housebuilding into fewer and fewer hands is simply an evolutionary response by housebuilders to the regulatory environment in which they are required to operate. And to change the course of evolution, one must change the conditions. It is precisely this that I have suggested the government should do (Bacon Review, August 2021).

The entire system needs a large-scale injection of certainty. We have to end the lengthy time-horizons, the frequent delays, high cost, complexity, lack of predictability and lack of consistency in a way that only the government as system architect and referee can deliver. At present, the government itself is a source of the failure of the market for building houses to operate as it should. Yet while the government may be part of the problem, only the government or its agencies can deliver the solutions at the speed and scale required.

Serviced Plots of Land

What is required to break the current impasse is the delivery of serviced plots of land everywhere, for everyone, across every tenure, in every part of the country, at a scale which will give customers real choices, while spurring a renaissance for small housebuilders building to commission for customers, and while also changing the behaviour of volume housebuilders because they would be genuinely afraid of losing customers. The government needs to deliver disruptive change at scale, radically lowering barriers to entry and increasing consumer choice.

The government “warmly welcomed” the Review when it was published but although a self-commissioned homes unit has now been set up in Homes England it has not yet been given a budget, more than a year after it was established.

I greatly welcome the references to my review in the CMA’s working papers but my proposals will only make a difference if they are delivered. [REDACTED]

Declaration

For the avoidance of doubt, I am content for the CMA to make any use of this submission which it sees fit to do, including publishing it.

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