RESEARCH

Knight Frank

LONDON RESIDENTIAL DEVELOPMENT

H1 2019

LONDON IN CONTEXT

Ambiguity over the UK's future relationship with the European Union has dominated the news agenda, though the China, US trade war and weakness in the Eurozone have added to economic headwinds and impacted sentiment.

Beyond the political uncertainty, London's economy has remained healthy since the vote to leave the European Union. Average UK weekly wages grew at their fastest rate since 2008 in the third quarter as employment in the capital hit another record high.

It is these fundamentals that have underpinned the property market, alongside low borrowing costs, schemes like Help to Buy and upgrades to infrastructure. However, the market faces structural challenges that are suppressing long-term sales activity, including stretched affordability, tighter mortgage regulations introduced in the wake of the financial crisis, and patchy house price growth – though reports, including the latest RICS sentiment survey, indicate January was a stronger month than November and December.

These factors, and a challenging policy environment, have also weighed on residential construction. Upward momentum in annual housing delivery that had continued unabated since 2012-13, reversed in 2017-18, with the number of dwellings added to total housing stock in the capital, including conversions and change of use, falling 20% compared with the previous year.

This report brings together a wide range of data on the London property market to examine trends, rents, demand, the development pipeline, construction costs and more.

KEY TAKEAWAYS

House prices

House prices declined 0.6% in 2018, according to the Land Registry, but markets are increasingly localised and performance differs greatly by borough.

Supply

There were 20% fewer additional dwellings added to London's housing stock during 2017-18, though delivery remains well above the pre-crisis average. The construction and planning pipeline suggests delivery may fall further.

Housing targets

Just five of London's 33 boroughs met their targets for housing need during 2017-18 and twenty delivered less than half.

Affordable housing

Delivery of Shared Ownership via section 106 has more than doubled in three years and is likely to increase further as land values adjust to new GLA policies.

Construction costs

Construction costs have risen 14% in three years which, along with economic uncertainty, is exerting pressure on development land values.

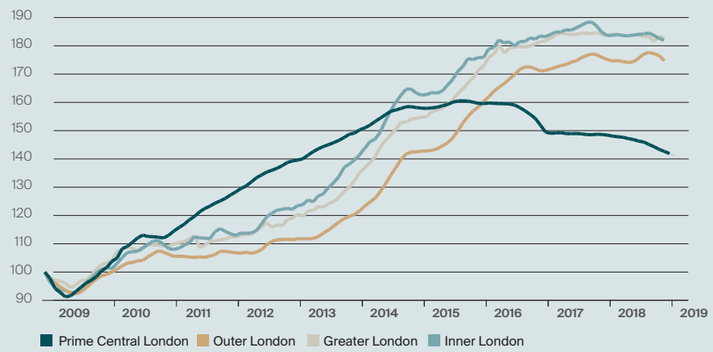
PRICES

House prices in Greater London declined 0.6% during 2018, though markets are localised and performance varies greatly by borough (fig 1). Outer London Boroughs have broadly been outperforming over the last 12 months following strong demand for affordable housing aided by Help to Buy and exemptions from stamp duty for first-time buyers.

In Prime central London, prices declined 4.8% during the twelve months to February and are now down 12% since the market's peak (fig 2). The weak sterling is attracting interest from overseas buyers, with the effective discount in dollar terms approximately 25% when compared to 2015.

FIGURE 1
House price heat map

FIGURE 2
Long-term resale price movements Indexed 100 = Dec 2008



Source: Knight Frank Research, Land Registry

LONDON ANNUAL PRICE CHANGE

Year to Dec 2018

- More than 3%
- 1% to 3%
- 0% to 1%
- 0% to -2%
- -2% to -5%
- Below -5%

HF Hammersmith & Fulham
KC Kensington & Chelsea
CW City of Westminster
CL City of London

Source: Knight Frank Research, Land Registry

ACTIVITY

Sales in London during the third quarter of 2018 were 12% lower than the previous year, amid hesitancy among buyers as the date of the UK's March EU departure drew nearer (fig 3).

Some 6,670 transactions were recorded by the Land Registry in October. Repeated changes to property taxation and political uncertainty created by three general elections and two referendums has weighed on sales activity over the longer term. The government's consultation proposing an extra 1% stamp duty on overseas buyers will run until May 6th.

Knight Frank data indicates pent up demand is forming in many prime markets while buyers wait for greater political clarity before making purchases, with the ratio of new prospective buyers to homes available at highest level in four years.

RENTS

Declining supply pushed prime central London rents up 1.3% during the year to January. Prime outer London rents remained unchanged (fig 4).

The decrease in supply is due to more landlords leaving the sector following tax changes. Annual growth in the number of outstanding buy-to-let mortgages has slowed dramatically since early 2016, in a sign that an increasing number of landlords are rationalising their portfolios.

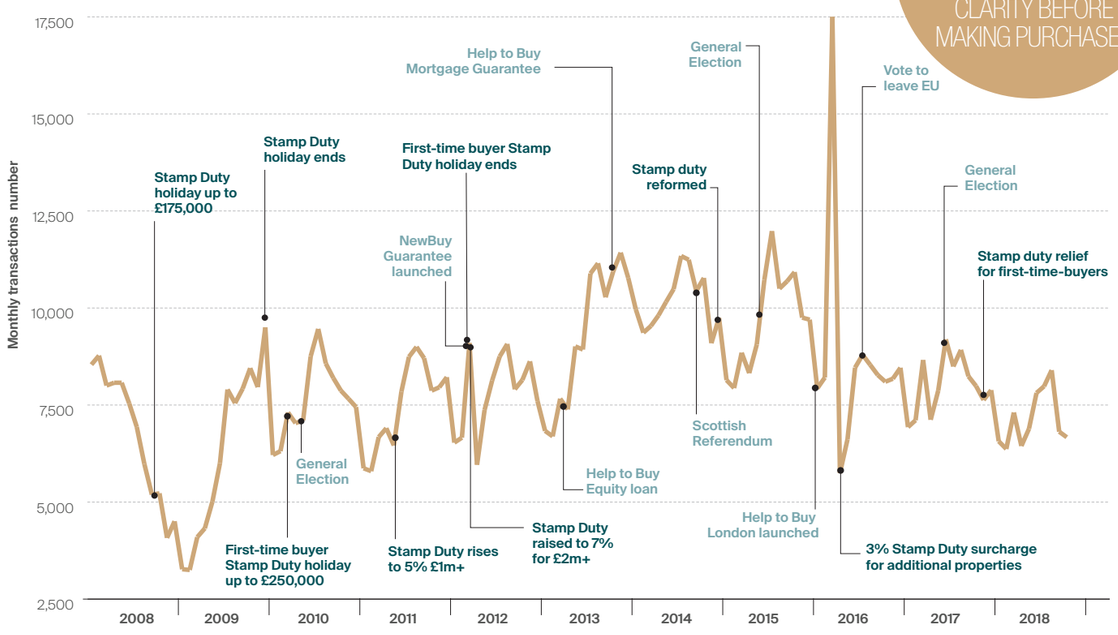
Mainstream rents edged upwards 0.1% during the year to January and have remained largely flat for the past two years.

The Build to Rent sector accounted for 23% of private starts in the capital during 2018. In Greater London, estimated net initial yields for the sector's prime properties, defined as institutional quality, stabilised assets, stood at 4% during Q4 2018. In zones 3-4, estimated net initial yields stood at 3.75%.

> Mainstream rents in the capital climbed 0.2% during the year to December and have remained largely flat for the past two years.

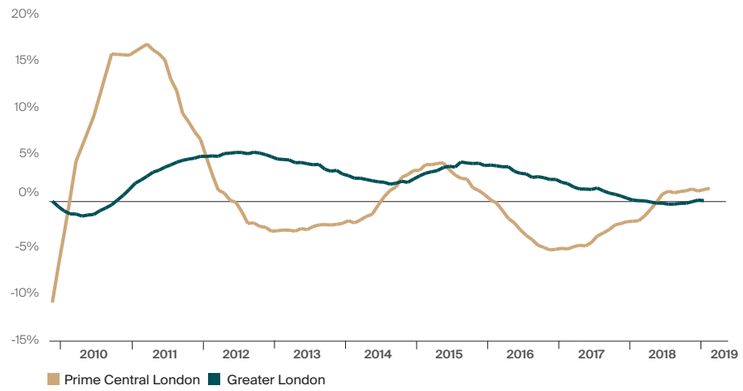
PENT UP DEMAND IS FORMING IN PRIME MARKETS WHILE BUYERS WAIT FOR GREATER POLITICAL CLARITY BEFORE MAKING PURCHASES

FIGURE 3
Monthly sales, Greater London



Source: Knight Frank Research, Land Registry

FIGURE 4
Annual change in London rents



Source: Knight Frank Research, ONS

THE PRIME LONDON PROPERTY MARKET IS IN A STRONGER POSITION THAN IT APPEARS TO BE ON THE SURFACE

Tom Bill
Head of London research

The influence of political uncertainty on the prime London property market has grown markedly over the last nine months. During the first half of 2018 there were signs the market was beginning to stabilise as asking prices adjusted more fully to reflect higher transaction costs.

Sales volumes in prime central London were 7% higher in the year to March 2018 than the previous 12-month period, LonRes data showed. However, by January this year, with Brexit uncertainty persisting ahead of the UK's planned departure from the EU, volumes were down by 16%.

Pricing behaved in a similar way. While the annual decline recorded in prime central London in February 2018 was 0.1%, 12 months later the decrease had widened to 4.8%.

Identifying individual factors affecting the performance of the prime London property market can be a complex task but the impact of political uncertainty has been decisive in recent months.

However, there are signs that pent-up demand and the conditions for a recovery are building. While the number of exchanges is declining, the number of new prospective buyers registering rose by 6% in the year to February. Indeed, the ratio of new demand to new supply rose to 9.4 in February 2019, the highest monthly figure on record.

Meanwhile, the average number of days between listing and a property going under offer fell 2% in 2018 compared to the previous year, in a sign that more appropriately-priced properties went under offer more quickly.

So, while it is unknown when the current level of political uncertainty will recede, the conditions for a recovery in the prime London property market appear to be taking shape.

> The number of new prospective buyers in Prime Central London registering rose by 6% in the year to February. Indeed, the ratio of new demand to new supply rose to 9.4 in February 2019, the highest monthly figure on record.

HOUSING DELIVERY

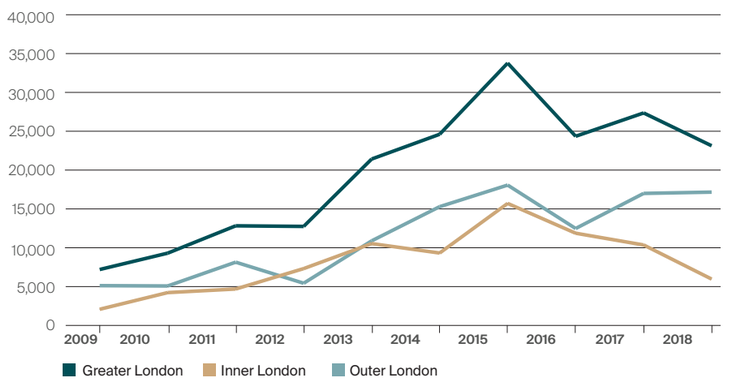
During 2017-18, 31,723 net additional dwellings were added to Greater London's housing stock, a 13% decline in new homes compared to the previous year, largely due to a significant decline in the number of offices being converted into homes (fig 6). Office to residential conversions fell 52% to just 2,993 units, suggesting much of the most suitable space has already been converted since the Permitted Development Right was introduced in May 2013.

The decline in delivery will pose challenges for Mayor Sadiq Khan, who has set a target of 66,000 annual additional dwellings in the capital, itself some way below the government's standard method for calculating housing need, which indicates councils should plan for at least 72,407 homes a year.

Just five of London's 33 boroughs met their targets for housing need during 2017-18 and as many as twenty delivered less than 50% (fig 7). However, three of the boroughs that met their target actually exceeded the target by more than 40%.

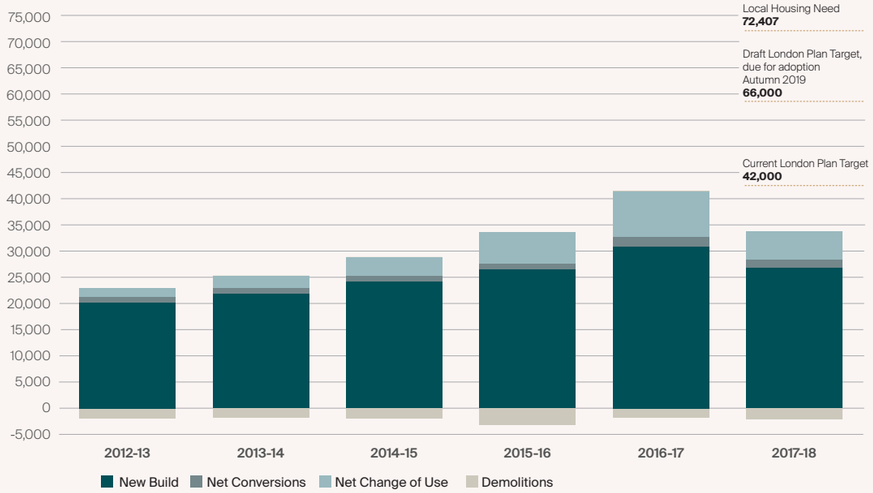
Looking ahead, new build completions dipped 13% in 2017-18 to 26,769, and could be set to fall further. Data from Molior, which includes projects of 20 or more private units, indicates the number of units that started construction in 2018 was 23,130, a drop of 32% compared to the 2015 peak (fig 5).

FIGURE 5
Housing Construction starts
Developments of 20+ private units



Source: Molior

FIGURE 6
Net Additional Dwellings, Greater London



2017-18 data and annual change

31,723 ▼20%
Net additions

26,769 ▼13%
New build completions

2,993 ▼52%
Office to residential change of use

Source: MHCLG

FIGURE 7
Housing delivery in London measured against the Government's housing need assessment
Percentage of annual housing need achieved during 2017-18, by borough

Source: Knight Frank Research, MHCLG

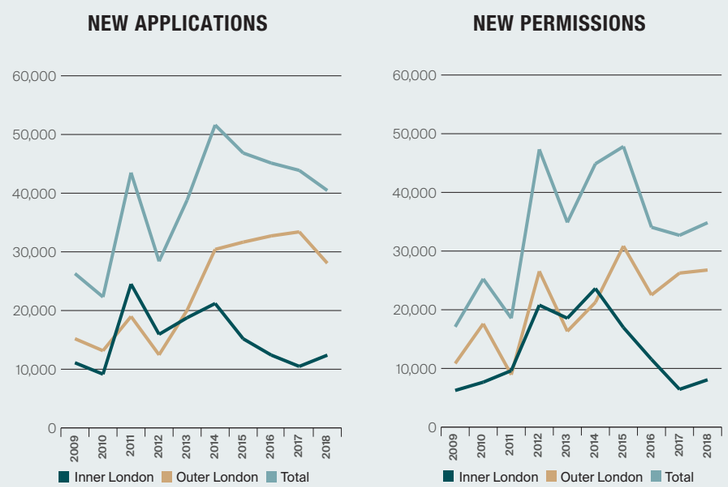
PLANNING

The number of residential units entered for planning permission in projects of 20+ private units has been falling since 2014, from 51,621 to 40,461 in 2018, according to Molior (fig 8). Meanwhile, the number of units granted permission in large schemes in 2018 increased slightly to 34,834, though remains well below the 2015 peak of 47,818.

The planning environment in the capital remains challenging. Official statistics on planning applications state 88% of major applications were decided within 13 weeks during Q3 2018, though the complexities of negotiating section 106 agreements and discharging planning conditions is a source of delay and uncertainty for developers.

The Mayor's 35% Affordable Housing threshold, that climbs to 50% for projects on public land, is creating further challenges as land values take time to adjust to the new policy.

FIGURE 8
Planning Applications, Permissions
Developments of 20+ private units

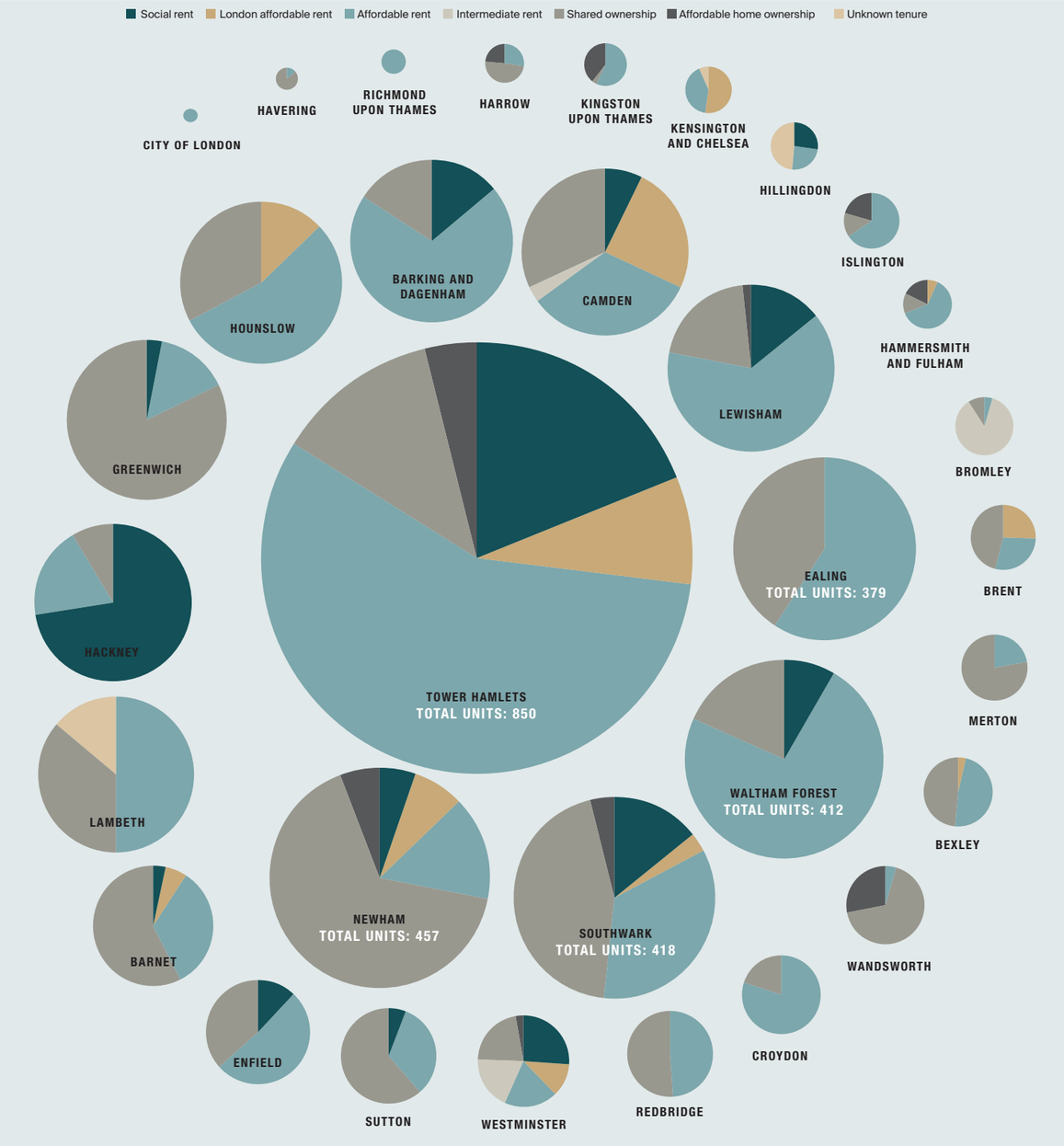


Source: Molior

AFFORDABLE HOUSING

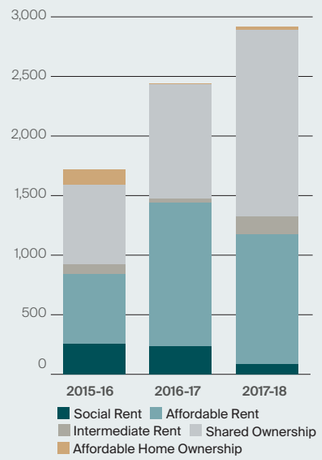
Affordable Housing policy in London is in a state of flux as developers adjust to new tenures and more stringent targets from City Hall.

FIGURE 9
Total affordable housing completions 2017-18, tenure split
Size of the circles correspond to the number of affordable units delivered



Source: MHCLG

FIGURE 10
Affordable Housing delivered by developers via Section 106



The Mayor's introduction of a fast-track through planning if developers hit 35% Affordable Housing, or 50% on public land, is still being digested and some schemes that pre-date the policy change remain in limbo.

Affordable Housing delivery via section 106 (nil grant) in London has climbed more than 70% in three years, though the mix of tenures has changed notably (fig 10). Homes built for Social Rent were 66% lower in 2017-18 than 2015-16, and the proportion of Shared Ownership has more than doubled over the same period.

This trend is likely to continue as land prices take time to adjust to the new threshold policy. Meanwhile the challenge to increase delivery of Affordable Housing via section 106 is likely to grow amid a wider environment of declining residential construction.

The onus to hit ambitious targets is likely to fall on Registered Providers, who are in turn increasing construction of homes for market sale to offset a lack of grant funding.

> "The Mayor's introduction of a fast-track through planning if developers hit 35% Affordable Housing...is still being digested and some schemes that pre-date the policy remain in limbo.

LAND AND CONSTRUCTION COSTS

In prime central London, land values declined 2.8% in Q4, taking the annual decline to 5.6% (fig 11).

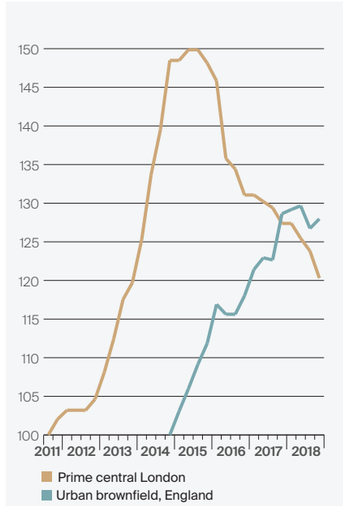
Values have dropped almost 20% since the peak of the market in Q3 2015, and with the weak sterling, some notable buyers have decided prime central London land now represents good value.

Knight Frank's Urban Brownfield Index, which measures the average price of Urban Brownfield land across the country climbed 1% during Q4, taking the annual decline to 0.5%. Labour costs continue to edge up and the relatively weak pound has made imported building materials more costly for housebuilders.

Residential construction costs, which include materials, plant and labour, have climbed 14% in the three years to January (fig 12). Rising costs, alongside economic uncertainty over Britain's impending departure from the European Union, have prompted developers to increase their margins, which is suppressing growth in land values in both inner and outer London.

Sites of all types are transacting, though volumes remain low. Land owners are in many cases choosing to wait for more economic clarity before choosing to sell.

FIGURE 11
Residential Development Land Prices
PCL Indexed 100 = Q3 2011, Urban Brownfield Indexed Q4 2014



Source: Knight Frank

FIGURE 12
Construction costs, 10 yr change
Indexed 100 = Oct 2008

Source: ONS

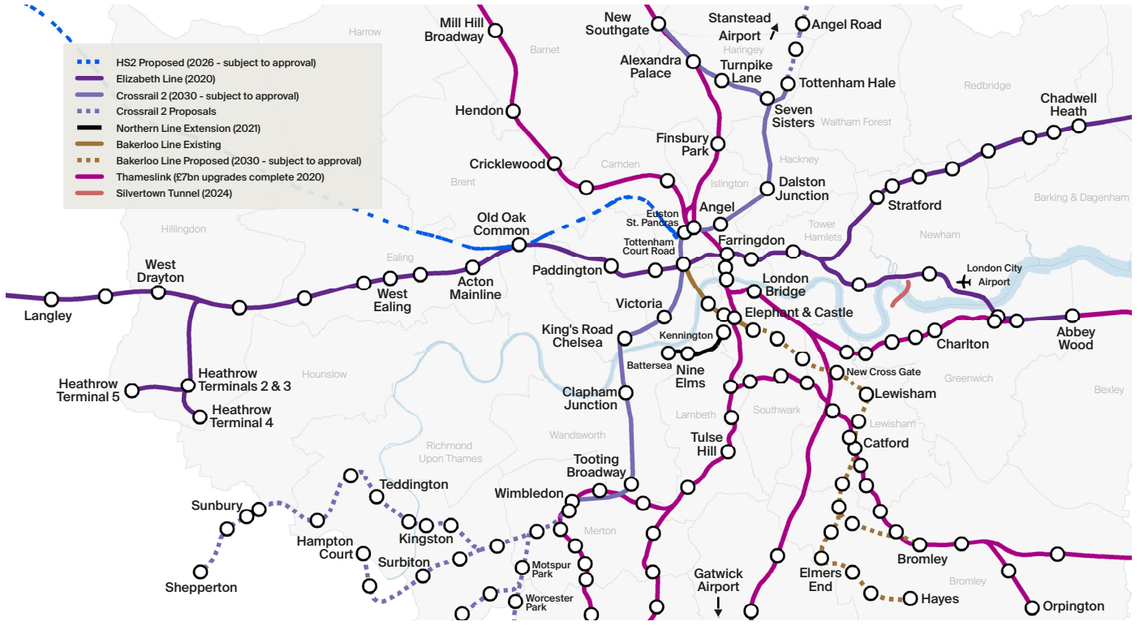
INFRASTRUCTURE

The capital has seen unprecedented investment in new infrastructure, with key projects reaching fruition over the next three to five years. The majority government-sponsored, £7 billion Thameslink Programme that has been underway for a decade is now largely complete, including 115 new trains, station upgrades and new technology.

In the short term, the scheduled December 2018 opening of Crossrail, which upon opening will be known as the Elizabeth Line, was delayed after cost overruns and is now scheduled to open after Autumn 2019, with multiple reports suggesting a 2020 opening at the earliest. Similarly, the £1 billion Northern Line extension, originally due to open in 2020, is now expected to open in 2021.

Looking further into the future, the plan for the Silvertown Tunnel Thames crossing was approved in May 2018 and the tunnel is expected to be operational by 2024. The twin-tunnel cross will connect the Lower Lea Valley, where 20,000 homes are in the pipeline, with the 10,000-home regeneration of the Greenwich Peninsula.

More transport upgrades are proposed, including the High Speed 2 trainline, which is slated to be operational by 2026, Crossrail 2, and an extension of the Bakerloo underground line, both of which have proposed opening dates in 2030.



FORECASTS

SALES MARKET Annual % growth

	2019	2020	2021	2022	2023	2019-2023
London	-2.0%	1.0%	3.0%	2.0%	5.0%	**9.2%**
Prime Central London	1.0%	2.0%	3.5%	2.0%	4.5%	**13.7%**
Prime Outer London	0.0%	2.0%	3.5%	2.0%	5.0%	**13.1%**

RENTAL MARKET Annual % growth

	2019	2020	2021	2022	2023	2019-2023
London	2.5%	2.5%	3.0%	3.5%	3.5%	**15.9%**
Prime central London	3.0%	2.0%	1.0%	1.5%	2.0%	**9.9%**
Prime outer London	2.0%	1.5%	1.5%	2.0%	2.0%	**9.3%**
UK	2.0%	2.0%	2.5%	2.5%	3.0%	**12.6%**

NB. Price forecasts are for existing homes. Property values in the new-build market may perform differently.

1.7 million
Projected growth in London's population, 2015-2035

40,461
Private units submitted for planning in Greater London in 2018

9.1
New prospective buyers compared to homes listed for sale in Prime London, January

24%
Forecast growth in gross value added, a measure of economic growth, Greater London, 2019-2029

15,056
Greater London homes bought with Help to Buy equity loans since April 2013

Sources: Knight Frank Research, GLA, Molior, Experian, MHCLG

DATES TO WATCH

13th March	1st April	8th April	12th April	2nd May	20th May	22nd May	Summer	Autumn	Date TBC	7th May	Date TBC	Date TBC	5th May
Spring Statement	Mayoral CIL 2 payable	Mayor's Ultra Low Emission Zone charging begins	Delayed EU departure date	UK local elections	Extra Stamp Duty for overseas buyers consultation ends	EU departure date if May's deal is approved by MPs	Government response to Letwin Review	New London plan adopted	Crossrail opens	London Mayoral election 2020	Northern Line extension opens	Construction scheduled to begin on Heathrow third runway	UK general election

2019 | 2020 | 2021 | 2022

"BEYOND THE POLITICAL UNCERTAINTY, LONDON'S ECONOMY HAS REMAINED HEALTHY SINCE THE VOTE TO LEAVE THE EUROPEAN UNION. AVERAGE UK WEEKLY WAGES GREW AT THEIR FASTEST RATE SINCE 2008 IN THE THIRD QUARTER AS EMPLOYMENT IN THE CAPITAL HIT ANOTHER RECORD HIGH."

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If you would like further insight into residential markets please get in touch.

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UK Res Dev Land Index – Q4 2018

The UK Tenant Survey – 2019

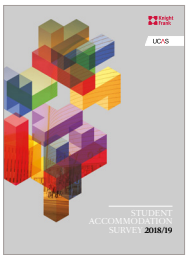
The London Review – Spring 2019

The London Report – 2019

The Wealth Report 2019

Eastern Opportunities – 2019

UK Housing Market Forecast - November 2018



Knight Frank/ UCAS Student Housing Survey - 2018/19

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Get in touch

If you're thinking of buying or selling, or would just like some property advice, please do get in touch.

Residential Capital Markets

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