

RESIDENTIAL RESEARCH



GAINING GROUND

HOUSEBUILDING REPORT **2015**



CONSTRUCTION TRENDS

ECONOMIC AND
MARKET UPDATE

HELP TO BUY ANALYSIS

SUMMARY

Activity in the housebuilding sector has continued to pick up over the last year, but the supply of new homes is still falling well short of demand. Boosting supply, where new housing is most keenly needed, is a key priority if the UK housing market is to avoid long-term distortion.



“Development levels are increasing, but demand for housing continues to outpace supply. Our survey of the housebuilding industry suggests some key measures which could help boost delivery further in the coming years.”

GRÁINNE GILMORE
Head of UK Residential Research

This report examines the factors currently at play in the housebuilding sector, from policy to planning, and looks ahead at how the sector may perform in the years to come.

The report also includes the findings from Knight Frank’s annual housebuilder survey. More than 160 respondents from housebuilders and developers of all sizes across the UK shared their views with us as part of our market-leading survey. Some key findings include:

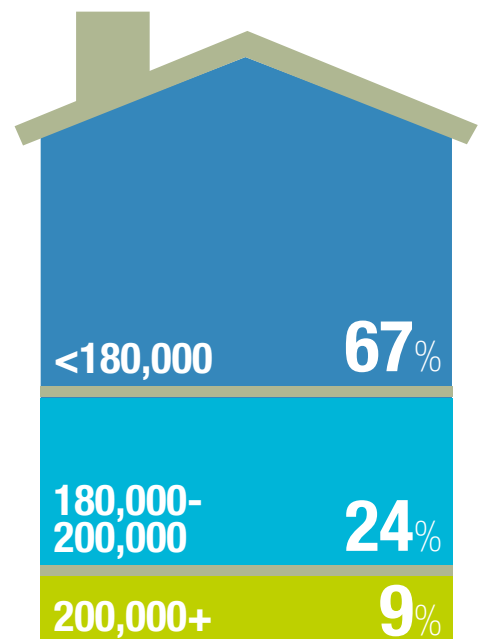
- Nearly 60% of respondents expect housing completions to rise over the next year, with 18% saying the rise could be between 10% and 25%. However around half of respondents expect no change in the delivery of affordable homes over the next 12 months.
- Just 9% of respondents said that under current market conditions it would be possible to deliver more than 200,000 homes a year, every year.
- More than 90% of respondents are expecting construction costs to rise again over the next 12 months and two-thirds expect that development land prices will rise again this year.
- Rising labour and build costs are expected to pose the greatest risk to the sector in the coming year.
- Some 56% of respondents said that the Community Infrastructure Levy (CIL) was weighing on development volumes.

- The biggest policy change that would help boost development volumes would be recruiting more people to Local Authority planning departments, according to respondents.

FIGURE 1

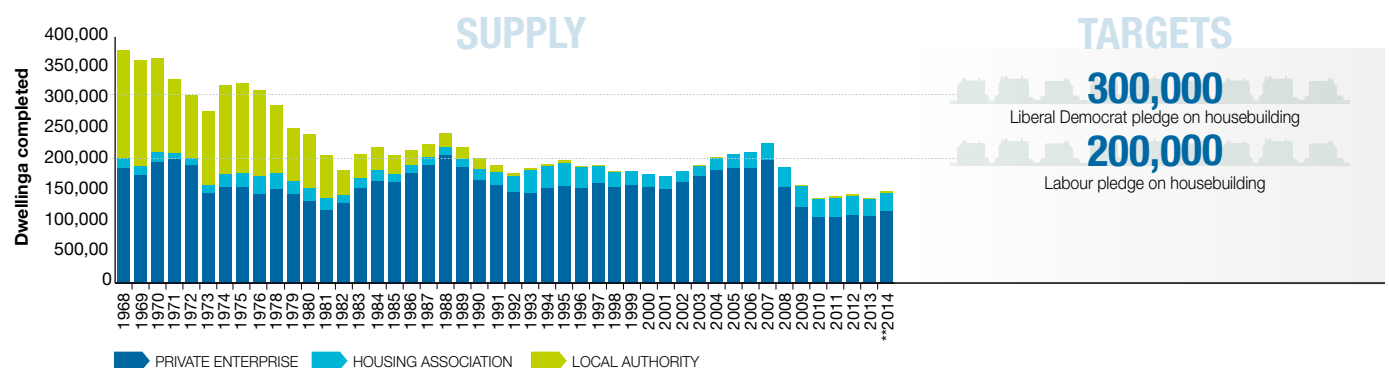
What is a sustainable annual level of housebuilding?

% of respondents, housebuilder survey



Source: Knight Frank Residential Research

FIGURE 2 How housebuilding has changed: 1968-2014



**estimate

Source: DCLG / Knight Frank Residential Research

Delivery of new homes

The imbalance between the demand for new homes and the number of units being built is well-recognised, by the industry and political parties alike. In the 12 months to April 2014, some 141,000 homes were built in the UK, up by 4% on the previous year. However, official household growth projections suggest an additional 230,000 potential households a year in the UK.

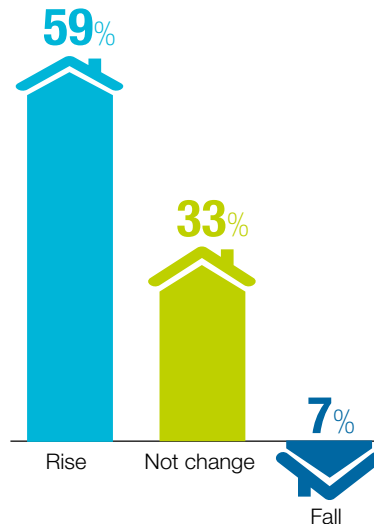
Below these headline figures, there is a recognition that the right type of homes must be built in areas where there is the most housing need, typically adjacent to existing urban areas. This has led to tensions about the greenbelt, with a lack of consensus on how to expand accommodation in some of the UK's most thriving towns and cities.

Nearly one half of the respondents to the housebuilder survey said that rules around developing on greenbelt land should be loosened (figure 12).

FIGURE 3

Over the next 12 months, completion volumes will...

% of respondents, housebuilder survey



Source: Knight Frank Residential Research

Housebuilder survey:

62%

proportion of respondents who expect their start volumes to increase over the next year

Economic and market update

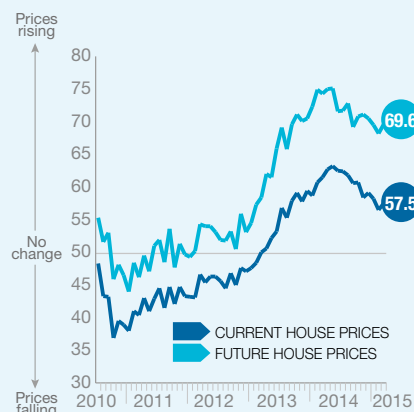
The UK economy has fared well over the last year compared to many of its closest neighbours. Economic output rose by 2.8% in 2014, up from 1.7% in 2013. This was the highest growth since 2007, before the effects of the financial crisis were being felt. Alongside this better economic news, there has been positive data from the labour market, with unemployment continuing to fall. Some 1.86 million people are now unemployed, down from a peak of 2.66 million in November 2011, while the employment rate of 73.3% is the highest since records began in 1977.

Improved confidence in both businesses and job security, coupled with ultra-low interest rates helped boost sentiment around the housing market in the first half of last year – as shown in our house price sentiment index, produced in conjunction with Markit Economics. While sentiment remains positive, it started to ease in the second half of 2014, affected by new, tighter, mortgage regulations, and a slowing in the pace of house price growth in London and the South East.

FIGURE 4

Rising sentiment

House Price Sentiment Index



Source: Knight Frank / Markit Economics

NB: A score of 50 equates to no change, above or below representing growth or decline respectively

The reform of stamp duty in December last year has provided a fillip for many potential buyers, making it cheaper for those buying homes priced at up to around £930,000 to purchase a home in England and Wales. However, on the other hand, the General Election, one of the most uncertain in terms of outcome in decades, has caused some to adopt a "wait and see" approach until the result is decided.

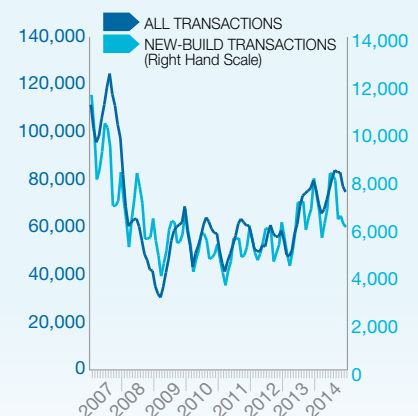
Housing transactions rose by 18% in 2014 in England and Wales, and new-build sales climbed by 11%, according to data from the Land Registry.

Meanwhile house prices are up 7.2% year-on-year across the UK in the year to February, according to data from the ONS.

FIGURE 5

Rising sales

Monthly transactions, 3-month average, England & Wales



Source: Knight Frank Residential Research, Land Registry

Housebuilder survey:

67%

proportion of respondents who say maximum annual housing delivery is 180,000 units or less

Policymakers from all parties are keen to encourage development on brownfield land – indeed RICS has published research suggesting there is enough brownfield land available in England to build 226,000 homes by 2019. However, brownfield development is more costly than that on greenfield, and there must be some recognition of this.

In addition, there must also be some recognition that brownfield sites are not always ideally situated to provide the right type of units where they are needed.

In terms of housing delivery, nearly 60% of respondents to our survey expect to increase their housing completions in the next 12 months, with a fifth expecting to increase by up to 10% compared to the previous 12 months (figure 3).

While any uplift in development volumes will be welcome, it will be a worry for policymakers that, when asked the maximum level of housing supply that could be delivered to the market under current conditions, more than two-thirds said it was 180,000 units or less. Only 9% said that it was possible to deliver more than 200,000 homes a year across the country.

Labour has pledged to build 200,000 homes a year, while the Liberal Democrats would like to see 300,000 new homes

every year. The Conservatives believe targets should be set on a localised basis.

The developers and housebuilders we surveyed outlined some policy measures they believe would be most beneficial to boost the levels of new housebuilding – and these are examined later in the report (pages 7 & 8).

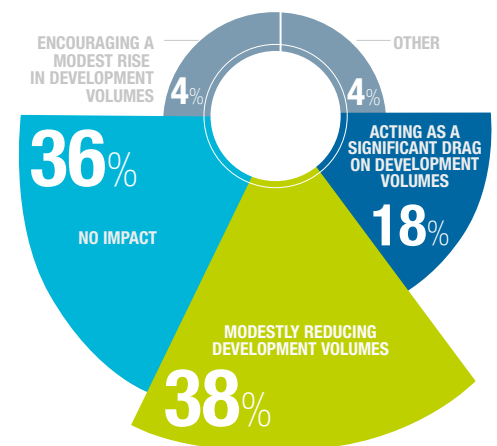
Planning

The deadline for the changes to the use of Section 106 payments to fund infrastructure passed on April 6th 2015. However, fewer than a third of local councils have so far adopted a new Community Infrastructure Levy (CIL) charging structure instead, meaning that development may be stalled as these charging structures are organised.

FIGURE 7

What impact is CIL having on development volumes?

% of respondents, housebuilder survey



Source: Knight Frank Residential Research

CIL was identified by three-quarters of respondents as a potential risk to the sector in the coming years, with 56% of respondents saying it was acting as a drag on development overall. Some 44% said that policymakers should consider scrapping or reforming CIL to help boost development.

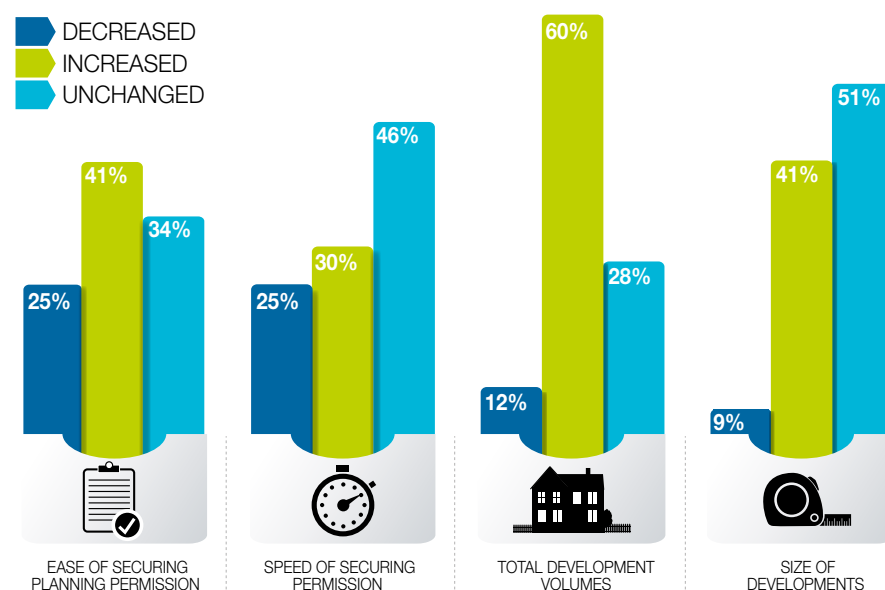
In terms of planning, the verdict on the National Planning Policy Framework (NPPF) three years on from its introduction is mixed, but overall housebuilders say it has contributed to a rise in development volumes, as shown in figure 6.

While there may be some issues with the NPPF, only 26% said that moving back to a more regional approach to planning was a

FIGURE 6

What impact has the NPPF had on...

% of respondents, housebuilder survey



Source: Knight Frank Residential Research

key priority for policymakers as shown in figure 12. While many in the industry believe there are issues that need to be ironed out with the NPPF, there is little appetite for policymakers to launch a new form of planning legislation.

However, it is notable that only a quarter of respondents said that under the NPPF the speed of securing planning permissions had fallen. This may underpin the feeling that more resources should be allocation to local planning departments, as examined later in the report (pages 7 & 8).

Development costs

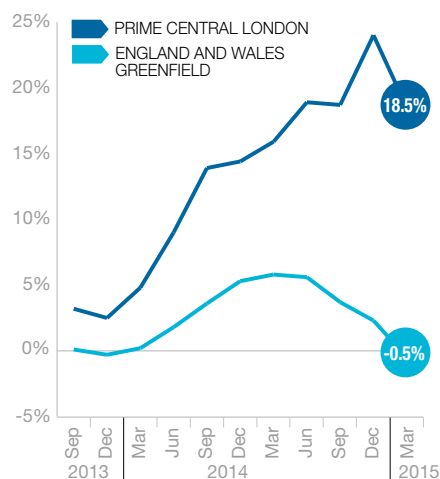
Costs across the construction sector have been climbing. Increased activity across all sectors is putting more pressure on supply chains, and coupled with material shortages, prices have been forced up.

The scale and the speed of the increases can be seen in figure 10, with the net balance of respondents in RICS' construction survey rising sharply over the last 12 to 18 months.

The rate of increase in some costs has been easing, according to those in the industry – but it is notable that nine out of ten respondents to our housebuilder survey expect construction costs to rise over the next 12 months, with nearly 60% expecting price rises of between 5 and 10%.

The survey also showed that the rising cost of development was identified as a key future risk for the industry.

FIGURE 8
Annual change in development land prices



Source: Knight Frank Residential Research

The increased cost of building (which includes the higher cost of labour) has affected developers and housebuilders' development economics, which in turn has weighed on the price of development land being bid in some cases.

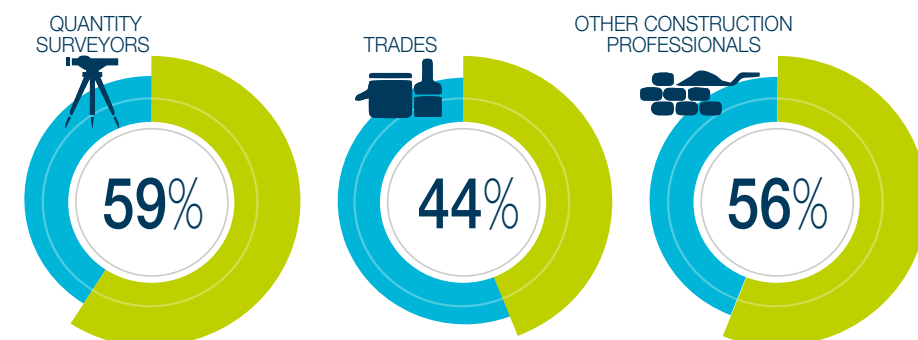
As figure 8 shows, there has been a slowdown in the growth of residential development land values since late last year. Greenfield development land values in England and Wales have slipped by 0.5% over the last 12 months. Prices in prime central London are 18.5% higher than last year, but this annual rate of growth is a slow-down from the 24% rise in Q4 2014.

But there are other dynamics in play in the residential development land market too. Not least is the fact that housebuilders and developers have been replenishing their pipeline of strategic and consented land over the last couple of years. They have been shepherding schemes through the planning process.

As a result, the demand for consented land is not as strong as in recent years. Yet 'oven-ready' sites for 50-100 units, with planning consented, in the 'perfect location' – on the edge of a town or city – will attract strong interest. There has also been a notable shift recently towards major housebuilders buying strategic land as this provides an opportunity to improve their margins.

Overall, respondents to the housebuilder survey expect development land prices to rise again over the next year, with a quarter expecting a rise of up to 5% and a quarter expecting a rise of 5% to 10% for greenfield land. A further quarter expect prices to remain unchanged.

FIGURE 9
Are labour shortages hampering activity? % responding "yes" Q4 2014

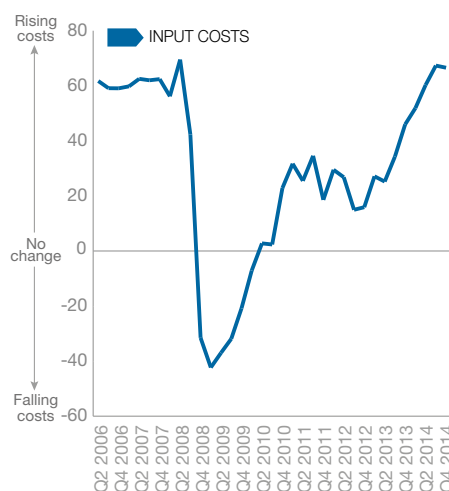


Source: RICS

“Since 1964 the population of the UK has grown by over 10 million people (18.7%). About half of this growth has occurred since 2001.”

Office for National Statistics

FIGURE 10
Rising costs
Labour and material costs, net balance

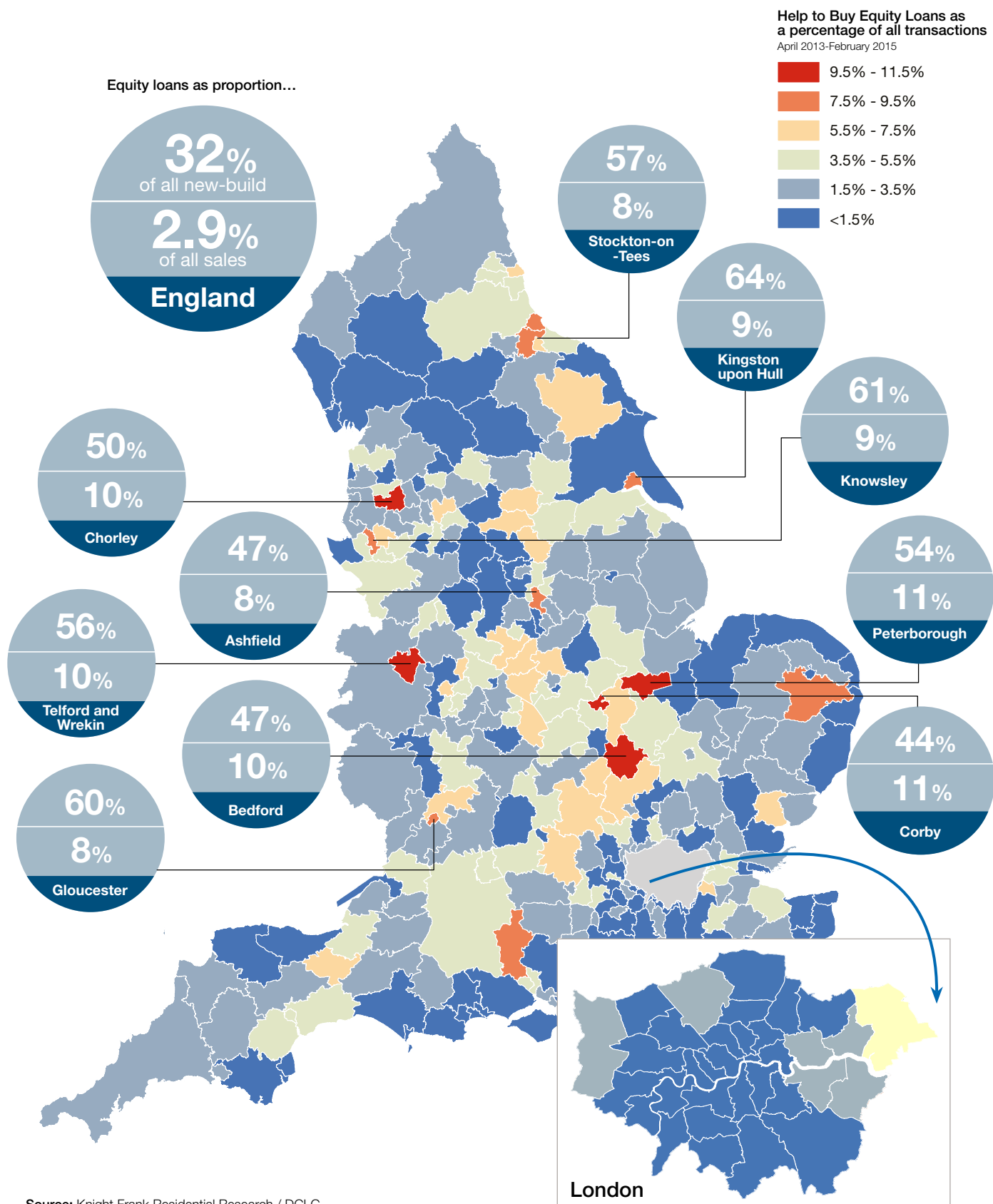


Source: RICS

FIGURE 11

Help to Buy – Equity Loan

Help to Buy purchases as a % of all transactions (April 2013 - March 2015), top 10 locations



Source: Knight Frank Residential Research / DCLG

Help to Buy

The introduction of the Help to Buy Equity Loan had an immediate impact on the housebuilding industry in an era of relatively high price to income ratios. The scheme, which helps buyers access better mortgage deals, resulted in developers and housebuilders submitting higher numbers of planning applications and taking on larger schemes. In the last year, the total number of units in planning or under construction is up nearly 10%, according to data prepared for Knight Frank from Glenigan.

As can be seen from the map on page 7, the biggest take-up of Help to Buy as a proportion of all sales has been in Corby in the East Midlands and Peterborough in East Anglia, where equity loans accounted for more than one in ten of all housing transactions. Some 45,000 Equity Loans have been advanced so far, with around 36,000 of these to first-time buyers, underwriting some £8.8 billion in sales.

While the housebuilding industry has made it clear that maintaining the extension of Help to Buy to 2020 is key, only 37% of respondents to our survey said that extending the scheme beyond 2020 should be a priority for policymakers (see figure 12).

The Mortgage Guarantee, which can be used on new-build properties as well as existing homes has also supported mortgage borrowing, accounting for around 4.5% of all transactions in England and Wales since it was introduced in late 2013.

Market outlook

Housing starts data, and the results of our survey, suggest that housebuilding will continue to gain momentum in the years to come, although it is unlikely to approach levels targeted by the main political parties in the short to medium term.

Knight Frank has analysed the possible impact of some [key election pledges](#). Alongside this, our survey respondents were clear in what they wanted to see from policymakers.

Providing additional resources to local authority planning departments was identified as the key measure for boosting development volumes by respondents, as shown in figure 12. Many planning departments have been affected by public sector cuts, and as a result are now overstretched. While it may on the surface seem counter-intuitive, housebuilders and developers are in favour of robust local planning departments, it follows that developers not only want speedier

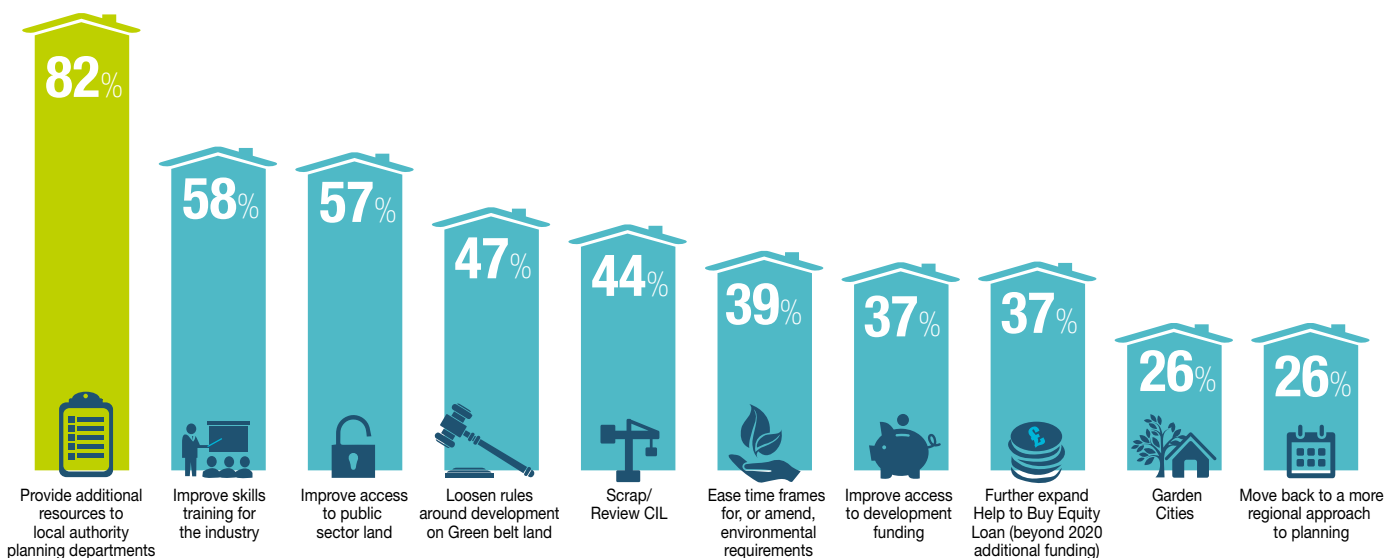
“The single biggest constraint to increasing the delivery of housing in the UK is the lack of capacity in the development industry. Developers are responding by increasing their workforces, but this is a slow process and supply is unlikely to rise quickly.”

Justin Gaze, Joint Head of Residential Development, Knight Frank

FIGURE 12

What measures should policymakers take to help boost housing supply?

% of respondents, housebuilder survey*



Source: Knight Frank Residential Research

*Respondents could choose more than one option



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decision times, but also more robust discussions around planning decisions, resulting in fewer appeals, and planning permissions granted subject to long lists of conditions.

Improving and encouraging more skills training for the construction industry is seen as the second most important measure. The need for more skilled labour is underlined further in our survey, with 94% of respondents saying that the current cost and availability of labour was a risk to the industry.

Some 40% of respondents said the risk was significant, while 42% said the risk was moderate. A further 12% said the risk was modest. Those working in the industry also report that lack of available labour is hampering activity, as shown in figure 9.

The effective release of public sector land continues to be a key concern of the industry. Last year, the government

announced that from this year, the HCA would become the default disposer of centrally held government land. In last year's Autumn Statement, it was pledged that land with the capacity for up to 150,000 homes would be released between 2015 and 2020.

There is a need for local councils to also get involved in disposing of land or using it as part of joint venture developments. In London, the pressing need to deliver more homes has been addressed by setting up a London Land Commission to help speed up the process. It is estimated that 100,000 homes could be built in the capital if all surplus land held by the GLA alone was used for development.

The need for more homes built where they are needed most is pressing. Ultimately it is a step-change in supply which will help ameliorate affordability issues faced by some buyers, creating a sustainable long-term housing market.

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FIGURE 13 Over next year, new-build prices will...

% of respondents, housebuilder survey



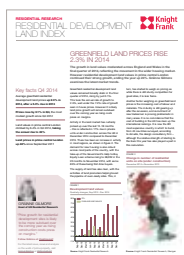
Source: Knight Frank Residential Research

Front cover image – Chase Wood View at Ross-on-Wye used courtesy of Persimmon Homes
Our thanks to the respondents to the survey for their time

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