Residential Development Land Index

Q1 2023

The Knight Frank Residential Development Land Index is designed to give a snapshot of broad trends in the development land market

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Dealmaking resumes after mini-budget fallout, but activity remains thin with housebuilders deferring land payments in a challenging market

UK greenfield and urban brownfield values fell on average by 3.0% and 4.6% in Q1 2023, taking the annual change to -9.1% and -13.7% respectively. In prime central London an ongoing lack of sites for sale and a rise in cash buyers supported land values which were flat on a quarterly basis and flat annually.

UK housebuilders are navigating more challenging circumstances as house prices are easing, while build and labour costs remain high. This inflationary environment combined with uncertainty in the sales market has led to housebuilders becoming more selective with land, and in particular, payment structures.

The UK inflation rate was 10.1% in March, compared with 10.4% in the previous month, following a surge in food prices, adding to the squeeze on household incomes.

73%

of housebuilders are looking to delay payments for land

33%

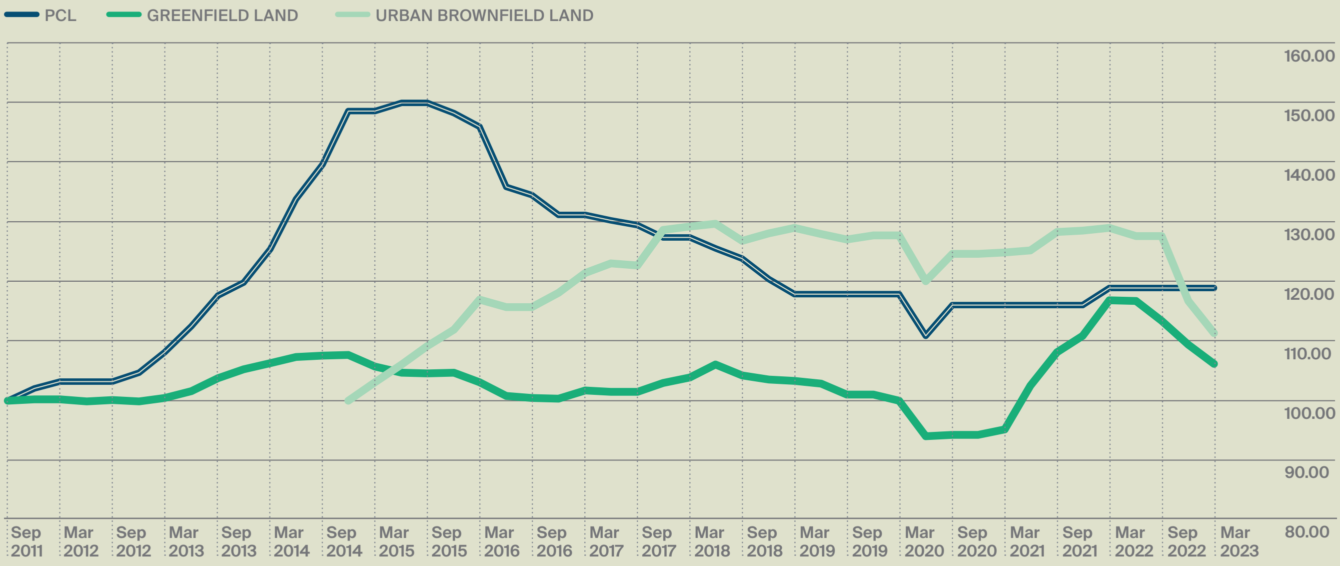
of housebuilders are seeking partnerships or bulk sales deals with institutional investors in the private rental sector this year

65%

think land prices will stay the same in Q2

Residential development land prices

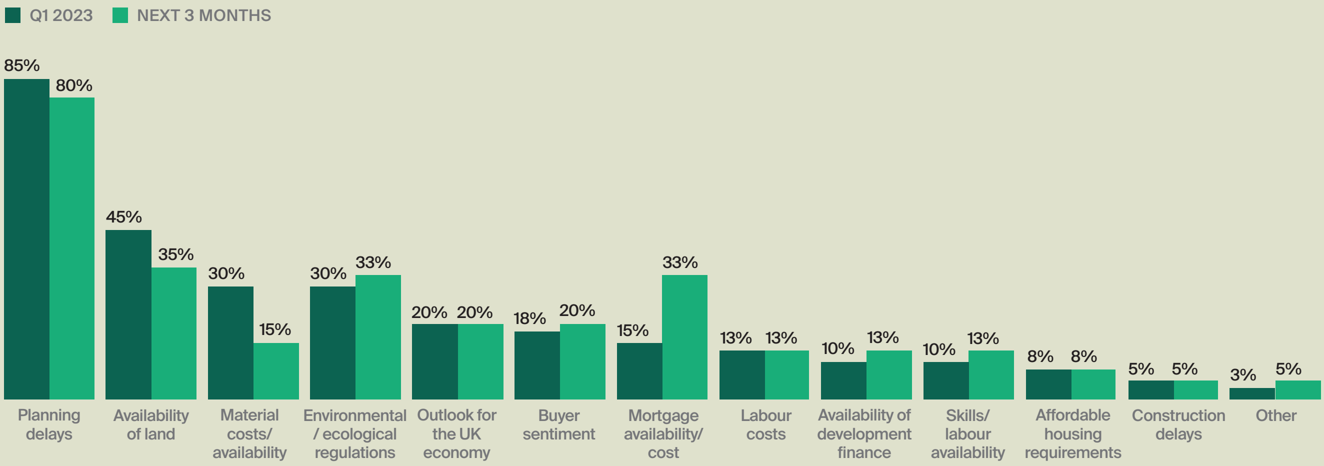
Index rebased 100 = Sep 2011 (Urban Brownfield = Dec 2014)



Source: Knight Frank Research

What are the key challenges for the sector?

% of respondents (choose up to three)



Source: Knight Frank Research

COST PRESSURES

In the current economic climate, housebuilders are focused on preserving cash by deferring payments for land. Our survey of volume and SME across the UK found that 73% are looking to defer payments for land, with two thirds seeking to defer over 40% of purchases. In total, 70% of them are aiming to delay payments over a one-to-three-year time period. A third are looking to slow down on land acquisition this year compared to 2022, but the majority (67%) have no plans to do so.

In the absence of sales supports such as Help to Buy, which officially closed to new applications in October, a third of respondents said they were seeking partnerships or bulk sales deals with institutional investors in the private rental sector this year.

Looking ahead, a third of respondents also think mortgage availability and cost will be a key challenge for the sector over the next few months. Lenders approved 43,500 mortgages for house purchases in February, the first monthly increase since August last year, but still well below the pre-pandemic average of about 66,000, according to the Office for National Statistics. Mortgage rates have been stable for several weeks and some borrowers can still secure sub 4% five-year fixed rate deals. That stability will come under pressure during the weeks ahead as rate hikes draw nearer, though there is still considerable competition for business among lenders.

While the larger players are being highly selective, SMEs are cutting profit margins to compete for land. Indeed, more than half of SME respondents, those building up to 100 units in their region, said they had cut their profit margins when bidding for plots of land in Q1, whereas 60% of those building upwards of 100 units said they either increased their profit margins or made no change to them.

Our survey found that build costs had a 'significant' impact on 48% of respondents' businesses in Q1, down from nearly 60% in Q4. However, build costs are expected to stabilise as construction supply shortages are easing. Overall, the Build Cost Information Service (BCIS) is forecasting build costs to increase 4.2% this year, down from a jump of 11.6% in 2022.

PLANNING DELAYS

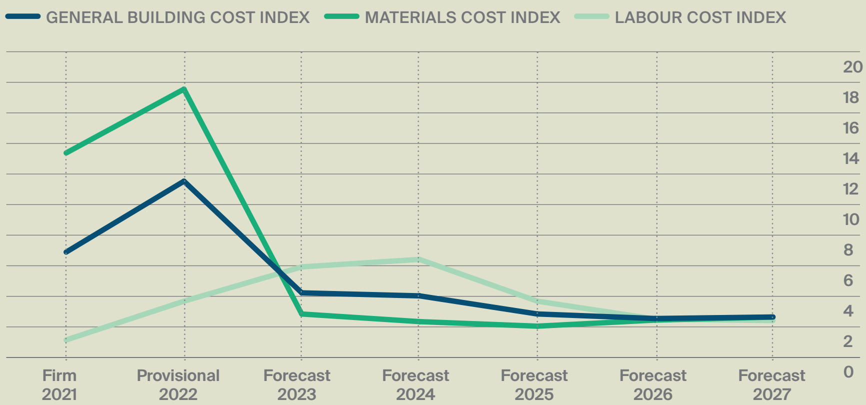
Overall, the number of housing projects granted permissions fell to a record low in Q4 to below 3,000, according to the latest Housing Pipeline Report from the Housing Builders Federation.

Net zero transition

Environmental and ecological regulations equalled build and labour costs as challenging factors for the sector, with 30% of respondents selecting both as key issues. Gas boilers will be banned in new build developments from 2025. In January, Redrow said it would fit out all new developments with a heat pump rather than a gas boiler, the sector's first pledge of its kind. On an industry-wide level, the Home Builders Federation (HBF) estimates that meeting all of the requirements of the Future Homes Standard will cost the industry an additional £1.9bn a year.

BCIS construction cost indices

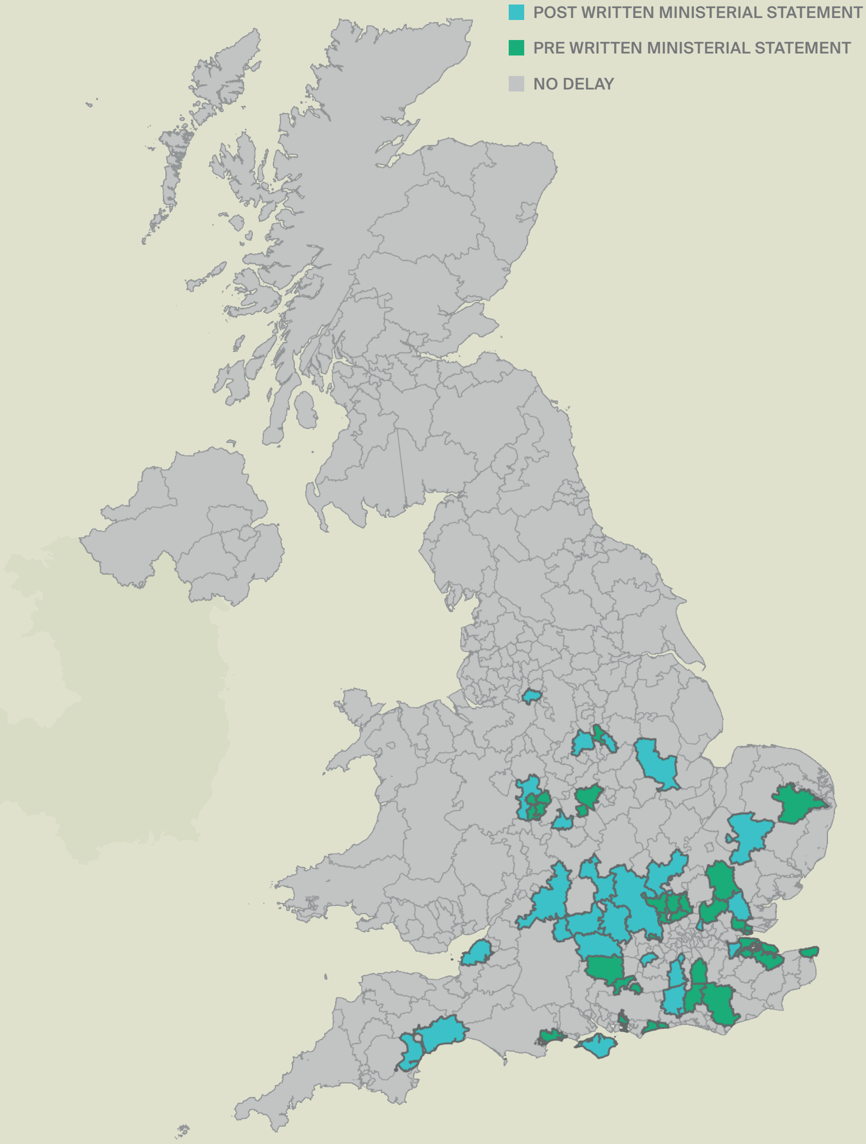
Annual percentage change 2021-2027



Knight Frank Research, BCIS

Delayed Local Plans

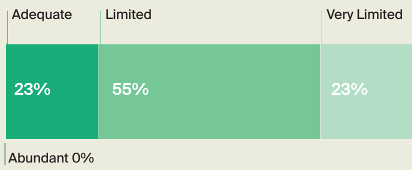
Local Planning Authorities where Local Plans have been stalled, delayed or withdrawn either pre or post Written Ministerial Statement (6th December 2022)



Source: Knight Frank Research

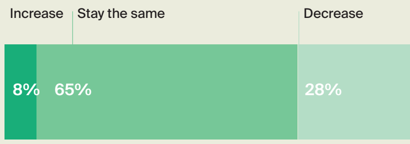
Land availability

% of respondents that said land availability was...



Land prices

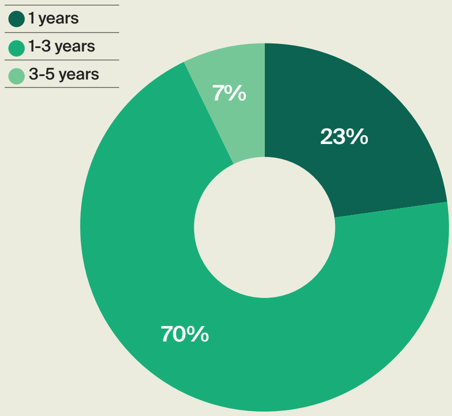
% of respondents that thought land prices would...



If you are purchasing land, will you be looking to defer payments?

73%	27%
Yes	No

Over what time period are you looking to defer payments for these purchases?



Cash buyers target Prime Central London

In prime central London, an ongoing lack of sites for sale and a rise in overseas buyer demand is supporting land values. The current planning pipeline points to continued constrained supply on the horizon. Developers are cautious on planning risk in the current economic environment and are prioritising consented land deals, of which there are very few available. They are also being highly selective and focusing on well-conceived sites with planning and avoiding sites with complex construction requirements.

Like the rest of the country, the PCL land market was impacted by the shock of the mini budget which led to a drop off in activity. However, it is more insulated from a sluggish UK economy given its access to a large overseas market. A higher proportion of sales in PCL are in cash, which makes the market more immune from the impact of higher mortgage rates. This, combined with the fact developers can command higher premiums on sales and protect their margins, means that opportunities to develop in PCL are currently more highly sought after, albeit limited due to constrained supply.

The two core boroughs of PCL, the City of Westminster and Royal Borough of Kensington & Chelsea, have introduced more protectionist planning policies of late and so new development opportunities are become increasingly scarce. They both also have a high proportion of conservation areas, where certain additional planning controls apply.

Now that the mini budget is in the rear view and borrowing costs are stabilising, PCL transactions are expected to pick up later this year. But residential developers will face competition for the best sites from owner occupiers who do not need to make a profit, as well as other land use classes such as hotels and offices.

Against this backdrop, volume housebuilders are in the market for land at all stages of the planning process, including strategic land, while over 60% of SME housebuilders said they were looking for land to be purchased subject to planning. So far, 55 local authorities have withdrawn or paused their housing delivery plans, including 17 since Michael Gove announced plans to abandon mandatory housing targets late last year (see map on page 3). Overall, 85% of respondents cited planning delays as the greatest challenge for their business in Q1, up from 73% in Q4.

SALES SLOWDOWN

More than half of respondents said site visits and reservations fell on quarter. However, this is an improvement from Q4 when 79% said they had declined compared with Q3. It mirrors more positive news from housebuilders so far in 2023, with recent trading updates suggesting that reservations have picked up from the lows of Q4, albeit they remain down year-on-year. Bellway said its private reservations had recovered to 107 per week in January, up from 91 per week in Q4. Persimmon's net private sales rate per outlet was 0.62 in the first quarter, compared with 0.30 in Q4, but down from 0.98 in Q1 2022.

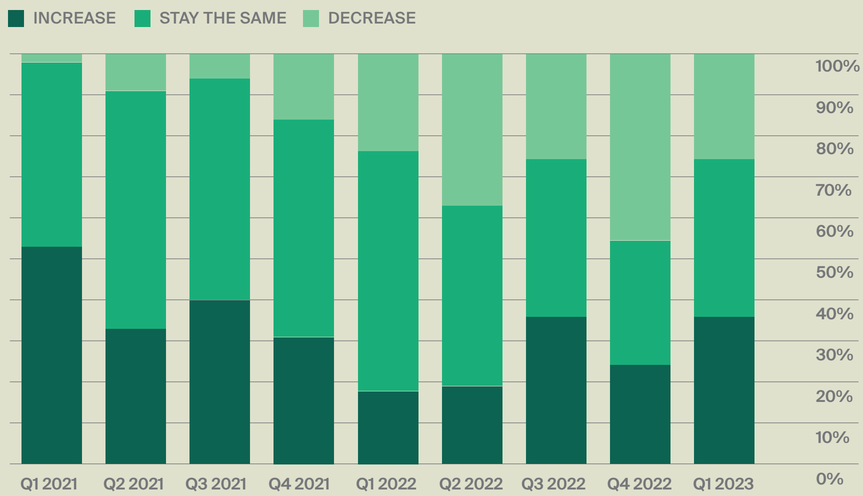
While sales rates have picked up this quarter, they remain down on year. Reflecting this reduced demand, we expect UK house prices to decline by around 10% over the next two years as the impact of higher mortgage rates takes its toll on affordability. Mortgage lender Nationwide Building Society reported that average house prices in March were 3.1 per cent lower than a year earlier, the biggest annual drop since 2009. However, we expect any weakness to be short-lived and forecast a 4% rise in house prices in 2025. That's up from the 2% increase we predicted in October – back when five-year fixed-rate mortgages were above 6%. Currently they are below 5%.

OUTLOOK

Despite the economic challenges, limited land availability means that land values and seller expectations have not necessarily reduced in line with cost inflation, putting pressure on profit margins, particularly for SMEs. Tight land supply was cited by respondents as the second most challenging factor for the sector this quarter, lending some support to values. Overall, 65% of respondents expect that land values will hold steady in Q2. Previously, just over half had expected values to fall in Q1. Well located sites will remain in demand given the constraints of supply and worsening planning delays, but activity will remain subdued given the ongoing economic uncertainty.

New housing starts April-June

% of volume and SME housebuilders that thought start volumes would...



Source: Knight Frank Research

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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Disclaimer

The Knight Frank Residential Development Land Index is designed to give a snapshot of broad trends in the development land market, and should be only be used as such. It is derived from valuations of a basket of more than 70 residential development sites around the country. Every quarter Knight Frank surveys between 30-50 SME and large housebuilders to gauge their sentiment and views on the market. The survey was conducted between 6th-14th April.

Knight Frank