RESIDENTIAL RESEARCH

Knight Frank

LONDON CALLING

Residential development 2013

2013
LONDON DEVELOPMENT

The resilience of London's residential property market in recent years has led to a rapid increase in development activity in the capital. In this report, we aim to address the question often key to development decisions: is there a risk of oversupply of housing?

"Price performance, as well as London's position as a global hub, has attracted attention from buyers and developers alike."

Gráinne Gilmore, Head of UK Residential Research

London's property market has far outperformed that in the rest of the UK. Prices and activity, especially in prime central London, have bounced back much more quickly from the fall-out of the financial crisis with prices in prime central London climbing nearly 60% since the post-crisis trough. This performance, as well as London's position as a global hub, has attracted attention from buyers and developers alike.

One of the key factors underpinning any residential market is the relationship between housing demand and housing supply. The London market, like the rest of the UK, has been affected by a lack of supply of housing for many years. The financial crisis exacerbated the downturn in housebuilding, with the number of private residential units being completed in the capital dropping by nearly 30% between 2009 and 2010. At the same time, the population continued to grow – the number of people living in the capital has risen by 20% over the last two decades.

While this points strongly to a historical structural undersupply of housing, we wanted to look at how the situation is set to develop in the coming years. Using official data, industry figures and Knight Frank market intelligence, we have measured supply and demand over the coming decade. Our inaugural London Development Report last year showed that there was an overall undersupply of housing compared to demand across the capital, and that this trend would continue.

It is now an opportune time to revisit this analysis, given the changing dynamics in the market. On the supply side, there has been a rise in development activity; while on the demand side, new official figures were published in March forecasting how many extra households are expected to be created in the capital over the next decade.

LONDON IN CONTEXT

London has continued to be the UK's economic powerhouse since the financial crisis and subsequent downturn, delivering stronger economic growth than every other English region between 2007 and 2011, according to recent data from the Office for National Statistics (figure 1). The dominance of London's economy is underlined by the fact that the capital now accounts for nearly a quarter of the country's total Gross Value Added (GVA), a measure of economic output.

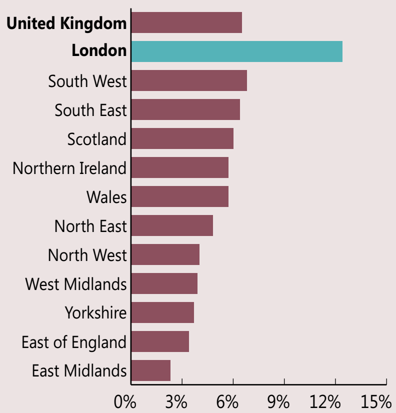
Such robust economic data points towards an employment market which is healthier than the national average, and the data supports this. At the turn of the year London's overall employment rate was 0.9 percentage points higher than in the pre-crisis peak in 2007. In comparison, the average employment rate across the UK is still lagging this pre-crisis peak by nearly 2 percentage points. The number of actual jobs in London climbed by more than 260,000 between 2007 and 2012, making it one of only three regions (along with the South East and Wales) which have not seen a net decline in workforce jobs over the same period.

Demand for housing has been underpinned by this solid employment picture, with many people keen to move into or around London to enhance their job opportunities. This trend has helped to boost property prices across the capital (figure 2), as well as development land prices (figure 4).

Turning to prime central London, prices have performed even more strongly than Greater London, with a desire among buyers to own property in the heart of a global hub. Property values in prime central London are now 7.2% higher on an annual basis. Demand for the very best London homes remains strong, with the number of new applicants 40% higher between January and April compared to the same period in 2012. Domestic demand for prime London property continues to be a key factor in the market, with UK buyers accounting for 58% of purchases across London's prime markets in 2012.

The demand among buyers for lateral living means that apartment prices have slightly outperformed those of houses since 2009.

Figure 1
London's economy outperforms
Growth in nominal GVA; 2007 to 2011

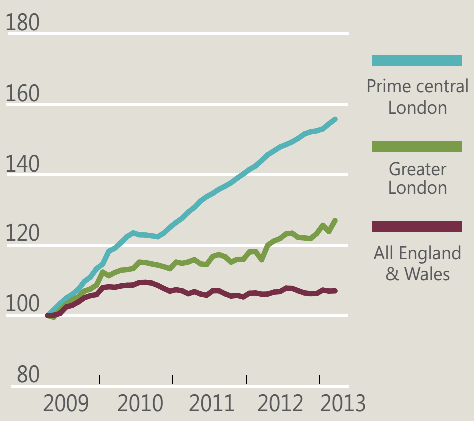


Source: Knight Frank Residential Research/ONS

Knight Frank

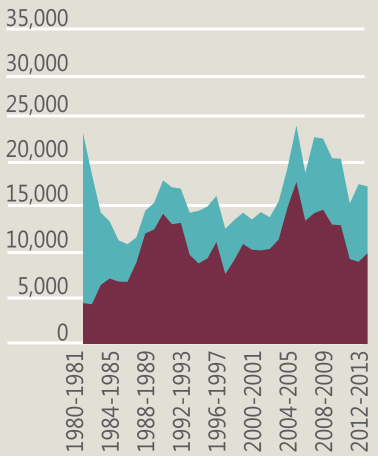
London snapshot...

Figure 2 **Prices outperform**
2009 - 2013



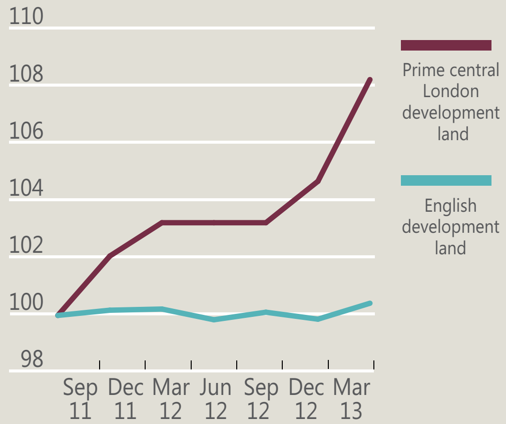
Source: Knight Frank Residential Research / Land Registry

Figure 3 **Supply is constrained**
Annual housing completions



Source: Knight Frank Residential Research / DCLG

Figure 4 **Development land prices pushed up**
Q3 2011 - Q1 2013



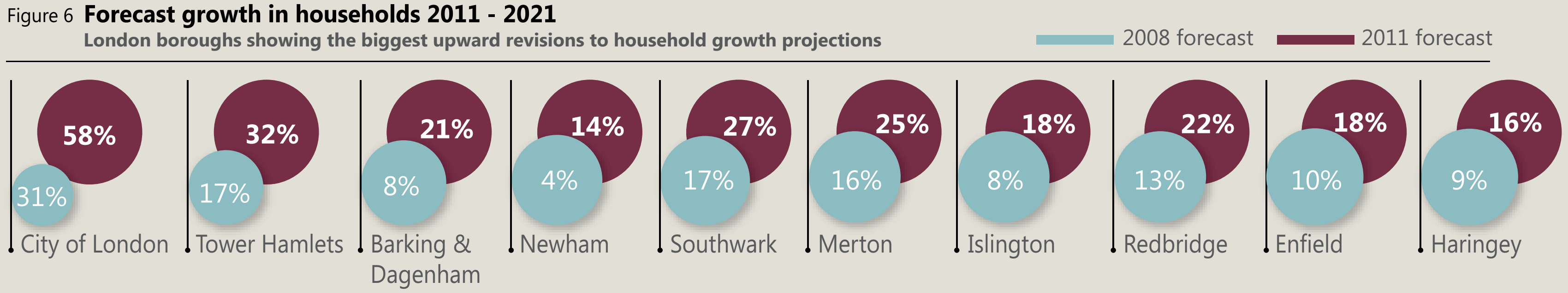
Source: Knight Frank Residential Research

Borough breakdown: supply and demand

Figure 5 **Where will private housing be delivered in the future?**
London boroughs' housing supply: % of total delivery 2013 - 2022

Source: Knight Frank Residential Research / Molior London

Figure 6 **Forecast growth in households 2011 - 2021**
London boroughs showing the biggest upward revisions to household growth projections



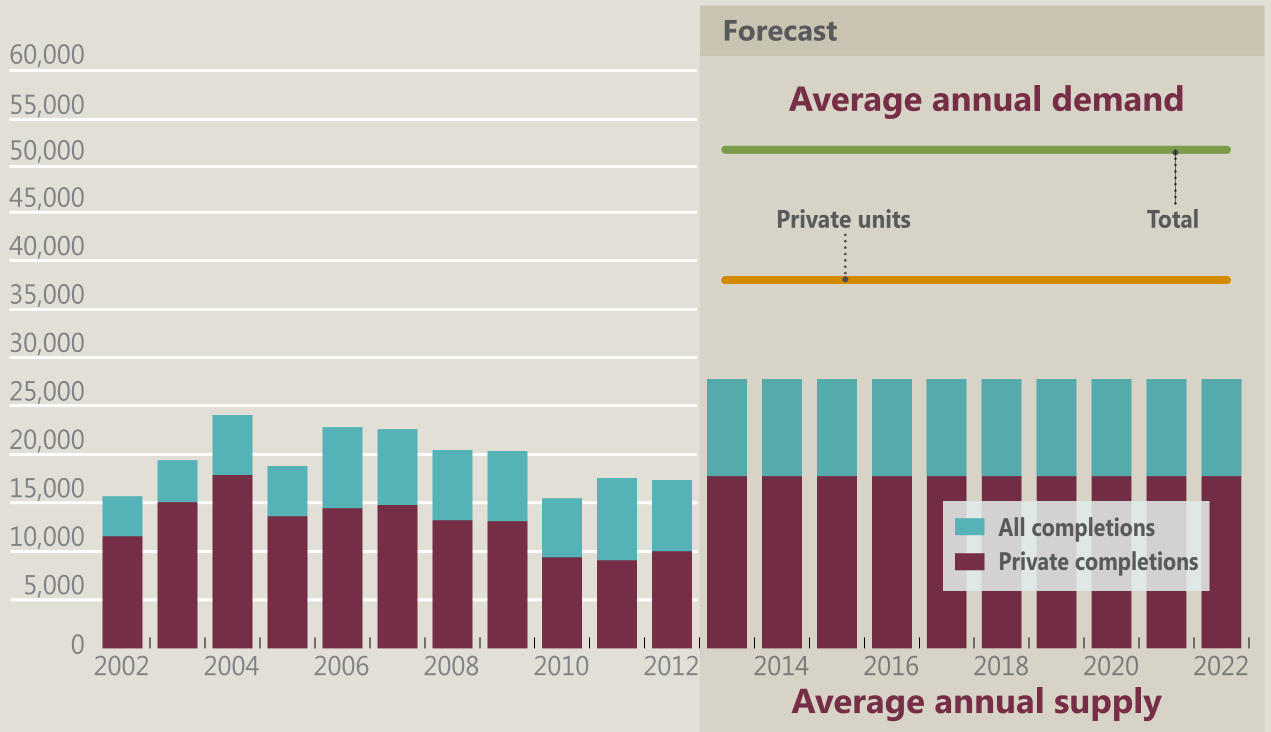
Source: Knight Frank Residential Research / DCLG

Market still undersupplied...

Figure 7 **Demand vs supply**

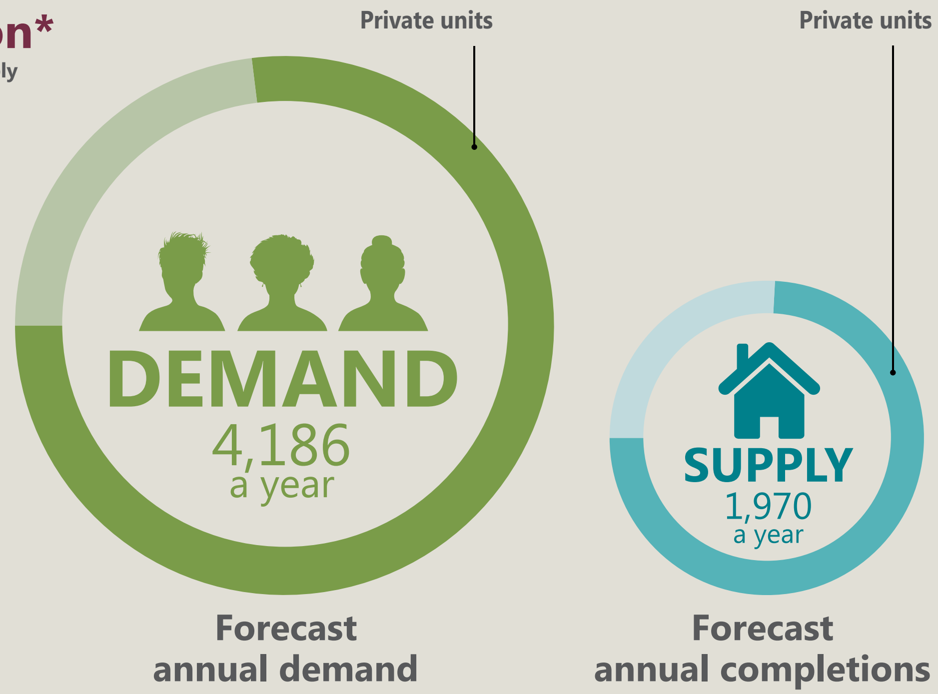
Source: Knight Frank Residential Research / Molior London / DCLG

Greater London



Central London*

Annual average demand vs supply
2013 - 2022



* Kensington & Chelsea, City of Westminster, City of London, Camden

THE PRICING FACTOR

The strength of prices and sales for prime and super-prime London property since 2009 (figure 2) has led to increasing numbers of developers targeting this portion of the market. While our data indicates that supply will fail to keep up with demand this does not mean that there is unlimited capacity for delivery at every price point.

The sheer weight of interest by developers at the top end of the market means those active in this sector will have to keep a very close eye on their pricing, especially for schemes moving away from the traditional core central prime areas.

There is also the issue of tax changes for high-value properties. Stamp duty charged on the purchase of £2m+ homes rose from 5% to 7% from March last year. Those buying a home through a company may also be liable to further charges under the Annual Tax on Enveloped Dwellings (ATED), previously referred to as ARPT, which was introduced in April this year. The ATED was introduced with wide-ranging reliefs, but those who are liable to pay face an annual tax on property held in a company structure.

The effect on the market of higher stamp duty and the new ATED rules have led to a more 'multi-speed' market, with sales activity for properties worth between £2m and £3m being most affected. Knight Frank forecasts that sales of properties worth between £2m and £5m will be 5% lower than they otherwise would have been as a result of these changes.

Measuring demand

In order to assess demand for housing, we examined official projections for household growth which indicate how many additional 'households' will be created in the capital over the next 10 years.

This data from the Department for Communities (DCLG) and Local Government (CLG) has recently been revised to take into account population data from Census 2011 for the first time. The census data showed that London's population jumped faster than expected in the decade to 2011 – climbing by 850,000 to hit 8.17 million.

The household growth forecasts anticipate population growth moving forward, but also model expectations for the average size of households, which are slowly getting smaller.

However the ONS has downgraded the rate at which households are expected to shrink, given the difficulties currently evident in the housing market. As a result – most of the country saw the forecasts for household creation downgraded as a result of the census data. London, however, is the exception.

The sheer scale of population growth expected in the capital means that the data shows that some 525,790 households are expected be created between 2011 and 2021, a hefty 39% rise from the previous forecast for a 379,000 rise over the same period.

To assess demand for housing, we have averaged out this total to show an annual average, which indicates that there will be demand for an extra 52,579 units each year. Within this total, we see demand for private sector accommodation at 37,492 with the remaining demand being in the affordable sector (figure 7).

Focusing in on central London, which for this report includes the four boroughs of Kensington & Chelsea, Camden, City of London and Westminster, an extra 41,860 households are expected to be created between 2011 and 2021, giving an annual average uplift of 4,186. We estimate that demand for private sector homes will be around 3,218 a year.

Measuring supply

Accessing funding for development is still challenging, even six years after the start of the financial crisis, and planning regulations are also in a state of flux. These factors, which are examined in more details in our recent Housebuilding Report, increase the uncertainty about when schemes will be built out.

Despite these difficulties however, it is worth noting that there has been an uplift in development over the last year. The number of residential units granted planning permission in 2012 in London rose by 63% compared to 2011, although this was still 22% lower than the total number of units granted permission in 2008.

£80 bn

Total value of the new-build pipeline for London 2013 - 2022

In order to measure supply of housing across London, we examined the pipeline supply of schemes currently in the planning system. It is worth highlighting that we cannot second-guess when developers will bring a scheme forward – many of these decisions are based on factors unique to a scheme, such as funding, planning and development in the local area.

There are some 2,000 development schemes labelled as 'pre-planning' across London, meaning they have yet to enter the planning process. If all of the initial plans for these developments come to fruition, they could deliver 650,000 extra homes. But as yet, there is no guarantee that these schemes will be delivered.

There are more than 2,000 schemes in the planning system or currently under construction, yet some of the bigger schemes could take decades to complete. Schemes which include permission for 1,000 or more units make up 35% of the development pipeline currently in the planning system.

As such, we have analysed these schemes individually, to judge their likely phasing in order to assess the total development potential over the next decade.

As figure 7 shows, we have calculated total housing delivery between now and the end of 2022, and averaged this to achieve an annual figure, although we recognise that the total figures for yearly housing supply may fluctuate.

Our data indicates that over the next 10 years, some 277,240 residential units will be completed in Greater London. Around 177,340 of these will be private sector housing. This overall development figure is an increase from our 2012 forecast for delivery of 240,000 residential units.

In central London, around 19,700 units are expected to be delivered over the next decade, with 14,590 in the private sector.

However, these overall forecasts will mark a rise from recent housing delivery in the capital. This has raised concerns about an oversupply of housing.

Outlook

Our analysis indicates that the supply of new housing will fall some way short of demand as indicated by the growth in new households in the capital. If the annual uplift in households in 2022 is assumed to continue on the same trajectory as the previous decade, then there is an indicated undersupply in housing of more than 40% across the capital between now and 2023.

Drilling down into the data however, it is clear that the delivery of new-build properties will vary from borough to borough, as shown in figure 5. The planning data suggests that Newham and Greenwich will see the highest levels of new units completed over the next decade.

In terms of supply by value, Tower Hamlets is out in front. Calculations based on current average house prices suggest that the total value of private sector housing which could be completed between now and the end of 2022 could be as high as £7 billion. Hammersmith and Fulham is next on this list, with a potential £6.8 billion of new-build housing in the pipeline over the next 10 years.

The estimated value of pipeline delivery which could come to market between now and 2022 in the four boroughs of central London is around £11.5 billion, with the total figure for London adding up to £80 billion.

We are not ruling out the possibility of supply outstripping demand in some local areas based purely on local data. But the ease with which people can re-locate within London means that the headline figures are probably a fairer judgement of housing supply and demand in the capital.

Residential Research

Gráinne Gilmore
Head of UK Residential Research
T +44 20 7861 5102
grainne.gilmore@knightfrank.com

Liam Bailey
Global Head of Residential Research
T +44 20 7861 5133
liam.bailey@knightfrank.com

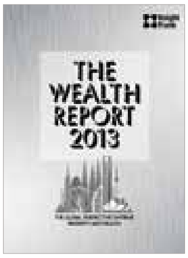
Residential Development

Stephan Miles-Brown
Head of Residential Development
T +44 20 7861 5403
stephan.miles-brown@knightfrank.com

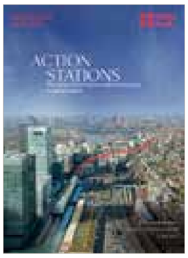
Justin Gaze
Head of Residential Development Land
T +44 20 7861 5407
justin.gaze@knightfrank.com

Ian Marris
Head of Residential Development Consultancy
T +44 20 7861 5404
ian.marris@knightfrank.com

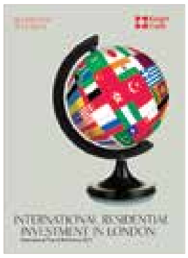
Recent market leading research publications



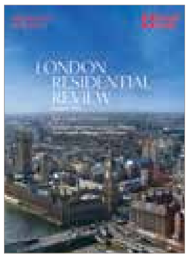
The Wealth Report 2013



Crossrail 2013



International Residential Investment in London 2013



London Review Summer 2013

Knight Frank Research Reports are available at **www.KnightFrank.com/research**

Knight Frank Residential Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.