

Residential Development Land Index

Research, Q2 2021

9.1%

GREENFIELD DEVELOPMENT LAND ROSE 8% IN Q2, AND INCREASED 9.1% ON AN ANNUAL BASIS

4.3%

URBAN BROWNFIELD LAND VALUES WERE FLAT IN Q2, BUT UP 4.3% ON YEAR

4.7%

PCL DEVELOPMENT LAND VALUES REMAINED FLAT THIS QUARTER AND ROSE 4.7% ON YEAR

Greenfield values strengthen as concerns grow over supply chain disruption and rising build costs

Supply chain issues and rising build costs have come into sharper focus this quarter, with housebuilders seeking to replenish their pipelines after scaling back from investing in land last year.

Outside London, they are managing to offset build costs due to strong housing sales and rising prices in areas of high demand from movers looking for more space. Greenfield land prices have strengthened as a result between April and June by 8% as housebuilders focused on increasing their pipeline of land across the country. Annually, greenfield values rose 9.1%.

Average land prices in Prime Central London were flat on a quarterly basis but increased 4.7% year-on-year. The PCL figure has risen on an annual basis following a 6% drop in Q2 last year, due to the disruption caused by Covid-19. There remains a scarcity of product within the PCL market, and this lack of supply is despite ongoing international travel restrictions.

Values were largely flat across regional cities and Greater London, with agents reporting slower demand and tighter margins with rising build costs a particular concern. Brownfield land prices were flat on the quarter but up 4.3% compared to a year ago. In some instances, housebuilders are favouring brownfield sites subject to planning over sites with consent. In some cases, this preference for sites subject to

planning allows the flexibility to modify units to reflect changing trends post-Covid, with an emphasis on more open space, balconies, and extra bedrooms.

Supply chain issues drive up build costs

Supply chain gaps – from timber to roof slates, cement and concrete – are driving up build costs, with housing minister Christopher Pincher having said earlier this month that he was prepared to intervene if shortages become a ‘material obstacle’. This is reflected by our second quarterly Residential Development Land Index Survey of SME and volume housebuilders based in the UK. Just over a quarter of respondents said that a shortage of key building materials was the most challenging factor for their business in Q2, up from just 7% in Q1.

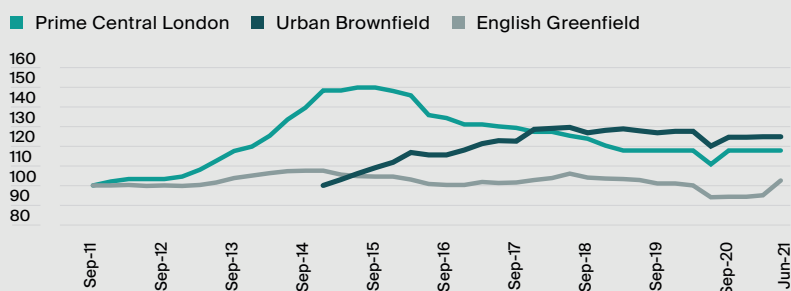
Covid-19 quarantine restrictions have led to logistics bottlenecks around the

world. For the housing sector, the issue has been exacerbated by high levels of construction activity following the seven-week housing market shutdown last year. Separate data on weekly EPC registrations for new build homes shows a recovery in supply, with registrations this year back up to pre-pandemic levels of, on average, over 4,800 per week up to early July. This compares to an average of 3,448 per week for the same six-month period in 2020. EPC data can be viewed as a lead indicator for new supply.

Cost inflation is therefore a dark cloud in an otherwise broadly positive picture for the land market and the UK economy, which grew for the fourth consecutive month in May, albeit at a slower pace than seen recently. Despite tighter margins in some areas, residential development outside city centres has been boosted by a sustained demand for space as a result of the pandemic.

Residential development land prices

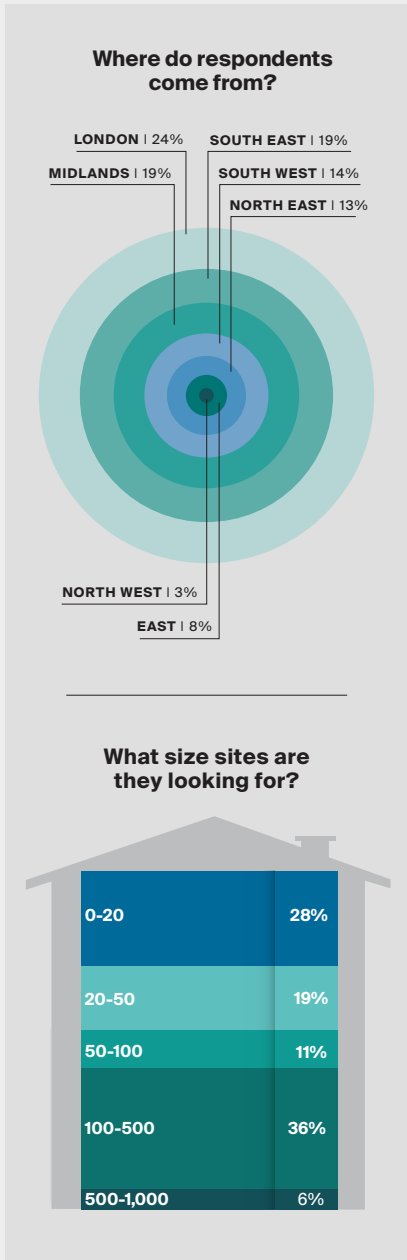
Index rebased 100 = Sep 2011 (Urban Brownfield = Dec 2014)



Source: Knight Frank Research

HOUSEBUILDER OPINION SNAPSHOT

Our survey of volume and SME housebuilders across England looks at the most pressing issues for the sector



This quarter we asked housebuilders whether they are having to reduce their profit margins to compete for land in the current market. In total, **40% of our survey respondents said they had reduced their margins**, with none increasing and half maintaining the same margins on quarter. Split by group, larger housebuilders reported more instances of reducing margins (50%) compared to SMEs at 28%. Looking to Q3, the majority said they would maintain their margins, with 18% saying they planned to reduce them.

Margins are beginning to come under pressure as house prices are expected to moderate combined with an increase in build costs, with supply shortages driving material cost inflation. Increasing regulation to drive energy efficiency in new homes is also adding to cost pressures.

However, **the introduction from 1 April of a less generous Help to Buy programme with regional price caps has so far not had a material impact.**

While it has been a significant driver of new homes sales since its introduction in 2013, sales have been stronger than expected for the year to June 2021.

Some housebuilders have reported they are selling homes at rates 10% higher than 2019. In total, **44% of our survey respondents said their total completed home sales in the year to June 2021 had surpassed their original expectations.**

Planning delays remain an obstacle, with a third of housebuilders claiming this was the greatest challenge of the quarter. But

respondents were divided as to whether the government's zoning plans would increase the supply of land. In total, 40% said it would not, while 30% said it would, with the remaining 30% claiming it would make no difference.

What we'll be watching in Q3:

End of the Stamp Duty Holiday

The tapered stamp duty holiday will run from 1 July to 30 September for residential properties and will then return to the standard rate on 1 October.

Post-Covid recovery

From July 19, Boris Johnson has lifted most pandemic restrictions. How will the UK emerge out of the crisis? When will international travel resume and how will the Bank of England smooth out rising inflation rates?

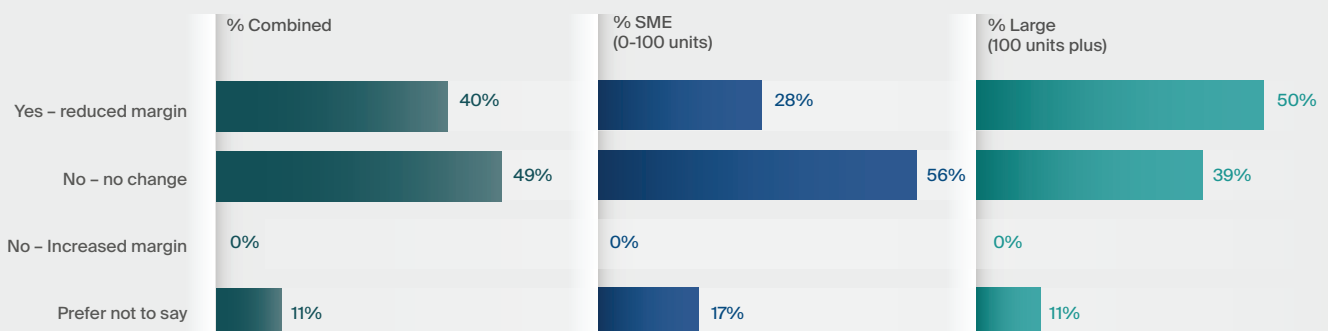
Supply chain disruption

Material shortages have become a much more significant issue, according to our survey. How this plays out next quarter will be important for housebuilder profit margins.

Planning reform tweaks

Following the Lib Dem Chesham and Amersham by-election win, the government has been making some tweaks to its original proposed planning overhaul. Planning reform is expected to remain in flux in Q3.

When bidding for plots of land, did you reduce profit margins in Q2?



Over a quarter of housebuilders have concerns about supply shortages

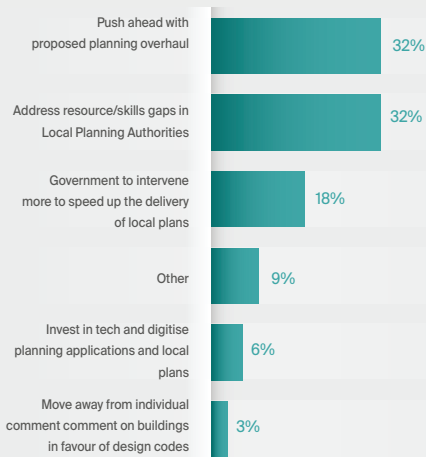
Both SME and larger firms hit by supply chain issues this quarter, with delays expected to persist into Q3

In Q2, **over a quarter of all respondents pointed to 'supply shortages of key building materials' being a challenging factor this quarter**, up from just 7% in Q1. While **planning delays remained the greatest challenge**, selected by a third of all respondents, material shortages are clearly a growing concern with supply chains having become less

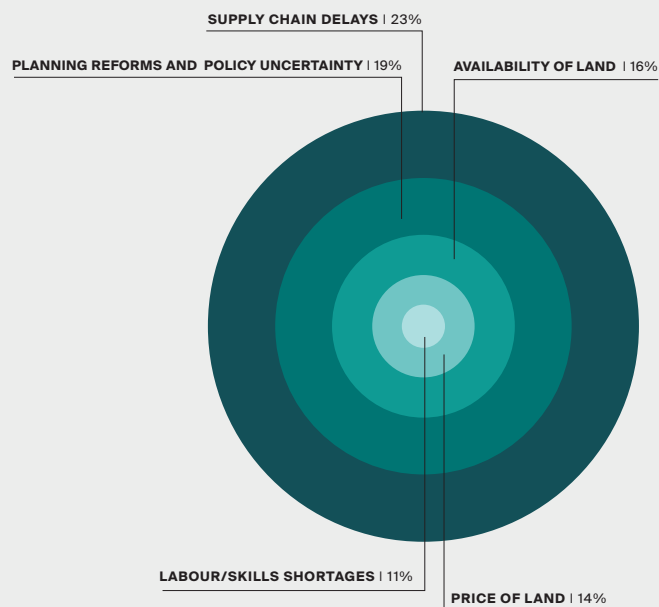
resilient to the double impact of Brexit and the pandemic. Interestingly, these issues are impacting SME and larger housebuilders equally, with 26% of both groups reporting delays. Looking ahead, **supply chain delays are expected to have the greatest impact on the**

housebuilding sector in Q3. Previously, respondents in Q1 said land availability would be the most significant factor for this quarter, with **70% describing the current supply of land available for development as either 'limited' or 'very limited'.**

What would you like the government to do to address planning delays?

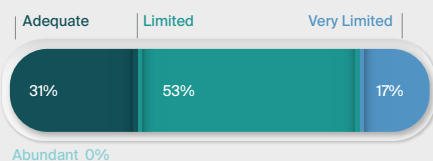


Which five factors will have the greatest impact on housebuilding in Q3?



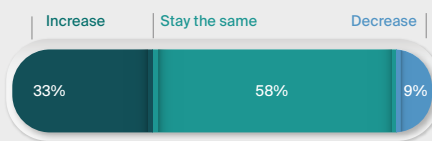
Land availability

% of respondents that said available land market supply was...



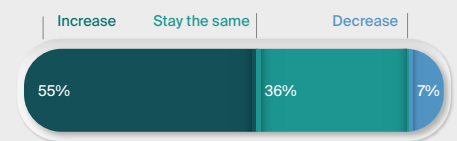
Start volumes

% of respondents that said start volumes would...



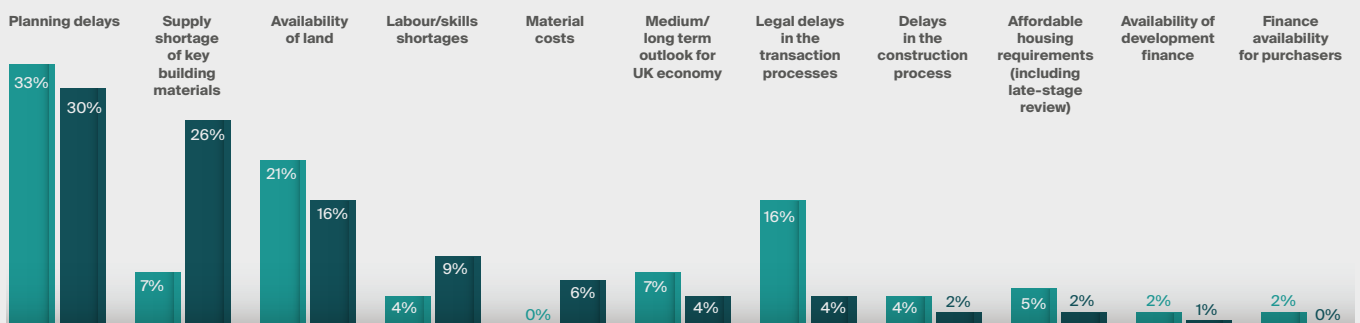
Land prices

% of respondents that thought land prices would...



Which factors proved most challenging for the sector this quarter?

Q1 2021 Q2 2021



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Q1 2021



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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.

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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