RESIDENTIAL
RESEARCH

NEW-BUILD SECOND HOMES REPORT 2011

Knight Frank

DEMAND FOR NEW-BUILD SECOND HOMES REMAINS STRONG

The demand for new-build second homes has bucked the trend of slowing activity seen in the mainstream UK housing market since the financial crisis hit in 2007.

Gráinne Gilmore, Head of UK Residential Research at Knight Frank, examines the factors supporting this sector.

A desire for 'staycations', the search for good investment returns by investors and the weaker pound have combined to boost demand for new-build second homes and holiday homes, especially in the most desirable areas of the UK (figure 1).

While housing transactions in the UK mainstream market have slumped since 2007, the number of second homes continued to rise steadily in 2008 and 2009.

In the popular second home destinations of the South West, the growth in second homes continued in 2010, taking the number of holiday properties to new record highs in that region.

This growth is due to a combination of factors, not least of which is the increasing desire for 'staycations' in the UK. Spending by domestic tourists is expected to rise by 2.6% a year in real terms over the next decade, while spending by overseas visitors is tipped to climb by 4.4% a year.

Britons are seeking out holiday destinations which involve less travelling, cutting down on expense as well as pollution. But they look for resorts that can match the amenities and attractions on offer in some overseas holiday spots. This is one of the main reasons why UK coastal resorts are so popular, especially in the South West, where a wide variety of water activities are available – from surfing to sailing.

Around half of the top 30 second home hotspots are based in the South West, and the region dominates the domestic tourism market – accounting for more than one in every five trips taken by UK holidaymakers last year. We examine the prospects for this region more fully on pages 4-5 and 6-7.

The prospect of a second home which can be rented out when not in use is also an attractive one, and, as explained on page 3, the longer holiday season improves the chances of achieving high levels of bookings. In this way, a second property has become an investment opportunity as well as just a luxury.

The demand for holiday lets has remained robust throughout the recession and its aftermath, with a 70% uplift in bookings for UK holiday lets in Devon and Cornwall in the early months of this year compared to 2010, signalling a healthy trade for the rest of the year.

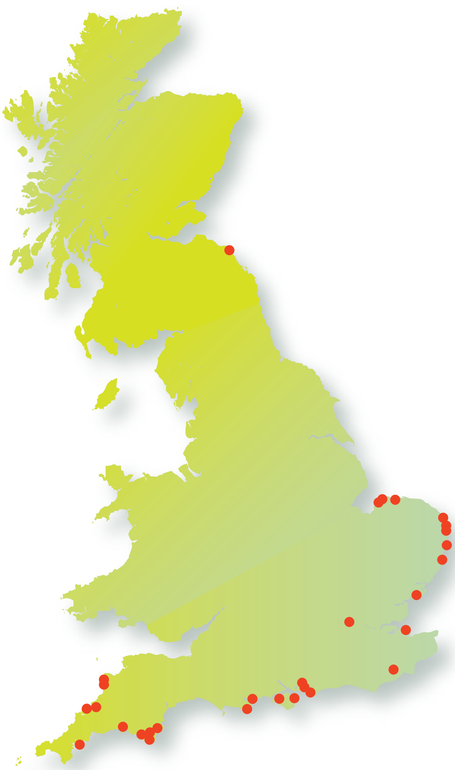
SPENDING BY DOMESTIC TOURISTS IS EXPECTED TO RISE BY 2.6% A YEAR IN REAL TERMS OVER THE NEXT DECADE

The current low-interest rate environment is also boosting investment interest in rental property. Property prices in many areas of the UK have yet to regain the heights seen when the market peaked in 2007, which has helped boost rental yields. In contrast to the minimal interest paid on savings accounts, gross yields of between 6% and 7.5% achieved on some properties in the South West are pulling in investors.

The interest from prospective second-homers and investors has been further piqued by the weak pound, which not only makes the prospect of holidaying abroad less appealing but reduces the attraction of buying a property overseas. Demand in the UK is benefitting from increased activity among those who traditionally would have bought a home in Spain or France. A slight easing in the mortgage market over the past 12 months has also helped boost trade.

Finally, while the tax regime for furnished holiday lets has been overhauled in the last year, there are still favourable tax breaks on offer for investors or those buying a second home to let out, as explained on the opposite page.

Figure 1
Second home hotspots
Neighbourhoods with the highest % of second homes (See chart page 5)



Source: Knight Frank Residential Research, DCLG

HOME ECONOMICS

Demand for holiday lets remained strong last year, with more than 39 million nights spent in UK self-catering accommodation, underlining that the strong rise in 2009 was not a flash in the pan and that the staycation trend has some way to run.

Official figures show that visits to Europe by UK holidaymakers were down 4% in the year to April compared to the previous 12 months.

Demand for self-catering accommodation has risen by more than 20% since before the financial crisis. The spend on self-catering flats and houses in England also rose by 5% last year to £1.7 billion, according to data from VisitEngland. This trend is expected to continue, with Deloitte and Oxford economics forecasting that spending by Britons holidaying at home will rise by a cumulative 30% by 2020.

The boost in spending on self-catering accommodation partly reflects the longer holiday season which is making it easier for landlords to rent out their properties the whole way through the year.

The summer season, which used to mirror the school holidays, has become much longer as more people choose to take their holiday in June or September instead of the traditional peak months of July or August.

As well as high levels of bookings at Easter, the rising popularity of short breaks – long weekends or mid-week breaks, have effectively extended the season to the whole year for the most popular locations.

As a result, landlords are finding rewarding yields. With the best properties commanding strong rates during the summer season, yields in the South West average between 6% and 7.5%.

But some high-end developments can garner even more. One-bedroom apartments at the Ocean Gate development in Newquay, which have an average asking price of £175,000, can garner an 8.8% yield with good occupancy rates, while a three-bedroom house in the Talland Bay development in South Cornwall, where properties have been selling for £330,000, can deliver a gross yield of 8.2%. However the cost of frequent 'change-overs' as well as maintenance can add up, and those who opt to use a lettings management company can be charged as much as 25% of rental income. Even so, the net yield after paying the charge would still average just over 5%.

Another alternative for buyers is to invest in a managed property let which offers a guaranteed income. Stonerush Lakes, a development of holiday lodges by Charteroak Estates in Lanreath in Cornwall, offers investors a guaranteed net yield of 6% for two years, as well as the use of their lodge during a number of weeks of the year.

Because these properties are usually bought under lease or licence, a specialist mortgage is required. But lodges are typically more affordable than apartments or houses, which can boost returns.

Taxing issues

There are several tax breaks on offer for owners of furnished holiday properties which are available to rent.

When the property is sold, the rate of capital gains tax (CGT) charged on any rise in the value of the property is less than half the usual 28% rate at just 10%, as holiday lets fall under the Entrepreneurs' Relief rules.

In addition, in some circumstances, the proceeds of the sale may be eligible for 'Business Asset Roll-Over Relief', which allows landlords who reinvest the sale proceeds into certain other assets to defer payment of CGT until the new assets are sold.

But it is also worth remembering that holiday homes or other properties which come with a time-limit on occupancy are treated as a business for tax purposes, so VAT is payable when the property is purchased, although some lodges are excluded from this. Annual business rates are also paid instead of council tax.

Owners of properties classed as a furnished holiday let can also claim up-front tax relief on the cost of furnishing a property. But the threshold for reliefs on this spending, currently £100,000, will fall to £25,000 from April next year.

There have been some major changes to the tax treatment of furnished holiday let properties recently after consultations which have been rumbling on for more than two years.

New rules came into force in April this year meaning landlords can no longer offset losses made on holiday lets against their other income.

Instead, losses incurred can only be offset against income made from other holiday lets or otherwise carried forward and offset against future income made from the holiday let.

John Endacott, tax partner at Winter Rule, the holiday lettings tax specialists, said: "The new regulation is likely to prove a minimal barrier for existing landlords looking to extend their portfolio of existing properties as they will be able to claim back losses made on refurbishing a new property against the money made from other properties.

"But the new rules are likely to mean that landlords are less inclined to invest heavily in refurbishing a property when they buy, especially if it is their first holiday let. In some respects, this is only a continuation of a trend that has been prevalent for several years, given the scarcity of credit available for mortgages and renovation since the financial crisis."

The second change, which will come into force next April, lengthens the time a property must be let out for it to qualify as a furnished holiday let.

At present, landlords must make the property available to let for 20 weeks a year, and achieve at least 10 weeks' occupancy each year, with each let being no longer than 31 days.

From April next year, they will be required to make the property available for 30 weeks a year, and achieve 15 weeks' occupancy.

A failure to do this means that the property will not be treated as a furnished holiday let for tax purposes, instead falling into the category of a residential property let.

While this is unlikely to impact on holiday lets in popular holiday locations with long letting seasons, the concern is that it makes life more difficult for peripheral locations in the UK where the season is shorter.

There is still scope for tax perks on holiday let properties but potential purchasers need to carefully consider the implications of the rule changes.

DEVELOPMENT AND PLANNING INSIGHT

The South West of England is the most popular domestic tourist destination in the UK, accounting for a fifth of every 'staycation' last year.

Many coastal resorts in the South West are favoured destinations because of their unique attributes. For instance Newquay in Cornwall offers some of the best surfing in the country, while up the road in Padstow, the wide range of restaurants and cafes opened by chef Rick Stein are a major draw.

But there is also growing interest in more secluded spots, with the beaches of Talland Bay and Portwrinkle in South Cornwall becoming more popular with holidaymakers seeking a quieter atmosphere.

39.06m

Number of nights spent in self-catering accommodation in the UK in 2010

Second home developments traditionally do well in areas which already have a high proportion of second home owners as new, high-spec apartments tempt existing owners of houses to trade-in (figure 3). But there are also opportunities in some more remote areas, especially on sites which have already been used for caravans, or on old industrial sites.

Building work on new developments, which ground to a halt during the financial crisis, is starting again in the South West, delivering a fixed supply of new property which is helping support prices.

Prices for new-build properties are still strong in the most popular areas such as Rock, Polzeath and Watergate Bay, while the wider market has remained broadly stable.

Prices for new properties in the South West slipped by 2% in the year to March, but are still 5% higher than in early 2009, according to data from Nationwide. Over the last 10 years, new-build property prices have risen by 75%.

One route for developers seeking to build new properties is to re-use an existing site. Several coastal hotels have been re-developed as high-end apartments.

In some cases, the hotel is re-vamped, and run as a smaller operation alongside the new apartments, which come with access to the hotel.

At the Whitsand Bay hotel in Portwrinkle in South Cornwall, Galleon Homes Ltd is building 23 two, three and five-bedroom houses in the hotel grounds which will have full access to the hotel's amenities including the swimming pool and health club.

If developers cannot access traditional sites in or near coastal resorts, another option is to move inland to former industrial sites such as quarries and gravel pits. These have the added bonus of offering the possibility of a lake, creating a water-side location. The highly successful Cotswold water park is an example of how this approach can work.

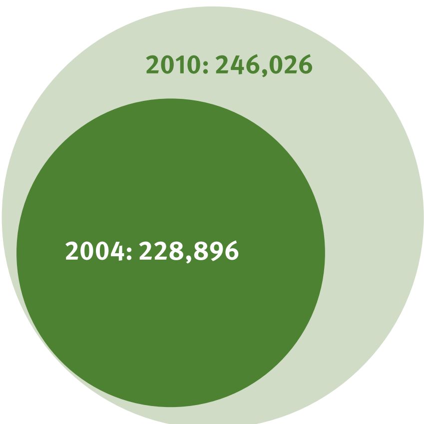
Alternatively developers can use existing caravan park or chalet sites to build holiday lodges. These buildings are not classed as fully permanent structures for planning purposes but developers fit them out to very high standards, making them a better value option for buying a luxury second property. Lodges are typically less expensive to buy than traditional homes as they are sold on a long lease or under licence.

Planning rules often stipulate that holiday lodges, and in some cases other types of development, can be occupied all year round by anyone, but the planner imposes a maximum monthly time-limit that any 'one person' can stay, usually a maximum of six or eight months. The argument is that this protects the local economy as visitors spend more than those who live in the region permanently.

However these rules make it trickier for potential buyers to raise finance as any property with such restrictions is classed as a business asset. Lenders will not offer a traditional mortgage and buyers must instead choose from only a handful of specialist home loans. Buyers are also liable

Figure 2
Second home ownership in England

7% growth



Source: Knight Frank Residential Research, DCLG to pay 20% VAT when buying such a holiday home, and while many developers roll this into the price of a property, others choose to market their property at sale price plus VAT.

Some developers are lobbying local authorities to remove holiday restrictions, and in some cases have been granted permission to build permanent homes, with the necessary quota of affordable houses and amenities that are required in all new-build developments.

THERE IS GROWING INTEREST IN MORE SECLUDED SPOTS, WITH THE BEACHES OF TALLAND BAY AND PORTWRINKLE IN SOUTH CORNWALL BECOMING MORE POPULAR WITH HOLIDAYMAKERS SEEKING A QUIETER ATMOSPHERE

A real growth area over the next year or two will be developments which offer larger properties, as the rising trend of 'generational' holidays, with three generations of family holidaying together, have boosted demand for more spacious apartments and houses. One agent said it was not unusual for families to organise a holiday with both sets of grandparents taking it in turns to visit.

Sales of older, larger homes are already benefitting, although the interiors must be modern. As the agent said, 'draughty cottages just won't cut it any more.' However beautifully finished new properties with three or more bedrooms will command the highest premiums.

One of the key routes to maximise rental yields for holiday homes is to offer flexible lettings arrangements, especially outside the peak season. Long weekends or mid-week breaks have become increasingly popular, especially as visitors can fly into Plymouth, Exeter or Newquay. Alternatively the train from London to Exeter can take as little as two hours.

ASK THE PLANNER

David Lobban, Director of PCL Planning and Environmental Consultancy, Exeter

How is the government's localism agenda affecting planning decisions in the South West?
As is the case all over the UK, local authorities are in 'wait and see' mode. The details of the localism bill, especially the parts dealing with planning, have yet to be set in stone. But in the meantime, the signs are that local authorities will deal with their increased powers quite differently. In some areas, such as Plymouth, the strategy for a sharp growth in housing looks to be pushing ahead, while Exeter recently cut its planned new housing target from 15,000 to 12,000 by 2026.

What is the attitude to second homes?
It is a fine balancing act. Local authorities are very aware that the tourist industry is a major part of the economy and the largest employer in the South West. But they are also trying to balance the needs of local communities. This is not an easy task.

How are they trying to address this issue?
In recent years local authorities have granted planning for second-home developments under the proviso that residents could not live there all year round – putting an 8, 10 or even 11-month limit for the amount of time one individual could stay. This was an awkward rule, and many authorities have moved to a new form of restriction – that the property cannot be the resident's sole or primary residence, which is no barrier to second-home buyers or those investing in a holiday let looking for annual returns on their investment from rental income. But it does throw up the issue of VAT payments, which is another hurdle for developers to navigate.

Is there an alternative?
In some cases, especially in urban areas, developers are working with local authorities to draw up plans for amenities that would be required under a typical residential development, such as additional infrastructure and affordable houses. As a result, the developments are being built with no restrictions, and buyers can also use the property as their primary residence should they wish.

Top 30 neighbourhoods for second homes

Key village/town	Local authority	% of second homes
1. Leysdown-on-Sea, Isle of Sheppey	Swale	64.8
2. Hemsby	Great Yarmouth	57.1
3. Trebetherick/Polzeath	North Cornwall	48.6
4. Scratby	Great Yarmouth	45.6
5. Salcombe	South Hams	42.0
6. Brancaster	King's Lynn and West Norfolk	40.7
7. Padstow	North Cornwall	38.0
8. Sandbanks	Poole	35.3
9. Aldeburgh	Suffolk Coastal	35.2
10. Rock	North Cornwall	34.1
11. Beadnell	Berwick-upon-Tweed	33.0
12. Southwold	Waveney	32.9
13. Constantine/St Merryn	North Cornwall	32.9
14. Selsey	Chichester	32.4
15. Seaview, Isle of Wight	Isle of Wight	32.3
16. Burnham Market	King's Lynn and West Norfolk	31.6
17. Winterton-on-sea	Great Yarmouth	31.5
18. East Rother, East Sussex	Rother	30.9
19. St Osyth, Essex	Tendring	30.4
20. Rame Peninsula	Caradon	30.4
21. Norton, Isle of Wight	Isle of Wight	29.8
22. Durlston Bay, Swanage	Purbeck	28.9
23. East Wittering, West Sussex	Chichester	28.6
24. St Mawes/Portscatho	Carrick	28.5
25. Inner/Outer Hope & Malborough	South Hams	28.3
26. Southbourne	Bournemouth	27.5
27. Brompton	Kensington and Chelsea	26.9
28. Hunstanton	King's Lynn and West Norfolk	26.8
29. Dartmouth (estuary shore)	South Hams	26.7
30. Thurlestone	South Hams	26.2

Data is for all properties on which council tax is payable including chalets

NEW DEVELOPMENTS

HOLIDAY LODGES

Stonerush Lakes, Lanreath, South Cornwall

2 or 3-bedroom lodge

£175,000-£185,000

This newly launched development of 70 sustainably built holiday lodges by Charteroak Estates, which is due for completion in 2013, is on the site of an old fishing holiday retreat which had caravan and camping pitches. Six lodges have already been sold from the first phase of development.

The site, which is situated inland, with the lodges surrounding a stocked fishing lake, is just 15 minutes' drive from the coastal town of Fowey, which sits in the Fowey Estuary.

Fowey is a popular destination for sailors, with the local yacht club welcoming visiting yachtsmen and also boasts many other attractions such as coastal walks, horse-riding, day cruises and canoeing. The lodges are also situated within 10 miles of the popular Eden Project near St Austell.

The lodges are perfect for investors, as they come with the option for rental with a guaranteed yield of 6% for the first two years. Buyers who choose this option can use the lodge for several weeks a year, although use during the high season is likely to be restricted.

Those who prefer to use the property can still benefit from a 'lock and leave' option as they can rent it out for the rest of the year through Charteroak Estates who will manage all changeovers and rental bookings in return for 25% agent letting fee.

COASTAL APARTMENTS

Ocean Gate, Newquay, Cornwall

2-bedroom apartments

from £220,000

3-bedroom penthouse apartment

£595,000

This development, which is nearing completion, has made the most of the views in the already popular Pentire area which is a mecca for holidaymakers and locals alike. The main reason for this is Fistral Bay, perhaps one of the most popular and famous surfing beaches in Cornwall. Each apartment comes with access to the communal roof terrace which overlooks the beach and the ocean.

The development will be attractive to surfers of all levels, as those who are inexperienced can visit one of the several surf schools based just minutes from the apartments along the shore.

Golfers will also be enthused by the location as the site sits on the edge of the Newquay links golf course. Ten of the 26 apartments have already been sold in the few weeks since the development was launched. A two-bedroom sea-facing apartment in this complex is expected to command £1,000 a week in rent during the high season.

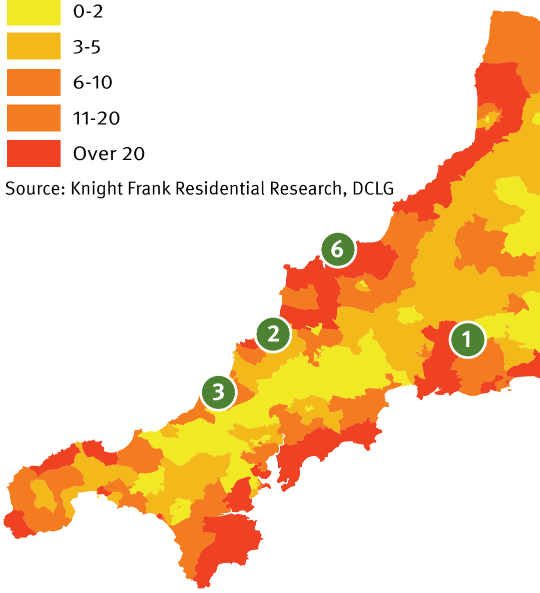
Newquay town centre is a 15-minute walk away, or a 30 to 40-minute walk along the stunning coastal path. In the opposite direction is the coastal walk along the Pentire headland, with access to the highly rated Lewinnick Lodge restaurant.

Figure 3
Second home heat map – South West England

% of second homes

0-2
3-5
6-10
11-20
Over 20

Source: Knight Frank Residential Research, DCLG



COASTAL HOUSES

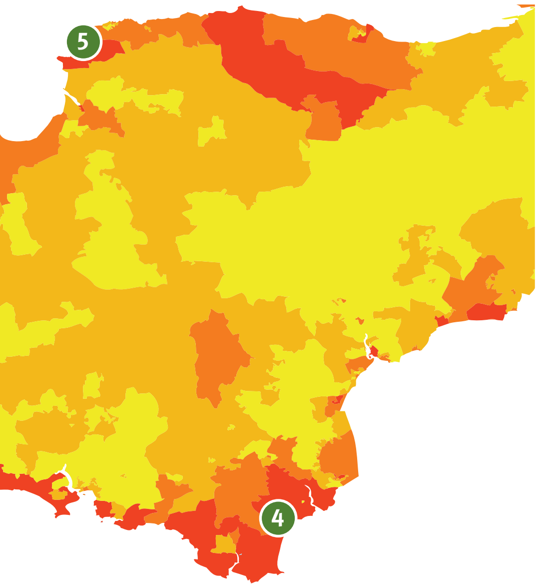
Rocky Lane, St Agnes, Cornwall

£300,000-£595,000

These very contemporary three-bedroom holiday homes are set in a hillside woodland setting around 400 metres from Trevaunance Cove. The sandy beach sweeps down to the Atlantic swells that make the sea perfect for surfing.

St Agnes is a popular Cornish seaside village, and a vibrant location with many shops specialising in selling local produce.

With holiday bookings for this summer up by 100% in some North Cornwall locations, these houses should make an ideal investment as well as a welcome retreat from the hustle and bustle of normal life. The first phase of the development has already sold out.



RE-DEVELOPED HOTEL
At the Beach, South Hams, Devon

2-bedroom apartment

£295,000

2-bedroom house

£310,000

A hotel in a superb coastal location has been completely re-developed into 15 apartments with one, two, three and four bedrooms. Three cottages have also been built in the hotel grounds. The development is based in the popular area of South Hams, where the coastline makes up most of the South Devon Area of Outstanding Natural Beauty.

Six of the apartments and three of the cottages are still to be sold.

A two-bedroom apartment could be let out for between £700 in low season and £1,100 in high season per week.

LARGER COASTAL HOUSES
Long Beach, Woolacombe, Devon

£620,000-£720,000

Reflecting the demand for hi-spec larger houses, this development of two 4-bedroom beach houses alongside a three-bedroom property, is on an enviable site with views of Woolacombe Bay.

While two of the houses by London developer Lyndon Living have holiday restrictions, one of the four-bedroom houses on the end of the terrace development is also available for full residential use.

The three-mile long Woolacombe beach, which lies between Baggy Point and Morte Point, has been voted one of the best in Britain, and is popular with surfers and swimmers alike. The lively town of Woolacombe is a popular destination on the North Devon coast, and links nicely with Croyde, another renowned surfing sea-side resort in that area. The development is around ten miles from the market town of Barnstaple.

The four-bedroom house is expected to attract weekly rents of £1,500 in high season.

Figure 4
Number of second homes in the South West

Source: Knight Frank Residential Research, DCLG

COASTAL HOUSES
Pinewood, Polzeath, Cornwall

4-bedroom house

£950,000

With one of the most coveted addresses in Cornwall, the one, four and five-bedroom houses are designed to appeal to the holiday market. They are light and airy, with most laid out over three storeys, perfect for extended families to stay in. Each house also comes with underground car-parking and storage.

Polzeath is one of the most popular coastal towns on the North Cornwall coast and the houses are a short walk away from three beaches, including Daymar Bay, a popular spot for families and surfers. The St Enodoc golf course is just 15 minutes away, while the coastal walks offer stunning views. Those keen to visit Padstow can travel by ferry from the nearby town of Rock.

The five houses situated towards the front of the development are expected to command rents of £2,250 a week in the peak summer season, and £1,300 off-season.

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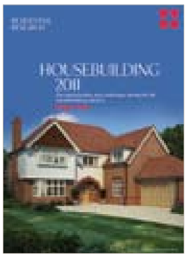

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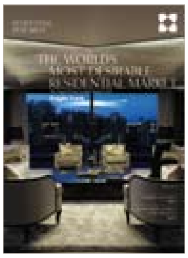

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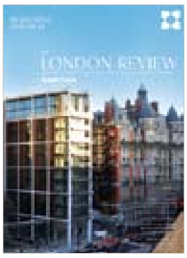

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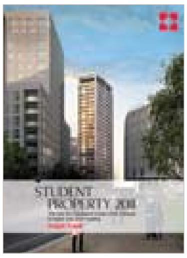

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