

# South East

## Residential Development Review

2023

Knight Frank's review of the key development and investment themes in the South East land market

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► A decline in housing delivery across the region comes against a backdrop of a weaker sales market across England, but development is slowing at a faster pace than the rest of the country and new supply has been delayed by planning obstacles, notably the impact of nutrient and water neutrality rules



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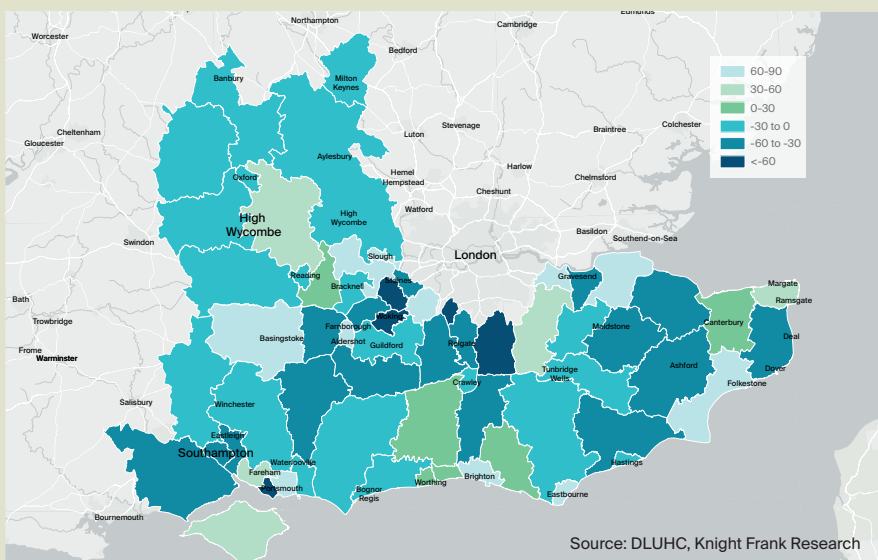
### Development slows

The events of the last 18 months have ushered in a new dynamic to the residential development market. The mini-Budget in September 2022 led to a slowdown in both sales and development, while the planning environment remains a challenge.

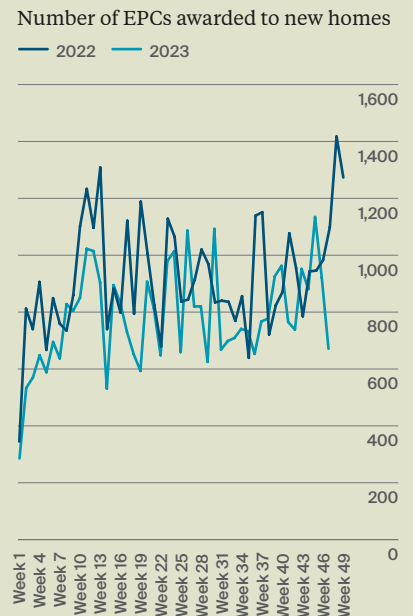
In the South East, there has been a notable decline in housing delivery in recent months, with the number of Energy Performance Certificates granted to new homes falling 16% to 36,824 (See Fig 2) this year (to end November) versus the same period in 2022 compared with a 7% fall for the whole of England. The drop in output can be explained in part by a fall in demand. The rising cost of mortgage debt has decreased the demand for homes for private sale, but a lack of clarity around the future direction of planning policy has also led to some local authorities pausing local plans, creating a delay in the volume of land being allocated for development. Last year, the government removed mandatory housing targets and softened the five-year land supply requirement, while it is also planning to introduce a new single national infrastructure levy on new development over the next decade. Sentiment around the state of the UK planning system has worsened in recent months. In our latest Q3 survey of over 50 volume and SME housebuilders, 80% of respondents cited planning delays as a key issue.

“In the South East, there has been a notable decline in housing delivery in recent months, with the number of Energy Performance Certificates granted to new homes falling 16% in 2023 to end November versus the same period in 2022.”

**Fig 1: Over 60% of South East local authorities see fall in new homes**  
% change in EPCs granted, Q2 2023 vs Q2 2022



**Fig 2: Housing supply declines in 2023 - South East**  
Number of EPCs awarded to new homes



In the South East the impact of political and planning upheaval has been considerable. More than 20 councils in the region have delayed their local plans, according to the latest figures from the Home Builders Federation (HBF). This represents around 40% of a total 64 councils who have paused or delayed plans across the whole country. Nutrient neutrality requirements have also affected 23 local authorities in the region. Neutrality regulation is an additional planning concern, which is already leading to slower build out rates of new homes in some affected areas. As a result, developers who can proceed with new schemes will benefit from selling into a market that is likely to be starved of new stock.

### Constrained pipeline of new homes

The South East region faces a constrained pipeline of new homes at a time of growing demand to live in the region from untethered commuters to employees in the growing life sciences sector. The number of people moving from other parts of the UK to live in the area has grown steadily over the past few years, with a particularly notable increase in the proportion of higher earners moving from London.

Buckinghamshire, Milton Keynes and Medway are the top three areas that have attracted the most residents from the capital for the past two years' running, data from Experian shows. Strong employment prospects are a key contributor to drawing in new residents as well as supporting the case for new housing.

It also means that the South East is forecast to be at the forefront of the UK's economic recovery over the next decade, only surpassed by London. Its Gross Value Added (GVA), a measure of the value of goods and services produced in an area, totalled £290bn in 2022. Oxford Economics is forecasting this will increase by 16% to £340bn by 2032. Key growth areas such as professional services, science and technology are set to see a 14% increase in employment numbers over the next decade.

### Supply falling short of housing need

Against this backdrop, we expect the supply of new homes will remain constrained relative to demand. In the South East the latest data on new homes delivery shows a consistent imbalance between housing delivery and housing need.

There were 42,140 net additional dwellings added to housing stock across the region in the 12 months to March 2023, representing a 2% increase on the previous year. Although a step in the right direction, this remains lower than the requirement for more than 50,000 homes per annum put forward using the Government's Standard Method of calculating housing need, resulting in a housing shortfall of around 7,860 homes.

Delivery in this 12 month period has been supported by a historically high level of consents agreed over the last few years making their way through the system, combined with a pick up in housing starts ahead of changes to new home building environmental standards.

But housing construction has fallen in the second half of the year, with key indicators pointing to a looming supply crunch.

Boosting these numbers will be a challenge given the current economic and policy backdrop. This is especially true in the South East where local authorities also have to reconcile the required growth and infrastructure with Green Belt boundaries, some of which have not undergone review for decades.

### Planning pipeline

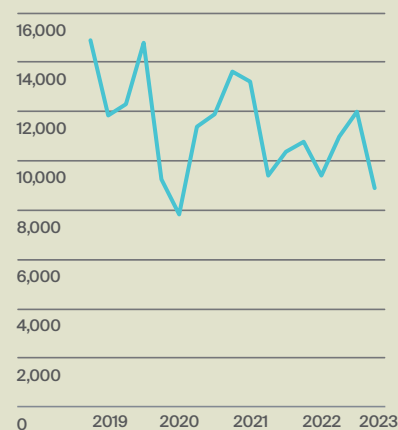
Forward looking indicators suggest that housing delivery is likely to remain constrained (unless conditions improve). Planning pipeline data from Glenigan and the HBF shows that the number of housing units granted full planning permission in England fell to a seven-year low of 270,559 in the 12 months ending March 2023, the lowest level on record since the year ending March 2016. It also marked an 11% fall compared to the previous year. In the South East the number of housing units that secured planning also fell to a seven year low,

# 21%

Decline in the number of housing units granted planning permission in the South East in the second quarter of 2023 versus Q2 2022

**Fig 3: Slowdown in planning permissions**

Number of housing units approved in the South East (quarterly)



Source: Knight Frank Research, HBF, Glenigan

# 22%

Increase in average property price in the South East since 2019

dropping 6% on year to 41,671. In the second quarter, the number of housing units granted planning in England fell to 54,272, the lowest level since the pandemic impacted Q2 2020. The supply pipeline is more constrained in the South East, where approvals fell to 7,552 in Q2 this year, down 21% compared to Q2 2022, an 11-year quarterly low.

### Pricing, transactions and affordability

Over the long term, a lack of new housing supply to meet demand will have knock-on consequences, some of which are already being felt.

Since 2019, the average property price across the South East has risen by 22%, increasing from £322,249 to £393,975. Value growth has been supported by a mixture of factors, including the region's relative affordability compared with London and improving transport connectivity. House prices have grown at a faster pace in the South East region than London since late 2020, when the pandemic prompted a 'race for space' outside the capital. This led to a jump in London movers to the region (see Fig 5). Since then, house price growth has slowed across the country.

The race for space supported a significant increase in transaction volumes. In the South East, transactions peaked at just over 30,000 in June 2021. Since then, however, squeezed affordability and a lack of stock on the market have meant that monthly transactions in the region have fallen below 10,000. Affordability pressures are also being keenly felt. The ratio of median house prices to median workplace earnings across the region stands at 10.75, ONS data shows, which is well ahead of the national average of 8.1. Over the past five years, between 2017 and 2022, 70% of local authorities in the South East have seen an increase in the house price to earnings ratio.

### Lords block plan to scrap homebuilding pollution rules

The House of Lords has defeated the government in a vote on removing nutrient neutrality rules. Labour led a rebellion in September on loosening the restrictions. Previously, in August, ministers had said they planned to amend the levelling-up and regeneration bill to remove EU-era rules that had led to Natural England blocking housing developments in areas of environmental concern. The government claimed that this would have allowed 100,000 new homes to be built by the end of the decade.

The amendments proposed would have enabled local authorities to proceed with developments in areas where they are currently blocked.

The move by the House of Lords is a highly significant development for the South East, since 30% of the councils impacted by nutrient neutrality are located in the region. It is also important since the South East region also has the biggest shortfall of new homes relative to demand outside of London, according to Census data.

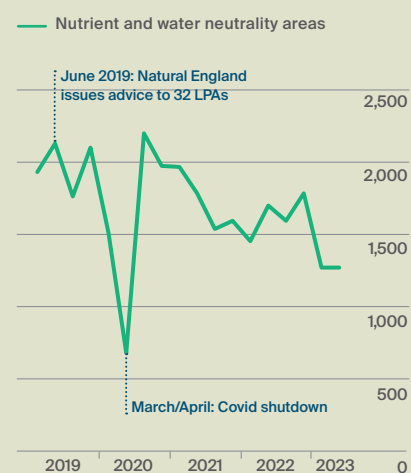
# 40%

of a total of 64 councils who have paused or delayed local plans across the country are located in the South East

“Affordability pressures are also being keenly felt. The ratio of median house prices to median workplace earnings across the region stands at 10.75, ONS data shows, which is well ahead of the national average of 8.1.”

**Fig 4: Eco rules hit South East housing delivery**

Number of EPCs granted to new dwellings



Source: Knight Frank Research, EPC

### Water neutrality: key context

Nutrient neutrality and water neutrality are separate issues, but both have effectively established a moratorium on new development.

Southern England has been experiencing problems supplying water due to population growth and climate change.

The UK Environment Agency has called the entire South East region among others in the country as a place with “serious water stress”.

Water neutrality refers to advice from Natural England which states that any development that takes place must not increase the rate of water abstraction for drinking water supplies above existing levels.

Current water neutrality advice applies to a handful of local authorities in the South East within the Sussex North water supply zone which has a ban on new development unless water can be supplied without damaging the ecosystem. The water zone covers Horsham, Crawley, Mid Sussex, and Chichester.

### Local impact of nutrient neutrality

In total, 74 local authorities are affected by nutrient neutrality, representing nearly a quarter of the total 300 plus authorities in England.

Out of the original 32 cohort affected since 2019 (a further 42 were added to Natural England’s list last year), nearly 70% are located in the South East.

To understand the impact so far on supply, we can look at completions in the catchment zones. Overall, new EPCs granted in these areas fell 40% in the first half of this year versus H1 2019 – just before the guidance was first introduced in June of that year (see Fig 4). This is sharper than the 25% fall in EPCs granted across England during this period.

Planning approvals have also slowed. Half of the 2019 group have seen new housing approvals fall by over 30% between 2018, the year prior to Natural England issuing guidance, and last year.

While developers have been able to start building all homes in catchments approved prior to Natural England issuing guidance, since then they have had to either demonstrate nutrient neutrality in their planning submissions or it becomes a Grampian condition on approval. This means they cannot build until neutrality is achieved.

As a result, some local authorities in the region have seen a sharp fall in new housing starts.

### Land values under pressure

As with the housing market, land values have climbed rapidly over the past few years, with average greenfield values rising 17% between early 2020 up until early 2022. This has been largely driven by strong interest in strategic sites by national housebuilders, although the number of bids from Registered Providers and Build to Rent or Seniors Housing developers had also been climbing.

Since then, urban brownfield land values across England have now fallen by 20% since the most recent peak of the market in the first quarter of 2022 up to Q3 this year, with greenfield values down 17% during this period. Higher build costs remain a challenge for developers. However, they are expected to stabilise as construction supply shortages area easing. Looking ahead, we expect that we will see build costs start to taper as development across all sectors starts to slow. BCIS forecasts suggest annual build cost increases will fall below 3% from 2025 onwards.

### House price forecast

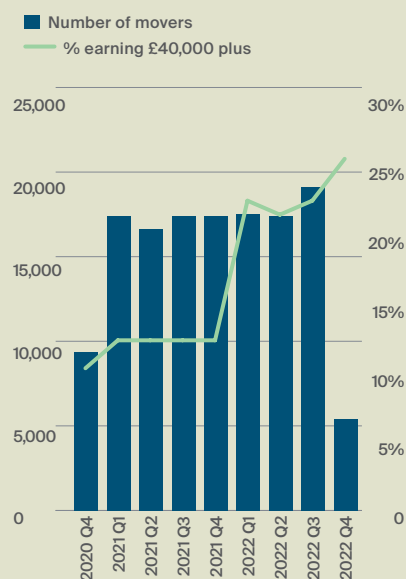
We expect UK house prices to decline by around 11% over the next two years as the impact of higher mortgage rates takes its toll on affordability, and the absence of Help to Buy limits sales to first-time buyers. In our October 2023 forecast, we have predicted a return to moderate house price growth from 2025. A fall in inflation from a recent peak of 11.1% in October 2022 to 4.6% in October supports the view we have either reached or are close to the peak of the current rate hiking cycle. The arrival of a rate ceiling will be critical in bolstering buyer confidence.

### South East primed for growth

In the South East, the highest growth sectors include professional services, science and technology which, combined, is set to see employment numbers grow 14% over the next decade from 472,060 to 536,310, according to Oxford Economics. Arts, entertainment and recreation is another high growth area (14%), followed by human health and social work (11%).

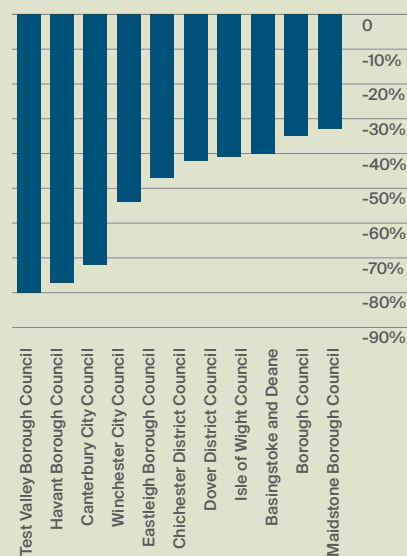
Life sciences brought in over £94 billion to the UK economy in 2021, a 9% increase on the year before. It is therefore a key sector the government is prioritising and the South East, which has the highest number of life sciences sites than any other UK region, stands primed to benefit. In the Autumn statement on 22 November, the government announced £520m in funding for life sciences manufacturing, a new "simplified" research and development tax relief scheme, and clinical trials accelerator schemes.

**Fig 5: London movers into the South East 2020 - 2022**



Source: Knight Frank Research, Experian

**Fig 6: Top ten falls in new homes in nutrient areas - South East**  
% change in housing units approved, 2022 vs 2018



Source: Knight Frank Research

Out of all UK regions, the South East has the highest concentration of life sciences sites and employs nearly half a million people in the sector.

In total there are 1,379 life sciences sites in the South East, according to the Office for Life Sciences, representing about a fifth of the total 7,599 around the country. In London there are 1,120.

Wokingham and Reading in Berkshire and Elmbridge in Surrey are set to see the sharpest growth in overall employment numbers over the next decade at 20%, followed by a joint 17% respectively.

Population growth in the region is also expected to outperform, reaching 9.6 million by 2033, up by 3% on today's level and higher than the 2% growth forecast for the UK. The region's population has grown 7.5% from 2011 to 2021, according to ONS data.

### Migration

Pre-pandemic, internal domestic migration into the South East region from other parts of the UK had been steadily rising. Numbers increased from 240,285 in the year to June 2015 to 282,739 by the year to June 2019, a rise of 18%, according to ONS figures. This figure fell 9% during the year to June 2020, when restrictions were in place on moving home in the spring. On average, London represents half of all annual UK-migration to the South East region, with 16% of overall annual London emigrants settling there.

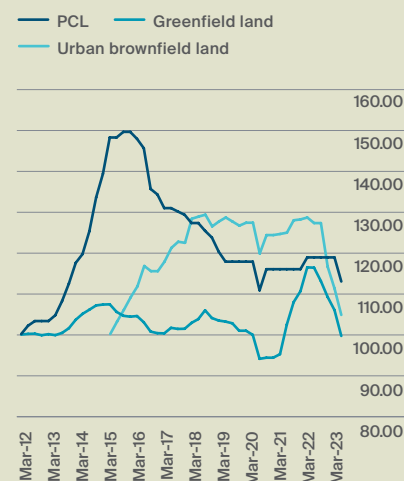
More recent data suggests an uptick in London movers in 2021 versus 2020 when housing transactions spiked driven by stamp duty holiday changes. In total, 68,734 Londoners moved to the South East region in 2021, according to Experian data.

In 2022, the migration of Londoners into the region eased 13% to 59,945, with the total figure impacted significantly by the mini-Budget which contributed to a sharp rise in mortgage rates. However, the proportion of above average earners increased from 12% in 2021 to just over a fifth in 2022. Above average includes those earning £40,000 and above, which is higher than median UK annual pay.

Broken down by quarter, the data shows that quarterly migration levels from London rose sharply between Q4 2020 and the start of 2021 and peaked in Q3 last year at 19,121, before dropping 70% to 5,930 in the aftermath of the mini-Budget.

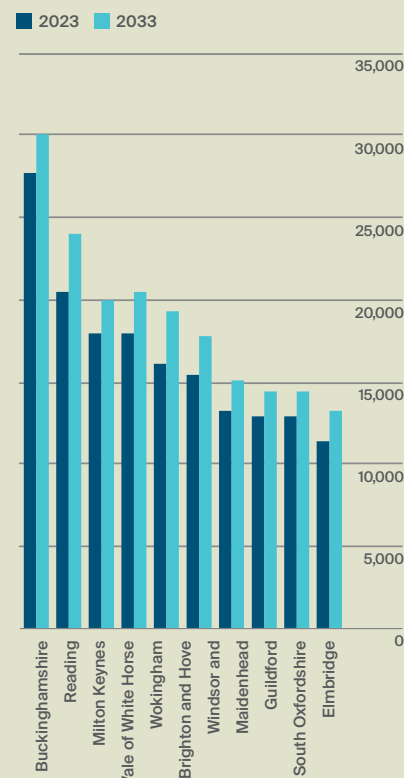
**Fig 7: Residential development land prices**

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



Source: Knight Frank Research

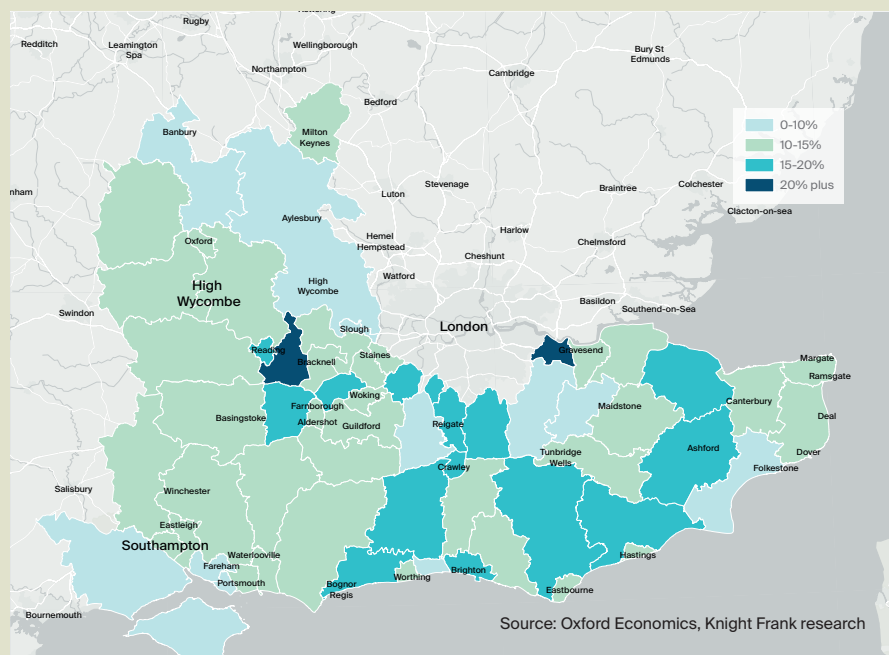
**Fig 8: Top ten areas by number of life sciences employees**



Source: Knight Frank Research, Oxford Economics

**Fig 9: Life sciences employment hotspots in the South East**

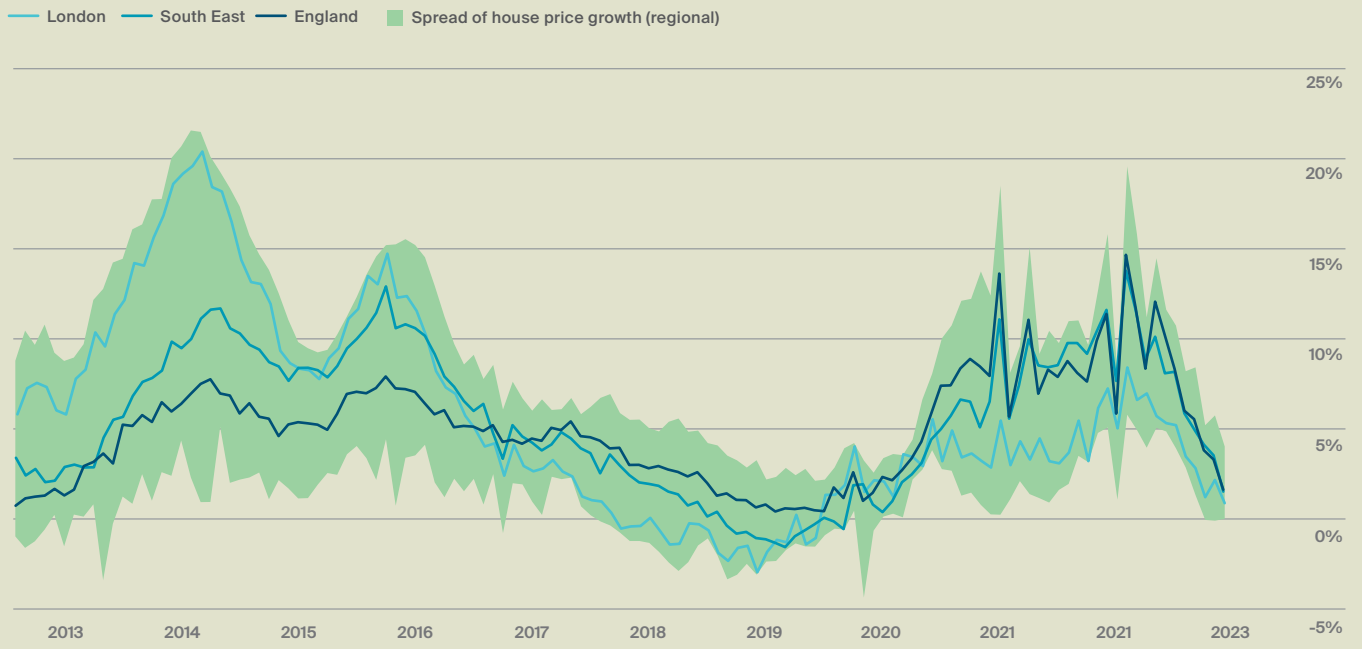
Forecast % change in employees 2033 vs 2023



Source: Oxford Economics, Knight Frank research

**Fig 10: South East house price performance vs London and England**

Annual % change



Source: Knight Frank Research, Land Registry

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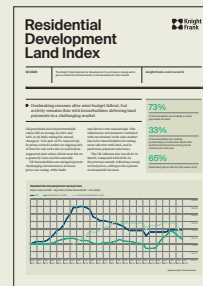
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Student Accommodation Survey 2023



Senior Housing Development Update 2023



Residential Land Index Q2 2023



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