Dear Clive,

Help to Buy Equity Loan Scheme – Economic Appraisal

Thank you for your letter of 25 November regarding economic appraisal of the Help to Buy Equity Loan Scheme.

This appraisal uses a standard methodology that has been agreed with HM Treasury for all of the Department’s policies where there is an expected impact on land use. This approach has not only been used in appraisal of policies for the duration of this current parliament, but also in the previous one. The approach follows HM Treasury Green Book principles and is well documented as part of the Department for Transport’s Transport Appraisal Guidance for appraisal practitioners. As I mentioned in my letter to you on 10 October, my Department continually looks for opportunities to refresh and update its appraisal techniques to ensure cost-benefit analysis of its policies stays as robust as possible.

In your letter you asked what “the net private benefit of a new home” means in practice, and whether all the wider negative externalities of the scheme are included. In summary, the production of a new home creates value, which is principally enjoyed by the home owner. The wider costs and benefits of the scheme are monetised as far as they can be in the economic appraisal. I provide further details of these methods in the attached annex. If you would find it helpful, my officials would be happy to take you through this technical detail.

THE RT HON ERIC PICKLES MP
Annex A – Response to detailed questions.

Net private benefit of a new home

Regarding your first question, the production of a new home creates value, which is principally enjoyed by the home owner, but there are also costs. The Department calculates the net benefit, on the basis of estimates supplied by the Valuation Office Agency, as the difference between the value of land with and without planning permission for residential development.

On average (at the time of the original decision for the scheme), the value of land in its existing use (without planning permission for housing) in England was £11,000 on a per-home basis (2013-14 prices). The average value of land with planning permission for housing was £40,000 on a per-home basis (2013-14 prices). This gives an uplift of £29,000 (£40,000 minus £11,000). It is worth pointing out that these estimates are all weighted averages for England to account for the spatial distribution of housing and the balance between green and brownfield development.

This methodology follows HMT Green Book principles, that states ‘Costs and benefits should normally be based on market prices as they usually reflect the best alternative uses that the goods or services could be put to (the opportunity cost)’

Externalities arising as a result of development

The uplift figure of £29,000 should further be adjusted to reflect any loss in amenity value of the land in its current use, as I pointed out in my letter on 10 October. This responds to your second point. The Department, therefore, reduces the private benefit value ascribed above by £1,000, to come to an overall net benefit figure of £28,000 per home in 2013-14 prices. The loss of amenity value of £1,000 for the average property reflects that the vast majority of residential development takes place on Brownfield rather than Greenfield land.

There may be further external costs and benefits, but many of these we are unable to quantify in monetary terms. For example, the marginal impact of an additional house increasing congestion in a local area, or carbon impacts of an additional household. On the other hand, there may be significant benefits in the form of improved public health and education through reduced overcrowding in the housing stock, and increased labour mobility.

When I referred to ‘net cost to the taxpayer’ on 24 March, I should clarify that there are no net costs to society. The £494 million economic costs refer to costs to the exchequer, whilst the economic benefits are to society as a whole, as measured by the methodology above. When the exchequer costs were set against the economic benefits, there was a net benefit to society.

Burdens on public resources

With regard to the specific examples that you raise, the greater burden on public resources as a result of new housing should not be an additional cost to what has been set out above. This is because, in order for the land to have obtained residential permission, the development needs to be acceptable in planning terms through the planning system, which is designed to deal with the additional pressures that you describe.

Changes in house prices

In terms of changes to house prices arising in the surrounding area, the overall effect will depend on the specifics of the development. In some areas, new development can lead to a fall in house prices, whereas in others, prices can increase as a result of regenerative effects.

In the economic appraisal, price changes are not strictly economic costs, but economic transfers. Transfers are not classified as a cost in economic appraisal, as corroborated by the HMT Green Book: ‘Transfer payments may change the distribution of income or wealth, but do not give rise to

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1 HMT Green Book, paragraph 5.11, p19.
direct economic costs.\textsuperscript{2} In the instance of new housing leading to a reduction in surrounding property values, there is a transfer from those who might be described as relatively asset-rich, who lose out from new development, to the asset-poor, such as First Time Buyers. This is not to say that such distributional effects are unimportant, and again, alludes to another of the many reasons why we have a planning system in order to ensure existing residents are not overly affected by new development. Notwithstanding all of the above, the economic benefits only pertain to housing which is ‘additional’ – homes which wouldn’t have been built in the absence of the policy. If, as anticipated, Help to Buy: Equity Loans leads to more homes being built than otherwise would be the case, this increases supply, and reduces prices relative to where they would have been in the absence of the policy.

**Improvements to methodology and appraisal**

The Department continues to refresh and update its appraisal techniques and values for use in cost-benefit analysis of its policies. A change to the methodology on 7 March this year suggested that the uplift figure for a new home was £52,000. The figure was revised upwards, as the Department obtained revised land values which reflects the additional value to society of affordable housing requirements (affordable housing requirements reduces the market value of land to prospective developers, which suppressed the value used in the original appraisal). The newer value corrected for this, again in line with HMT Green Book principles\textsuperscript{3}.

The use of the land value uplift methodology is clearly an important part of appraising the economic impact of new housing development. The Department continues to develop its evidence base in this area, for example by continuing to work with the VOA to increase the number of site valuations being used to calculate national and sub-national averages.

**Department for Transport’s Transport Appraisal Guidance for appraisal practitioners**

Further details can be found at:

\textsuperscript{2} HMT Green Book, p.21, footnote 3.
\textsuperscript{3} HMT Green Book, p.21, paragraph 5.26: ‘Real or estimated market prices provide the first point of reference for the value of benefits. There are a few exceptions where valuing at market prices is not suitable. If the market is dominated by monopoly suppliers, or is significantly distorted by taxes or subsidies, prices will not reflect the opportunity costs and adjustments may be required and specialist economic advice will be needed’.