

RESIDENTIAL RESEARCH



BUILDING MOMENTUM

HOUSEBUILDING REPORT **2014**



EXCLUSIVE 2014 UK
HOUSEBUILDER SURVEY
RESULTS

OUTLOOK
FOR HOUSING

HELP TO BUY –
DETAILED ANALYSIS

DEVELOPMENT
ECONOMICS



“Consistency of housing policy is key to help boost supply, as well as expanding access to public sector land.”

GRÁINNE GILMORE
Head of UK Residential Research

SUMMARY

The supply of new homes in the UK is falling well short of demand. After a significant year for the industry in terms of government policy, as well as the wider economic recovery, there are strong signs that private sector construction is picking up. There remains a real need for more homes in order to prevent long-term distortions in the UK’s housing market.

Our market-leading housebuilder survey, aims to shed more light on the direction of travel for residential development across the country, as well as flagging up other key issues facing the industry.

More than 100 respondents from the UK’s largest, medium-sized and smaller housebuilders took part in our survey this year, across a broad geographic spread, as shown in figure 1.

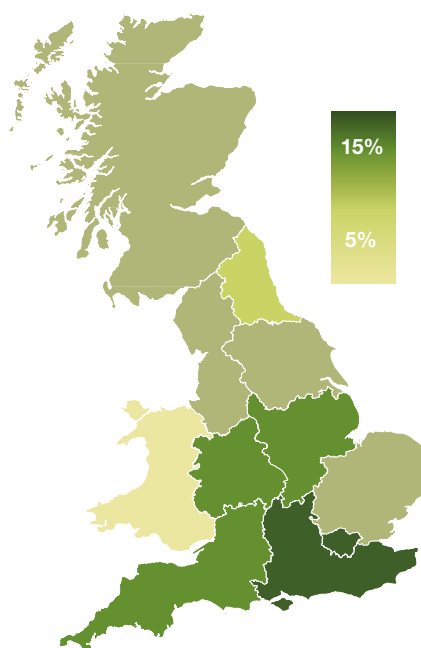
The key findings from the survey include:

- More than 90% of respondents expect land prices to rise over the next year, with the majority expecting rises of between 5% and 10% for rural

greenfield land, and rises of 10% to 15% for urban sites

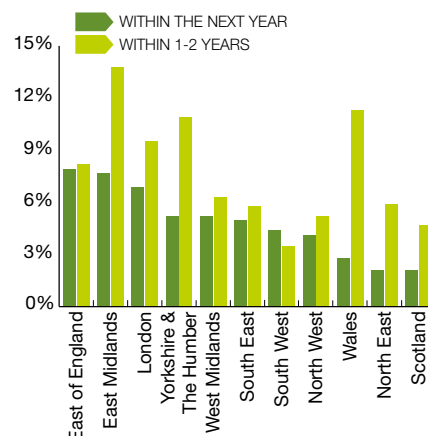
- Housing starts are expected to rise over the next year, with more than half of respondents expecting an increase of more than 10%, and more than a quarter expecting an uplift of more than 25%
- The Help to Buy extension will lift development volumes between now and 2020, more than three-quarters of respondents say, while more than 40% say that it will increase the size of schemes undertaken
- Just 6% of respondents say that under current market conditions consistent delivery of more than 200,000 homes a year is achievable
- Rising build costs, the planning system and public sector land supply are highlighted as key challenges to the market.

FIGURE 1
2014 Housebuilder Survey respondents
Geographical weighting



Source: Knight Frank Residential Research

FIGURE 2
Buying intentions
Households who intend to buy a property
(April 2014)



Source: Knight Frank Residential Research / Markit HPSI

UK development dynamics:

The UK economy has bounced back to life over the last 12 months, with GDP growing at the fastest rate in six years and unemployment dropping to its lowest level since early 2009. Wages have also started rising at the same rate as inflation for the first time since 2008.

This has had a noticeable impact on buyer sentiment. First-time buyers and home-movers feel more secure in making a move on the property ladder in more settled economic times.

The increase in buyer confidence is amply demonstrated in the [Knight Frank/Markit house price sentiment index](#) (fig 4), which shows that households' positive outlook for house prices is at a near record high. This in turn has underpinned a more positive trading environment for housebuilders.

The pick-up in buyer activity, as five years' worth of pent-up demand comes back to the market, looks set to continue. Recent [Knight Frank research](#) showed that 5% of households planned to buy a home in the next year (fig 2). If all of those planning to buy a home were successful, this would

indicate that transactions could climb by nearly 20% to 1.35 million.

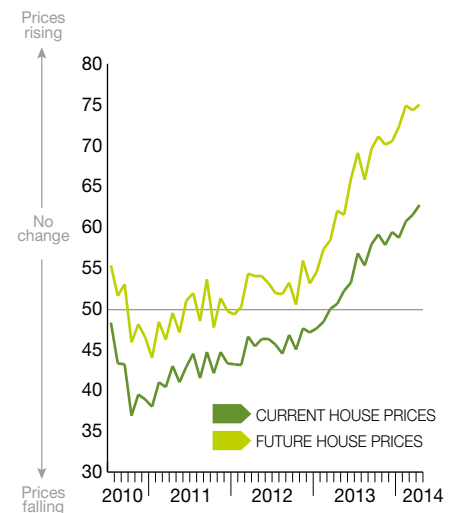
At the same time, the Government's Help to Buy Equity Loan, launched in April last year, has boosted interest in the new-build sector, as examined in more detail later in this report.

The new planning laws, under the National Planning Policy Framework (NPPF) introduced in 2012, have also created an opportunity for a rise in construction as there is a presumption in favour of development, especially when local authorities cannot demonstrate that they have a five-year housing supply. However challenges remain in the planning landscape, especially the localised nature of the planning decision process.

The increased role that construction is playing in the economy is underlined by the 26% uplift in construction activity for private housing in the year to March 2014, as measured by the Office for National Statistics.

FIGURE 4

Rising sentiment House Price Sentiment Index

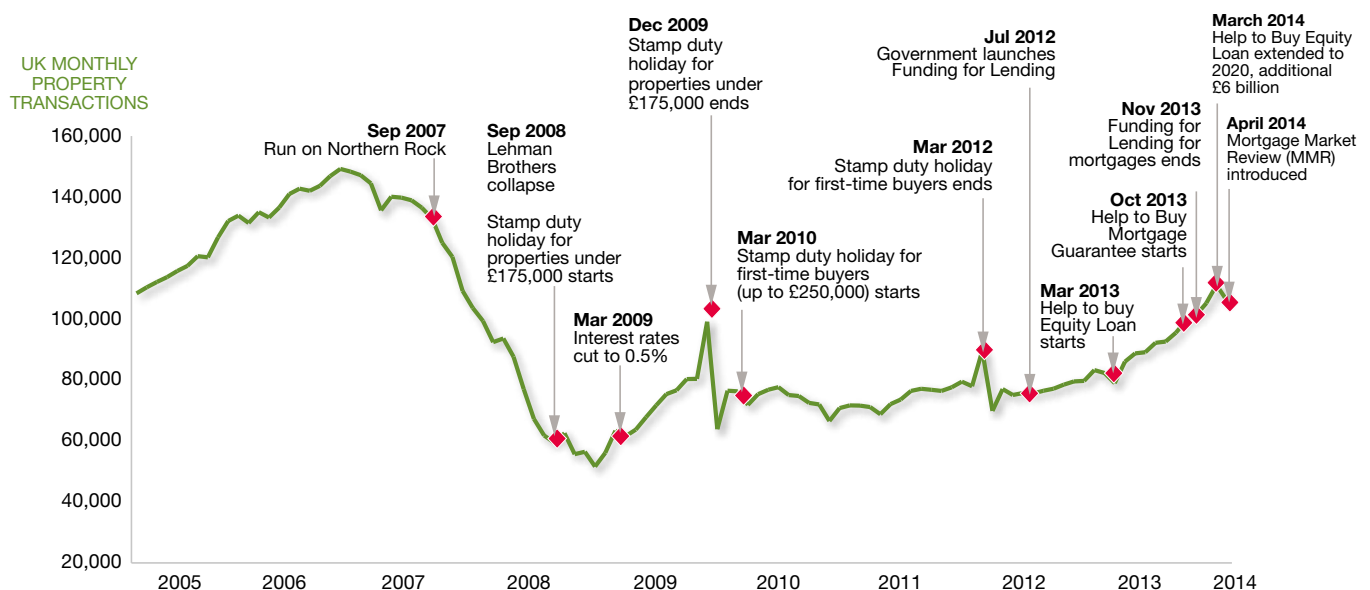


Source: Knight Frank / Markit Economics

NB: A score of 50 equates to no change, above or below representing growth or decline respectively

FIGURE 3

Policy interventions: impact on market



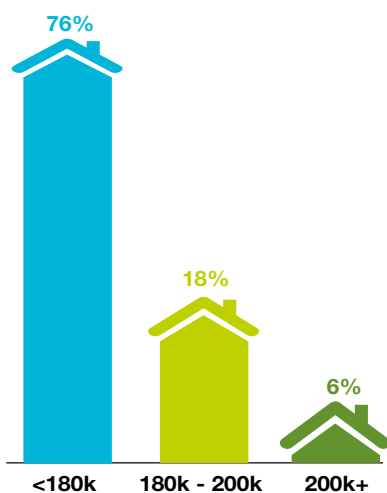
Source: Knight Frank Residential Research / HMRC

OUTLOOK FOR DEVELOPMENT VOLUMES:

Housebuilding in the UK is now seen as largely the preserve of the private sector. This is perhaps less surprising when seen in the context of a 99% fall in the delivery of new homes by local authorities since 1970, although registered providers have to a small extent taken up some of this slack.

FIGURE 5

What is a sustainable annual level of housing that can be delivered in the UK under current conditions (April 2014)?
% of survey respondents



Source: Knight Frank Residential Research

As can be seen from figure 6, the output from private housebuilders has been broadly stable, allowing for cyclical fluctuations, over the last four decades.

While the larger question of whether it is feasible for housebuilders to plug the housing hole left by the relative lack of government investment remains, there is no doubt that developers have stepped up activity since the zenith of the financial crisis. Official data shows completions in England rose 4.5% over the last year. As shown in figure 6, this still leaves development some way off the levels needed to meet demand.

Our survey suggests however, that development volumes will continue to rise. This is backed up by recent official data which shows that housing starts rose by a third in Q1 on an annual basis, hitting a 23 year high. Looking further forward, more than seven in ten respondents expect

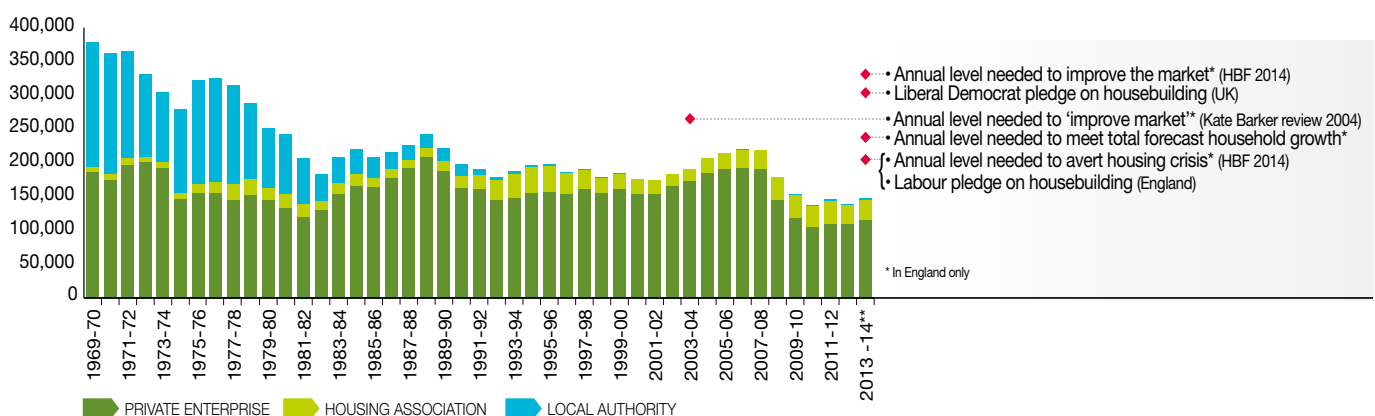
the number of housing starts by their business to rise over the next 12 months, and nearly half of respondents expect an uplift in housing completions of up to 25% (figure 8).

While 12 or 18 months ago the housing market story was all about London, the broader recovery is reflected in the fact that there is an expectation of a country-wide uplift in activity over the next 12 months, with our survey showing housebuilders and developers active in Wales, Scotland and the North East expecting some of the biggest rises, albeit from a low base. The number of planning permissions for residential units rose most strongly in the Midlands last year, as shown in figure 7.

The number of residential schemes with 10+ units achieving planning permission in England in 2013/14 is 24% higher than the average in 2010/11 and 2011/12, according to data from Glenigan.

FIGURE 6

Housebuilding in a historical context
Annual housing completions, UK



**estimate

Source: DCLG

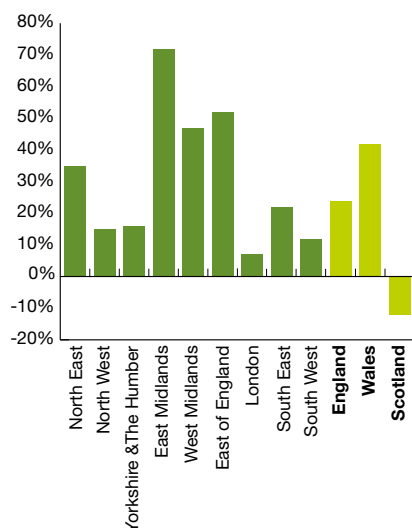
The central issue is whether housebuilders are able to provide the future housing requirements of the UK, however defining a “sustainable” annual delivery total has proved problematic. Kate Barker, former member of the Bank of England’s Monetary Policy Committee (MPC) and author of one of the most influential reports on housing supply in 2004, said earlier this year that she did not believe that, *under current conditions*, consistently delivering more than 200,000 new homes a year was achievable at present.

The majority of housebuilders agree, with 76% saying that 180,000 or fewer is achievable, and only 6% saying that exceeding 200,000 on a regular annual basis is possible (fig 5). **However as the HBF highlights, under the correct conditions, the industry can and will ‘scale up’.**

The £525 million Builders Finance fund was announced after the completion of our survey, but it highlights the increased role smaller developers can and will play in supplying new homes as access to development finance eases.

FIGURE 7

Annual change in planning permissions for residential units 2013 v 2012



Source: Knight Frank Residential Research / Glenigan

Pricing expectations

The lack of housing supply to meet the demand both in terms of new-build and existing homes, is putting upward pressure on property values. The housing shortfall was recently highlighted by Mark Carney, Governor of the Bank of England.

Prices have risen by 5.6% in England and Wales in the year to March according to Land Registry data. This figure masks some regional variations however, with a 12.4% rise in London compared to a 1.8% rise in Yorkshire & The Humber. But there is no doubt that the trajectory of prices is upwards.

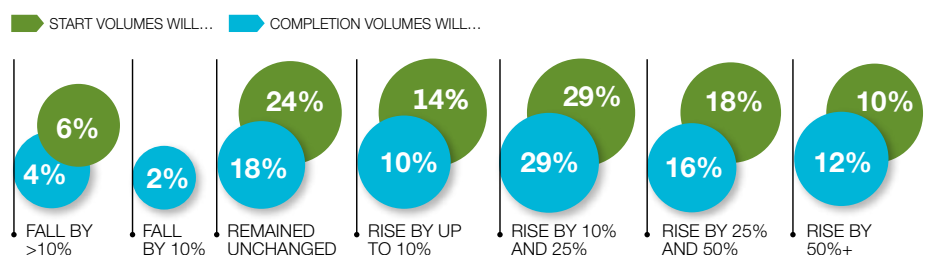
Knight Frank forecasts that average UK prices will rise by 7% this year, and more than half of our survey respondents expect new-build prices will match this increase, forecasting a rise of between 5% and 10% over the next 12 months. However a fifth of respondents expect a larger rise of between 10% and 15%.

Overall, housebuilders and developers based across the whole of London and the South East expect the biggest price rises, followed by those in Scotland where buyer activity has picked up markedly over the last 12 months, as highlighted in our quarterly [Scotland and Edinburgh prime property indices](#). Around one in five respondents active in the Scotland market expect price rises of between 10% and 15% over the next year. The only market where any respondents thought new-build prices might remain unchanged was London, although this was a small minority of just 6% of respondents.

FIGURE 8

Housebuilders’ outlook for housing starts and completions (April 2014)

Over the next 12 months, your...



Source: Knight Frank Residential Research

“The only market where any respondents thought new-build prices might remain unchanged was London.”

26%

of respondents think new-build prices will rise by 10%-15% this year

£4bn

total value of homes bought using Help to Buy Equity Loan in the scheme's first year

THE IMPACT OF HELP TO BUY

The Help to Buy Equity Loan has helped 19,394 people in England to buy a home in its first year, accounting for around 30% of all new-build sales over that time, and 2.4% of all sales across England.

Some 85% of those using the equity loan are first-time buyers, underlining the pent-up demand among would-be purchasers who have been struggling to amass a deposit large enough to climb onto the housing ladder.

Around 60% of these loans have been extended on homes worth up to £200,000 (fig 9), underlining the regional spread of the take up of the equity loan scheme, also illustrated in the map (fig 10). The median purchase price for all loans extended was £184,995. On a regional basis, the highest take-up of Help to Buy equity loan has been in the West Midlands, where some 38% of all new-build sales have been carried out under the scheme. This is nearly three times more than in London, where only 13% of new-build buyers have used the equity loan. This calls into question the assertion that Help to Buy is pushing up prices in London and the South East where average house prices are much higher. **It is likely that the confidence engendered by the Government intervening in the housing market has had a bigger effect on prices than the scheme itself.**

While the government has so far extended around £791 million in equity loans, the programme is still undershooting expectations in terms of the number of people it will help buy a home. When it was launched, the Government said it would help around 74,000 borrowers over 3 years. So far it has helped around 20,000, and there is still £2.7 billion in the original budget. Policymakers had originally assumed average loans of around £47,000 would be extended for each house purchase, but the median so far has been lower at £36,999. If this remains steady, there is actually room in the original £3.5 billion budget to help an additional 73,000 borrowers. When the chancellor announced in March that the scheme would be extended by a further £6 billion and run for an extra four years, the Chancellor said the move would help a further 120,000 homebuyers.

Based on current take-up rates, it is debatable whether the additional £6 billion will be used in full. Take-up rates will have to accelerate markedly if the scheme is to help 200,000 buyers as the Chancellor hopes.

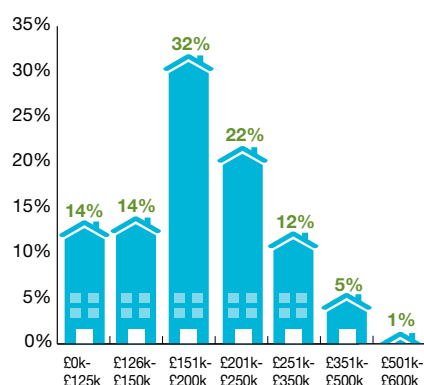
At the other end of the housebuilding cycle, the impact of Help to Buy is also clear. As shown in figure 7 there has been a rise in planning applications over the last year by developers and housebuilders of all sizes which their feedback suggests is at least partially due to the Help to Buy Equity Loan.

There has been some criticism of Help to Buy however – Help to Buy spans three schemes, the equity loan, the mortgage guarantee and NewBuy.

But recently 'Help to Buy' is often used as shorthand for the mortgage guarantee. The Organisation for Economic Cooperation and Development (OECD) highlighted the mortgage guarantee (which according to the latest data has helped fewer than 3,000 buyers so far) saying it should be reined in, while three former Chancellors of the UK have said that this part of Help to Buy needs to be rethought. The Government may now be wishing it had not encompassed three different schemes under the same Help to Buy banner.

Next year's general election throws up some uncertainty about Help to Buy – Labour have not commented on their intentions around the equity loan, although they too have criticised the mortgage guarantee. Also, **finding a suitable unwinding mechanism for the Equity Loan will be paramount in the coming years if a 'cliff edge' market distortion is to be avoided in six years' time.** A gradual widening of the LTV's available, or tightening criteria over a year is one option to phase it out.

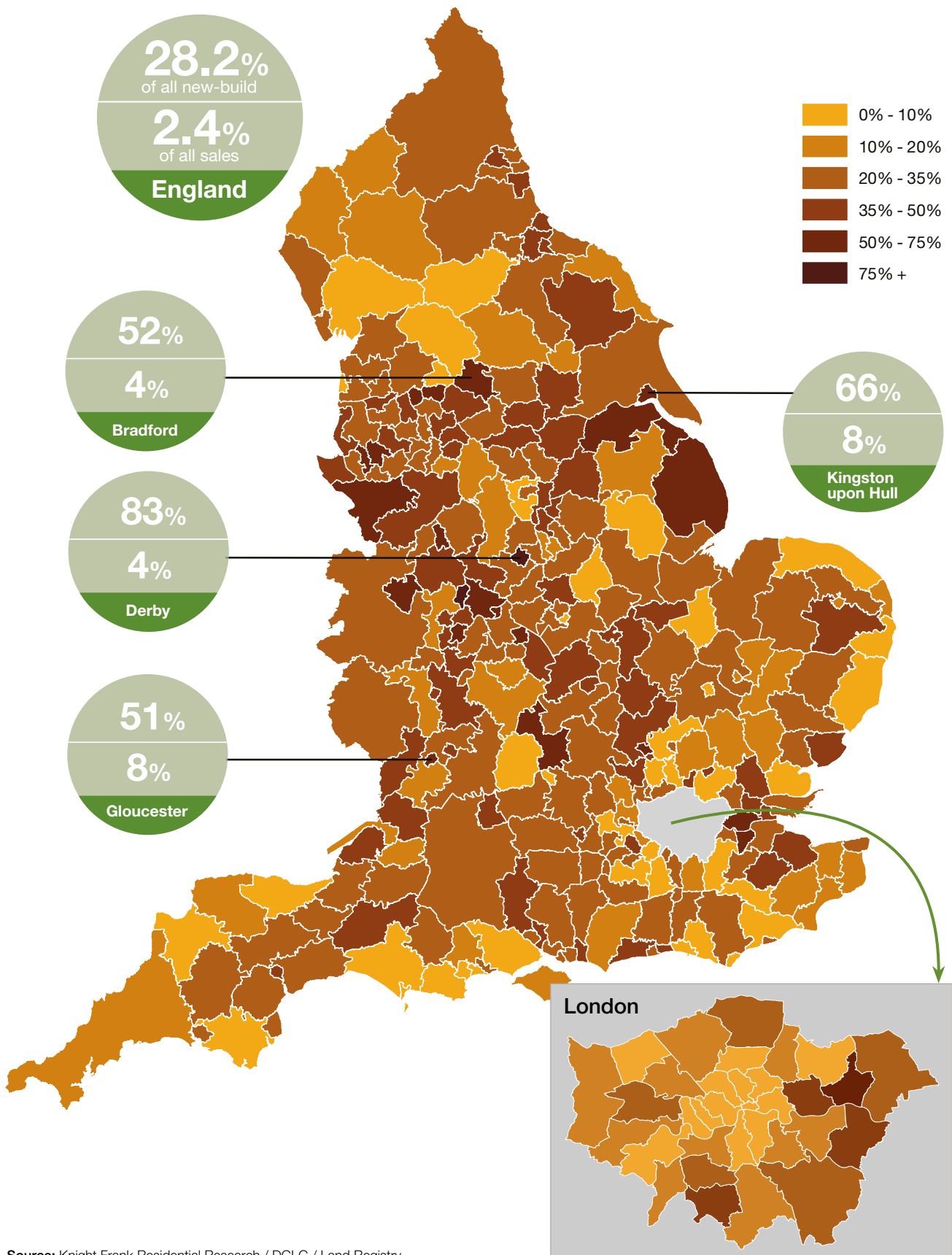
FIGURE 9
H2B equity loans extended by house price
April 2012 - March 2013



Source: Knight Frank Residential Research / DCLG

FIGURE 10 **Help to Buy**

Help to Buy purchases as a % of all new-build and total purchases (April 2013 - Feb 2014)



Source: Knight Frank Residential Research / DCLG / Land Registry

40%

proportion of land suitable for development held by public sector

DEVELOPMENT LAND

Development land prices have started to gain momentum across England, following the trend in prime central London.

English land values rose by 7.3% in the year to the end of Q1 2014, according to Knight Frank's Development Land index, and developers are expecting further increases in the year to come. More than nine in ten of our respondents said they expect greenfield land prices to rise over the next year. Around a third said they expected increases of between 5% and 10%, while a further 29% said they expected a larger increase of up to 15%. **The majority of respondents expect urban land prices to rise by 10%-15%.**

The sourcing and use of land for development remains a key factor in the sector, and it has now become a hot topic of political debate. Housebuilders must ensure they have a flow of sites coming through with planning permission at the right time to enable them to build homes in line with their strategy. The expected rise in activity in the next 12 months is certainly supported by our survey, which shows that 74% of respondents expect to increase their pipeline of land with planning, while 69% expect to increase their strategic land holdings.

But there is increasing debate about landbanks, whether housebuilders are keeping land and not building it out in order simply to make a profit on re-selling it. Ed Milliband said that developers who 'hoard' land would be taxed under any Labour government.

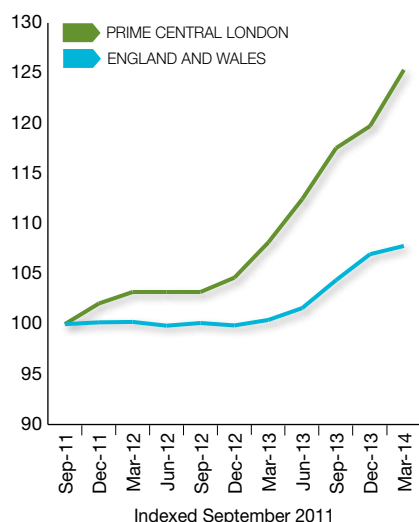
Yet keeping land and not using it runs against the financial models for housebuilders, who must assess the cost of capital of all their assets. If the asset is sitting idle, there is no return and the cost of capital is increased. While decisions about sites where the economic fundamentals have changed significantly since the land was first put into planning must be assessed individually, in general terms it makes little sense for a housebuilder to keep swathes of land with planning sitting empty. Indeed, the Homebuilders' Federation have questioned whether the idea of hoarding land is as big a feature in the market as

commonly believed. (fig 12). It highlights that for the large housebuilders, only 4% of sites are waiting for work to start.

This goes to the heart of the question of whether strategic land, on which a housebuilder has agreed an 'option' with the landowner, which may or may not lead to them gaining planning or buying the land, or which may be bought and have started the long process of going through planning, (fig 14) should be classed as a 'land bank'.

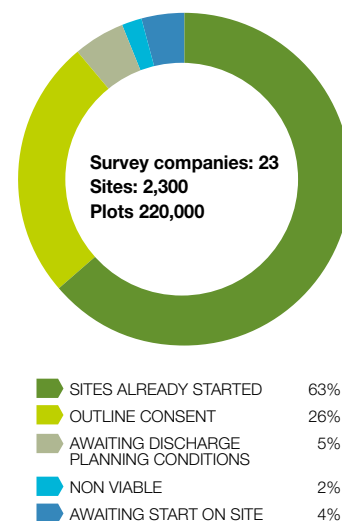
Our survey showed that improving access to public sector land was the factor highlighted by housebuilders and developers as the biggest additional positive step the Government could take to improve housing delivery (fig 17). Whitehall has already released 430 brownfield sites from central government departments, with the capacity to build 68,000 homes, meaning that the Government is likely to meet its target of releasing enough land for 100,000 homes by 2015. But Kris Hopkins, the Housing

FIGURE 11
Growth in development land prices
Knight Frank Residential Development Land Index



Source: Knight Frank Residential Research

FIGURE 12
Land banking?
Home Builders Federation Survey 2013



Source: Home Builders Federation

Minister, has called for even more public land to be released, especially at a local level.

The Strategic Land Review (SLR), published at this year's budget, has identified some £5 billion of land and property that can be sold. There will be more detail given on how this will happen in this year's Autumn Statement.

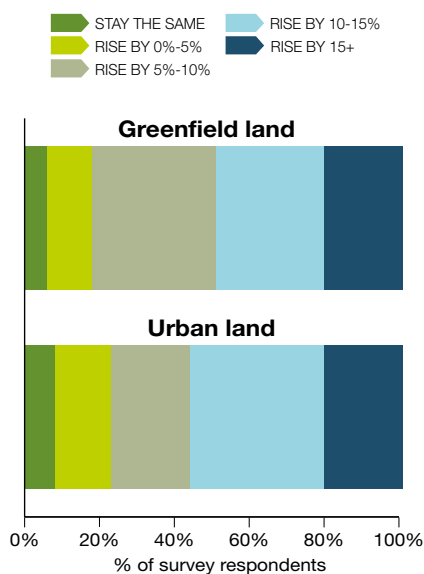
The move to encourage local councils to release plots for self-builders should be welcomed in terms of helping boost development, but the scope of the current plan, at 10,000 units, is too small to make a significant contribution to the much-needed uplift in supply.

There will also be challenges for self-builders. Local councils have to adapt to identify the plots to sell for self-build and then provide infrastructure, which may take some time. In addition, the availability of mortgages for self-build projects has not yet fully recovered since the financial crisis.

The presumption in favour of development, the extension of the Equity Loan and the improving economy provide a solid foundation for a continued rise in housing supply, but the **consistency of housing policy is key, not least improving access to public sector land.**

FIGURE 13

Over the next 12 months development land values will...



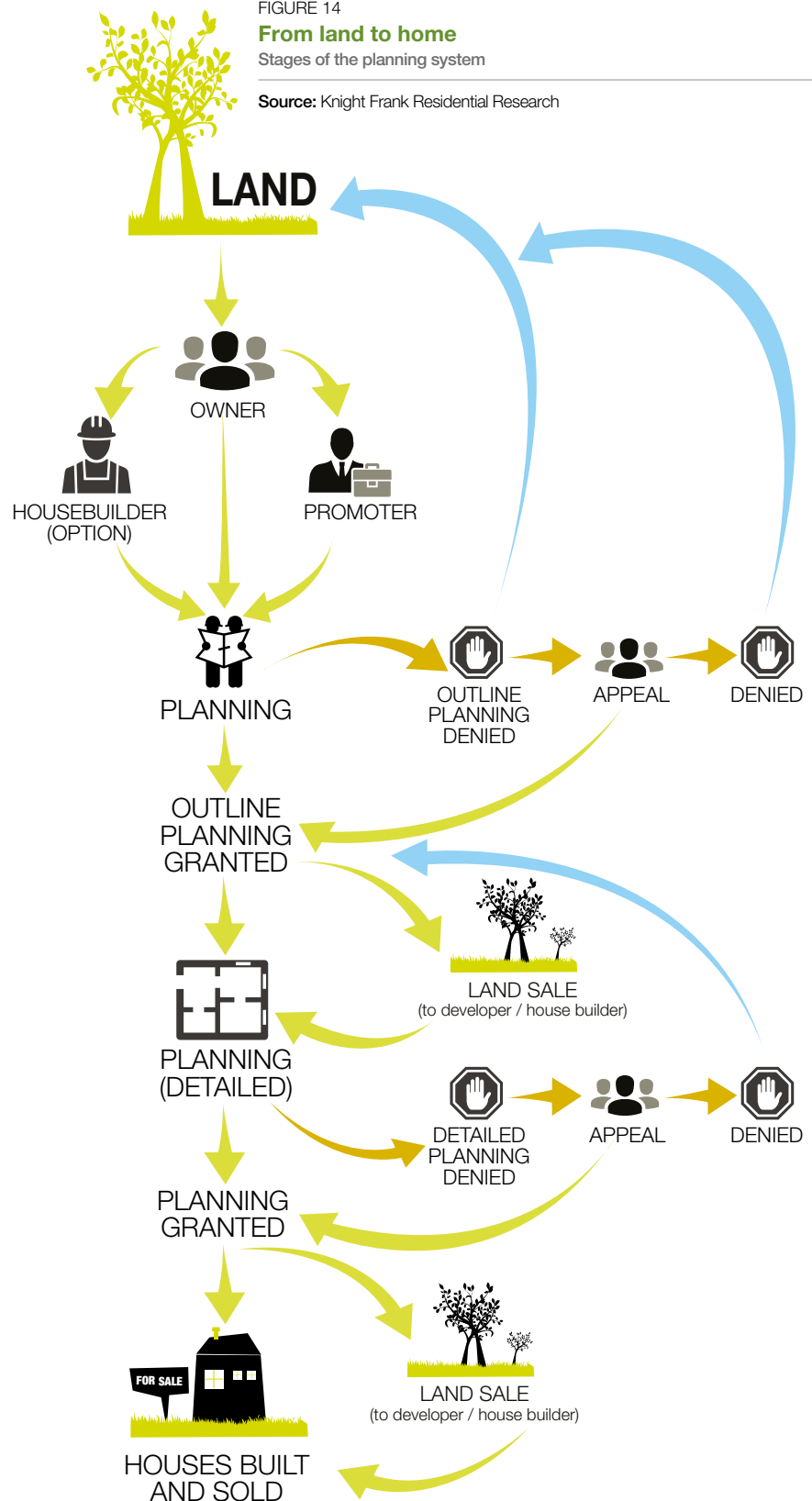
Source: Knight Frank Residential Research

FIGURE 14

From land to home

Stages of the planning system

Source: Knight Frank Residential Research



CHALLENGES AND OPPORTUNITIES

There is no doubt that Help to Buy has provided a fillip for the industry, but developers still have their eyes on the wider economic picture for issues that may affect their business in the years to come.

70%

proportion of respondents reporting a rise in planning applications granted permission *on appeal*

One million shortfall

in homes built in the decade since Kate Barker's 2004 housing review (source HBF)

Construction costs

Our survey respondents isolate rising construction costs as one of the biggest challenges facing the sector. During the downturn, demand for building materials and skilled labour slumped, and as a result capacity is now being stretched and prices are being forced upwards. In some cases developers are having to import materials from overseas. The transport costs for these materials are notable, and can over-ride any cost savings.

Official data shows that material costs for housebuilding were 16% higher at the end of last year compared to early 2008, while labour and plant machinery costs were 12% higher. These expenses are expected to continue rising. Some 70% of respondents expect construction costs to rise between 5% and 10% this year.

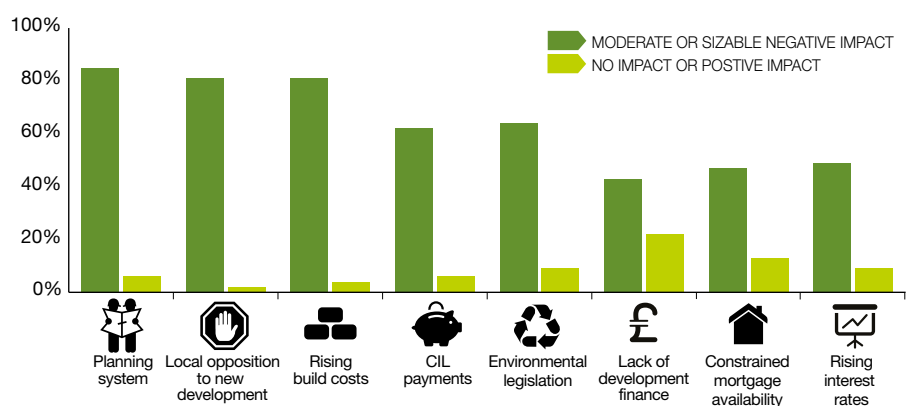
More than 90% said rising costs would have a negative impact on the market, with 34% saying this impact would be sizeable (fig 15). Getting the UK up to

capacity in terms of material production will take time, and may weigh on supply.

While the new planning rules are seen as positive by some of our survey respondents – more than a half say that it has allowed an increase in the size of schemes achieving planning – it is still throwing up some challenges, not least the localism problem which leads to a NIMBY reaction to developments in some communities. In fact, **local opposition to development is seen as one of the biggest challenges to the sector in the coming years**, with 82% of respondents saying it will have a moderate or sizeable impact on the market.

Our survey also pointed to the onerous nature of the planning regime itself, with 70% of respondents saying there had been a rise in their planning applications granted permission on appeal over the last year. Yet only 7% of respondents said that the planning system should return to a regional, rather than local structure.

FIGURE 15
Challenges to development
What effect will these factors have in the next year?



Source: Knight Frank Residential Research

Yet as can be seen from fig 17, there is little appetite to move back to a more centralised regional planning system – a reflection that changing the planning system again would cause even more upheaval, and the current regime must be allowed to bed in.

Other interventions in the development market are striking varying notes with housebuilders. The New Homes Bonus continues to underwhelm, with nearly 70% saying it has had no impact on development volumes since its introduction in 2011. However this is an improvement from when we last canvassed opinion in 2012 when 81% said it had no impact.

The community infrastructure levy (CIL) is seen as a challenge, as is the more onerous carbon home legislation which is due to be introduced in 2016.

More than 60% of respondents said that CIL was acting as a moderate or significant drag on construction, and when asked how the government could ease the path to boost construction, scrapping CIL is one of the most popular choices (fig 17).

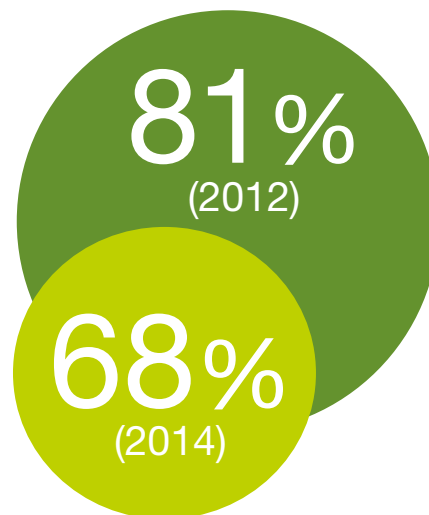
The current demand for housing in the country throws up significant opportunities for housebuilders and developers. Those that can navigate their way through sometimes onerous systems and legislation have an

opportunity to deliver new homes into a market where they are badly needed, working with communities to help ensure neighbourhoods can grow in the best way possible.

The presumption in favour of development, the extension of the Equity Loan and the improving economy provide a solid foundation for a continued rise in housing supply, but consistency of housing policy is key as is the improvement of access to public sector land.

FIGURE 16

Proportion of respondents who say New Homes Bonus has had no impact on development volumes...



What steps could be taken to encourage development?

“Remove affordable housing requirements on sites of less than twenty units.”

“Force planning officers to meet targets”

“Sea change required to welcome development rather than fight it”

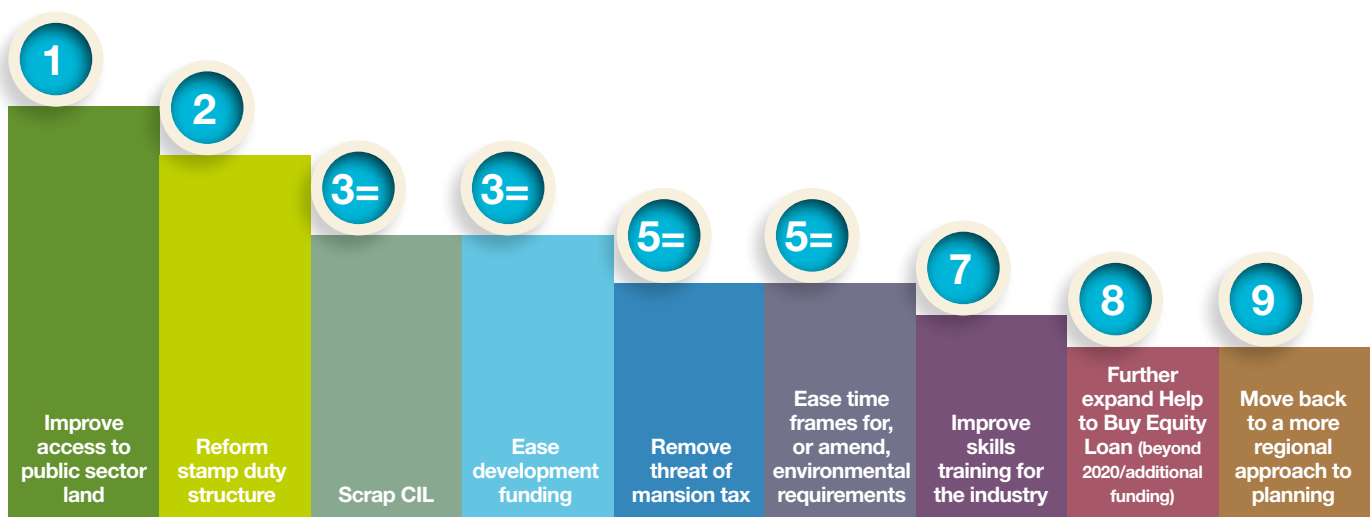
“Reduce the number of pre-commencement and pre-occupation conditions on planning permissions”

Respondents: Knight Frank Housebuilding Survey 2014

FIGURE 17

What additional steps could the government take to encourage development volumes in the long term?

Survey responses in order of popularity...





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RESIDENTIAL RESEARCH

Liam Bailey

Global Head of Research

+44 20 7861 5133

liam.bailey@knightfrank.com

Gráinne Gilmore

Head of UK Residential Research

+44 20 7861 5102

grainne.gilmore@knightfrank.com

RESIDENTIAL DEVELOPMENT

Justin Gaze

Joint Head of Residential Development

+44 20 7861 5407

justin.gaze@knightfrank.com

Ian Marris

Joint Head of Residential Development

+44 20 7861 5404

ian.marris@knightfrank.com

David Fenton

Head of Regional Land

+44 78 3658 7931

david.fenton@knightfrank.com

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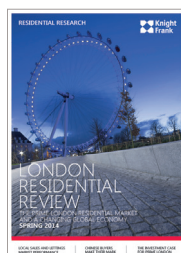
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