Residential Research

Flight to quality

South East residential development review • 2008

Contents

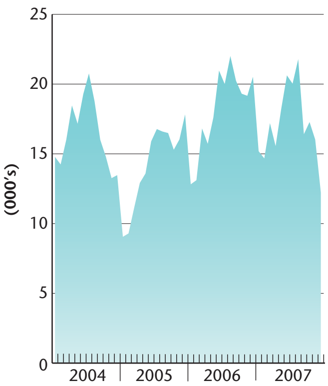
Summers Place, Billingshurst

Executive summary

- In 2007 the South East's housing market outperformed both Greater London and the UK as a whole, experiencing 7% capital growth on average. This was despite regional sales activity falling 14% due to the wider economic downturn in the final quarter of 2007.
- The dynamics of the regional land market have altered significantly in 2008. Sharply lower sales activity, a tightening mortgage market and wavering confidence levels have led to an environment in which premiums are now a rarity and liquidity is proving key.
- The Government is not only advocating volume housebuilding but it is placing design and sustainable development at the top of its policy agenda. The report looks at the region's key sites set for eco-development and highlights the value of quality design, architecture and place-making which is fast emerging as the key consideration for developers in a cooling market.
- Our assessment is that the South East will experience at best moderate price falls in 2008. However, there is a risk of more significant falls should the mortgage market not see any improvement over the next six months. Nonetheless, despite the current economic turbulence housing demand in the South East continues to exceed supply. Household projections are forecast to rise by 35,000 each year up until 2026 but in 2006-07 completion rates totalled just 27,600.

Knight Frank Newmark Global

Figure 1
Sales activity in the South East
2004-2007



Source: Land Registry

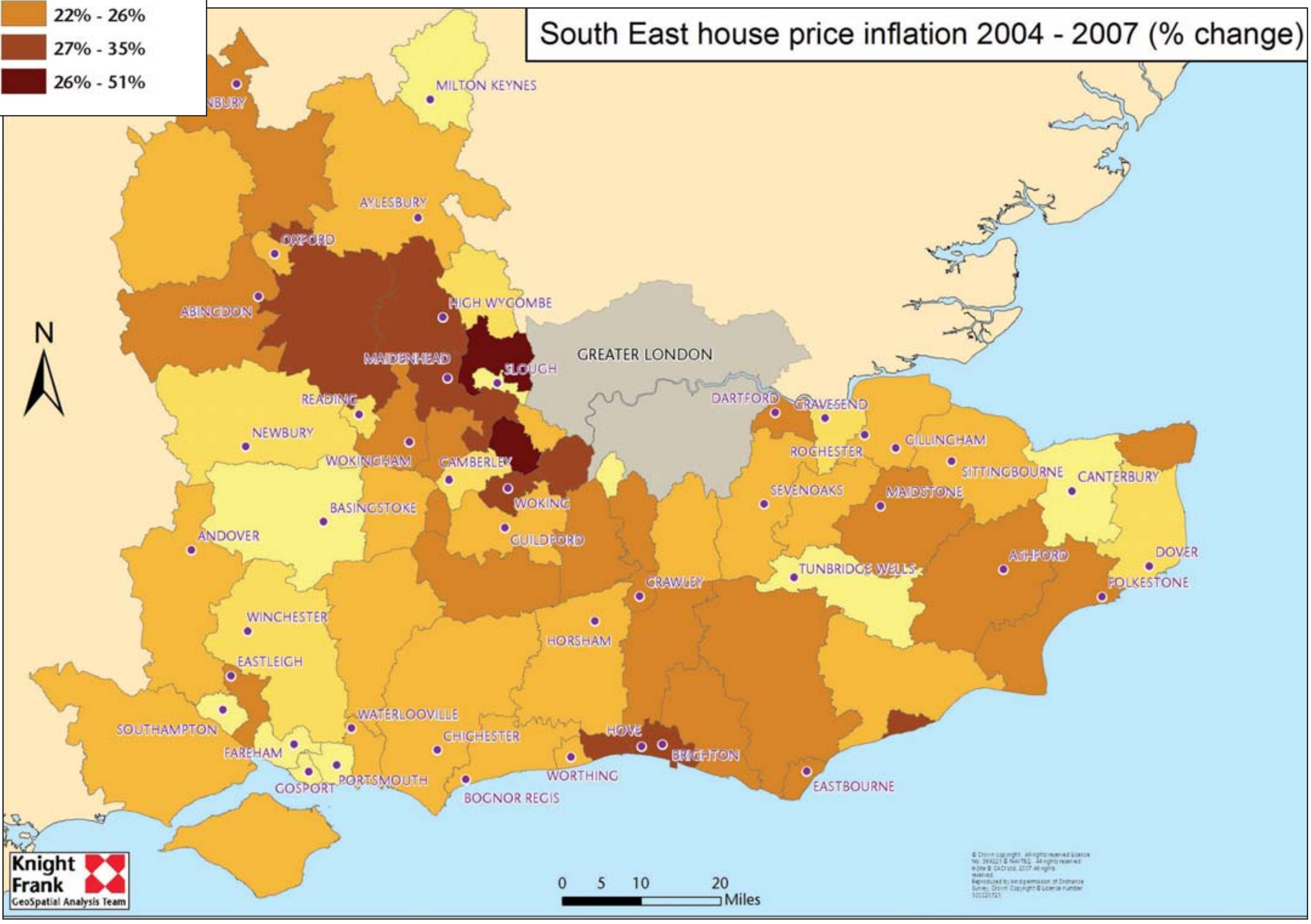
South East market update

The South East housing market averaged 7% capital growth in 2007, outperforming the UK average (5%) as well as Greater London (4%). However, the region's strongest performing local authorities varied considerably in terms of location and character. The traditionally affluent home county locations such as South Bucks and the Wealden area in East Sussex experienced growth in excess of 19% but similar levels of growth were achieved in coastal locations such as Adur (Shoreham-by-Sea) and Hastings, both the focus of significant regeneration. These trends become even more evident when analysed over a three year period (2004-2007) as shown in the map below.

Despite recording positive capital growth in 2007, the regional housing market has not been immune to the wider national and international economic downturn. According to the Land Registry sales activity in the South East fell by 14% in 2007 to approximately 12,200 sales in December 2007, (see Figure 1), we expect sale volumes to fall still further this year.

That said, there were six local authorities in the South East that saw an increase in sales volumes in 2007; Wycombe, Bracknell Forest, Slough, Ashford, Crawley and Thanet. All are areas either undergoing major regeneration, earmarked for significant new supply, or due to benefit from improved transport links.

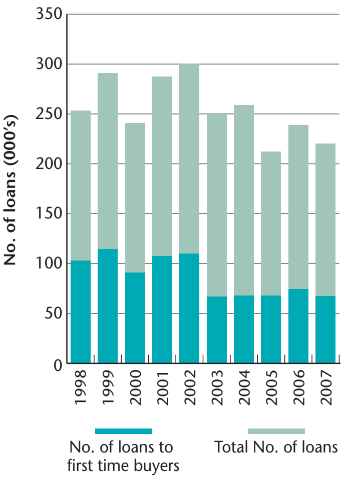
Clearly, we are entering a period of much weaker market conditions than we have experienced in recent years. Despite the fact that long-term housing market fundamentals remain relatively healthy in the South East and demand still outweighs supply, we should not be surprised by price falls and declining sales volumes through 2008 and into 2009.



Source: Knight Frank Residential Research, Land Registry

Figure 2

Mortgages to first time buyers as a proportion of total mortgages in the South East (1998-2007)



Source: Council of Mortgage Lenders

Over the last 12 months conditions in the region's new homes market have mirrored the wider UK market. Site visits by prospective purchasers fell by almost 20% in the six months to April 2008, however, prime locations such as Esher and Sevenoaks continued to outperform the regional average recording values of £550 and £400 per sq ft respectively for new build apartments. There were also mixed messages from the region's mortgage market. While the total number of mortgages taken out fell in real terms to 220,000, the proportion of loans taken out by first time buyers remained steady at 31% (see Figure 2).

Market drivers and future trends

So, what is driving the South East housing market? Essentially it comes down to the region's economic strength. The South East's economy is worth £166.3 billion, the largest output of any UK region outside of London and according to Eurostat it has a similar size economy to that of Sweden or Austria. The regional economy is not only large but it is performing strongly (2.7% GDP growth in 2007), stronger in fact than the UK as a whole (2.5%). Strong productivity and high rates of employment combined with the fact that median earnings are on average 10% higher than the national average have contributed to an additional market driver – wealth.

In contrast to other UK regions the South East's housing market is largely equity and not credit driven. Since 2000 the average home in the South East has grown in value by 102%. In fact, for the 31% of the region's households that own their home outright this has meant that the market's performance since 2000 has generated on average £116,700 in equity over the eight year period. This is not only a key generator of wealth, but in many cases a driver of additional demand. A large proportion of this equity has subsequently re-entered the housing market in the form of second homes, buy-to-let investments and deposits for children to buy their first homes.

The Clock House, Byfleet

Commuters

Aside from the economy, earnings and overall wealth generation, planned improvements to the region's transport links are also likely to be an important driver of future growth. The South East of England Development Agency (SEEDA) estimates that the gross income of commuters from the South East to London totals £22 billion, roughly one sixth of the South East's GVA. The planned improvements to infrastructure are likely to expand this influential commuter belt even further, reaching new parts of the South East.

Transport

The introduction of the high speed rail link between St Pancras, Ashford and the Kent coast will radically reduce journey times from December 2009 (see Table 1). In the case of the growth area of Ashford, for example, journey times into London will be reduced from 83 to 37 minutes. The planned delivery of Crossrail will also have repercussions for the South East as areas around Maidenhead in the west and Shenfield in the east benefit from 24 trains per hour across London. Finally, the new Hindhead tunnel will reduce congestion on the A3, one of the region's main trunk roads, when it opens in 2011, improving traffic flow in and around the Haslemere and Farnham areas.

Table 1

Impact of high speed rail link

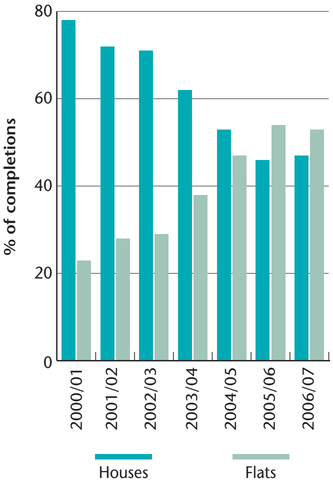
	Current journey time to Charing Cross (mins)	Journey time to St Pancras from Dec 2009 (mins)
Ashford	83	37
Canterbury	102	61
Chatham	60	43
Dover	112	74
Ebbsfleet	n/a	17
Faversham	78	66
Folkestone	98	63
Margate	109	98
Ramsgate	119	84

Source: Southeastern Railway

Housing associations

One final trend likely to have an important bearing on the region's new homes market is the expanding role of housing associations. In a softening market there is a growing realisation that housing associations may be the one source of demand capable of plugging the gap left by the credit crunch. However, one concern has been that until now grant funded homes have had to meet the Housing Corporation's strict design and sustainable homes criteria. The Housing Corporation has recently announced, however, that these standards are to be relaxed on a 'case-by-case' basis to enable housing associations to take advantage of the greater availability of stock, some of which is at discounted rates.

Figure 3
Completions by housing type in the South East (2000-2007)



Source: CLG

Land and development

The land market in the South East altered dramatically over the course of 2007-08. Prior to Q3 2007, developers were willing to pay premiums for sites with planning consent. Since this time, premiums have disappeared and unconditional offers are now being discounted to allow developers to factor in potential price falls in the future. Slowing sales activity, a tightening mortgage market and wavering confidence levels are impacting on the land market as the rush to acquire sites and capitalise on strong price inflation has waned. In contrast, sites without planning consent are now facing stronger demand. There are two main reasons for this. Firstly, by bidding for sites being sold subject to planning, developers are able to defer payment providing a more favourable internal rate of return. Secondly, some developers remain hopeful that protracted planning negotiations will buy them time enabling the mortgage and sales market to have recovered by the time the scheme launches.

There are of course those developers who are continuing to thrive in the current market conditions. By identifying prime sites and delivering quality homes they are still managing to achieve their margins despite rising build costs and slowing growth. The credit crunch has divided the housebuilding industry into two camps; those with access to funds and those whose finances are tied up in slower selling sites. The recent spate of mergers has enabled some housebuilders to reduce previously replicated costs producing a leaner organisation and, in some instances, a more competitive bidder.

The product mix has also become a key consideration for developers. Sites suitable for family accommodation as opposed to apartments now generate the greatest interest, particularly since 2006 when Planning Policy Statement 3 (PPS3) advocated an improved mix of housing types and granted planning authorities greater flexibility in matching supply to local market need. Figure 3 shows the extent to which completions in the region shifted from houses to flats between 2000 and 2007, the effects of PPS3 are still to be felt.

Land values

Since the summer of 2007 land values in the South East have fallen in response to global economic uncertainty, its resultant impact on mortgage lending as well as the rising build costs facing developers. In the six months to January 2008 the Valuation Office reported static growth for land values in the South East but our experience is that in the year to June 2008 land values in the region experienced negative growth for the first time since the early 1990s.

Southlands Hospital site, Shoreham-by-Sea

Prime sites

Knight Frank has been involved in the sale of a number of key ex-public sector sites in 2007-2008, these include two previous NHS sites sold on behalf of English Partnerships; Graylingwell Hospital in Chichester and Southlands Hospital at Shoreham-by-Sea. The Graylingwell Hospital site will provide 800 new homes. A detailed planning application is to be submitted during the summer of 2008 with the objective of creating a mixed-use scheme which will incorporate community facilities such as a theatre, an artists' studio and a restaurant whilst also acting as an exemplary model of sustainable design. At the Southlands Hospital site Crest Nicholson has been chosen to deliver 220 homes, 35% of which will be affordable. Other prime sites currently being marketed include a 1.13 hectare site in Addlestone town centre and the former Thornchace School adjacent to Guildford Golf Club. English Partnerships is also seeking a development partner for Roussillon Barracks, a prime opportunity situated next to the Graylingwell site and with the potential capacity for 350 new homes.

Special Protection Areas

In last year's report we highlighted the impact that Special Protection Areas (SPAs) were having on development in the Thames Basin Heath area, a region home to a number of protected species of birds that spans 8,000 hectares and covers 11 local authorities. Any development likely to cause harm to the SPA is currently prohibited under an EU directive. Since 2007 Natural England (the Government's statutory advisor on nature conservation) has considered that if Suitable Accessible Natural Green Space (SANGS) are provided housing development can go ahead within five kilometres of the SPA and a financial contribution is then made by the developer. This process is already in operation in Woking and Guildford. Waverley and Elmbridge Councils have taken similar steps but Surrey Heath has yet to formalise any such measure.

Ditton Place, Balcombe

Flight to quality

The commonly recited adage "location, location, location" still holds true but it is now increasingly being accompanied by calls for "quality, quality, quality". We assess why this drive to improve design standards intensifies in a cooling market and what evidence there is of this happening in the South East and in particular which organisations are proving key to raising the bar. We also summarise the efforts being made by Government to incentivise housebuilders to invest in design and look at what evidence there is to suggest that well designed homes and neighbourhoods appreciate in value faster. The push for improved design standards is increasingly being pursued hand in hand with the delivery of sustainable homes. In the second part of this themed section we therefore highlight key examples of eco-design in the region, what Government policy such as The Code for Sustainable Homes really means for developers in terms of compliance and the estimated additional costs.

Why does quality matter and why does it seem to matter more in a softening market?

Good design, architecture and place making can reap rewards not just for developers but investors, occupiers, local authorities and the wider community. Research carried out by the Commission for Architecture and the Built Environment (CABE) shows that by building a quality product and environment developers gain planning consent more rapidly, increase public support for the scheme, achieve higher capital values, and help to differentiate themselves from the rest of the marketplace. CABE also argues that investors usually achieve higher rental returns, have an increased asset value on which to borrow and attract higher quality longer-term tenants. Occupiers for their part enjoy reduced energy costs and repair works, and CABE would argue – less crime and more community cohesion, while local authorities minimise planning and crime prevention costs and can use the development to drive the impetus for wider regeneration.

"Development based on sound design principles can raise values by as much as 10% to 20%."

Why is quality starting to matter more? Put bluntly in a boom market developers can sell pretty much anything especially when the main market is investor led. The realisation now is that this model is broken. Trends in the recent strong market have led to speeding up the delivery process, be it via design, planning, or by using more easily available materials. There is little incentive for developers to distinguish their product, confident that demand is such that they will be assured of a quick sale regardless of specification or finish. In contrast, in a cooling market when capital growth slows due to economic uncertainty or strong supply housebuilders face less pressure to get the product out of the ground, conscious that they are not missing out on high volume sales. Instead, the power switches to the buyer who aside from location uses quality as a means to differentiate between competing schemes.

What is the Government doing to encourage better designed homes?

Since the millennium the Government has introduced a range of policy initiatives but arguably the most important came in the form of PPS3 in 2006. PPS3 was the first mechanism to encourage the use of Design Coding a tool since encapsulated in the Building for Life Standard. This is widely considered the national benchmark for well-designed housing and neighbourhoods. The Housing Corporation and English Partnerships (both members of Building for Life), along with a growing number of local authorities, now require new housing developments to fulfil between 12 and 16 of the 20 criteria established by the Building for Life Standard.

Imber Place, Thames Ditton
(computer generated image – details may vary)

Does good design mean higher price growth?

Several studies produced by CABE, English Partnerships and The Prince's Foundation suggest that developments based on sound design principles can raise values by as much as 10% to 20%. A recent report highlighted the fact that too much weight is given to the argument that good design costs more money as opposed to the view that poor design wastes money. In 2007 over 65% of the Building for Life gold award winners, an initiative led by CABE and the Home Builders Federation, received no public sector subsidy. In these instances the decision to promote high quality design was made purely on commercial grounds.

The Beacons, Chelwood Gate

Sustainable development in the South East

The sustainable development of new homes has a significant part to play in the Government's target of reducing the UK's carbon footprint by 25% by 2020. Paul Ruyssevelt, a director at Energy for Sustainable Development estimates that the cost of retrofitting existing homes in the UK to ensure they have lower carbon emissions could cost an average of £25,000-£30,000 per home. Consequently, for the growing number of eco-conscious consumers keen to embrace greener living a new home is increasingly the easiest and cheapest way to improve their energy efficiency.

Two new policy documents published in 2007; the Housing Green Paper and the Code for Sustainable Homes, together provide an indication of the important role the South East is set to play in delivering large-scale sustainable development in future years. According to Government proposals the South East is due to deliver at least 16% (313,000) of its ambitious housebuilding target of 2 million new homes by 2016. This is likely to be a conservative estimate given the current proposals for new Growth Points and Eco-towns in the region. All of these new homes will need to meet environmental standards established in the new Code for Sustainable Homes which became mandatory on 1 May 2008.

The Code measures the sustainability of a new home against nine categories of sustainable design, rating the 'whole home' as a complete package. The Code uses a 1 to 6 star rating system to communicate the overall sustainability performance of a new home, setting a minimum standard for energy and water use at each level (see Table 2).

The national regeneration agency, English Partnerships, along with the Housing Corporation have already adopted Level 3 of the Code and by 2016 the Government aims to ensure all new homes are Level 6 compliant i.e. zero carbon. At the Graylingwell site in Chichester English Partnerships is pursuing a zero carbon strategy. All of the 800 homes proposed will have to produce zero net emissions of carbon dioxide from all energy use in the home.

In addition to the new Code, the Government is undertaking a range of measures to encourage energy efficiency including the introduction of Energy Performance Certificates in the Home Information Packs and also the creation of ten Eco-towns each comprised of 5,000-20,000 new homes. At present Ford Airfield in West Sussex, Bordon-Whitehill in Hampshire and Weston Otmoor in Oxfordshire are the three sites in the South East included in the Government's preliminary shortlist of eco-towns. However, the Ashford Growth Area as well as the Growth Points of Maidstone, Basingstoke, Reigate and Banstead will together deliver 50,690 new homes, all with a strong eco-bias. Shoreham-by-Sea has also applied for Growth Point status and if successful it will receive £2.95 million from SEEDA towards the creation of a sustainable community.

Table 2

The Code for Sustainable Homes

Code Level	Minimum reduction in CO^2 emissions (% in dwelling rate over target emission rate)	Maximum indoor water consumption (litres per person per day)
Level 1	10	120
Level 2	18	120
Level 3	25	105
Level 4	44	105
Level 5	100	80
Level 6	Zero carbon home	80

Source: CLG

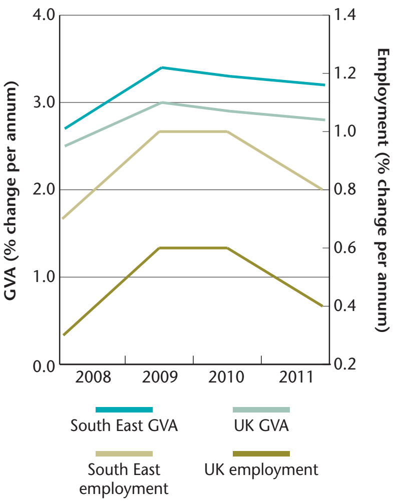
Cathedral cities

Chichester market focus

Chichester is more than simply another historic market town on the South coast. Analysis of the population in socio-economic terms confirms that the cathedral city appeals as much to prosperous professionals and retirees as to young families starting out and students. Some 38.4% of the population are classified as comfortably off (compared to 28% nationally) and a high proportion own their home outright (35%). While the 55+ age group is larger than the UK average so too is the 15-24 year age group which includes a high proportion of students. Average full time annual earnings stand at £33,278, marginally lower than the average for the South East.

Privately and socially rented homes as a proportion of housing stock exceed the national average and together account for 32% of tenure types suggesting there is a significant proportion of residents precluded from home ownership. Mindful of this demand for affordable and social housing English Partnerships has specified that 40% of the new homes planned for the Graylingwell Hospital site and Roussillon Barracks are to meet affordable criteria.

Figure 4
GVA and employment forecast: South East vs. UK (2008-2012)



Source: Experian Business Strategies

According to Government household projections Chichester is forecast to experience a requirement for an additional 11,000 new homes between 2006 and 2026 (550 per annum). In contrast, the revised Draft South East Plan specifies 480 new homes are to be completed each year.

Health, education and public administration together account for 32% of employment but the private sector is also well represented with IBM and the Rolls Royce headquarters located close by. The tourist industry is fuelled by the annual Chichester Theatre Festival and a wealth of leisure activities, these include sailing facilities at Chichester and Bosham Harbours, as well as Goodwood Racecourse and Golf Club, all within a four mile radius of the city.

Canterbury market focus

Canterbury's demographic profile differs starkly from the national picture. In 2001 15-24 year olds represented 35% of the population, compared to 19% nationally. This is largely explained by the city's two large and expanding universities – the University of Kent and Canterbury Christ Church University. Together the number of students enrolled at the two institutions has risen from 24,300 to 33,300 in the past seven years. This expanding student population has been a key driver of the city's large private rented sector which accounts for 20% of housing stock compared to 9% nationally.

The introduction of the domestic high speed rail link from December 2009 will effectively convert Canterbury into a prime commuter market. Journey times will be reduced from 101 to 61 minutes placing it almost on a par with Brighton and Tunbridge Wells in terms of journey times into central London. Despite Canterbury's appealing historic character, at £221,965 the city's average house price is approximately 39% below the average for the South East. Semi-detached properties account for the largest number of sales in 2007 although terraced homes experienced the most significant price growth at 18%. House prices in Canterbury are 7.4 times average full time earnings compared to 8.9 times for the South East region as a whole. With improved accessibility this level of comparative affordability may appeal to first time buyers who want to move out of the capital but still commute in to London for employment purposes.

Market outlook

The South East's housing market faces a period of uncertainty, but this is a reflection of the wider national and international trend as opposed to any weakening market conditions specific to the region. The fallout from the credit crunch will dominate during 2008 and into 2009, having repercussions for the availability and cost of mortgage finance as well as levels of consumer confidence.

However, in simple terms housing demand in the South East continues to exceed supply. The Government's household projections for the South East have recently been revised upwards from 34,400 to 35,800 per annum. Yet against this level of demand the region is currently only delivering around 27,500 new homes each year.

This scenario combined with the absence of both sharply rising interest rates and little evidence of a rapidly deteriorating employment market has meant there are not a large number of forced sellers. Consequently, we envisage that the South East will experience limited price falls in 2008, on a par with Greater London and still outperforming the wider UK market. In relation to the new build market, incentives rather than price reductions are likely to be most popular with developers as they try to maintain both margins and sales levels.

Sales volumes, however, will be the main casualty of the cooling market, but those markets being targeted by large scale investment and regeneration, improved transport links and new employment opportunities will witness higher than average market activity. Shoreham-by-Sea, Chichester, the Kent coast (as well as Canterbury and Chatham) and many rural locations between Tunbridge Wells and Ashford will still spark investor interest.

Knight Frank has recently extended its coverage of the Kent market by opening a new office in Sevenoaks, which works in conjunction with our Tunbridge Wells office. Based in modern refurbished premises in the High Street the office will serve the needs of both the country homes market and the residential development sector.

Farnborough Central, Hampshire
(computer generated image – details may vary)

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Mosaic Apartments, Slough (computer generated image – details may vary)

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