Residential Development Land Index

Q2 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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The UK's worsening economic outlook weighed on the residential development land market in the second quarter, leading to a slowdown in activity and a decline in prices across the board

In prime central London, land values fell 5%, the first quarterly decline since the pandemic related downturn during the second quarter of 2020. UK greenfield and urban brownfield values also fell on average by 6.1% and 5.9% in Q2 2023, taking the annual change to -14.6% and -17.9% respectively.

Land values are falling as house prices are declining, borrowing costs are rising sharply and the economic picture remains uncertain. In June, Nationwide reported that house prices were flat compared to a month earlier, but down 3.5% on an annual basis.

While the land price falls are significant, residential land values tend to be volatile and highly sensitive to house price changes. As the economic situation improves and inflation eases, we could see a sharp rebound in land values.

Housebuilders are operating a more cautious approach to land purchases in order to reduce outgoings as slowing sales rates and a need for more competitive pricing squeeze profitability.

Average operating margins for the sector are forecast to fall from 20.1% in the 2021-22 financial year to 15.7% in 2022-23, according to equity research analysis firm Redburn.

Currently, the volume homebuilders are increasing their profit margins to reflect the market uncertainty. Our survey found that around a fifth of housebuilders raised their margins in Q2, with nearly 60% keeping them the same on quarter.

Mortgage rates are approaching 7% following the Bank of England raising the base rate again by 0.5bps in June to 5%, the highest level since October 2008. Persistent inflation drove this decision, with the headline rate remaining at 8.7% in the year to May.

53%

of housebuilders expect land prices to fall in the third quarter (July-September)

42%

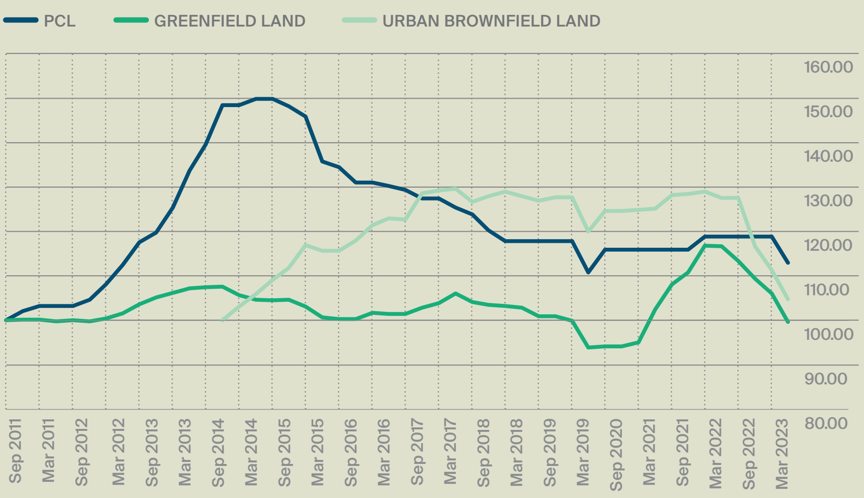
of housebuilders said the short-term outlook for the UK economy was the most challenging factor for their business this quarter

A quarter

have renegotiated a land purchase this quarter

Residential development land prices

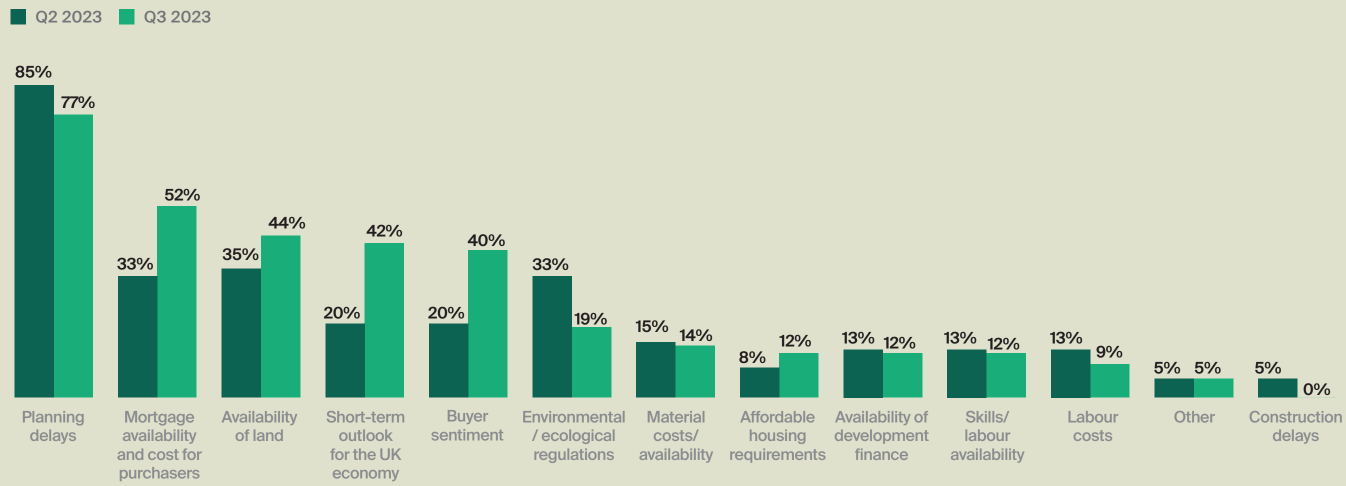
Index rebased 100 = Sep 2011 (Urban Brownfield = Dec 2014)



Source: Knight Frank Research

What do you think will have the greatest impact on the housebuilding sector next quarter?

% of respondents (choose up to three)



Source: Knight Frank Research

Since then, UK inflation has cooled, coming in at 7.9% annually in June, below consensus expectations. This has improved market sentiment and brought interest rate predictions down.

SHIFTING SENTIMENT

Our latest survey of over 45 volume and SME housebuilders shows that the short-term outlook for the UK economy is one of the biggest concerns for the industry. Just over 40% of respondents said that this had been the most challenging factor for their business in Q2, up from 20% who cited this factor in Q1. Likewise, 44% selected 'mortgage availability and cost for purchasers' as the most challenging factor, up from just 15% in the first quarter. Looking ahead, over half thought that 'mortgage availability and cost for purchasers' would have the greatest impact on the housebuilding sector in the third quarter, second to planning delays.

The sluggish economy has led to greater caution towards land purchases, with deferred payment structures, conditional agreements and withdrawals all on the rise. Over 40% of housebuilders said they had been involved in a conditional land purchase in the second quarter, another 40% had agreed a purchase with a deferred payment structure, a quarter said they had renegotiated a purchase and a fifth said they had either withdrawn or deferred a purchase.

Land buyers also want certainty: in terms of preferred status of land to buy, the split in our survey is towards land with principle of development (allocation or consent).

MORE MANAGEABLE BUILD COSTS

The slowdown in construction activity has increased the availability of building materials and labour. Supply chains are also recovering post-pandemic and following disruptions caused by the ongoing Ukraine war. Key building materials such as timber, steel, concrete saw prices surge by around 60-80% in 2021. But there are signs these costs are now abating slightly, and costs for these materials have fallen by around 20% over the past 12 months.

That said, build costs remain historically high: increasing by 8.7% last year and up 24% since 2020, according to the BCIS. Materials costs have risen 43% in two years, while labour costs are up by nearly 10%.

The BCIS is forecasting build costs will increase by a more manageable 5.1%

Volume housebuilders scale back

Larger housebuilders remained selective in terms of land purchases this quarter, with some no longer proceeding on previously approved sites, and most expecting to deliver a reduced volume of new homes over the coming months.

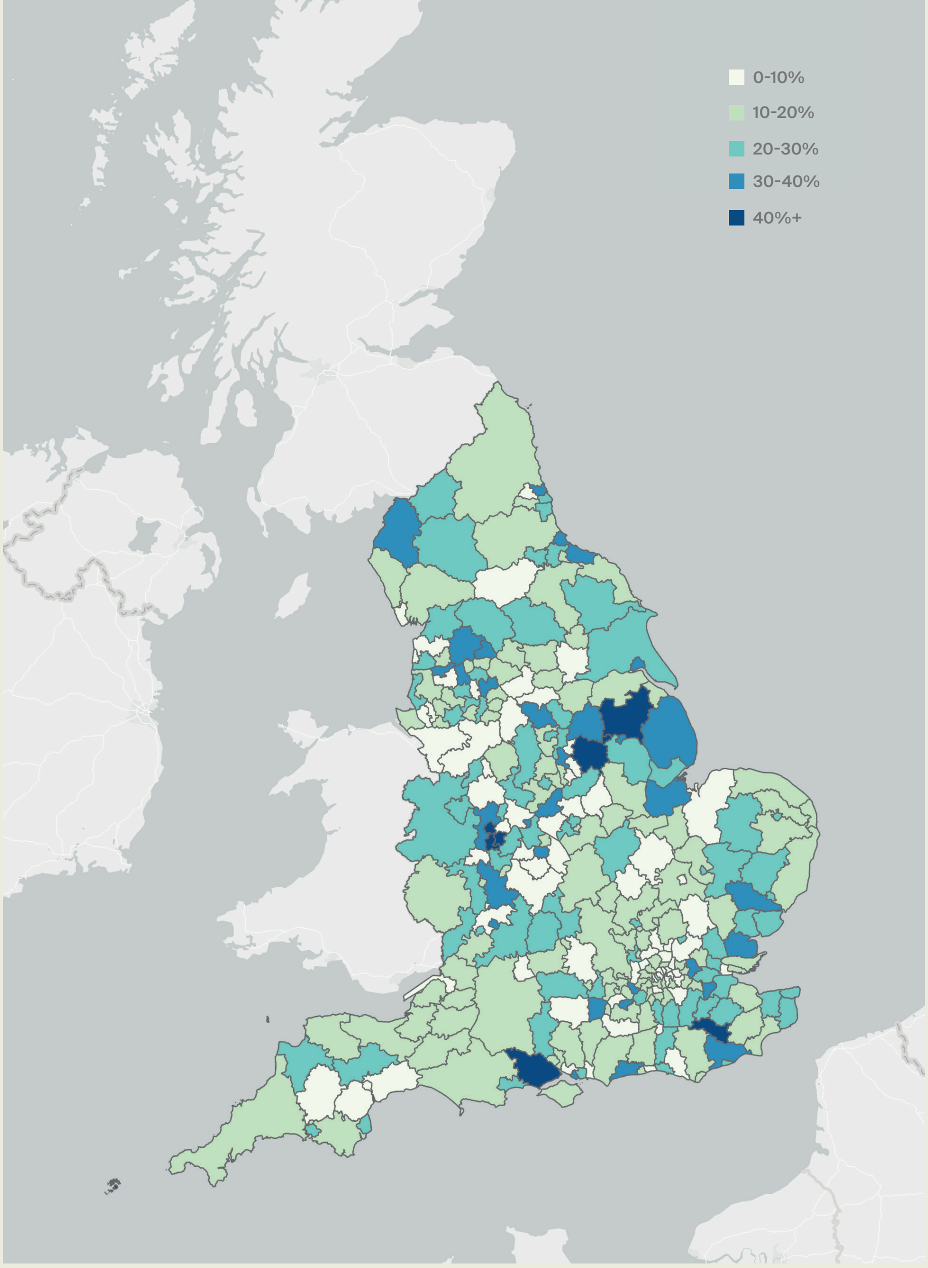
Housebuilder average sales rates were 0.60 in the first half of 2023, up from 0.49 in H2 2022 but below the long run average of 0.70 sales per outlet per week. Activity levels are hugely varied across the country, with scarcer greenfield housing sites in the South East and some regional urban brownfield sites in the North of England attracting competitive bids, with greater affordability in cities such as Manchester and Leeds driving more sales. While housebuilders are diversifying revenue streams through bulk deals with institutional investors in the private rental sector, such as Barratt's 604-homes deal with Lloyd's subsidiary Citra Living in June, 30% of survey respondents said 'normal sales' were the strongest sales supports in the first half of the year, with over 60% selecting 'offering incentives'. Just under a fifth chose sales to build to rent or single family housing operators or investors.

Looking ahead, our survey points to a slowdown in delivery, with 61% now expecting start volumes to decrease in the third quarter, compared to a quarter in Q1 (looking ahead to Q2). Over half of respondents also think land values will fall again in Q3.

The June S&P Global/Cips construction purchasing managers' index found that work on residential building projects decreased for the sixth month running and at the steepest pace since May 2020. Other than the Covid market slowdown, the latest reading for residential construction activity was the lowest for just over 14 years.

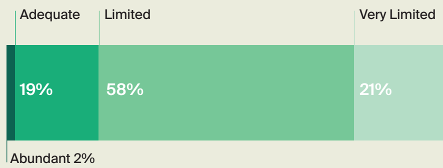
Major development decisions

Percentage agreed by local authorities within 13 weeks over the past two years to end March 2023



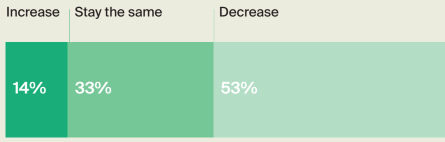
Land availability

% of respondents that said land availability was...



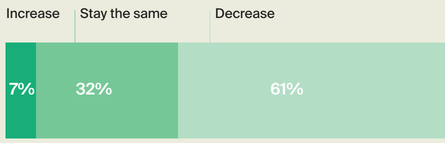
Land prices

% of respondents that thought land prices would...

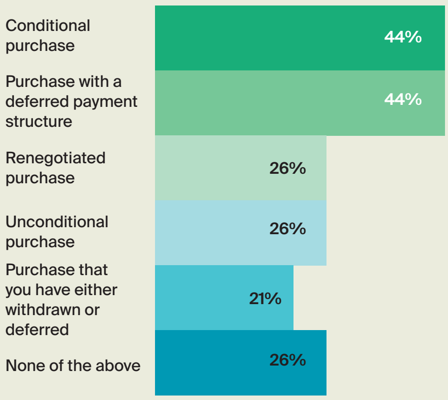


Start volumes

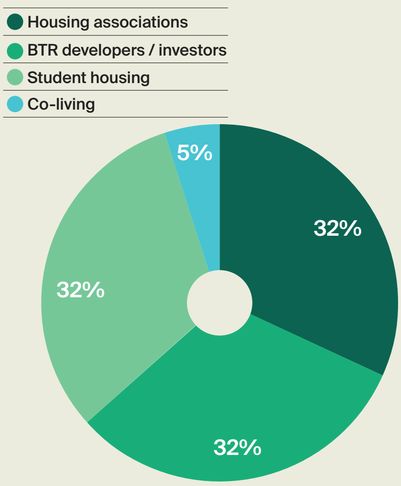
Thinking about the next three months do you expect start volumes to...



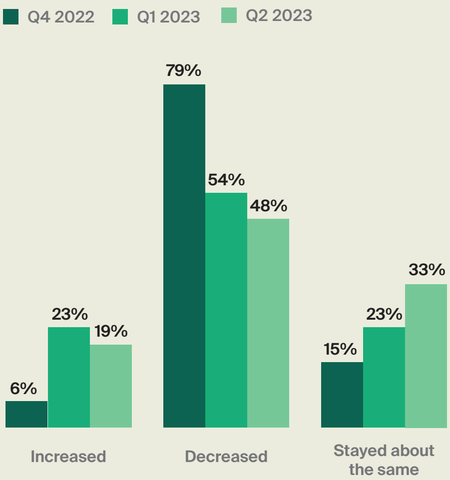
Have you been involved in one of the following land purchase types in H1 2023?



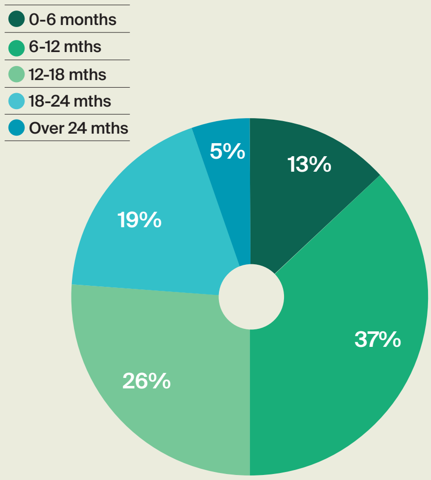
Which group was most active in your region?



How active was the new homes market, looking at site visits and reservations?



How long do you typically allow for getting reserved matters approval on an allocated site?



overall this year and by 10.6% between 2024-2027. Our survey also suggests that build costs are still rising, even if at a slower rate than the surges seen in recent years. Just over half said that prices for key building materials had increased in Q2 compared with Q1, while just under 40% said that labour costs had risen.

PLANNING SLOWDOWN

New development projects have stalled amid uncertainty over the future direction of planning and the subdued state of the property market. The latest Home Builders Federation figures show that 58 LPAs have delayed or withdrawn their local plans. This has contributed to a reduction in planning consents, which will further restrict new build delivery.

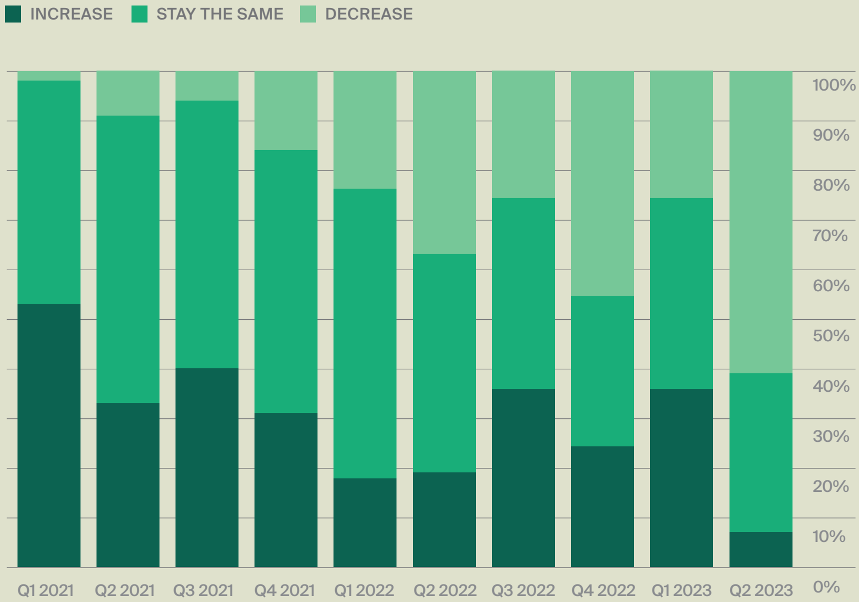
England had the slowest start to the year in Q1 2023 since 2009 in terms of major residential planning decisions granted, government data shows. Decisions granted fell 16% compared to Q1 2022 to 1,037. Our survey also points to planning delays as a recurrent issue, with half of housebuilders allowing over a year to secure reserved matters approval on an allocated site, the next stage after an outline permission has been granted. Typically, this approval process should take eight weeks or three months for large developments. Some homebuilders allow even longer: A further 18% would allow up to two years, with just 13% building in up to six months of approval time.

Nutrient neutrality rules are also weighing on delivery, with the HBF estimating that more than 145,000 new build homes have been stalled as a result. In total, 74 local planning authorities are subject to Natural England's nutrient neutrality guidance, which prevents development in 'catchments' around some waterways if the new homes would increase levels of nutrients.

While the immediate picture for the land market is challenging, a reduction in cost inflation should eventually help reduce pressure on margins and give developers more of an incentive to purchase land. The longer-term fundamentals for the new homes market also remain robust, with supply shortages likely to support pricing.

What will happen to start volumes over the next three months?

% 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.

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 20th June-10 July 2023.

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