

RESIDENTIAL RESEARCH
JUNE 2017



HOUSEBUILDING REPORT 2017



EXCLUSIVE
HOUSEBUILDER SURVEY
2017

HOUSING SUPPLY

DEVELOPMENT LAND UPDATE

SECTOR OUTLOOK

KEY FINDINGS

Knight Frank estimates that net annual housing supply **climbed to more than 200,000** in England in the year to April 2017...

...and our Housebuilder Survey suggests delivery will continue to rise, with more than half of respondents saying their organisation **would build more homes in the next 12 months**

However, two-thirds of housebuilders and developers **do not think housing delivery can be maintained at a level above 200,000** every year in the current policy environment...

...labour costs and availability, build costs and the planning system **were identified as the biggest hurdles** to development

Some **60% of respondents** said Brexit negotiations could weigh on supply

More than four-fifths of respondents said the Housing White Paper could have gone further in its suggested reforms

MARKET UPDATE

The fundamentals of the housing market mean that the pressure on the new-build sector to meet the rising demand for homes has never been greater.

The imbalance between the demand and supply of housing is why housebuilding has risen so rapidly up the political agenda in recent years.

Measuring pure demand (the population rising at a pace which equates to around 200,000-250,000 additional households in England every year) against the supply of new homes (net housing supply in England averaging 160,000 over the last 15 years, and hitting a low of around 130,000 in 2012/13) shows the fundamental reason why more homes are needed.

So what is the outlook for the sector? In order to find out, we engaged with nearly 70 respondents from housebuilders and developers across the country for this year's Housebuilder Survey. The companies represented in the survey built more than three-quarters of all new housing in England in 2015/16.

There have been several notable changes in the housing landscape since last year's survey, including the vote to leave the EU in June last year, and the long-awaited publication of the Housing White Paper

earlier this year. The current political uncertainty may also present new challenges for the sector.

We asked our respondents about some of these issues as well as the wider challenges in the market.



The policy environment is uncertain at present, but housing needs to remain a top priority for the Government

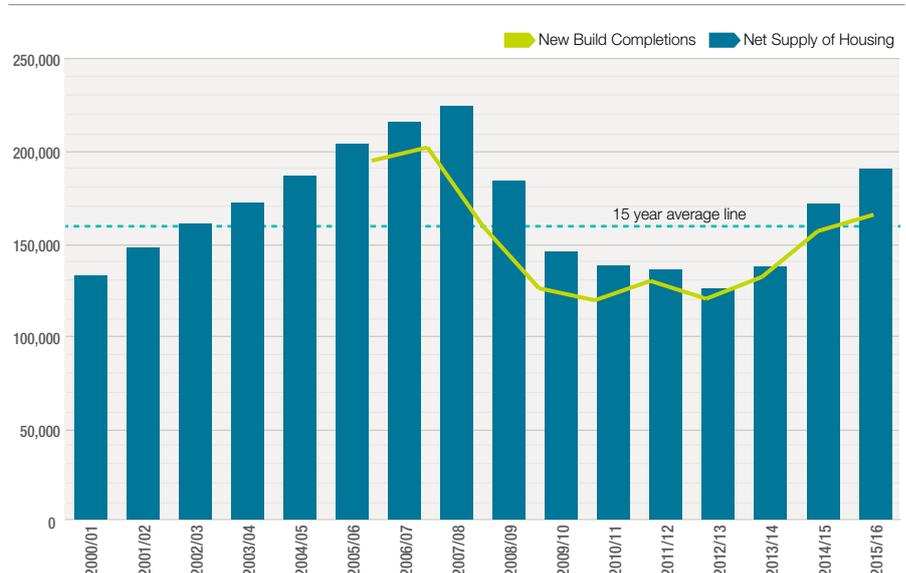
JUSTIN GAZE

JOINT HEAD OF RESIDENTIAL DEVELOPMENT



The survey suggests that the overall delivery of homes will continue to rise in the coming years across the UK, although

FIGURE 1
Rising delivery
Net Supply of Housing, England



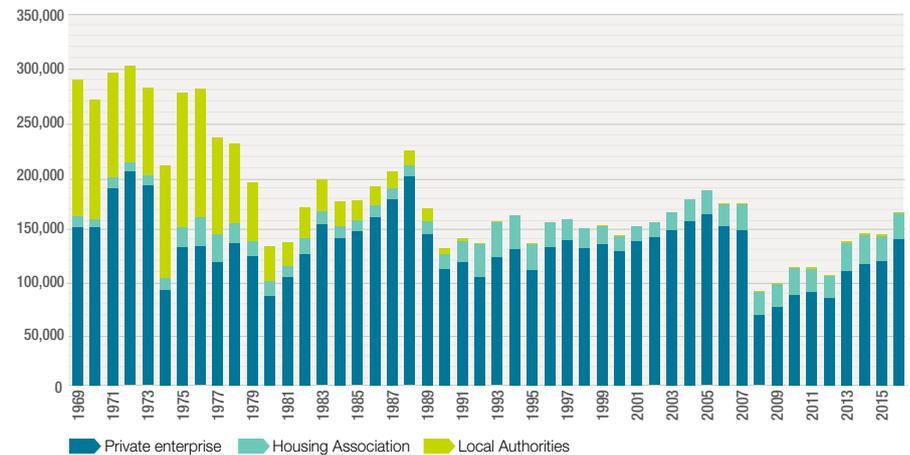
Source: Knight Frank Research/DCLG

it is worth noting that some local markets may not follow this trend. It also highlights the pinch points for the industry as Brexit unfolds.

Some housebuilders and developers said they would have liked to see more detail in the Housing White Paper, with increased flexibility around the Green Belt being raised as one of the key issues. Smaller housebuilders are also keen to see changes to the planning system that could make it easier and more affordable for them to steer development schemes through the planning process.

The survey results are examined in further detail throughout the report, addressing the key drivers of the market, from development land to the outlook for sales values.

FIGURE 2
New-build housing starts, England



Source: Knight Frank Research/DCLG

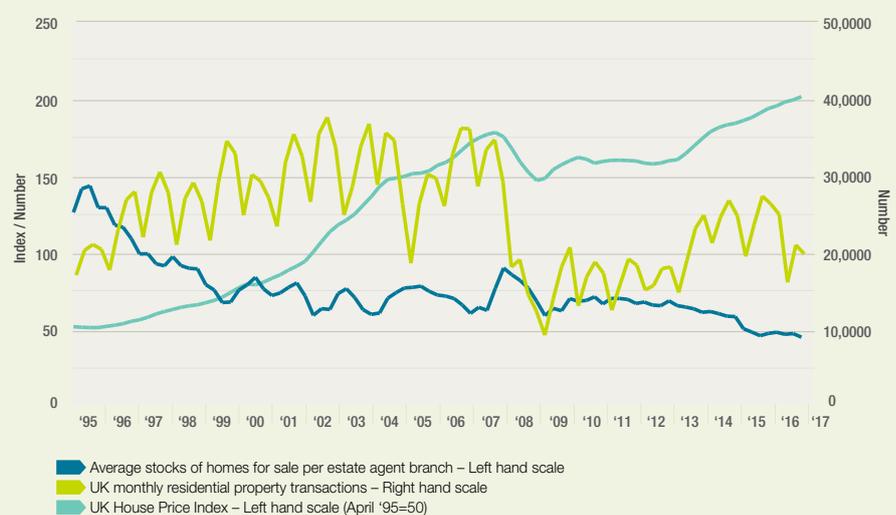
Market in context

The UK has failed to build enough houses on a regular annual basis for decades. The tenure of housing built has also changed since the 1970s, with the government ceasing to build or fund council housing. The large loosening of mortgage credit seen through most of the 2000's, as well as in the introduction of the buy-to-let mortgage in the mid-1990s increased competition for housing, helping push average prices up by 260% between 1995 and 2007.

Yet the affordability constraints that inevitably emerged as a result of these rising prices were masked somewhat by the generous mortgage offers available before the financial crisis – with some lenders offering to lend up to 125% of the value of a home.

In the wake of the financial crisis, the clampdown on lending, with many lenders requiring a 25% deposit, marked a sharp reversal and highlighted the affordability challenge relating to raising a deposit for those trying to buy a home, even as mortgage rates fell to record lows. Yet the forbearance shown in the mortgage market immediately after the crisis, coupled with a continued demand for housing, underpinned pricing.

FIGURE 3
Prices vs activity vs stock



Source: Knight Frank Research/RICS/HMRC

As such, affordability is still an issue in many areas of the market, exacerbated to some extent by the repeated increases in stamp duty. Back in 1997, stamp duty was charged at 1% on all residential property transactions. Today all transactions valued at more than £125,000 are charged at a minimum of 2%, rising to 15% in some circumstances.

The rise in transaction costs is one factor why activity in the re-sales market is lower

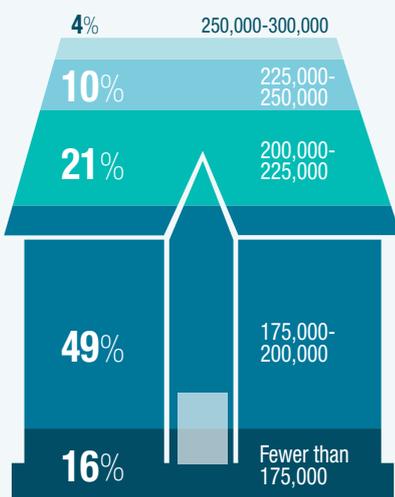
than long-term norms. The average number of homes being listed for sale by agents across the country has been falling for 20 years, underlining the fall in liquidity in this market. These factors all underpin why the new-build sector is being placed under intense pressure to deliver housing, especially in the areas of the country where the need is greatest.

HOUSEBUILDER SURVEY

Future annual delivery

Only a third of respondents said that net annual supply of new homes in England could be sustained above 200,000 every year by 2022 under current market conditions.

FIGURE 4
Achievable annual net housing supply by 2022 – ENGLAND
% of respondents



Source: Knight Frank Housebuilder Survey

Supply

New housing delivery

- **Net supply in England has risen to an estimated 200,000 (including conversions and permitted development rights) in 2016/17**
- **National construction starts and completions will continue to rise over the next 12 months**
- **Annual housing supply cannot be sustained at above 200,000 a year under current market conditions majority of survey respondents say**

Housebuilders have responded to the call for more housing in recent years. A turning point came in 2013, when an improvement in the UK economic picture coincided with a notable rise in delivery levels. The introduction of Help to Buy the same year also allowed buyers to circumvent the 'deposit gap' when buying a home and boosted confidence among developers to commit to larger schemes. Developers and builders who were more reliant on external funding also benefited from an increased availability in debt, equity and mezzanine finance – although the path remained, and still remains, challenging for the smaller developers, especially those with little track record.

New-build construction numbers have risen notably every year since then, and Knight Frank estimates that net supply of housing has broken through the 200,000 barrier in England in 2016/17, a target which seemed like a stretch even five years ago. However, it must be noted that net housing supply data, as shown in figure 6, includes alternative sources of new housing supply such as conversions and office-to-resi schemes, not just new housebuilding, helping push the headline figure higher.



A simplification of the planning system has to be a goal. This would reduce costs and help housebuilders, especially SMEs, to build more housing

JUSTIN GAZE

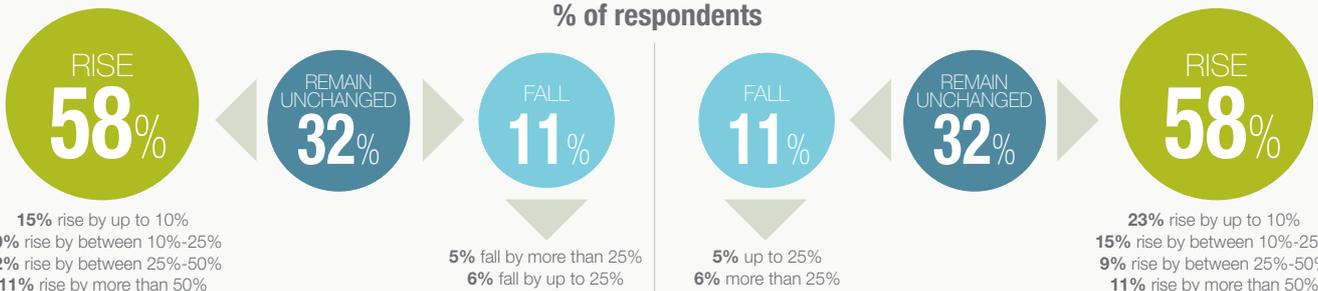


In addition, the number of permitted development rights schemes being transformed from residential to

Over the next 12 months

START VOLUMES WILL... COMPLETION VOLUMES WILL...

% of respondents



Source: Knight Frank Housebuilder Survey

FIGURE 5
Net housing supply, England



Source: Knight Frank Research

commercial has declined over the last two years – indicating that in some areas, many of the opportunities available may have already been taken, and also reflecting the fact that in some secondary markets, there has been a re-balancing of commercial and residential space.

Knight Frank analysis of energy performance certificate (EPC) data suggests that the delivery of homes in 2016/17 breached the 200,000 mark, as shown in the chart above. Indications from the Survey suggest that levels of delivery will continue to rise in the short-term, with 58% of respondents saying completions would rise over the next 12 months, and only 11% saying that they would fall. Looking slightly further ahead, 58% of respondents also said that housing starts would rise.

The most recent planning data also indicates that delivery is set to rise, with an increase in planning for private residential units being granted. However, it is noticeable from figure 7 that while the number of units granted planning in England has risen, the number of schemes has fallen, suggesting that more large schemes are going through the planning system. The cost of planning has risen in recent years, and is only set

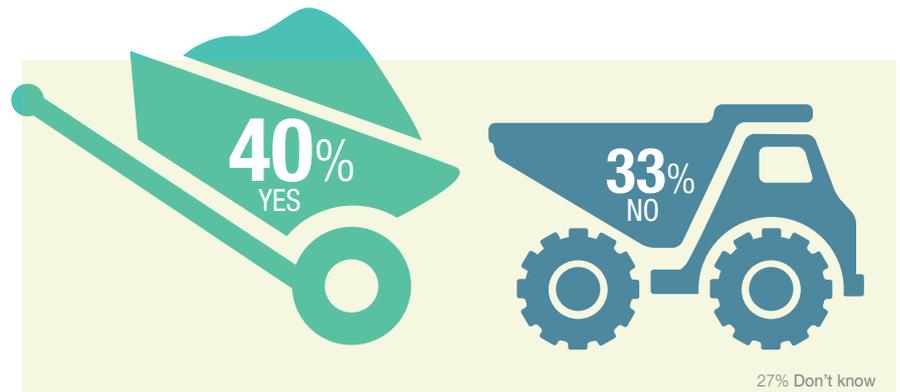
to rise further. While SMEs can attract funding for construction, it is difficult to finance the costs of planning given the risks involved, which can make it very challenging. The planning environment is examined in more detail on page 10.

Yet, at the same time, the need for more SME developers to become involved in the market is well recognised. SME developers were responsible for 4 in 10 new homes built in the 1980s, whereas this figure is closer to 1 in 10 today. The House Builders Federation has estimated that returning to the levels of delivery by SMEs last seen in the 1980s

could boost overall supply across the country by 25,000 a year.

The paradox between the more complex planning system and the need for smaller developers has not escaped policymakers, with the Housing Minister calling on Local Authorities to release residential development sites suitable for smaller developers earlier this year. The Government’s Accelerated Construction scheme, currently running only on central government landholdings, is aimed at providing sites which can be broken up with the offer of joint ventures with SME developers on the smaller sites.

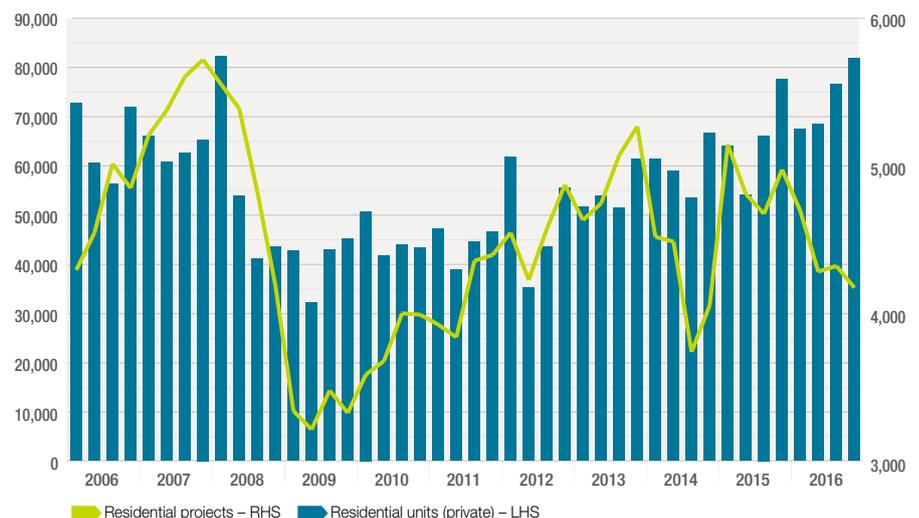
FIGURE 6
SMEs – will you build more homes in the next 12 months?
% respondents which build fewer than 20 units a year



Source: Knight Frank Housebuilder Survey

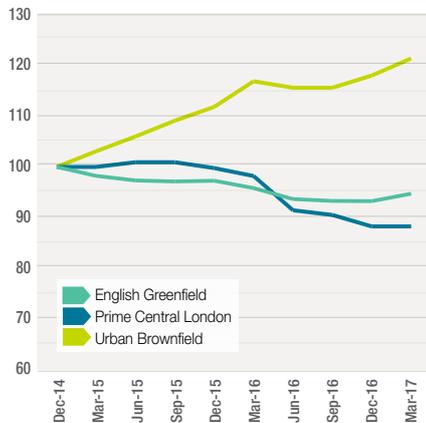
FIGURE 7
Planning permissions granted

By scheme and units, schemes including residential units



Source: Knight Frank Research/Glenigan

FIGURE 8
Average change in development land values Indexed (100=Q4 2014)



Source: Knight Frank Research

Land market

- Activity in the land market will rise over the next 12 months
- Land values in urban markets are expected to increase, with the value of greenfield land expected to remain unchanged over the next year, respondents say
- Availability of land still a key challenge for development

Activity levels in the residential land market have eased slightly in the last two years after a period when larger housebuilders, in particular, were fulfilling their need for strategic land.

Land values have to some extent reflected this, with the latest [Knight Frank Residential Development Land Index](#) (fig 8) showing that greenfield land prices dipped by 4% between late 2014 and the end of 2016. However, it is worth noting that land values in urban markets moved strongly upwards over the same period, as the economic recovery in some key regional cities continues to underpin pricing and spur activity.

The majority (54%) of respondents expect greenfield land prices to remain unchanged or to dip slightly over the next 12 months, while the opposite is true for the urban land market, where the majority (61%) of respondents expect values to rise.

The survey also suggests that activity in the land market is set to rise over the next 12 months, with the majority (69%) of larger housebuilders saying activity in the strategic land market will increase. Some 46% of larger housebuilders also said they would increase their acquisition of land with planning consent – or ‘oven ready’ sites – over the next year.

However, as examined later in the report, access to land is still a key challenge for developers and housebuilders. In many cases, especially where site assembly is needed, the co-ordination of making the land ready for development, including guaranteeing infrastructure and utilities at the right time, can be a major hurdle, and ultimately a development risk for housebuilders. To mitigate these risks, there is a role for local authorities to step in and act as negotiators or ‘path smoothers’ to try and push development through.



The sooner there is some level of certainty over the availability of skilled labour needed by the housebuilding sector, the sooner more investment can be committed to building new homes

JUSTIN GAZE



FIGURE 9 % all respondents



Policy

Housing White Paper

- **Housebuilders and developers hoped for a greater level of detail in White Paper**
- **Supporting LAs and HAs to build will boost housing supply, respondents say**

More than four out of five respondents said the Housing White Paper, published by the DCLG earlier this year, did not go far enough in terms of reforms needed to address the challenges in the housing market. This may have something to do with the nature of the report, as, despite promising a direction on housing, much of the document was highlighting areas that

need work and launching a series of consultations, which only closed in May. Certainly, when asked to identify what was missing from the White Paper, “detail” was a popular answer, as well as direction on the use of Green Belt land, as shown below.

However, this is not to say that the respondents did not identify positives including the support for Build-to-Rent or Multihousing schemes and the support for local authorities (LAs) and housing associations (HAs) to build more homes. Perhaps the real question is what happens now, given the political uncertainty ahead. Post-election, Sajid Javid is still Secretary of State for the DCLG. The new housing minister, Alok Sharma, does not have a housing background, but does come from the financial sector and sits on the Treasury

64%

respondents who said more planning support for Build-to-Rent/Multihousing schemes would boost housing supply

FIGURE 10
Did the Housing White Paper go far enough in terms of proposed reforms? If not, what was missing?



What effect will these proposals have on overall supply?

	BOOST SUPPLY	NO EFFECT	REDUCE SUPPLY
Agreeing formula for housing need in Local Plans	53%	39%	6%
Monitoring build-out rates by large developers	21%	67%	11%
Supporting Housing Associations and Local Authorities to build more homes	58%	32%	6%
More support through the planning framework for the delivery of Build-to-Rent schemes	64%	27%	5%
A focus on the delivery of all type of affordable housing	48%	40%	11%

% of respondents

53%

of respondents said ending H2B equity loan in 2021 will have negative impact on supply

Select Committee. Although Gavin Barwell, the former housing minister, lost his seat as an MP, his appointment as chief of staff at Number 10 may well indicate that housing continues to take some space near the top of the agenda.

More clarity will be delivered at the Autumn Budget this year, when some of the proposals are expected to be announced as future legislation.

Help to Buy

- **Majority of respondents say ending Help to Buy Equity Loan in 2021 will negatively impact supply**
- **Borrowers' repayments on equity loans to start next year**

Another key policy question for the development market is the Help to Buy (H2B) Equity Loan. The scheme, launched in 2013 for new-build homes, is due to end in 2021. Until there is some certainty on what the next move is, it is difficult for some housebuilders and developers to finalise the development economics for upcoming schemes, particularly in parts of the country where H2B has been popular. Some 53% of respondents to the Survey said that not extending the H2B scheme would have a negative impact on supply.

Some 112,338 homes were purchased with a H2B equity loan between 2013 and end of 2016. Next year, those who took

out a loan in 2013 will start paying a fee on the equity portion unless they have repaid it, as shown below. The annual fee is 1.75% of the total loan, and this rate will rise in line with inflation (RPI+1%) every year.

CIL

- **40% of large developers said CIL reforms will lead to more housebuilding**
- **34% of SME housebuilders said the reforms could curb developments**

The Community Infrastructure Levy (CIL) has had a chequered and long-drawn out introduction. The levy, announced in 2011, has still not been adopted in some local authorities, creating planning confusion. Also, the rates at which CIL are applied can vary greatly, causing more hurdles in the planning process. Last year's [Housebuilding Report](#) showed that nearly 40% of housebuilders thought CIL should be reformed.

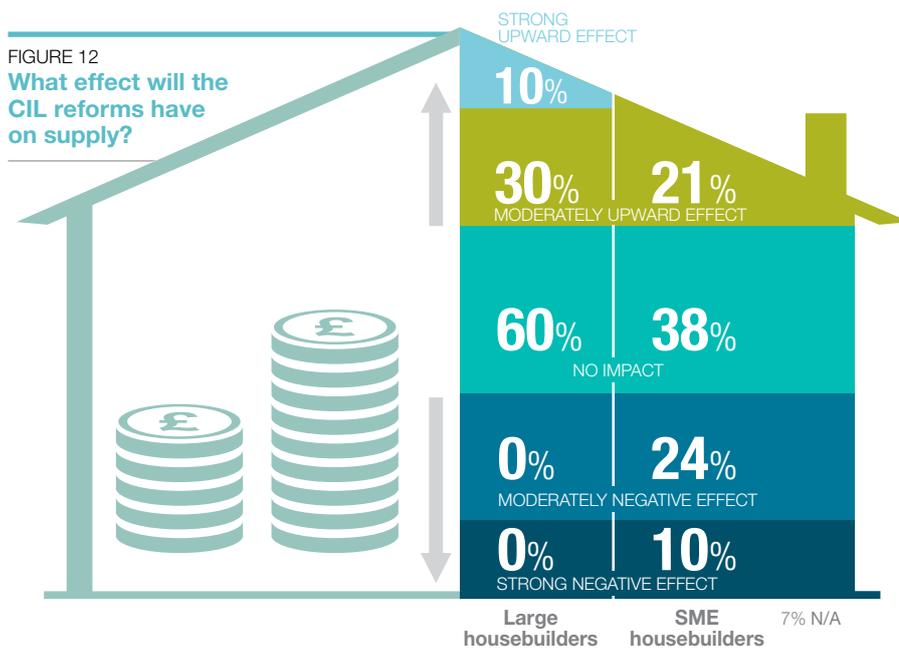
The Government ordered a review of CIL late last year, and the results were published alongside the Housing White Paper. A further announcement is expected in the Autumn. The review recommends reforming CIL, turning it into a less complicated Local Infrastructure Tarriff (LIT). This would be a mandatory lower level charge applied to all developments (residential and commercial). However, Section 106

FIGURE 11
Help to Buy Equity Loans

Total number granted



Source: Knight Frank Research



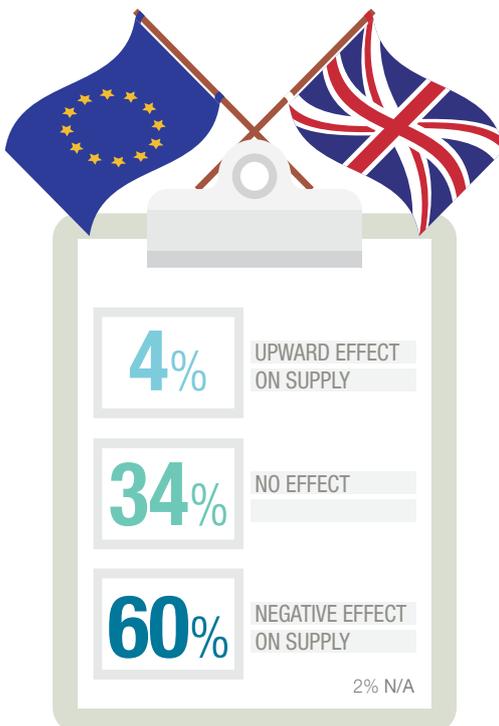
Source: Knight Frank Housebuilder Survey

payments would be applied on larger developments – following the example already set by some LAs.

The majority of overall respondents to our survey thought the reforms would not make a difference to overall supply, but it

is noticeable that 40% of large developers said that the moves would boost supply, while 34% of small developers thought it would have a negative impact, reflecting how the new rules would affect different parts of the industry.

FIGURE 13
What impact will the triggering of Article 50 and start of Brexit negotiations have on housing supply?



Source: Knight Frank Housebuilder Survey

Brexit

- 60% of respondents say triggering Article 50 and Brexit negotiations will have negative impact on supply
- 12% of construction workers currently from overseas, according to FMB

The vote to leave the EU means the outlook for the whole UK is more uncertain as the Government negotiates a deal on what a separate UK will look like. Despite a rather upbeat outlook on housing supply overall from our respondents, they also signalled that this could be dampened by the triggering of Article 50 and the Brexit negotiations.

While the uncertainty over the Brexit negotiations raises the prospect of some economic turbulence, which could have second-round effects on the housing market, especially if employment and wages are squeezed, the more direct concern for most housebuilders around Brexit is access to labour. If the migration of skilled labour is curbed, this could affect the housebuilding industry as a whole. Some 12% of construction

workers across the country are from outside the UK, according to recent data from the Federation of Master Builders (FMB) although there are regional variations to this figure, with a larger proportion in the capital. As can be seen later in the report, access to labour is already seen as one of the biggest hurdles in the market, with 80% of respondents saying that this issue alone is having a negative impact on supply.

Challenges

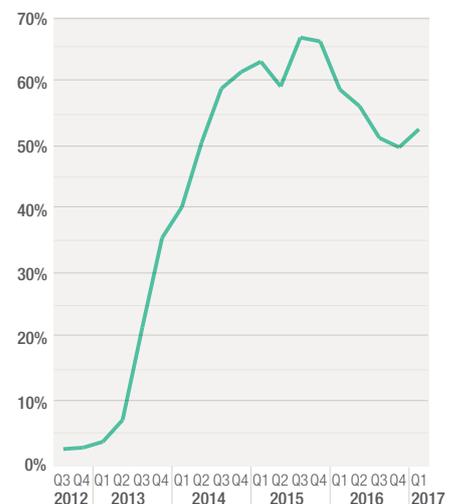
Labour

- 80% of respondents say problems accessing labour are negatively impacting supply
- 85% of large housebuilders say they are increasing opportunities for apprentices in the next 12-24 months

The scale of the challenge to access skilled labour is clear from the chart below. However, the majority of respondents said they were also increasing the opportunities for apprentices in the next year or two.

This rise in the number of people being offered apprenticeships, while positive, is unlikely to be the short-term solution to the issue of labour. And the difficulties in accessing labour have wider repercussions for the sector as a whole.

FIGURE 14
Shortage of labour affecting activity...
Respondents saying yes, % net balance



Source: RICS Construction Survey

“
The step-up in training being provided by some of the biggest housebuilders will go some way to plugging the skills gap, but this will remain an issue for years to come

DAVID FENTON
HEAD OF REGIONAL LAND



FIGURE 15
What impact will these factors have on supply in the market over the next 12 months? % of respondents

	BOOST SUPPLY	NO EFFECT	REDUCE SUPPLY
Labour availability and costs	8%	9%	80%
Build costs	15%	11%	73%
Planning system	15%	12%	71%
Availability of land	23%	26%	49%
Access to development finance	15%	39%	42%

Source: Knight Frank Housebuilder Survey

Some policymakers are suggesting a return to local authority-led development. It is clear that housing associations are already taking up the mantle, becoming very active in the residential development land market.

As local authorities become more involved, we expect to see them enter into more Joint Ventures and agreements with housebuilders and developers, pairing up to share costs and skills to produce housing. But the issue of labour may actually limit the total capacity of the market, meaning that despite positive policies, there will still be a drag on delivery.

The question of labour has resulted in increased attention on the opportunities for less labour-intensive construction methods, such as modular construction. Some 61% of respondents said that modular construction could have a positive impact on supply, even if it was in the longer-term. Some 39% said that this form of construction would make labour easier to source.

Planning

- **71% of all housebuilders say the planning system is having a negative impact on supply...**
- **... rising to 88% for medium-sized firms**

There was clear recognition in the Housing White Paper that the planning system is still posing problems in and around development, despite the many welcome reforms of the NPPF. An issue highlighted in last year's Housebuilding Report – staffing in local planning offices – was examined, and a pledge was made to try and boost the resources of local authorities for this purpose, even allowing them to charge for some services and ring-fence the proceeds.

Yet, the rising cost of gaining planning is becoming a bigger challenge for smaller builders, and this is reflected in our survey. Whilst 54% of larger housebuilders say that the planning system was having a negative impact on housing supply, this rises to 88% for medium-sized firms, delivering between 100 and 500 units a year.

FIGURE 16
Are you planning to increase the opportunities for apprentices in your company in the next 12-24 months? % of respondents



Source: Knight Frank Housebuilder Survey

Another challenge for planning departments is trying to balance the tension between local concerns and national priorities.

Market outlook

The political environment after the June election may be uncertain, but housing has the potential to be a positive for policymakers. Some of the groundwork has been laid within the Housing White Paper – so there is room to focus on increasing housing delivery. In this report, the Housebuilder Survey focuses on every aspect of policy and the wider market which has an impact on new housing delivery in order to highlight where some of the biggest challenges lie, including access to labour, costs and planning. By focusing on how every aspect of housing policy which has an impact on new housing delivery, either positively or negatively, we have emphasised where some of the biggest

challenges lie, including access to labour, costs and planning.

While the survey results indicate that the overall outlook among housebuilders and developers for housing supply is largely positive in the short-term, any progress in these areas could help further boost development on a longer-term sustainable basis.

While overall supply in England is set to breach 200,000 this year, the majority of respondents to the Housebuilder Survey thought that this level of delivery was not sustainable year in, year out, under current market conditions.

As was made clear in this summer's election, housing is a pressing issue. Only moves to boost liquidity in the second-hand market and step up the supply of new homes where they are needed on a long-term basis will relieve this pressure.

80%

of respondents say labour availability and costs will have negative impact on supply in the next 12 months

Residential Market Forecasts

2017-2021 Forecasts

	2016	2017	2018	2019	2020	2021	2017-2021
Mainstream residential sales markets							
UK	5.0%	1.0%	2.5%	3.0%	3.0%	4.0%	14.2%
London	7.0%	-1.0%	2.0%	2.5%	3.0%	5.5%	12.5%
North East	0.0%	0.5%	2.5%	2.5%	2.0%	1.5%	9.3%
North West	4.0%	0.5%	2.0%	2.5%	3.0%	2.0%	10.4%
Yorks & Humber	3.5%	1.0%	3.0%	3.5%	3.0%	2.0%	13.1%
East Midlands	5.5%	1.5%	3.0%	3.5%	4.0%	4.5%	17.6%
West Midlands	4.5%	1.5%	3.0%	4.0%	4.0%	4.0%	17.6%
East	7.5%	1.5%	2.5%	4.0%	3.5%	5.5%	18.1%
South East	8.0%	1.0%	2.0%	4.0%	4.0%	5.0%	17.0%
South West	4.5%	2.0%	2.0%	3.5%	3.5%	4.5%	16.5%
Wales	-0.5%	0.0%	2.0%	2.5%	2.0%	2.0%	8.8%
Scotland	2.0%	0.1%	2.3%	2.7%	2.8%	2.8%	11.0%
Prime residential sales markets							
Prime Central London East	1.0%	1.0%	3.5%	3.0%	3.5%	4.0%	15.9%
Prime Central London West	-7.0%	0.0%	1.5%	2.0%	3.0%	3.5%	10.4%
Prime Outer London	-1.5%	-1.5%	2.5%	3.0%	3.0%	4.0%	11.4%
Prime England and Wales	0.1%	1.5%	2.0%	2.0%	3.0%	3.5%	12.6%
Residential rental markets							
UK	1.2%	1.4%	2.0%	2.0%	2.0%	2.0%	9.8%
Prime Central London East	-2.5%	0.0%	2.0%	3.5%	3.0%	3.0%	12.0%
Prime Central London West	-6.5%	-2.0%	1.0%	2.0%	2.0%	2.0%	5.0%
Prime Outer London	1.5%	2.0%	2.5%	3.0%	2.5%	2.5%	13.1%
UK Transactions (000s)							
UK	1,231	1,275	1,291	1,303	1,313	1,321	

Source: Knight Frank Research, OBR

*% forecasts based on Nationwide HPI



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With thanks to Spitfire Homes for the front page image, showing Highworth Broadway.
Thanks to the respondents to the survey for their time.

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