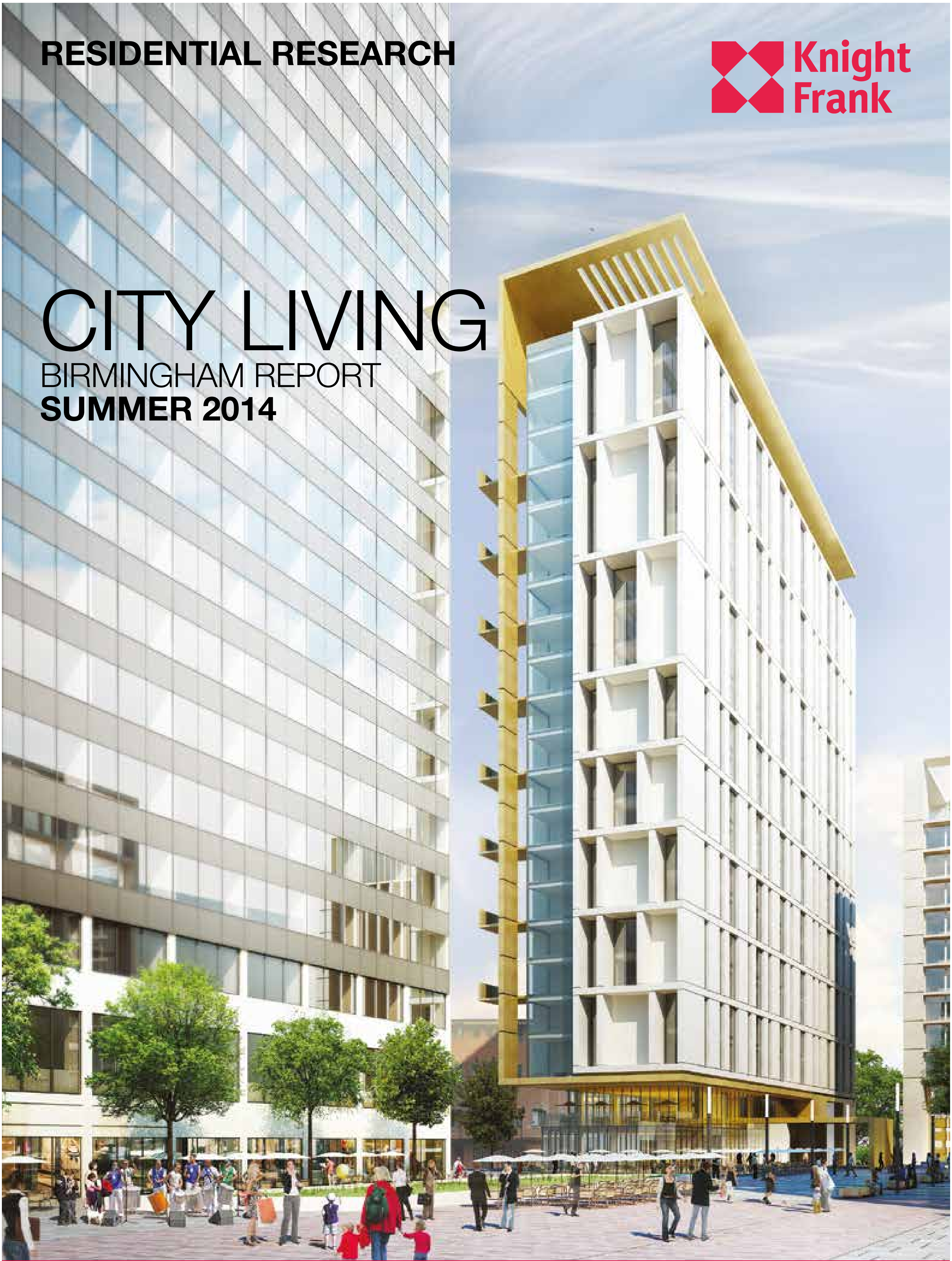
RESIDENTIAL RESEARCH

Knight Frank

CITY LIVING

BIRMINGHAM REPORT
SUMMER 2014



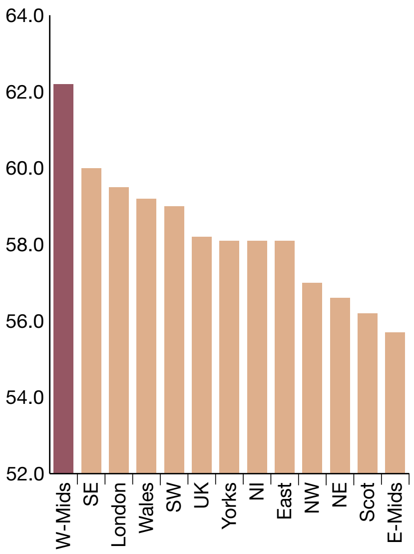
THE INVESTMENT CASE FOR BIRMINGHAM

PROPERTY MARKET DYNAMICS

REGENERATION OF THE CITY CENTRE

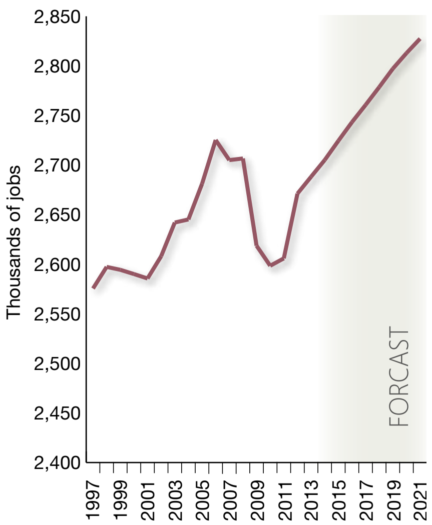
BIRMINGHAM: IN CONTEXT

FIGURE 1
PMI activity index
February 2014



Source: Markit Economics

FIGURE 2
Employment forecast for West Midlands



Source: Experian

The UK housing market is showing renewed life after several years of stasis in the wake of the financial crisis. While the central London housing market recovered relatively quickly, the rest of the UK has been slower to gain traction.

Over the last 12-18 months, renewed economic confidence, easier access to finance and record-low interest rates as well as a deep demand for new housing is helping to boost development and transaction activity. This has been particularly evident in Birmingham city centre, where agents describe the "taps being turned on" in terms of demand for housing. The relatively low entry costs into the housing market in the city, and the resulting higher yields, makes Birmingham an attractive alternative for first-time buyers, home-movers and investors alike.

Well positioned

As a more broad-based economic recovery takes hold across the UK, interest in markets beyond the prime hubs in London is increasing.

Dr Pippa Malmgren, founder of the DRPM Group, and former White House economic advisor, has identified Birmingham as one of the key beneficiaries of a wider international trend for investors to look beyond the traditional global hubs in order to achieve value and to tap into nascent economic growth.

Birmingham is certainly well positioned to attract investment – with a 20-year plan launched in 2010 to completely revitalise its city centre and the prospect of a completely new high speed railway link to London and the North of England.

The city is already attracting attention from overseas, not least because of the business investment and job creation being seen. There has been particular interest from China, which last year overtook the US as the largest export partner of the West Midlands, helped by, but not solely due to, Jaguar Land Rover's presence in the region.

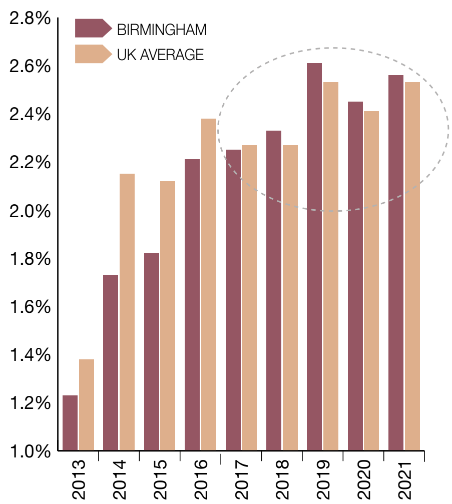
Enhanced transport links, including the £200 million extension of the runway at Birmingham airport, which will allow more long-haul flights to destinations such as China, Brazil and the West Coast of the US, as well as the prospect of a new high speed rail link to London has further enhanced the investment case for the region. In fact, it has been reported that China has offered to finance a new Birmingham station on the HS2 network. China Railway Group has also offered to build connections from the proposed interchange in Birmingham to the airport and cities including Coventry and Peterborough.

Sir Albert Bore, leader of Birmingham Council, said: *"Birmingham sits at the heart of a wider economic region that has seen huge growth and success in recent years, despite tough economic headwinds. Manufacturing is seeing a resurgence, as companies bring production back to the UK, and brand new sectors such as digital technology are thriving."*

Renewed confidence

Increased demand for housing is rooted in the regional recovery from the recession, which is really starting to take hold.

FIGURE 3
Forecast GVA growth



Source: Experian

The UK's economic output is expected to rise by 2.7% this year, up from an annual increase of 0.3% just two years ago. If this level of growth is achieved, it is forecast to be the strongest rate of economic growth in the G7 in 2014.

All regions of the UK are now contributing more fully to the country's growth, with a recent closely-watched PMI measure of regional economic activity showing that the West Midlands is currently leading the way in terms of services and manufacturing, as shown in figure 1.

The local economic recovery has led to an upturn in employment. The jobs market in the West Midlands has improved from a post-crisis trough in 2010, and employment levels are forecast to continue rising according to independent forecasts from Experian, figure 3. The cheaper business rates and rents on offer compared to London are proving a draw for companies, with many digital start-ups heading to the West Midlands including mobile payments company, Droplet, and clothing e-tailer, ASOS, and this is leading to further job creation. In March this year, a regional task force unveiled a fund worth £150m to help 500 advanced manufacturing companies to double their growth in four years in a bid to turn Birmingham into an enterprise hub to rival London.

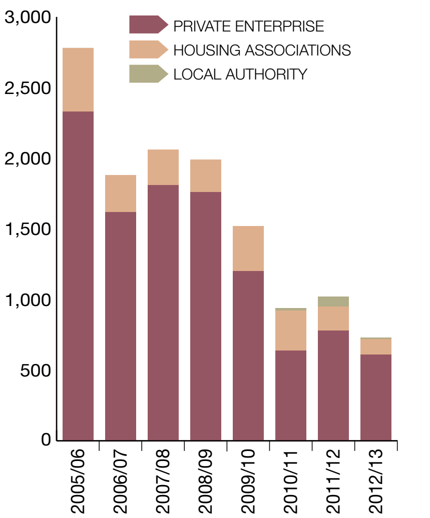
The draw of the West Midlands for companies has had a clear impact on commercial property in Birmingham over the last year, with increased demand and a lack of supply pushing up office rents. This is also likely to result in a step up in demand for rental accommodation among young economically active workers, with this form of tenure set to become an increasingly dominant factor in the Birmingham market.

The overall demand for homes is also picking up. Not only is there renewed confidence among would-be buyers, but looser credit conditions are also helping to release pent-up demand into the market.

Access to mortgage finance has become easier especially after policy interventions including Funding for Lending and the Government's Help to Buy scheme. These measures have not only widened the pool of potential demand but have also helped to boost confidence in the housing market. This is illustrated by the Knight Frank/Markit House Price Sentiment Index (HPSI), figure 5, which shows how perceptions of house price performance, and expectations for

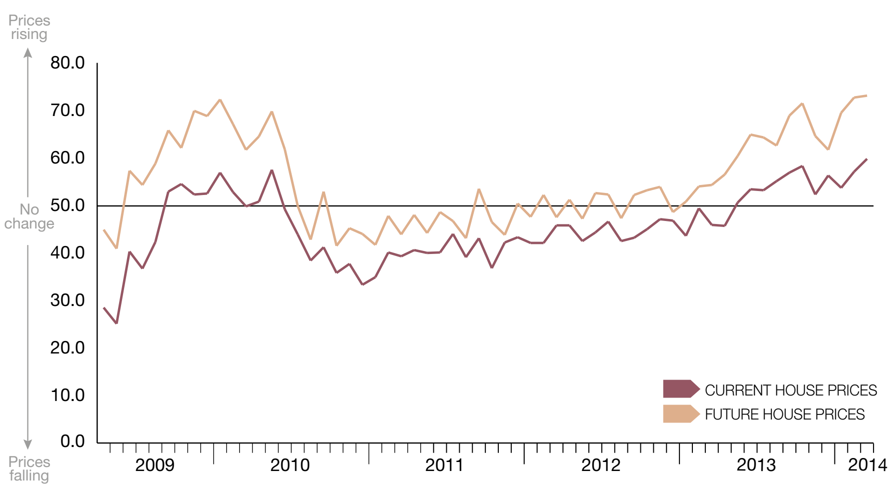
> "Birmingham is seen as a net beneficiary of the return of the manufacturing in the Midlands, the fact that property prices are rising across the country and the fact that London can't keep expanding forever."
>
> **Dr Pippa Malmgren, founder of the DRPM Group, Knight Frank Wealth Report 2014**

FIGURE 4
Dwellings completed: Birmingham



Source: Knight Frank / DCLG

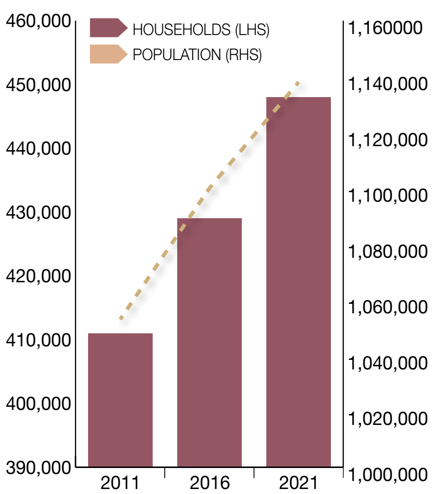
FIGURE 5
Sentiment rising
Households in the West Midlands expectations for current and future house prices



Source: Knight Frank / Markit Economics
NB: A score of 50 equates to no change, above or below representing growth or decline respectively

> “While the wider city continues to deal with the decline of manufacturing, the knowledge-based services growth in [Birmingham] city centre puts the city in a strong position to contribute to future economic growth as the UK continues to specialise in this type of activity.”
>
> **Centre for Cities 2013**

FIGURE 7
Population and household growth forecasts, Birmingham



Source: DCLG

future house price growth has risen in the West Midlands, especially after the announcement on Help to Buy in March last year.

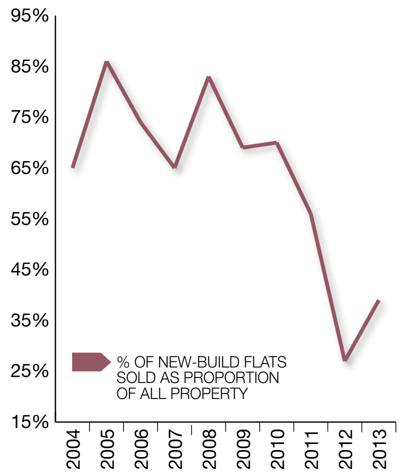
Market dynamics

Official data shows that Birmingham’s population is set to grow by 8% between 2011 and 2021, boosting the number of people living in the city area by 53,000 to 1.14 million. The number of households is set to grow by 9% over the same period. An additional 3,670 households are expected to be created every year, raising the total number of households by 37,000 in the ten years to 2021.

A robust delivery of new-build homes in the two years leading up to the global economic crisis meant that some stock remained on the market in late 2007/2008 while sales activity in the market slowed sharply. Transactions in the Birmingham market fell by more than 70% between late 2007 and 2008, figure 8.

However, in the years after the financial crisis, these units were absorbed into the market, sometimes at reduced sales rates. There was a sharp slowdown in the delivery of new homes in the wake of the crisis as shown in figure 4. Official government figures show that there was a 74% decline in the number of private home completions between 2005/06 and 2012/13 in Birmingham, a far more marked fall than the 42% decline in the UK as a whole. The downturn in supply is further illustrated when comparing a snapshot of activity just when the financial crisis

FIGURE 6
Proportion of new-build flat sales in central Birmingham market

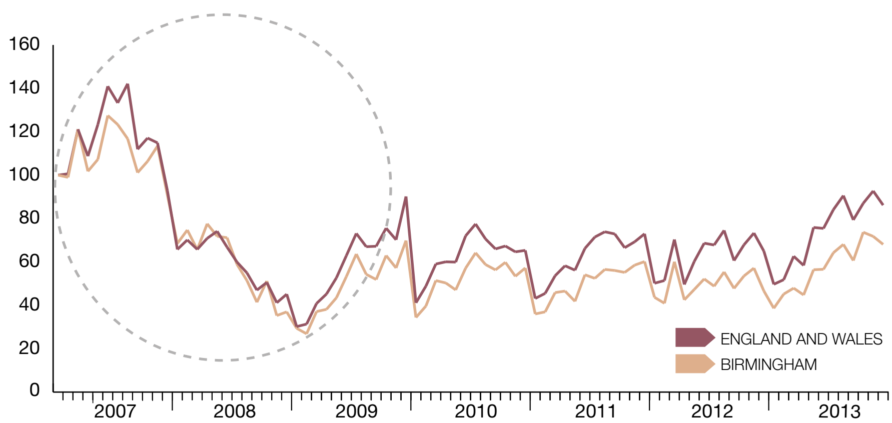


Source: Knight Frank Residential Research / Land Registry

hit in 2007 and six years later in 2013. In Q4 2013, the number of dwellings started in Birmingham was a fifth the number of those started in Q4 2007. Likewise, the number of dwellings completed dropped by a half. This fall in construction activity led to a shortfall of supply in the market. This shortfall has been starkly highlighted amid the return of buyers seen over the last year or two, figure 9 (page 6).

In the centre of Birmingham, this trend is even more clearly highlighted. Official data analysed by Knight Frank research, figure 6, shows that sales of new-build apartments, as a proportion of all sales,

FIGURE 8
Housing transactions (indexed 100 = Jan 2007)



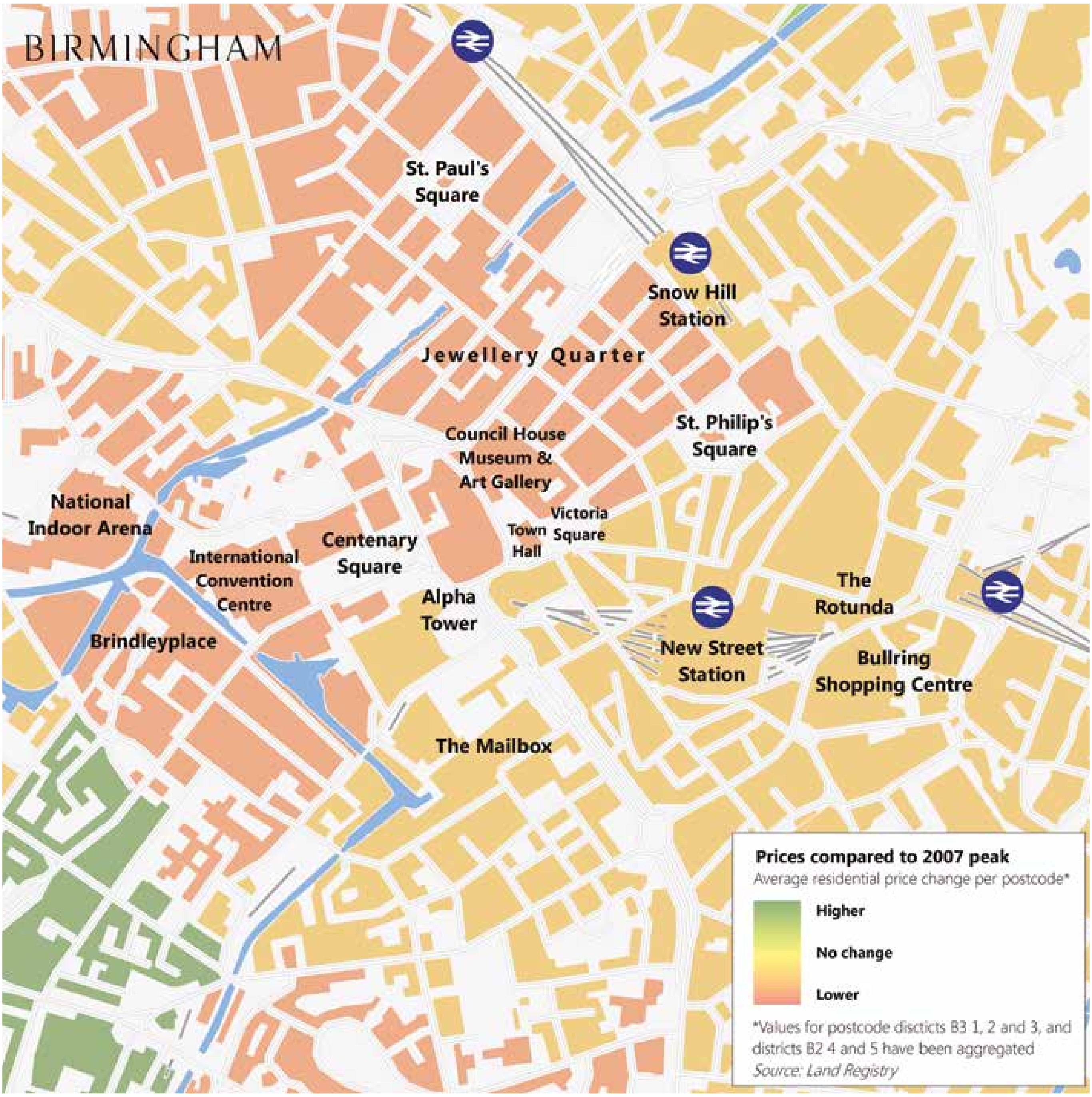
Source: Land Registry

dropped sharply after 2010. This came as a result of a lack of supply in the market, which in turn has led to an increase in prices for new-build apartments. Prices per square foot for central Birmingham new-build schemes are now reaching the levels last seen in 2007, figure 10 (page 6).

It is interesting at this point, to compare these new-build values to those in central London, where apartments can start from £1,000 per square foot and frequently command even higher prices. In comparison, Birmingham has much lower entry costs which not only makes it a draw for homebuyers, but also pushes up yields for those investing in rental property. Figure 11, shows how average house prices in Birmingham are still well below the peak reached back in 2007, while London prices have exceeded these levels by some margin.

Looking to the future supply, pipeline planning data for schemes with 10+ units suggests a rising delivery of units in the coming years, but the sites monitored here will still fall far short of delivering 3,000 units a year, the requirement suggested by the household growth forecasts. In fact, the annual delivery is likely to be even more modest as these figures identify total units in a scheme which may take more than one year to complete.

Peak v Present residential price change



“The imbalance between supply and demand is growing month by month. In the core city centre, there are, on a historical basis, a near record-low number of new-build apartments available. We expect that this supply will be absorbed into the market within six months, with owner-occupiers and investors both active in the market. Supply will remain constrained as, while we are seeing construction activity starting to pick up, the build-out time of the schemes will mean that there will be very few new-build properties available before late 2015.”

MARK EVANS
Head of Regional New Homes Sales, Knight Frank Birmingham

In the city centre there has been very little construction activity since 2007. There are signs that activity may start to pick up, with the recent notable deal by Seven Capital to buy St George’s Urban Village scheme in the Jewellery Quarter. But overall in the city centre, there is a significant imbalance between demand and supply of residential property.

There is a recognition of this from local authorities too. Waheed Nazir, director of regeneration at Birmingham City Council, said “Birmingham has taken a pro-growth agenda, particularly around housing and employment, because we are a city that is bursting at the seams, and unless we respond we wouldn’t be able to meet growth requirements.

“These are key things to show people that Birmingham is a place to invest.”

Private rented sector

Privately rented accommodation is now the second biggest form of tenure in the UK housing market. The rise in the number of households in the private rented sector (PRS) is set to grow further in the years to come as demand and supply both rise. Demand for city centre apartments boosted the proportion of urban rented accommodation by the largest margin of any housing tenure between 2001 and 2011 across the UK, according to the census. We expect this trend to continue, and that the PRS sector will grow by another 1 million dwellings by 2020.

The demand for rented housing in the UK has led to an upswing in interest from institutional investors. Birmingham is a key market, with our latest private rented sector index showing that institutional grade investment blocks in the city centre achieved average gross initial yields of 8.16%, compared to 4.42% in London Zone 1. There is more detail in the latest Private Rented Sector Index.

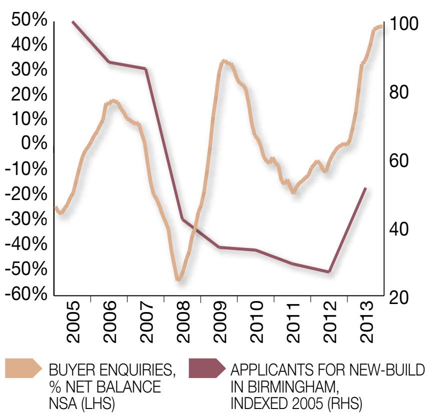
Birmingham’s education facilities also act as a draw to the city, with the city boasting five universities, and an undergraduate population of 65,000. This also means that the city has a large pool of graduate talent, which in itself can help boost business investment. As more graduates are retained in Birmingham, the need for housing will only be augmented.

The fact that Birmingham ranks as the top-scoring UK regional city in the Mercer quality of living index underlines the city’s cultural amenities as well as its economic heft.

Regeneration

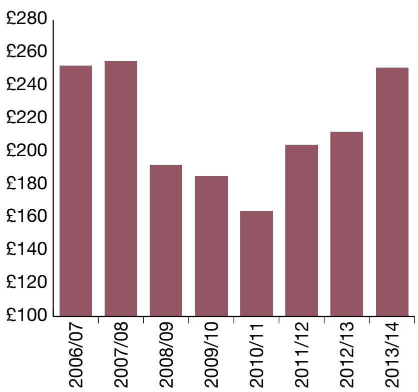
The Big City Plan, a 20-year regeneration plan for Birmingham, is set to dramatically change the city. As part

FIGURE 9
Rising demand for housing
Change in buyer enquiries



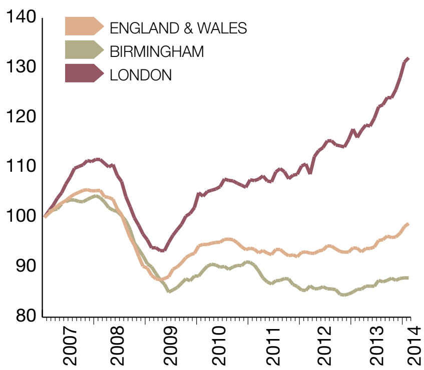
Source: Macrobond / RICS / Knight Frank Residential Research

FIGURE 10
New-build pricing Birmingham City Centre
Average £psf cost for new-build property



Source: Knight Frank Residential Research

FIGURE 11
How prices compare
England & Wales, London, Birmingham (indexed 100=Jan 2007)



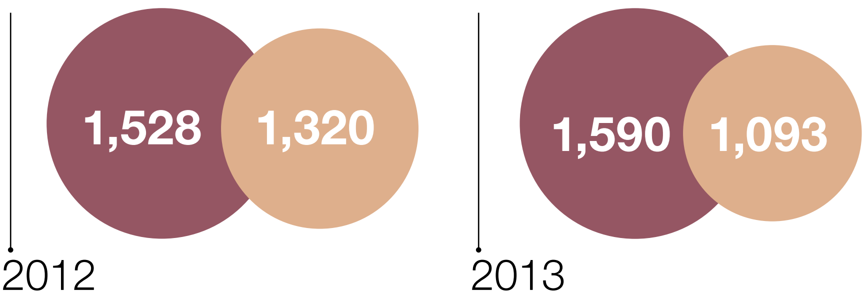
Source: Knight Frank Residential Research / Land Registry of this, the new £190 million Library of Birmingham has just been completed (and was awarded Building of the Year in the West Midlands by RIBA), and larger projects such as Paradise Circus, a multi-use regeneration scheme which will transform part of the city centre, are underway. The development of Paradise Circus, situated just beside the town hall in the heart of Birmingham, is being overseen by Argent, and it is planned that the £160 million scheme will be completed by 2017/18. New Street Station is already undergoing a £600 million transformation, in anticipation of the arrival of HS2, if this scheme is approved. Likewise, a £128 million Midland Metro extension linking the station with the existing tram line at Snow Hill will soon be completed.

HS2 has the potential to bring large economic benefits to Birmingham. In February, the city council unveiled its plans for a 141 hectare regeneration scheme to build a new station at Curzon Street to the east of the city, which will host an extension of the Metro and link directly with HS2. The scheme would revitalise areas of Digbeth and Eastside. The station would mark the first new station in Birmingham in 100 years, and it would be the biggest building in the city.

Birmingham city centre is on the cusp of massive change, and this will likely enhance the area's appeal to businesses and individuals alike.

FIGURE 12
Future supply

GRANTED PLANNING
CONSTRUCTION STARTED*



Source: Glenigan
*Construction may not have started on all units, just the scheme **There may be overlap between planning and construction

HS2

The high speed rail link, or HS2, will cut the travel time between London and Birmingham from 1hr 21 minutes to 49 minutes.

The rail link, which is yet to receive the official go-ahead, moved one step closer in April when the HS2 Hybrid Bill passed its second reading in Parliament.

Phase 1 will connect London and Birmingham, as well as going slightly further north to Hansacre, while Phase 2 will have two "legs" going further north, one to Manchester and one to Leeds via Nottingham and Sheffield. The construction of the line alone, and the rail links and infrastructure around it, could create 22,000 jobs in the West Midlands.

KEY DATES PHASE 1

2015: Target date for Royal Assent to hybrid bill for HS2, including legal powers to construct Phase One

2017: Construction starts

2026: HS2 opens to passengers

If phase two of the high speed rail link receives Royal Assent, then this is scheduled to open to passengers in 2033.

Paradise Circus, a joint venture development, managed by Argent

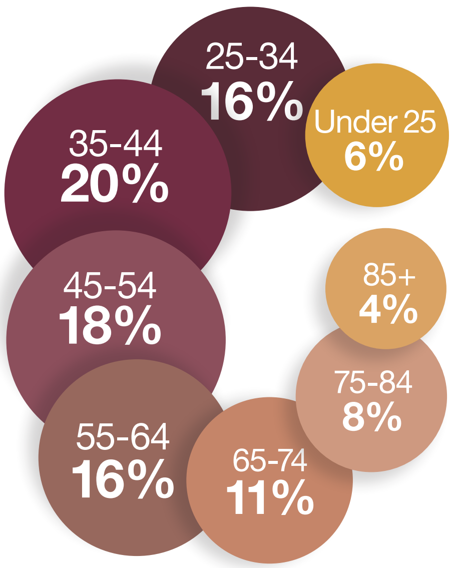
CONCLUSION

The rising demand for homes in central Birmingham is a clear example of the renewed confidence in the housing market moving across the UK at present. Better employment prospects, real wage rises and a more upbeat outlook for the economy have all fed into this confidence, as well as government interventions. Nearly 200 new homes have been sold across the whole of Birmingham using the Help to Buy Equity Loan, making it one of the areas with the highest take up of the scheme across the country, and underlining how much pent-up demand there was in the market.

In the city core area of Birmingham, the lack of supply of new homes could put further upward pressure on pricing, in addition to the lift already seen which has brought the average prices of new-build apartments back to levels seen before the financial crisis. The Knight Frank forecast for house price growth in the West Midlands is 7% nominal growth, but it is likely that the central Birmingham market will outperform this.

The regeneration and redevelopment taking place in the city centre, coupled with the large-scale infrastructure changes at the airport will give further opportunities for property prices to outperform the wider market. The launch of the HS2 railway, if it receives Royal Asset, will only add to this momentum.

FIGURE 13
Age of households in Birmingham



Source: Knight Frank Residential Research / Census 2011

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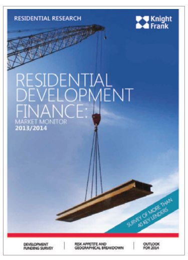
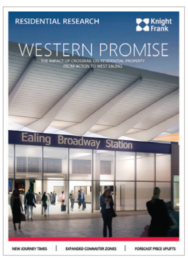


Residential Development Finance 2013 - 2014

Private Rented Sector Index Q4 2013



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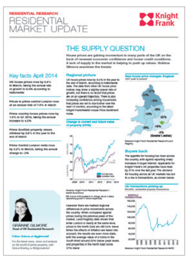

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