



UK COLLABORATIVE
CENTRE FOR
HOUSING EVIDENCE

Resilience in the housing system

The mortgage and housebuilding industries from
the global financial crisis to Covid-19

Interim report

Mark Stephens, Philip O'Brien, Alice Earley (University of Glasgow)

17 March 2021

About the authors

Dr. Alice Earley is a Tutor in Public Policy and Qualitative Methods at the University of Glasgow. She is also an Affiliate at CaCHE. Her research interests include housing inequalities, regeneration, gentrification and the role (and constraints) of the community sector in responding to policy problems.

Dr. Philip O'Brien is Lecturer in Real Estate and Housing Economics at the University of Glasgow. He has undertaken research on the economic role of planning, land value capture and alternative planning instruments used across north west Europe for funders including the Royal Institution of Chartered Surveyors and the Royal Town Planning Institute. Philip is a Co-Investigator at the UK Collaborative Centre for Housing Evidence.

Professor Mark Stephens. Mark Stephens is Ian Mactaggart Professor of Land, Property and Urban Studies at the University of Glasgow, and a Co-investigator in CaCHE. In his role with CaCHE, Mark is leading the 'Wider Drivers' theme that links housing to poverty, neighbourhood change, educational and health outcomes. The bulk of his research is on how whole housing systems operate, particularly from an international perspective, and the relationship between housing and poverty.

Mark is currently leading the UK Housing Review, is a member of the European Network for Housing Research Co-ordination Committee, and the Australia Housing and Urban Research Institute (AHURI) peer review panel.

Contents

Executive Summary	4
1. Introduction	6
2. The Mortgage Industry	9
3. The Housebuilding Industry	21
4. Conclusions	28
5. References	29



Executive Summary

This report outlines the preliminary evidence of a project that seeks to examine the evolution of the housing system between the Global Financial Crisis (GFC) and the Covid-19 pandemic, and the early impact of the pandemic.

The project seeks to establish whether key market institutions were more resilient going into the Covid-19 pandemic than into the GFC. It will further explore the impact of the pandemic on these institutions. The project focuses on two market institutions, namely the mortgage industry and the housebuilding industry.

The first stage of the research involved a series of semi-structured interviews in the mortgage and housebuilding industries. The semi-structured interviews followed the same five principal questions across the two industries, with scope for variation within these:

- How well was the industry able to *withstand* the shock of the GFC?
- How well was the industry and government able to *learn* from the shock?
- How has the industry *adapted* to changing markets?
- What has been the *initial impact* of Covid-19?
- What are the *medium and longer term-impacts* of Covid-19?

Two key informants and two senior providers were interviewed from the mortgage industry, and two key informants were interviewed from the housebuilding industry. Interviews took place in August and September 2020. They were recorded (with consent), summarised in note form with some sections transcribed. They were analysed manually within the framework of the main questions.

The research found that both mortgage and housebuilding industries had adopted business strategies that depended on an inflationary housing market, which could not go on forever. The shock that caused the market to collapse, also impacted on mortgage lenders and housebuilders through the availability of finance. Neither sector exhibited resilience, and both have depended on forms of state support to survive.

Both industries adopted more risk averse business models since the GFC. In different ways, both derisking strategies have, in the absence of a greater housing market correction, reduced the supply of both mortgage credit and new housing.

In terms of policy response, the mortgage industry has been subject to wholesale regulatory reform, whereas the housebuilding industry has not. Arguably state support for the housebuilding sector has continued through the availability of Help to Buy (restricted to new build) and planning concessions. The dependence of housebuilders on Help to Buy more than a decade after the GFC is notable. Therefore industry adaptation has been profoundly shaped by the government response.

Whilst both sectors appear to have been in a much stronger position going into the Covid-19 crisis, the discussion of the concept of resilience, offers the prospect of a deeper analysis of industry strategies since the GFC and the way in which they respond to Covid-19, as its impacts carry on beyond the first year.

This research has highlighted the importance of context – and in particular policy context – to the strategies that these industries have adopted. Key questions remain. Has resilience taken a conservative or radical form? Have the industries sought to adapt and reform, or to return to revert to “business as usual”? What role has policy played in shaping industry responses? In whose interests have policy and industry strategy adapted?

These fundamental questions will be addressed as we move into the second stage of this project.

1. Introduction

This report outlines the preliminary evidence of a project that seeks to examine the evolution of the housing system between the Global Financial Crisis (GFC) and the Covid-19 pandemic, and the early impact of the pandemic. It project seeks to establish whether key market institutions were more resilient going into the Covid-19 pandemic than into the GFC. It will further explore the impact of the pandemic on these institutions. The project focuses on two market institutions, namely the mortgage industry and the housebuilding industry. Work is also being conducted on the private rented sector, which is not included in this report.

Background

The Global Financial Crisis was a huge external shock to the UK economy with particular resonance in the institutions that form the housing system. The seizing up of wholesale markets in August 2007 (the “credit crunch”) immediately sent the mortgage industry into crisis and the housing market into freefall, and both these factors impacted on the housebuilding industry. The worldwide economic crisis that followed the collapse of the American investment bank, Lehman Brothers, in October 2008 brought about further turbulence in the banking sector as well as a deep recession that, but for co-ordinated fiscal and monetary stimuli internationally would have morphed into an ongoing depression. Within the UK, it necessitated immediately a series of bank rescues and nationalisations (FSA, 2009), and support for the housebuilding industry, for example the availability of state finance to assist with stalled sites (HCA and CLG 2011).

Over the period since the beginning of the crisis, there has been significant reform of the regulatory framework for mortgage lending and the wider banking system, following the Turner Review (FSA 2009) and Mortgage Market Review (FSA 2010). As a result of these reviews, the Financial Services Authority was divided into two: the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). New micro- and macro-prudential regulation has placed restrictions on mortgage lending. Interest-only mortgages became very rare and mortgages with loan to value ratios in excess of 95% in particular also almost disappeared. There has been no parallel attempt to reform the housebuilding industry.

Both industries have also operated within an economic environment of slow growth and weak earnings growth on the demand side. On the other hand, interest rates have remained at historically low levels – in large part because the economy has remained weak and the lack of inflationary pressure. Monetary policy, including the quantitative easing programme which was not reversed, has been designed to support asset prices. The Help to Buy (HtB) shared equity schemes that operate have operated in England, Wales and Scotland since 2013. Under HtB, governments provide an equity loan to purchasers of newly built properties with a minimum deposit of five per cent, and this continues to be a major stimulus to the market. In 2018, HtB accounted for 36-48 per cent of the total sales of five of the six largest housebuilders (Stephens and Blenkinsopp, 2020).

The advent of the Covid-19 pandemic in the early months of 2020 presented another shock to the world economy, as governments were forced to adopt lockdown policies that shut down large parts of the economy. The scale of economic contraction was much greater in 2020 than in 2008. However, in 2020 a contraction in the economy of one-fifth was followed by a sharp recovery, but nonetheless represented an overall contraction of 11 per cent – compared with a contraction two per cent in the autumn of 2008 (Stephens 2021). The fiscal stimulus required in 2020 was even greater than after 2008 – some 20 per cent of GDP was borrowed in 2020 alone. Interest rates were cut to just 0.1 per cent, but this was from a starting point of just 0.75 per cent, in contrast to 5.5 per cent in 2008 (Stephens, et al, 2020). The Quantitative Easing programme resumed, and the stock of bonds held by the Bank of England was doubled.

The principal stimulus in the housing market has been through lifting the threshold for stamp duty to £500,000 from July 2020 to the end of March 2021 (in England and Northern Ireland, with similar concessions in Wales and Scotland, at an estimated cost of £3.8 bn (Stephens, et al 2020). On the other hand, mortgage lenders have been required to exercise forbearance with mortgage arrears and to grant mortgage “holidays”

at borrowers' request. In contrast to the voluntary interest deferment scheme begun in 2009, there is no government guarantee of the deferred payments (House of Commons CLG Committee 2009).

After the initial lockdown was eased in the summer of 2020, there followed a housing boom, with high demand for houses and mortgages, which forced house prices to record levels. Whilst the release of pent-up demand and the context of the time-limited stamp duty "holiday" cast doubt on the sustainability of the boom, it is nonetheless unprecedented for such a huge contraction in the economy to be accompanied by a surge in demand for house purchase and the acquisition of mortgage debt.

Resilience

The project will examine the mortgage and housebuilding industries by employing the concept of "resilience." Resilience has a strong intuitive resonance, for example being employed four times in the Turner Review (2009), with its meaning assumed rather than stated.

A literature review has been conducted in parallel with this report (Earley, 2021), and some of the most significant parts are summarised in this section.

Resilience has also been deployed and developed in academic research. Within the academy, it has been adapted from its use in engineering where it can be characterised as being part of an "equilibrium model" whereby the subject is able to return to a static norm having experienced external stress. Holling's (1973) seminal paper developed the idea of "ecological resilience" in which "ecosystems are based around static equilibrium... ecosystems do not have one static point of equilibrium, but rather a zone of stability that allows for the reorganisation of a system to continually exist and function even in the face of disturbance and change" (cited by Cretney, 2014: 628).

Thus resilience in social science is "about being able to be flexible and also about the ability to adapt." Adger (2010: no page). Adger (2010: no page) identifies three aspects of resilience, namely: "the ability to absorb perturbations and still retain a similar function; ...the ability of self-organisation; and the capacity to learn, to change and to adapt... the key element is about the ability to change rather than the ability continue doing the same thing" (see also Shaw, 2012a). Further, Zolli and Healey (2012: 8) define resilience as: "the capacity of a system, enterprise or a person to maintain its core purpose and integrity in the face of dramatically changed circumstances."

In public policy, adaptation is a crucial component of resilience, because "systems [are] always complex and always in various states of change and transformation," regardless of whether there are "external shocks," (Porter et al. 2018: 388). This is in contrast to the traditional engineering understanding of resilience (McGlade et al., 2006; Cretney, 2014). Porter et al. (2018: 389) suggest that a focus on adaptability within "resilience thinking offers a way of thinking about how much disturbance a system can withstand and stay within critical thresholds... how much pressure can be borne, before it breaks?"

Consequently,

"resilience is not just about 'bouncing back from adversity' but is more broadly concerned with adaptive capacity and how we better understand and address uncertainty in our internal and external environments." (Gibson and Tarrant, 2010: 8)

In examining the financial system, Dowell-Jones and Buckley (2017) sought to distinguish between "robustness" and "resilience", and argued that postcrisis financial regulation has sought to build a stronger, more robust system, not a more resilient one... [by making] institutions too strong to fail" (Dowell-Jones and Buckley, 2017:1). Further, they argue that 'this is not self-evident, as the system has fundamentally changed over the last two decades...' (Dowell-Jones & Buckley, 2018:8).

In applying “resilience” to the GFC and Covid-19 crises, we may therefore distinguish between “conservative” and “radical” notions of resilience (Raco and Street, 2012). A conservative conception may focus on the ability of the subject to return to a status quo, whilst a radical notion would place greater emphasis on adaptability, and indeed improvement whilst maintaining core function.

The findings from Stage 1 of this project will be used to refine and operationalise the concept of resilience.

Methods

The first stage of the research involved a series of semi-structured interviews in the mortgage and housebuilding industries. The semi-structured interviews followed the same five principal questions across the two industries, with scope for variation within these:

- How well was the industry able to *withstand* the shock of the GFC?
- How well was the industry and government able to *learn* from the shock?
- How has the industry *adapted* to changing markets
- What has been the *initial impact* of Covid-19?
- What are the *medium and longer term-impacts* of Covid-19?

Two key informants and two senior providers were interviewed from the mortgage industry, and two key informants were interviewed from the housebuilding industry. Interviews took place in August and September 2020. They were recorded (with consent), summarised in note form with some sections transcribed. They were analysed manually within the framework of the main questions.

The Key Informants from the mortgage industry are identified as KI1 and KI2, and the senior providers as SP1 and SP2. The key informants in the housebuilding industry are identified as KI3 and KI4 to avoid confusion with those in the mortgage industry. In one case a relevant quote from one of the mortgage industry interviewees is used in the housebuilding section.

It is intended to conduct follow-up interviews in the spring of 2021.

Structure

The report is divided into three further sections: the interviews in the mortgage industry are reported in section 2 and those of the housebuilding industry in section 3. Provisional conclusions are drawn in the fourth and final section.

2. The Mortgage Industry

The key part of the exercise was to conduct a series of semi-structured interviews with two Key Informants (KIs) and two Senior Providers (SPs). These were undertaken in August and September 2020. They are referred to as KI1 and KI2, SP1 and SP2 in the text. Interviews were conducted over Zoom, recorded, and were subject to “note and quote” throughout, with the most relevant sections fully transcribed.

A topic guide as issued in advance of the interviews, and covered the broad areas listed in the methods section above.

As was anticipated the balance of the discussion focussed on the GFC and its aftermath as this concerns past events and actions that can be assessed, whereas the impact of the pandemic is more recent and necessarily contains a speculative element. However, follow-up interviews are planned for the spring.

(i) How well was the industry able to withstand the shock of the GFC?

In this section interviewees were invited to discuss the causes of the GFC, the relative roles of internal and external shocks to the mortgage industry, the role of mortgage finance in the wider financial crisis, and whether any generalisations could be made about whether ownership forms (especially mutuality versus PLC) and funding models (especially securitisation) contributed to the crisis. Government interventions, including banking rescues, changes to Support for Mortgage Interest and forbearance were also discussed.

How the crisis unfolded

The crisis was triggered as a result of the “credit crunch” when wholesale market seized up in August 2007, in response to the uncertainties of the veracity of mortgage backed securities that had been sold to banks around the world.

From our interviewees’ perspective the crisis broke in the UK with the impact of the credit crunch on Northern Rock which had expanded rapidly into “slightly sub-prime” (KI1) markets using securitisation (KI1). Attractive funding terms were available until 2007, but the credit crunch marked the end of this. SP1 describes Northern Rock’s business model as a “ponzi scheme” (SP1), relying on ever more lending to disguise its falling margins – noting that it received a favourable press for doing so. Once Northern Rock’s cash flow was hit, it experienced a liquidity crisis.

The crisis entered a second phase in 2008 after the failure of Lehman Brothers. All lenders affected by declining liquidity as they were borrowing short and lending long. With the “market in free fall” (KI1) other banks including RBS, HBOS and Bradford & Bingley were hit, and needed to be rescued by the government as they were “too big to fail” (KI1).

However, a key question is whether the credit crunch/ GFC were fundamental causes or merely triggers of the crisis for UK mortgage lenders.

Interviewees suggested that some kind of crisis would have been likely even if the GFC had not occurred.

KI1 suggested that although the GFC sparked the crisis, the system had sowed the “seeds of its own demise.” (KI1) Sooner or later the economy would have declined. SP2 was more specific. They compared the market to “playing pass the parcel with a hand grenade.” Mortgages were lent on the basis of house price inflation continuing rather than the borrowers’ ability to pay. The risk was limited because the time horizon was only two years before the mortgages were moved off the books through churn. When house prices stopped rising, “That’s what that was: the hand grenade going off.” (SP2) KI2 also points to house prices as being key to sustaining some of the imprudent lending, referring to the “complacency around the view that the house price inflation was with us to come...” (KI2)

It was therefore important to explore the internal weaknesses in the UK mortgage system in the run-up to the crisis.

Causes of the crisis for the UK mortgage industry

KI1 identified the context of the crisis as being the “Golden Decade” of “benign” (KI1) economic conditions with continuous economic growth. Within this context, the search for yield was “a huge part of it [lender behaviour]” (KI1), i.e. interest rates were low and lenders searched for higher yields, which often entailed taking more risks. The mortgage market had also reached maturity in the sense that its natural growth had ended as home-ownership peaked and began to go into decline. There was a “regulation light environment” (KI1) in which the Government assumed that banks “knew what they were doing” (KI1), which meant that there was little to constrain lender behaviour.

Nonetheless, KI1 also suggested that the mortgage industry did not move into high-risk activity until the middle of the 2000-2010 decade, as it had been so scarred by what happened in the early 1990s recession, when there were record levels of mortgage arrears and possessions, that it took almost a decade to get over it).

However, several structural changes began to change the dynamics of the industry in the direction of riskier behaviour.

First, the rise of brokers in the 1990s increased the numbers of actors with an interest in market growth, which, as we have seen could no longer be derived from the “natural” growth associated with rising levels of home-ownership. Second, technology enabled the rise of individual underwriting, opening up the possibility of market segmentation, and market growth based on moving into previously underserved (i.e. riskier) market segments.

Third, US entrants and ideas such as GMAC¹ (a centralised lender) embraced these changes to fuel growth. GMAC became a “machine for writing loans” (KI1), promoting sub-prime products such as self-certificated mortgages. Such specialist non-banks were “pretty much funded by American investment banks.” (SP2) KI2 also emphasised the role of new entrants “who were... offering mortgage finance on the back of a wave which [sic] nobody could do any wrong.”

SP1 identified a fourth factor, which was the access to cheap wholesale funding, which “burst apart” (SP1) the traditional lending model based retail savings. Securitisation was described by SP1 a “funding regime supported by risk appetite” and grew rapidly in the 2000s partly because it was unconstrained by prudential regulations. It also worked well until the wholesale funding stopped with the credit crunch in 2007. This view is supported by SP2, who noted that “there was a lot of funding out there... The cost of funding was very low.” (SP2).

KI2 agreed, but also identified the element of risk involved with dependency on short-term funding:

“The nature of that funding particularly looking at wholesale funds as opposed to having a dependency on retail funding meant that you were extremely vulnerable, but nobody saw that at the time... if you have that dependency on wholesale funding and therefore once you’ve gone in and you’ve shaken the money tree you have to keep on going back and shaking it and once the dynamics of that change is ultimately exposed.” (KI2)

The funding model increasingly adopted contributed to creating “a very quick two year turn around market and some of those longer term assumptions around how long a mortgage would stay on the books weren’t playing out at all.” (SP2). KI2 referred to this “continual cycle” of “just borrowing money, getting out there and borrowing money”.

SP2 identified an important implication of higher risk lending using short-term funding, namely that lenders were “creating markets that were based purely on the equity and the assumption that house price inflation would continue and therefore, whatever happened you will get your money back.” (SP2) KI2 confirmed that this model was predicated on “rampant house price inflation” (KI2) to support “your interest only, 120% LTV mortgages self [certificated], so six, seven, eight times income.” (KI2)

SP1 also noted that by mixing high risk products with low risk products, the result is not a medium risk product. SP2 believed that overall “the risk reward model was wrong” (SP2). They also suggested that “the ratings agencies were culpable. . . [they] created a false impression of the risk that was being taken” (SP2) which led to mis-pricing, i.e. some of the sub-prime mortgages were priced a High Street rates. KI2 made the point that once in the market it was difficult to withdraw: “I think the trouble was that you’ve initiated a cycle - particularly a funding cycle - which is very difficult to step away from.” (KI2)

Ownership models and risk: mutuals versus PLCs

The interviewees had described how higher risk lending based on short-term wholesale funding began to change the dynamics of the mortgage market, which then created a competitive dynamic of its own around 2004/05, when KI1 suggested that “a downward race on how liberal you could make your business” (KI1) began in which “anything went” (KI1). SP2 suggested that there was also “a race to the bottom in terms of price.” (SP2). Arrears and possessions were “almost absent” (KI1), and lenders were searching for the point where risks became real.

An important question is whether different ownership models were more or less resistant to moving towards higher risk funding and lending activities. In particular, were mutually owned building societies without external shareholders and therefore in principle less exposed to the pressure to deliver “shareholder value” any less likely to go down this path?

KI1 believed that there was, in practice, no difference between the risk behaviour of mutuals and PLCs: “Building societies can’t hold themselves up as paragons of virtue.” (KI1) However, SP1 maintains that “risk appetite” (SP1) changes when a building society demutualises. SP2 presented the opposite view – that PLCs were probably more risk averse than mutuals. They believed that banks “didn’t necessarily go into those [specialist] areas.” (SP2). Instead, they point to the subsidiaries established by building societies such as Coventry (Godiva) and Yorkshire (Accord) which targeted the more specialist markets. However, mutuals were non leaders: the market was driven by the non-bank lenders.

KP1 downplayed differences between banks and building societies, suggesting that they were all exposed to the same competitive pressures. So, in reality “all banks needed to play the same game,” so when NatWest tried to step back in 2005 it “got crucified” (KI1). SP1 argued that another major lender was criticised for not expanding rapidly when Northern Rock collapsed.

Lender and regulatory authority preparedness

SP1 believes that the industry was “wholly unprepared” (SP1) for the credit crunch and what followed. The vast majority of lenders believed that the market could not go wrong, or, if it did, someone else would bear the risk.

SP2 suggested that

“there was no real sign of that worry, particularly because the economy was so strong and house prices will continue to rise and the demand was there. And on the whole, people were paying. . . those loans didn’t have high arrears rates. People were paying and if they weren’t paying they’d remortgage to somewhere else. . .” (SP2)

KI2 agrees that the crisis was not anticipated:

“. . . nobody saw that at the time. So I think it would have been in hindsight, a wonderful thing. So, of course, it’s easy to say, ‘Oh, yes, we should have seen it coming’, but the reality is that it wasn’t obvious.” (KI2)

However, K12 did suggest that some people within the bank where they worked had been commenting on the “unsustainability of the share price”, but they “were probably being poo-pooed.” (K12)

SP1 also claims the Bank of England was unprepared, and relied on mortgage completion data that was subject to lags, and did not understand the market. K12 also suggests that the Bank of England and the Financial Conduct Authority were unprepared:

“I think it would be easy to say. ‘Yes, we saw it coming,’ and in hindsight the reality is that it was in the actions have been taken by the regulator, whether that be the FCA or Bank of England and so on again, indicates that it wasn’t just the funders themselves that were maybe caught on watch it was a much broader than that...” (K12)

Government policy

The GFC led to what were then unprecedented levels of government intervention, both aimed directly at the banking industry and the economy as a whole.

Monetary policy and policies towards mortgage arrears and possessions

SP1 argued that cutting interest rates was key to saving the market:

“Without doubt dropping interest rates was the single most important factor that saved the market. And I think that was absolutely right and necessary step that was needed. And it was in effect an acceptance that the housing market was too big and too important to fail.” (SP1)

Specifically, interviewees identified lower interest rates as being a key factor in limiting mortgage arrears and possessions, which were not as extensive as they had been in the early 1990s when interest rates were considerably higher.

Lower interest rates reduced the “carry costs” (K11) of arrears in 2007/08. The same fall in interest rates also benefited borrowers on base-rate-linked mortgages:

“...their payments were dropping and therefore those mortgages became a lot more affordable than they probably were at the time when it took them out.” (SP2)

However, interest rates were not the only reason why mortgage arrears and possessions were more contained than in the early 1990s. For example, interviewees pointed to the significant tranche of mortgages that were held by the government. SP1 believes that a big difference was that in the early 1990s first time buyers were effectively “hung out to dry” and effectively received “no state and lender support”. In contrast, the government moved quickly to remove the waiting period for Support for Mortgage Interest, and introduced the pre-action protocol and forbearance. SP2 agreed that arrears and possessions were “definitely” handled relatively well and “it [the problem of arrears and possession] certainly wasn’t as bad as people feared...” (SP2)

The politics surrounding this issue appears to have been different during the GFC. Given the banks’ dependence on government, “politics are part of things.” (K11) In other words the banks felt obliged to be co-operative, given their role in the crisis and their dependence on the government.

The Funding for Lending Scheme

The Funding for Lending Scheme (FLS) was operated by the Bank of England and Treasury from August 2012 to January 2015 (although the drawdown period was extended until 2018). It was intended to provide

lenders with funding on terms that incentivised them to increase lending after monetary policy (both interest rate cuts and Quantitative Easing) had disappointing results.ⁱⁱ During the last year of the scheme, mortgage lending ceased to be eligible, in order to focus funds on small and medium sized enterprises. It was intended that the lower interest rates on FLS would be passed on to borrowers and would boost demand.

SP2 describes the FLS as having been:

“... an absolute game changer. That’s when the market started to recover - really recover. And the lenders had started to move up the loan to value bandings and started to... increase their capacity and ability to lend...” (SP2)

The reasons were that it enabled lenders too access funding more cheaply than through savings or securitisation or whole loan sales. SP2 went on to note that lenders were paying back government funding before Covid-19:

“It [the industry] was paying it back so you know it was weaning itself off it. And getting quite close to having weaned itself off it having built up good capital behind it and that liquidity was in place so I think the market was in a good place to pay that back and become operating more normally in the normal cycle.” (SP2)

The Help to Buy scheme

SP2 also identified Help to Buy as being “the other game changer” (SP2) and in combination with FLS helped to revive the market. Help to Buy was introduced in 2013 to compensate for the lack of availability of high loan-to-value mortgages. In the main scheme the government provides an equity loan so long as the purchaser places down a minimum deposit of 5 per cent.ⁱⁱⁱ

(ii) How well was the industry and government able to learn from the shock?

Having identified weaknesses in industry practice and the regulatory framework, interviewees were asked to discuss the longer-term responses to the crisis.

Regulatory response

The Financial Conduct Authority established the Mortgage Market Review (MMR) in response to the crisis, which in turn made recommendations for the future regulation of mortgage lending.

The effect of the new regulatory framework, in the view of KI1, was to codify the practices that banks and building societies were already: “lenders were there already” (KI1). It established a benchmark for the future based on current (i.e. post-GFC) lender practice. Nonetheless, SP2 the MMR as “definitely needed”: “*particularly* self cert and the stress testing put some real stability into the market.” (SP2) SP1 agreed saying, “it’s the right thing to do.” Interviewees also believed that the macro-prudential rules introduced also codified existing practice.

Together, these interventions were judged to be “reasonable and appropriate” (KI1). SP1 is “pleasantly surprised by absence to a return to higher risk lending” (SP1), noting that most of his institution’s lending team arrived after the GFC so have no memory of it. However, he cautioned about the future:

“I think the industry remains vulnerable to some risk. And that’s partly because it has this massive herd instinct... Once it decides to do something, it’s very difficult to get lenders

to go against the status quo or the general feeling. It just doesn't happen." (SP1)

He was also dismissive of government policy relating to the housing market, stating that they were "constantly amazed by their level of ignorance and lack of understanding about Help to Buy and the dynamics of the mortgage market. I'm actually pretty furious..." (SP1)

Were the regulations too onerous pre-Covid-19?

However, it was suggested that regulations had become too onerous on the eve of Covid-19: in particular the combination of stress testing and the amount of capital required for high LTV mortgages limit their supply.

In effect, Help to Buy is used as an alternative to high LTV mortgages, but its ending will leave a gap. SP2 argued that lenders are in the "perverse situation" whereby a tenant is trapped paying more in rent than is deemed affordable as a mortgage. The stress test requires mortgage payments to be tested on interest rates up to 7 ¼%, SP2 clearly believed that this is too high in the current interest rate environment:

"...I think the markets, going to a decent stage to the point where I think things like stress tests are now too high." (SP2)

However, SP1 argued that easing regulatory restrictions on lending would risk "start[ing] more house price inflation." (SP1)

(iii) How has the industry adapted to changing markets

SP1 believes that the industry has "definitely" (SP1) become more risk averse. This is partly because of the departure of the "faceless lenders that had popped up prior to the recession" (SP1). They also suggested that there had been a cultural change within their institution, which had been "all about shareholder value" (SP1). The GFC made the realise that "we were part of the problem so, therefore we had to be part of the solution" (SP1), that "There was a huge amount of trust to be rebuilt" and that due to their size their behaviour is "going to have an impact on society and the economy..." (SP1) They suggested they had resisted government initiatives, such as Starter Homes, because they believed they would be damaging to the market.

Credit rating agencies

SP2 believed that the credit ratings agencies "[got] away fairly scot free in terms of blame" (for giving AAA ratings to bonds that did not merit it), but "... they had to get their act together and probably have now. You have a much better idea of what you're buying." (SP2) The main change is that they are gaining more information on bonds before rating them now.

Letting the market drop

An interesting argument emerged from the discussions. Clearly government intervention during the height of the GFC was intended to prevent banking collapses, prevent the housing market from going into freefall, and to avoid a mortgage arrears and possessions crisis.

However, SP1 argued that the price of protecting home-owners and the housing market in the aftermath of the GFC meant that affordability was not restored. He argued that:

"we probably had a very British recession in that we almost called came on it at a stage where it probably needed to go a bit deeper - particularly in the housing side..." (KI2)

“... The more affordability you create in the market the more you fuel house price inflation” (K12).

Both the over exuberant lending before the GFC, with very high LTV mortgages at many times income multiples, or government programmes such as Help to Buy have this effect. If prices had been allowed to fall further, “we would have rebased affordability better...” (K12)

SP 1 agreed:

“To some extent we are still paying the price today of that... Because house prices did not fall significantly and first time buyers continued to struggle to get on the market. The normal mechanism that prices fall and new entrants come in and sweep up and values recover didn’t happen. Instead we’ve got a market that still persists to today, which is that largely those that lived in their houses stayed in their houses they have moved rather than improved. *The housing ladder as a concept has just about disappeared* ... and first time buyers continue to struggle to access the market.” (SP1, emphasis added).

K11 also agreed with the hypothesis that the market had not been allowed to correct after the GFC, describing this as “spot on”, and contrasted the UK experience to that of the US where the market was allowed to fall. They argued that “The market looks remarkably similar to... pre-GFC” (K11), and that lenders know that the housing market is “dysfunctional” but that they had made no contribution to the policy debate. Instead, the government has relied on “sticking plaster solutions” (K11) and an “addiction to cheap money” (K11).

SP1 believed that the government should have exited from Help to Buy much sooner, as it enabled the housebuilders to carry on without reforming their practices or improving their treatment of customers (e.g. the leasehold scandal).

(iv) What has been the initial impact of Covid-19?

Nature of recession

The interviewees believed that the Covid-19-induced recession was different in nature from the GFC.

SP1 said they were “convinced that the entire financial system could have failed in 2007/08, but it is much harder to see that happen now” (SP1). SP2 also saw the Covid-19-induced recession as being “very different indeed” from the GFC, partly because lenders are much better capitalised and have liquidity, but crucially because “the demand is still there” (SP2). Together these factors “are fundamental differences” (SP2). They were confident that the recession is simply a result of restrictions, hence “[o]nce the virus goes away, then the market... [t]he economy should return very, very quickly because they [lenders] were in strong position going into this.”

SP1 also pointed to the beneficial effects of more prudential lending since the GFC: people were now on capital and repayment mortgages, so could shift to interest only if they had difficulties, and lower LTVs meant that most people had equity in their houses. They also observed that the people hardest hit economically by Covid-19 are younger people – who have been locked out of home-ownership. Overall, “We’re in a good place.” (SP1)

The Covid-19 boom – or “Crisis? What crisis?”

Although the economy contracted dramatically (by 20 per cent in Quarter 2) as a result of the original lockdown, the housing and mortgage markets experienced a mini-boom over the summer and autumn.

SP2 observed that “the only thing that is stopping lenders lending more money at the moment [August] is their capacity and the ability to service the, the amount of demand that’s out there.” (SP2). This is a reference to staffing

problems arising from staff having to work at home. They lost 30% of their workforce overnight with lockdown.

KI2 concurred with the capacity problem: "...the practical problem [of working at home, with the need to supply laptops, etc] should never be underestimated." (KI2) Capacity for lending was further reduced by need to process applications for mortgage holidays. However, by June they were back to around 85 per cent capacity.

However, they faced huge demand for mortgages: "June was our biggest every month of applications... Within June we had our... two busiest days... And July, we've just got the figures and that's surpassed June... So it doesn't make sense in the whole world to say this is a crisis..." (SP2) KI2 suggested that the capacity problem led to lenders using loan to value limits as a rationing device.

KI2 suggested that the boom in demand is partly attributable to pent-up demand arising from the temporary closure of the housing market. The boom in demand was, according to SP2, more than this and is also attributable to the strong position of people whose jobs are secure. With low mortgage rates and the stamp duty holiday:

"... why wouldn't you buy now if you were going to buy and you are secure in your employment?
... now is a brilliant time to buy if you're confident your employment is secure." (SP2)

In contrast, KI1 viewed the Covid-19 boom as being "dishonest and distasteful", reflecting an attitude of "The party's back on, chaps" (KI1). Overall it represented a "collective delusion". (KI1)

Government interventions

The principal general government interventions included the furlough scheme designed to protect the incomes of workers unable to work due to lockdown restrictions, supported by a huge increase in government borrowing, as well as cuts in interest rates (from the very low base of 0.5 per cent to 0.1 per cent) and Quantitative Easing programme (which partly assisted with funding the deficit).

The interviewees focussed on other interventions aimed more directly at the housing market. These included the revival of the Term Funding Scheme (TFS), the suspension of stamp duty, and obligations on mortgage lenders to allow mortgage "holidays", and to exercise forbearance when borrowers ran into arrears.

Term Funding Scheme

The TFS was revived in April 2020 to allow banks and building societies (but not intermediaries/non-banks) to access four-year funding at rates very close to Bank Rate. The intention was to ensure that cheap funds were passed on to households and businesses.

When asked if they could fund the strong demand for mortgages, SP2 responded with confidence: "We can fund it. We can fund it all day. We could fund double it.

We are really well capitalized." (SP2) Nonetheless, SP2 described TFS as "needed" and "it's really helped" (SP2) because it relieves pressure on refinancing loans: "you don't have to... worry too much about paying back the last lot [of funding]..." (SP2).

SP1 was also ambiguous about its necessity. Whilst "It may have been proved not to be necessary, but it was wholly necessary that it was put forward. The fundamental view needed to be that banks would not run out of money..." (SP1). In other words, it was needed to ensure that confidence in the market was maintained.

Confidence was also seen by KI2 as an important factor: "I think I think as far as creating some element of stability and therefore... creating an element of confidence by showing a responsibility is not necessarily a bad thing." (KI2)

Stamp Duty holiday

The threshold for Stamp Duty in England and Northern Ireland was raised from £125,001 to £500,000 from July 2020 until the end of March 2021. Most first time buyers had already been exempted (threshold set at £200,000), so the concession makes no difference to them.

K11 characterised the Stamp Duty holiday as “brib[ing] people with their own money”, and suggested that “now is not the time to prime the market” (K11) as it would stoke up a problem for next March. It was an example of “firefighting” rather than strategic thinking.

SP1 characterised the Stamp Duty holiday as “marketing noise... just a tool government plays with to send messages...” They regarded it as “a sensible intervention” but would apply to only a limited number of people as first time buyers were already exempted.

SP2 thought that the stamp duty holiday together with low interest rates was contributing to the Covid-19 boom by making it “a brilliant time to buy.” (SP2).

Mortgage holidays

The government announced the “payment holiday” in March, initially for three months, but it was subsequently extended for another three months until the end of October, and again so that applications can be made up to 31 March 2021 which means that the last payment deferrals will continue until the end of July 2021.

SP2 reported that 14 per cent of their borrowers took up the scheme, but fell back down to 10 per cent soon thereafter. They were confident that, “People took it because they could, not because they needed it.” (SP2) Nonetheless, “... a small number of people who took it out will continue to need it. And they’re the people we’ve got to really support.” (SP2)

K11 questioned the term “holiday”, and SP2 considered it to be unhelpful and “did more harm than good” (SP2). SP1 agreed, saying that “Not everyone necessarily understands what a payment holiday is... For me it means being let off.” (SP1) In their view it had the deleterious effect of signalling that there is no individual risk with home-ownership, and if anything goes wrong the state will intervene: “I don’t believe in an environment where people can buy houses and take no risk and expect the state to look after them forever.” (SP1)

Lender forbearance

Forbearance was adopted as a policy during the GFC in the form of guidance to courts and subsequently through the pre-action protocol. However, it was based on individual cases, whereas the forbearance required of lenders during the pandemic has been applied across the board regardless of the merits of individual cases. Subsequently (and after these interviews were conducted) the FCA has extended the moratorium on repossessions until the end of January 2021.

K11 believed that most lenders were reasonably well positioned to absorb forbearance. SP2 agreed that the industry was able to bear forbearance, but suggested that the provisions in lenders’ half-year results were “significant” (SP2): “it’s provisions and the provisions they’re putting aside for potential losses that will drive that ... I do think over time, they’ll be able to release some of those.” (SP2).

SP1 argued that lenders would have exercised forbearance with people in difficult even without the scheme: “I don’t think that fundamentally it’s been a driver of behaviour. I think that holding fire would have happened anyway.” (SP1). However, they said, “It helped with the mood music, it helped with the message making, but in terms of... an intervention that did more than that I don’t think that they [lender and landlord forbearance] count for anything more than noise.” (SP1)

K12 believed that forbearance was currently “acceptable” (K12), and that removing additional pressures from people during the pandemic “feels like the right thing to do.” (K12)

(v) What are the medium and longer term-impacts of Covid-19?

Asked to speculate on the state of the market in the spring of 2021, K11 suggested that although much depended on whether there were second or third waves of the virus, the chances of the economy returning to its pre-Covid-19 state were “thin” (SP1). If the crisis were to continue, it would become “difficult for large swathes of the industry.” They thought that the “big boys” would survive and that some of the smaller ones would be sufficiently flexible to adapt. There could be a “shake out” (K11) especially of medium-sized lenders. They argued that there was a need for “strategic market mechanisms” (K11) rather than “knee-jerk” (K11) reactions, and that relying on the private sector was “pretty stupid.” (K11)

SP2 expressed confidence that “the market will bounce back”, although unemployment remained an uncertainty. They said that forecasts of 4-14 per cent falls in house prices appeared to have been misplaced, although, again, this might depend on unemployment.

Longer-term SP2 believed that there could be some structural changes in the mortgage market. They noted the withdrawal of some specialist lenders who cannot access the Term Funding Scheme. The withdrawal of some of these would be permanent and “that will restrict choice in underserved markets.” (SP2)

K12 observed that the impact of Covid-19 over the period to spring 2021 would depend on the extent to which they specialised in residential mortgage lending, or lent more broadly - to industry, for example:

“The big banks will be having to look at a much more holistic impact than necessarily just the impact on the housing side. That that will be a critical consideration for them, but it can’t be the only solution whereas for others it is potentially the only consideration.” (K12).

K12 thought that lenders would remain cautious until it was clear whether demand remained after the recovery based on whether the release of pent-up demand dissipates:

“And it’s that fine balance between being irresponsible and being responsible and somewhere in between there acting as an inhibitor then market growth, but I think until the view that pent-up demand is beginning to disappear and you start seeing what the core market looks like I think lenders will remain fairly cautious and rightfully [sic] so until they know what that looks like...” (K12)

Overall, it would seem that the message is that it is too soon to say.

(vi) Did the experience of the GFC make the mortgage industry more resilient?

Asked whether the mortgage industry was better placed as a result of the experience of the GFC, K11 said “undoubtedly, yes.” (K11) If the GFC had not happened there would have been no regulatory change and the industry would have reverted to a “gung-ho” approach leading to continued housing market volatility. The regulatory regime is not perfect, but it had “safeguarded” the market.

SP1 said that it was “undeniable”:

“The industry is much more resilient. And I think there are a large number of interventions that we can point to that have happened that have made it so...” (SP1)

Another reason for greater resilience is that “the worst lenders all went, and the best lenders all flourished.” (SP1)

SP1 did have a “caveat”, however, which is that margins have become very low and the industry is vulnerable to a change in environment that would cause interest rates to rise.

A further caveat is that:

“... one consequence of increased regulation is there’s been an increased homogeneity across the market and that presents a new systemic risk which is that the whole market while individual elements of the market are protected from failure, the risk of collective market blind spots does increase in that kind of environment.” (SP1)

SP2 agreed that the industry is more resilient as a result of the GFC – a “definite conclusion.” (SP2):

“We came into this far stronger than we came into the last one. It is a very different crisis... [lenders] will recover in different ways, but the market is much better equipped to survive this one that it was the last.” (SP2)

KI2 believed that the industry is “certainly trying its best” to exhibit resilience, but suggested that a balance between responsible and irresponsible lending would need to be maintained.

Conclusions

The interviews provided clear agreement that the mortgage industry was highly vulnerable to shocks in the run up to the GFC. Weaknesses arose from lending, and in some cases funding, practices that were predicated on continually rising house prices and the availability of wholesale funding. If the GFC had not occurred, then it is probable that some other shock would have caused the industry to experience severe stress. The need for bank rescues and other extensive government intervention indicates a lack of resilience.

Lenders subsequently became more risk averse, and regulatory changes in both macro and micro prudential regulation followed the changes that lenders were making in any case. Those regulatory changes were regarded as being proportionate, but an unanswerable question is whether they would be needed should lenders wish to once more take on more risk. Some interviewees suggested that there was a case for relaxing some of the mortgage stress tests, but justified this on the basis that the interest environment has changed. Others suggested that regulation is required in order to prevent a return to “herd behaviour”.

There were particularly interesting discussion around the role of government in protecting the housing market, not least through Help to Buy. Some believed that it had been helpful when it was introduced, but it had continued for too long. However, others believed that there was a case for having allowed the market to fall further, so that affordability could have been restored through market forces. The legacy of this is the pricing out of younger – and now middle aged – households from home-ownership. An alternative approach would, however, have risked more banks and housebuilders becoming insolvent and for repossessions too rise.

Lenders were judged to be more resilient going into the Covid-19 crisis than into the GFC. They were better capitalised and the market was not on an unsustainable trajectory. But there was a view that fundamentals in the housing system had not been fixed.

Lenders might well have exercised forbearance without government intervention during the early stages of Covid-19, and they are able to absorb it in the short to medium term. Other interventions,

including the term funding scheme may have helped to maintain confidence in the market even if they were not essential. The stamp duty holiday was not obviously needed, not least because most first time buyers were already exempted, whilst mortgage “holidays” were poorly targeted.

The lockdown created pent up demand, fuelled by the stamp duty policy, leading to capacity constraints (exacerbated by working at home), rationing through limiting loan-to-value ratios and a mini housing market boom.

The future was regarded as being difficult to predict, not least because of the uncertainties of the virus, not least whether a vaccine would be found.

3. The Housebuilding Industry

Two semi-structured interviews were undertaken with Key Informants (KIs) from the planning and housebuilding industry selected on a non-statistical, purposeful basis intended to secure as broad a perspective on planning, land and housing development as would be possible using such a small sample size. The interviews, which were conducted over August and September 2020, were recorded and summarised in note form, with some sections transcribed.

The report draws on interview data and wider literature to answer outlined in the methods section above.

How well was the industry able to withstand the shock of the GFC?

Before the term 'Global Financial Crisis' came into usage, the effects of the mid-noughties US sub-prime mortgage crisis on the wider global economy came in the form of a 'credit crunch', or a throttling of private credit availability. The consequences of the GFC on the US housebuilding industry followed on from the unprecedented number of mortgage defaults and foreclosures that arose over this period and were thus direct and profound in scale and depth. But for the UK it was not overexposure of mortgage lenders to interest rate rises that impacted on housebuilding but the exposure of the wider UK economy to global capital markets that were to rapidly dry up (Jones et al, 2018). As such, the effects of the GFC on the housebuilding industry followed on from its effects in restricting access to credit and dampening demand in the wider economy.

Housing completions in England sank from a then recent per annum high of 200,300 in 2007-08 to a low of 117,695 in 2010-11, only rising to 2007-08 levels again in 2018-19 (MHCLG, 2020a). The effect of the GFC on the financial performance of UK volume housebuilders was also highly significant, with drastic reductions in profit, revenue and operating margin (Payne, 2015). The substantial dip in the delivery of new homes reflects dampened demand for market housing during and following the GFC and points to the fact that the primary response of housebuilders in its aftermath was to reduce the supply of new homes onto the market. While it might be expected that developers would reduce new home completions in response to lowered demand, the scale of the reduction reflects the protracted duration of the residential development process and the standard industry means of calculating land value.

In the so-called residual valuation method, the land value is calculated by subtracting costs and pre-determined profit from an estimate of the value of the completed development. As such, the value of newly constructed housing must reflect the price paid for the land acquired as an input. If the value of the completed development is reduced between the point at which the land value is calculated and when the completed houses are marketed for sale, the profit level will dip below the required margin. Housebuilders who had bought land in the heated market of the early-mid 2000s faced significant losses selling new homes at post-GFC prices. The materialisation of this prospect is related by KI4:

'In 2008 I worked for a bank and had a portfolio of mostly SME builders doing 100-200 units a year. A lot of them had massive amounts of debt at that time. Money was cheap and they were highly geared. Sites were acquired, options were taken on, with the expectation of rising values, so buyers were building in quite low profit margins of 16-17% on the basis that values were only ever going to go up. But what happened was that the market ceased immediately and house prices plummeted. And the land value is a very volatile component of the valuation, so a 5% reduction in the expected development value can mean a 20% drop in the land value.'

The emphasis on the volatility of land value within the residual valuation is due to its being a relatively small amount as compared to the value of the completed development, with the same being true of the developer's profit. Accordingly changes in the value of the completed development, as occurred following the GFC, have a much more pronounced effect on the price paid for development land and developer's profit (Ball et al, 2020). The

effects of the GFC on housebuilders were therefore to a great extent contingent upon the quantity of investment they had tied up in land that they had bought but not yet developed prior to the onset of the Crisis (Payne, 2015).

While housebuilders reduced the overall supply of new housing, it was necessary to maintain sales, and therefore development, at some level to generate revenue needed to service debt accumulated during the building boom of the early-mid 2000s. The banks' use of Return on Capital Employed (ROCE) as a measure of economic health influenced housebuilder behaviour at this time. ROCE is a measure of the operating efficiency of the business based on the ratio of its profit to its assets, less its short-term liabilities. It is typically used in capital-intensive industries because it measures the efficiency with which capital is used and because, unlike some other management ratios such as Return on Assets, it accounts for liabilities as well as assets. The effects of this focus on ROCE included housebuilders prioritising efficiency at the expense of profit margins, closely controlling the rate of development, and coordinating this with sales (Payne, 2016). Access to borrowing differed greatly by size of firm, however, with larger housebuilders often able to access credit facilities while SMEs struggled to stay afloat:

'The big boys have a have a big draw-down fund anyway, and I don't think they're really affected *per se*. You know, they've got their loan facility. Smaller ones, probably more so,' (K13).

'If you had the luxury you could write off the land on your balance sheet but SME builders couldn't do that. In some cases land was worth 10 or 20% of what they'd paid for it. So we thought, what tools do we have to get through this? How can we reduce costs or overheads? Can we go to more of a subcontractor model, can we drive value on our sites, can we look at our acquisition strategy, can we increase the [developable] coverage of our sites?' (K13).

The requirement to maintain cash flow demanded that the pipeline of sites for new development was maintained. While the magnitude of losses was to an extent dictated by the quantity of land bought prior to the GFC, the ability of housebuilders to maintain their pipeline of sites post-GFC was partly contingent on how much land they had under option at that time. As well as allowing land to be acquired without recourse to the competitive market, options often granted the ability to acquire land at its market value at the time at which the option was exercised. This meant that sites could be bought at a deflated post-GFC value and either developed as a less costly alternative to land bought on the market or left undeveloped until house prices had recovered, thereby yielding increased profit (Payne, 2015). The very different conditions faced by SMEs and volume builders were again evident here, as SMEs were inhibited in competing on the market for development land due to their reduced access to credit:

'I worked for an SME in debt, where you've got to make your financial covenants, and it's hard. We had an option bank, and we were largely buying off market, we weren't having to make offers at closing dates. When you've got a three or a five year plan, with unnamed sites – you don't know what they're going to be yet – but they need to deliver the sales volumes that you need, there's always pressure to secure sites. If you're competing with the Plcs, they've got cash at the moment. SMEs are by contrast reliant on debt funding' (K13).

Also important in cash flow management was the capital intensity of production, with relatively larger quantities of capital required in the construction of flats before individual units can be sold as compared to houses. That the nature of housebuilding makes it possible to realise returns on capital employed more quickly than is the case for flats drove an aversion towards flatted development following the GFC:

'This is where the choice about managing cash flows becomes important: if you're building a block of flats your generally going to build a block for, I don't know, say 50 units. You really can't sell them until you've built the whole block. So you're in for 50 units a shot, which is quite a lot of cash up front. Okay, now reflect down to housing where you tend to build and

sell them in batches of 10 or 12, there you can manage your cash flow really very carefully. So in this scenario, in a market that's going slow, you would say houses are less risky,' (K13).

The logic outlined in the quote above explains a move away from flatted development to houses. An upward trend in the percentage of total dwelling stock completions accounted for by flats from the early 2000s onwards reached a peak of 50% in the financial year 2008-09 (MHCLG, 2020b). This followed a combination of planning reforms that favoured the re-use of brownfield land and higher density construction (Schulze-Baing, 2010), and a housebuilding industry that was increasingly adapted to brownfield land assembly and higher density construction methods (Payne, 2013). Following this peak, and the onset of the GFC, flats as a proportion of new completions entered a steep and ongoing decline to reach 21% in 2019-20, before the Covid-19 crisis began (MHCLG, 2020b).

It was not only the need to maximise ROCE that led to a decline in flatted development but also a desire to minimise costs and to reduce risk relating to perceptions of consumer demand. UK volume housebuilders prefer to build standard products that can be adapted with minimal effort to different sites, following rationales that these products have been thoroughly market-tested and that they offer certainty in build costs (Adams and Watkins, 2002):

'House builders will always revert to their preferred typologies, because they're cheaper to build. They've got their standard off the shelf kit and as soon as you start to deviate away from that they see the cost of building going up. So they're not that keen [to diversify]. That's an issue with the housebuilding industry generally,' (K13).

'And what do house builders do? Well they protect their position and they address the risk issue. So they think about the land market and they are thinking about that issue of a lack of cash flow as well as a lack of revenue. And so they're doing stuff like to prioritize cash flow over output. Their risk position affects what they produce. So they go for the more, sort of, homogeneous end of housing, sites etc.,' (K13).

As will see in subsequent sections, the response of housebuilders to the GFC came to have a lasting effect on the residential development industry in the UK, with some of the behavioural shifts outlined here entering into practice under non-recessionary conditions.

(i) How well were industry and government able to learn from the shock, and how has the industry adapted to changing markets?

The GFC impacted on residential development just a few years into a period of intense policy interest in faltering rates of housebuilding that had prompted, and been spurred on by, the publication of the Barker Review of Housing Supply and Affordability in 2003. Planning reforms and initiatives around this time aimed to increase levels of private sector housebuilding, embodied most clearly in the Sustainable Communities Plan (ODPM, 2003). This policy focus on the need to increase private sector housing supply was to continue after the GFC, though subsequent reforms ran up against a counter-current of increasingly risk-averse behaviour among housebuilders. Indeed, a 'new normal' of housebuilder behaviour was identified in the years following the GFC, characterised by a lower appetite for risk, especially with regard to land acquisition (Payne, 2015). Interview findings verified this, pointing to the practice of paying for large sites in instalments that has become more widespread since the GFC:

'What they will always resist is paying far too much up front for the land in one slug. It's very rare that if they've got a giant site, they'll pay a huge amount of money up front. They want phased payments. They'll try and resist [making] those payments as early as possible. That's a big risk for them. ... I mean, it varies between developers and depends on what the rates of return are across the scheme but that exposure [coming from] paying for a huge chunk up front on the land and knowing you're

not going to get it back for a number of years is not a place housebuilders want to be,' (K13).

This experience is not a unique one within Europe following the GFC and can be observed in the case of public residential development in the Netherlands (Priemus and Louw, 2003) and private housebuilding in Ireland (Norris and Byrne, 2015). Though neither is it a uniform phenomenon (Satsangi et al, 2020), suggesting that there may be lessons to be learned from those housing systems in Europe that were not heavily impacted by the GFC, such as Germany and Switzerland (van der Heijden, 2011).

The UK government's housing policy following the GFC was aimed at supporting private sector housebuilding and aspiring owner occupiers. Through *Get Britain Building*, government made available £420m of public finance to housebuilders wishing to build on sites with planning permission but without the capital to do so. Also offered was the demand side stimulus of *Help to Buy* (HM Treasury, 2013), which provides a state guarantee on a proportion of total loan value for the purchase of a new home. Help to Buy was described by interviewees as having been of vital importance to the housebuilding industry since its introduction in making potentially loss-making sites profitable.

'They [volume house builders] had debt back in 2008 but they were aided a lot by Help to Buy in terms of securing volumes of sales, and I think a lot of their sites were pushed into cash positive territory. The volume builders are now in a much stronger financial position – all the big guys have been basking in big margins. They're still very much return-on-equity driven but I think their risk measures [are tighter],' (K14).

The scheme has, however, been seen as having become a crutch that the industry is now reliant upon and one that it may struggle to adapt to the loss of, as anticipated, in 2023.

'When government started to talk about reducing Help to Buy, the strength of response from the housing industry was amazing. That's a good metric about how important it is to them,' (K13).

SP1, from the mortgage industry, but with experience of the housebuilding sector, was very critical of the role of Help to Buy, and suggested that it had allowed housebuilders to carry on unreformed:

'Since 2007/08 mortgage lending has been fundamentally revised but no major change is yet to take place to the way in which the large builders operate and manage and offer their product to consumers. So there's been talk of a new homes ombudsman – not yet happened. But all the mis-selling... all we've had instead is leasehold mis-selling. We've fundamentally done the very worst thing. Which is we've taken the market that wasn't being lent to because it was wrong, and we rewarded it by giving it support that has made it. If you compare [it] to buying a second hand home you can borrow more, you can borrow cheaper, than you could... and with a lower deposit,' (SP1)

More recently UK government support to private housebuilding in England has come through Homes England, the successor to the Homes and Communities Agency, which since 2018 has been responsible for the operation of a range of funding programmes, including Help to Buy. Homes England has invested in supporting local authorities and housebuilders to increase the supply of new housing, with a focus on removing barriers to private investment such as infrastructure constraints and difficulties in assembling land in multiple ownership. Support has come in the form of grants to local authorities used to provide infrastructure upfront that is seen to be required to deliver major housing schemes, as well as through Homes England acting as master developer for large scale developments (Homes England, 2018):

'The interesting shift from Homes England is when we started working with them four or five years ago, when they were facilitators and master planners, you know, so they were

picking up the sites, assembling the sites, master planning them, getting the outline planning permission ... so they've unlocked the site essentially. But they're shifting towards being direct deliverers of the infrastructure. That's been a major shift,' (K13).

The wide-ranging nature of intervention undertaken by Homes England has been focused overwhelmingly on areas where housing is least affordable (MHCLG, 2018), reflecting government's prioritising of delivery in high growth parts of England.

While government attention since 2010 has been on supporting the development of housing for owner occupation and, in England, on reforms to the funding regime for affordable housing that entail a shift away from socially rented housing, the form of tenure that has grown at the fastest rate over the same period is the private rented sector (ONS, 2018). The growing profitability of the private rented sector, via the Build to Rent market, was raised by one interviewee:

'Yeah, people flip their products. This is what happens. So I started with a bid that was private residential [owner occupier market] and when the market started to wobble they flipped it to PRS. The yields on the PRS have been getting tighter and tighter. The issue for many years was that PRS could not compete with a traditional housebuilder for the site value ... but that gap is narrowing and in some places it's been overtaken,' (K13).

(ii) What has been the initial impact of Covid-19?

While the GFC triggered what was, when it occurred, the deepest dip in economic activity in living memory, the Covid-19 pandemic has in fact had a much deeper and more pronounced impact on output and business uncertainty. This has caused housebuilders to seek out all possible opportunities to reduce costs and maximise revenue. The need to maintain cash flow observed during the immediate aftermath of the GFC was equally true as the Covid-19 pandemic began:

'The response at first has been "how do we cut our immediate costs? Do we furlough? Which jobs are essential?" There are companies who've got rid of a lot of their site infrastructure and direct labour, moved to subcontractor models. Stopping the cash burn by taking these immediate measures. Focusing on sales to get cash in. Defer land contracts if you can. Review what cash is going out of the company over the next year and see if you can renegotiate those contracts to push out payment terms. So everything's been about cash so far. Ensuring that their stakeholders and banks are supporting them and making sure they've got a robust business plan to get them through this period,' (K14).

This quote describes some housebuilder actions directly reminiscent of those undertaken following the onset of the GFC, though the Covid-19 crisis and the GFC bear some notable points of contrast with respect to the housebuilding industry. Prior to the GFC the UK economy had been in a long expansionary phase, which offered cheap credit to housebuilders active in a highly competitive land market. But the period prior to the Covid-19 pandemic was one of caution and relative stability for housebuilders, as noted in Section 2. As well as a difference in market activity, the cash position of housebuilders was very different when Covid-19 hit as compared to the situation in 2008. Volume housebuilders who were in around £4.5bn of debt in 2008 are now held to be in a £1.5bn surplus (Savills, 2020), giving the prospect of a more resilient industry.

In the early stages of the pandemic, and up until the time of writing in mid-December 2020, the housing market has maintained its value. In addition to its importance as a measure of demand, this also ensures that land values hold up, due to their being calculated according to the anticipated value of the completed development, as described in Section 1. This in turn means that developers are not suffering book losses on

their land asset base. Interviewees indicated a tentative reception to such positive house price data however, and note that housebuilders are building at a controlled rate in order to maintain an efficient ROCE:

'Last time everyone was building lots of stock without having sold it first; this time around housebuilders are matching their construction much more closely with sales. Following Covid-19 construction ceased, then in July you saw record sales but builders had nothing to offer, so construction had to increase to meet demand. The question is how long demand was going to last,' (K14).

'Everyone's saying that we need a pattern of price discovery. There's a sense that July was just the release of pent-up demand, August has been good, developers were still meeting targets, but things were getting harder towards the end of the summer, suggesting the boost was a short-term thing,' (K14).

The long term nature of the residential development process is such that housebuilders are forced to engage in some level of prediction of future house prices though, in order to maintain their pipeline of sites. Activity in this respect is highly cautious however.

'They of course need a development pipeline, they can't do their job without a development pipeline. So they are still actively looking at acquisitions. There's no doubt about it. They're always interested in the short term pipeline. These two-to-three year delivery time scale sites which have either got planning or are likely to get planning. Those are less risky to them,' (K11).

'For new sites that aren't part of a business plan I don't sense that there's a desire to move particularly quickly. But for sites that are already in a five-year business plan, firms will act, because they need land to survive,' (K12).

(iii) What are the medium and longer term-impacts of Covid-19 likely to be?

Interviewees were cautious in speculating as to how the Covid-19 pandemic would impact upon the industry in the medium and longer term, though the cash position of the volume builders noted in Section 3 was brought up as a potential indicator of future as well as present fortunes.

While a change in product mix delivered on sites in an effort to reduce costs and risk was observed following the GFC, with the shift from flatted development to housing maintained in the years since, the early stages of the Covid-19 pandemic did not signal any subsequent adjustment. Housebuilders are, however, at the point of considering whether the coming months and years will necessitate a rethinking of their products:

'So we're certainly being asked [with respect to] our schemes questions about product - should we now be building slightly bigger houses so people can work? Are our house type policies which lack open space more risky? And how quickly are we going to build these things?' (K13).

In relation to the continued assistance provided by Help to Buy and the various programmes of investment overseen by Homes England, one interviewee brought up the issue of continued public funding alongside market risks in forecasting the future of the housebuilding industry:

'What's going to happen this time around is quite hard to answer just at the moment. We're not at the other side and we're not clear about the [continued] underwriting of public subsidy into holding up the market,' (K13).

The future of Build to Rent as a mechanism for the delivery of private rented sector homes was also speculated upon as a potential source of income for housebuilders to replace lost investment from potential owner occupiers. This

may be especially persuasive should the office market enter a period of decline following a substantial shift to home working in the wake of the Covid-19 pandemic, as institutional investors seek reliable returns from other markets.

'Now that will be a shift. I think there will be a shift. We all need to live somewhere. That shift may be to more PRS or built to rent,' (K13).

'Virtually all developers are doing it, but it's being driven a lot by the institutions too because it gives you a constant income stream and a fairly safe one. And they are desperate for constant income streams to meet their pension liabilities,' (K13).

Conclusions

The short-term changes in housebuilder behaviour made in response to the GFC, which we have described as encompassing a focus on reducing risk in both financial and product terms, and a move towards greater efficiency in the use of resources, appear to have had a lasting effect. Prior to the onset of the Covid-19 pandemic, more than ten years on from the GFC, the housebuilding industry was substantially more risk averse than it had been in the years leading up to the GFC. This is most evident in levels of debt among housebuilders, in trends in the rate of completions, which have not responded strongly to more liberalised release of land through the planning system in England since 2011, and in the entrenched shift away from flatted development (albeit the availability of less risky brownfield sites is inevitably more limited than it was in the 2000s).

The reduction in risk within the residential development sector has not only been driven by more risk averse behaviours on the part of housebuilders, but also by the absorption of risk by the state. This subsidy has been primarily in the form of the Help to Buy equity loan scheme, which interviewees stressed as remaining a vital support to the industry more than a decade after the GFC. The divergence in policy for affordable housing between England and Scotland since the GFC, with Scotland increasing funding for social housing and abolishing Right to Buy, may come to affect the housebuilding industry's path out of the Covid-19 pandemic. This can also be interpreted as a form of risk-absorption on the part of the state, with affordable housing development in Scotland potentially offering a counter-cyclical boost lacking in England should the housebuilding exit the pandemic at low levels of confidence.

4. Conclusions

The GFC and Covid-19 bookend a period of turbulence in the UK housing system.

Both mortgage and housebuilding industries had adopted business strategies that depended on an inflationary housing market, which could not go on forever. The shock that caused the market to collapse, also impacted on mortgage lenders and housebuilders through the availability of finance. Neither sector exhibited resilience, and both have depended on forms of state support to survive.

Both industries have adopted more risk averse business models since the GFC. In different ways, both derisking strategies have, in the absence of a greater housing market correction, reduced the supply of both mortgage credit and new housing.

The mortgage industry has been subject to wholesale regulatory reform, whereas the housebuilding industry has not. Arguably state support for the housebuilding sector has continued through the availability of Help to Buy (restricted to new build) and planning concessions. The dependence of housebuilders on Help to Buy more than a decade after the GFC is notable.

Whilst both sectors appear to have been in a much stronger position going into the Covid-19 crisis, the discussion of the concept of resilience, offers the prospect of a deeper analysis of industry strategies since the GFC and the way in which they respond to Covid-19, as its impacts carry on beyond the first year.

This first stage of the project has highlighted the importance of context – and in particular policy context – to the strategies that these industries have adopted. Has resilience taken a conservative or radical form? Have the industries sought to adapt and reform, or to return to revert to “business as usual”? What role has policy played in shaping industry responses? In whose interests have policy and industry strategy adapted?

These fundamental questions will be addressed as we move into the second stage of this project.

5. References

- Adams, D. and Watkins, C. (2002) *Greenfields, Brownfields and Housing Development*. Oxford: Blackwell.
- Adger, N. (2010) *An interview with Neil Adger: resilience, adaptability, localisation and transition*. Transition Culture [online]. Available from: <https://www.transitionculture.org/2010/03/26/an-interview-with-neil-adger-resilience-adaptability-localisation-and-transition/>
- Ball, M., Shepherd, E. and Wyatt, P. (2020) *Residential Development Land Prices and House Prices*. Report to the Scottish Land Commission. Available at: https://www.landcommission.gov.scot/downloads/5ee1f88cc6aa0_20200611%20SLC%20REPORT%20Residential%20development%20land%20prices.pdf [accessed 10/12/20]
- Cretney, R. (2014) Resilience for Whom? Emerging Critical Geographies of Socio-ecological Resilience, *Geoforum*, 8/9, pp. 627-640
- Department for Communities and Local Government (DCLG) (2011) *Get Britain Building*. London: The Stationary Office.
- Dowell-Jones, M. and Buckley, R. (2017) Reconceiving Resilience: A New Guiding Principle for Financial Regulation?, *Northwestern Journal of International Law and Business*, 37(1), pp. 1-33
- Earley, A (2021) Housing Systems, their Institutions and their Resilience: A literature Review, CaCHE
- Gibson, C. A. & Tarrant, M. (2010) A 'conceptual models' approach to organisational resilience, *Australian Journal of Emergency Management*, 25(2), pp. 6-12
- Holling, C. S. (1973) Resilience and Stability of Ecological Systems, *Annual Review of Ecology and Systematics*, 4(1), pp. 1-23
- Homes and Communities Agency and Communities and Local Government (2011) *Get Britain Building: Programme Prospectus* London: HCA
- Homes England (2018) *Strategic Plan 2018/19 – 2022/23*. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752686/Homes_England_Strategic_Plan_AW_REV_150dpi_REV.pdf [accessed 16/12/20].
- Financial Services Authority (2009) *The Turner Review: A regulatory response to the global banking crisis*, London: FSA
- Financial Services Authority (2010) *Mortgage Market Review: Responsible Lending*, London: FSA
- McGlade, J., Murray, R., Baldwin, J., Ridgway, K. and Winder, B. (2006) Chapter 6: Industrial Resilience and Decline: A Co-evolutionary Framework, pp. 147-177. In Garnsey, E. and McGlade, J. (eds.) *Complexity and Co-Evolution: Continuity and Change in Socio-Economic Systems*. Cheltenham: Edward Elgar
- Ministry for Housing, Communities and Local Government (MHCLG) (2018) Geographical targeting across 5 housing programme funds, MHCLG Policy Paper, 30 October 2018. Available at <https://www.gov.uk/government/publications/geographical-targeting-across-5-housing-programme-funds/geographical-targeting-across-5-housing-programme-funds> [accessed 16/12/20].
- Ministry for Housing, Communities and Local Government (MHCLG) (2020a) Live tables on housing supply: net additional dwellings. Available at: <https://www.gov.uk/government/statistical-data-sets/live-tables-on-net-supply-of-housing> [accessed 08/12/20]

Ministry for Housing, Communities and Local Government (MHCLG) (2020b) Live tables on housing supply: permanent dwellings completed by house and flat, number of bedroom and tenure, England. Available at: <https://www.gov.uk/government/statistical-data-sets/live-tables-on-house-building> [accessed 14/12/20].

Norris, M. and Byrne, M. (2015) Asset price Keynesianism, regional imbalances, and the Irish and Spanish housing booms and busts, *Built Environment*, 41 (2), 227-243.

Office for National Statistics (ONS) (2018) UK Private Rented Sector: 2018. Available at: <https://www.ons.gov.uk/economy/inflationandpriceindices/articles/ukprivaterentedsector/2018> [accessed 16/12/20].

Office for National Statistics (ONS) (2020) Gross Domestic Product: GDP First Quarterly Estimate Time Series (PN2). Available at: <https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/abmi/pn2> [accessed 08/12/20].

Office of the Deputy Prime Minister (ODPM) (2003) *Sustainable Communities: Building for the Future*. London: HMSO.

Payne, S. (2013) Pioneers, pragmatists and sceptics: speculative housebuilders and brownfield development in the early twenty-first century, *Town Planning Review*, 84 (1), 37-62.

Payne, S. (2015) Exploring the impact of the recession on volume housebuilders: a behavioural analysis, *Built Environment*, 41 (2), 271-288.

Payne, S. (2016) *Examining Housebuilder Behaviour in a Recovering Housing Market: Recommendations for Improving Britain's Housing Supply*. Report to The British Academy for the Humanities and Social Sciences. Sheffield: University of Sheffield.

Porter, L., Steele, L. and Stone, W. (2018) Housing and Resilience – When, for Whom and for What? A Critical Agenda, *Housing, Theory and Society*, 35(4), pp. 387-393

Raco, M. and Street, E. (2012) Resilience Planning, Economic Change and The Politics of Post-recession Development in London and Hong Kong, *Urban Studies*, 49(5), pp. 1065–1087

Stephens, M and Blenkinsopp, J (2020) Help with Housing costs, in Stephens, M, Perry, J, Williams, P, Young, G and Fitzpatrick, S (eds.) *UK Housing Review 2020*, Coventry: Chartered Institute of Housing, pp. 93-100

Stephens, M , Perry, J, Williams, P and Young, G (2020) *UK Housing Review Autumn Briefing Paper*, Coventry: Chartered Institute of Housing

Savills (2020) Real Estate Insights Podcast: Building a Future for Scotland's Residential Development Sector. Available at: <https://www.savills.co.uk/blog/article/304444/podcasts/real-estate-insights-podcast--building-a-future-for-scotland-s-residential-development-sector.aspx> [accessed 16/12/20].

Schulze-Baing, A. (2010) Target-driven brownfield use: a benefit for deprived areas? A spatial analysis of brownfield reuse patterns in England's core city-regions, *Journal of Urban Regeneration and Renewal*, 3, 290-300.

HM Treasury (2013) *Budget 2013*. London: The Stationary Office.

Van der Heijden, H., Dol, K., and Oxley, M. (2011) Western European housing systems and the impact of the international financial crisis, *Journal of Housing and the Built Environment*, 26, 295-313.

Zolli, A. and Healey, A. M. (2012) Resilience. London: Headline. Cited in Gibb, K., McNulty, D. and McLaughlin, T. (2016) Risk and resilience in the Scottish social housing sector: "We're all risk managers," *International Journal of Housing Policy*, 16(4), pp. 435-457

Notes

ⁱ GMAC was a centralised lender, which as GMAC-RFC entered the UK mortgage market in 1998 and became the 10th largest lender in the UK using the “create and distribute” model. It was acquired by Fortress Investment Group LLC in 2010 and is now known as Paratus AMC Limited. <https://www.foundationhomeloans.co.uk/about/our-history/>

ⁱⁱ See Churm, R and Radia, A (2012) The Funding for Lending Scheme, Bank of England Quarterly Bulletin, Q4, pp. 306-320 <https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2012/the-funding-for-lending-scheme.pdf?la=en&hash=57B13A5C9E94B5D02A451670C8B013DD22CF16EA>

ⁱⁱⁱ See Stephens, M and Blenkinsopp, J (2020) Help with Housing Costs in Stephens, M et al (eds) UK Housing Review 2020, Coventry: CIH, pp. 93-100