RESEARCH

Knight Frank

RESIDENTIAL DEVELOPMENT LAND

AUTUMN 2014

Dublin's residential development land market returns to growth

Early signs of an increase in development activity but not enough new supply to prevent continued residential price rises over the next two to three years.

Key insights

New starts in 2014 to be **highest since 2008**

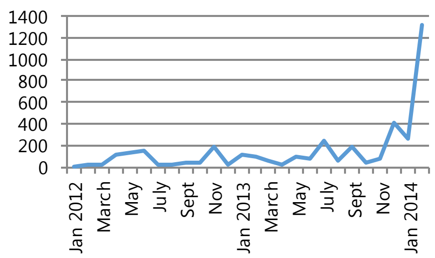
Lack of residential supply **driving price increases**

Lack of **domestic financing** availability still holding back the market

The return of confidence to the economy, positive demographic trends and a lack of supply are driving strong value appreciation in the capital with residential prices growing by 25.1% in the year ending August 2014, according to the Central Statistics Office.

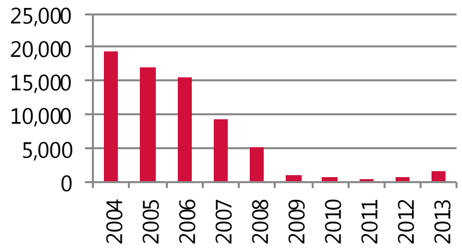
The residential development market has begun to show signs of a response to the increase in house prices with the latest data showing that new residential commencement notices in the first two months of 2014 totalled 1,575, exceeding the entire amount for 2013.

Figure 1: Dublin New Starts, January 2013 to February 2014 (Source: DoELG)



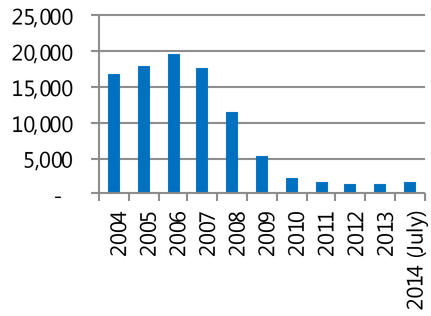
This expansion marks an acceleration of the tentative signs of recovery initiated in 2013 when new commencement notices of 1,451 were double that of 2012, but well below the levels preceding the crisis.

Figure 2: Dublin new starts, 2004 to 2013 (Source: DoELG)



The slight increase in construction activity in 2013 has resulted in almost three times more units (1,693) being completed in the first seven months of 2014 compared to the same period last year, albeit coming from a very low base.

Figure 3: Dublin new completions 2004 to July 2014 (Source: DoELG)



Based on analysis undertaken by Knight Frank, a requirement of at least 40,000 new units are required in Dublin over the next five years and therefore we expect house prices to continue to increase as long as this demand and supply imbalance persists.

Given this requirement, it is a welcome development that NAMA expects to deliver 4,500 housing units between now and the end of 2016 which will help address some of the shortages. However, for the market to undergo a sustained recovery, the two main forces holding back development need to be addressed, namely the lack of finance and the high costs of construction.

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> *"Construction Purchasers Managers Index expanded for the 14th month in a row in August"*

Financing

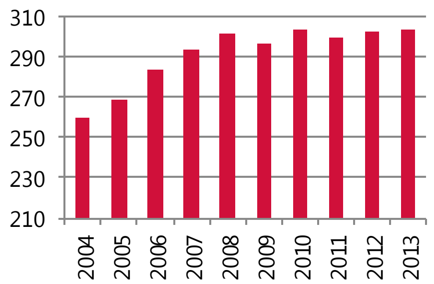
Due to the difficulties in the domestic banking system, the market has suffered from a dearth of financing. Even where financing is being made available, the typical equity requirement of 50% is too high for most developers. International capital is filling the resulting vacuum but is typically more expensive and arduous to raise than traditional bank funding.

In this context, it is encouraging to see AIB's new €350 million development fund launched in February, which will hopefully add much needed funds to the sector.

Cost of Construction

The other impediment to development is high construction costs. While residential prices fell by approximately 60%, the cost of construction has stayed relatively the same with the introduction of new development standards balancing out any cost deflation attained elsewhere.

Figure 4: Construction Cost Index, 2004 to 2013 (Source: DoELG)



In addition, Celtic Tiger legacy policies such as Part V requirements, will need to be reformed so that 6,000 new social housing units can be delivered annually over the next five years, the amount needed according to the homeless charity Threshold.

Part V requirements can add up to €30,000 to the cost of constructing a house and in its current format acts as a hindrance, rather than a solution, to the supply problem in Dublin and should be replaced by a more feasible solution.

Of further importance are the development levies imposed by local authorities, and while they have reduced by local councils in Dublin by 26%, they are still too high given current market conditions.

The preceding should also be considered in the context of additional building regulations requirements which are estimated to add approximately €5,000 in professional service costs to each unit constructed while the Building Energy Regulations requirements can add anywhere between €5,000 and €15,000 per unit. Of course, this should lead to a higher quality of residential development standard which will be of welcome benefit to the market although the additional layer of costs cannot be ignored.

On a positive note, the development of Strategic Development Zones (SDZ) in Dublin will be a major spur to development with the docklands set to deliver high-density apartment schemes and provide 2,600 superior-quality accommodation units in the city centre.

Recent data shows that confidence is growing amongst house builders with The Ulster Bank Residential Construction Purchasers Managers Index expanding for the 14th month in a row in August, standing at 63.7, well above the 50 mark which represents growth in an industry.

Thus, while challenges remain, there is no doubt that the development land market has undergone a remarkable turnaround over the last twelve months, with continued recovery needed in order to meet the strong demand for new residential properties.

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