The future role of the SME sector in housing supply: a study of the housing market in England

**The challenge**

The number of small medium enterprise (SME) housebuilders has decreased by 65 per cent in the past 30 years (National House Building Council’s (NHBC) 2012). Their decline continued despite upturns in the economy. This study seeks to understand why, by interviewing participants in the housebuilding sector. Every year the UK produces about 100,000 houses fewer than needed to meet demand. Combine this fact with consolidation at the top of the industry and the result is a dysfunctional housing supply that delivers a narrow band of products on a small number of large sites. The situation is made more challenging by the lack of availability of small sites. The government’s house building White Paper (February 2017) set out plans to help small and medium sized developers build more homes through a £3bn home building fund but, at present, around 60 per cent of new homes are built by 10 companies. The current situation cannot satisfy demand from all parts of society and this case study brings focus to the barriers to entry for new starters.

**The aim**

This research will establish reasons for the long-term decline in the number of SME housebuilders and consider whether the SME sector could make a meaningful contribution to increasing the supply of homes in England. The research will consider the history of housebuilding in the UK from the late 19th century and literature on the subject including government housing policy and reports. From this review a number of SMEs were selected for interviews and analysis that linked the data gathered in the interviews with the literature review to form the conclusions. Of the 16 main
interviews 11 were with housebuilders, two were with local authority planning officers, two were with industry representative bodies along with one lender from a large high street bank and one from a warranty provider. Of the 11 housebuilders, nine were SMEs, two interviews were conducted with businesses that delivered more than 500 units per year. No statistical significance is placed on the data gleaned from such a small group of interviewees; the research offers an exploration of the opinions and attitudes of industry participants at a point in time.

The house-building landscape and decline in SME housebuilders

Since 1990 the average number of house completions has been 181,000 per year in the UK and 143,000 in England. Since the financial crisis these numbers have fallen to 140,000 per year for the UK and 115,000 for England (Department for Communities and Local Goverment, 2015). Housing starts took a large hit during the financial downturn, post 2008. Bottoming out at 127,000 units per annum in the UK it represented a 24 per cent drop versus a 20 per cent drop in completions. This suggests that companies built out existing sites but did not start new ones. This trend has been reversed since 2014 – housing starts have increased and are back at levels last seen in 1990.

Contributing economic, business and political factors

- A large part of the drop in housing supply since the 1970s can be attributed to reduction in government-funded council house building
- The transaction cycle in housebuilding is very slow. Time between buying land and selling property can be years. Macroeconomic volatility during long transaction period is a significant risk for housebuilders
- Brownfield sites are not always in economically-viable locations for residential developments
- Alongside the dramatic fall in the number of SME housebuilders from the 1980s to today, the number of small businesses registered with the NHBC fell from 29,000 to 16,000 between 1990 and 2004

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- The large volume housebuilders now dominate supply of private housing (this is the reverse of 60 years ago). In the past 30 years, 65 per cent of small housebuilders have ceased trading.

Data and analysis

Semi-structured interviews secured a depth of information from interviewees. In total 24 interviews were conducted – two mock interviews, 16 full interviews and six follow-up interviews (January to July 2016).

The first part of this study analysed opinions of owners/founders of small housebuilding businesses through semi-structured interviews to assess their decline over time. The data analysis was split into internal and external forces impacting SME housebuilders. The internal forces analysed were; business models, finance, scale and growth, land banks and employee training. The external forces were; market volatility, taxation, planning and government policies.

The second part of this study focused on supply and the SME sectors role in increasing England’s output. There was agreement among interviewees that it is unlikely the SME sector will become a significant engine for growing the housing supply in England.

Findings

In a bid to increase supply, governments focused on the major housebuilders and released huge tracts of public land for residential development. Most of the land comprises large single location sites for thousands of homes. However, large sites cannot be built out in one phase by private developers due to risk of flooding a market and the capital intensive nature of housebuilding.

Planning departments have increased the number of homes given planning permission, but have ignored the fact that a small number of large sites yields homes at a slower rate than a large number of small sites.
External forces impacted SMEs more profoundly than their larger counterparts. Navigating the planning permission is a more significant barrier to the growth of the SME sector in speculative housebuilding than access to finance. While interviewees acknowledged cost of finance as a business challenge none identified it as a barrier to growth.

If the government was to focus on smaller sites, realistically, only the SME sector could develop them. Unfortunately this approach would require significant political will and effort to execute – the SME sector is distant and hard to reach in government terms. In addition, this study found that among SME housebuilders are many businesses which do not want to grow having learned lessons from a volatile housing market.

**Recommendations**

- Large sites only appeal to a narrow band of the market and take a long time to complete. A large number of small sites can appeal to every segment in the market and get built out in a shorter time frame. Smaller sites can only realistically be serviced by the SME sector.

- To achieve growth in the SME sector, encouragement should be given to increasing the number of businesses rather than growing the existing businesses. If 25 per cent of the existing SME housebuilders all grew by 25 per cent, the overall increase in number of units per year would likely be less than 10,000. Even this modest increase in supply would be difficult to achieve as shown earlier. This suggests that the focus should be on encouraging new entrants and removing barriers to entry.

- The government hopes to add 100,000 homes per year to the nation’s current output of around 140,000 new homes.

- To quickly increase the national output, effort must be directed at developing both large and small sites to offer homes in every market segment and ensuring the full range of providers are engaged – from both public and private sectors.

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**Conclusion**

Evidence from this dissertation indicates that the SME sector cannot by itself solve the housing supply crisis in England. There is opportunity for the sector to play a greater role in housing supply. Unfortunately the changes required to encourage new starters are unlikely to happen. Furthermore the political effort required to help and nurture the sector is less forthcoming for the simple fact that SMEs are harder to reach and in the short term yield smaller numbers of houses.

**Next step**

Despite encouraging economic conditions new small housebuilders are not being set up. Further study of the barriers to entry for new starters is required.

The planning system has been highlighted as an increasingly difficult area to navigate. The administrative effort in converting outline permission to implementable permission can add significant time into a project. Research into ways to quicken the process could be valuable to all industry participants, especially SMEs.
Case study

This case study is based upon a Laing O’Rourke Centre for Construction Engineering and Technology Construction Engineering Masters dissertation titled: *The future role of the SME sector in housing supply: a study of the housing market in England* (2016). The research is by Geoff Davis, Project Engineer at Expanded Structures, Laing O’Rourke.

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