Assessing the landscape for new homes, planning and development

London Residential Development

H1 2020

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LONDON IN CONTEXT

Politics has had a marked impact on the capital's residential market so far this year, with significant planning changes on the horizon, but for now questions surround the impact of the coronavirus pandemic

The London residential development market has entered a new, uncertain phase but government intervention should ease the pain.

Coronavirus has understandably caused buyers to become more cautious, whilst a number of volume housebuilders are deferring land purchases until more clarity emerges. While the government-imposed lockdown has had an impact on viewings, agents are innovating through the use of technology to facilitate video viewings.

Some housebuilders are scaling back their operations temporarily, but others are continuing, and current government advice is that they can still operate, though circumstances are liable to change.

The government has stepped in by announcing a £350bn lifeline for the economy. The support includes a furloughed workers scheme paying 80% of salaries to retain workers as well as a Coronavirus Business Interruption Loan Scheme to help small and medium sized firms borrow up to £5m to weather the impact of coronavirus.

Some economists are predicting a short, sharp crunch followed by a quick and strong recovery.

These kinds of interventions should ease the pressure on mortgages and limit defaults. Longer term this will reduce the chance of forced sales, such as were seen following the financial crisis.

Indeed, some economists are predicting a short, sharp crunch followed by a quick and strong recovery. They are hoping for a faster recovery than the 2008 global recession, potentially a "V"-shaped recession, rather than a slower "U" or a prolonged "L".

Perhaps the best way to anticipate what will happen once government restrictions are lifted is to look at what was happening before the pause button was pressed. Sales markets in London were in recovery mode after spending years re-pricing. There was certainly a short-term bounce after the election

KEY TAKEAWAYS

Sales markets in London were in recovery mode at the start of 2020, but coronavirus has understandably caused buyers to become more cautious

While constrained, the new homes market remains open for business with evidence of deals being agreed at all levels of the market

but activity levels were getting stronger after successive tax changes and Brexit had started to work their way through the system.

Not all of this pent-up demand had been released by the time the coronavirus came along, which suggests that once current measures are relaxed or lifted, sales volumes could quickly strengthen.

What happens to unemployment rates between now and then will also have an impact. For now, pledges of unprecedented levels of government support are keeping unemployment forecasts relatively low. For instance, Oxford Economics expects unemployment levels will rise to 4.17% later this year but recover to the current level of 3.42% by next year.

Moreover, the Bank of England has made two emergency interest rate cuts, first to 0.25% and later to 0.1%. The availability of cheap lending can help support the property market at this time. It will also ease pressure on those with tracker mortgages.

Some activity continues

In this more challenging environment, agents note that business is still continuing in some areas.

For instance, housebuilders in the middle of projects with contractual obligations are carrying on building.

There is also a strong appetite from the more entrepreneurial developers and private equity-backed land buyers looking to acquire opportunistically.

Such purchasers are balancing the potential for slower market conditions, against the fact that land is a long-term consideration.

The new homes market, while constrained, remains open for business. Conversations with agents in London reveal evidence of deals being agreed at all levels of the market, from Help to Buy-backed transactions all the way through to £10 million-plus sales, all of which provide an indication as to the depth of demand in the market.

Virtual viewings have replaced physical ones in several developments and provide a touchpoint for potential purchasers impacted by travel restrictions, or by the latest government measures in the UK.

Developers are also still pursuing longer term projects, such as re-engineering retail-led sites to include more purpose-built rental accommodation. Agents note they are hiring architects to draw up plans to repurpose schemes.

4.17%

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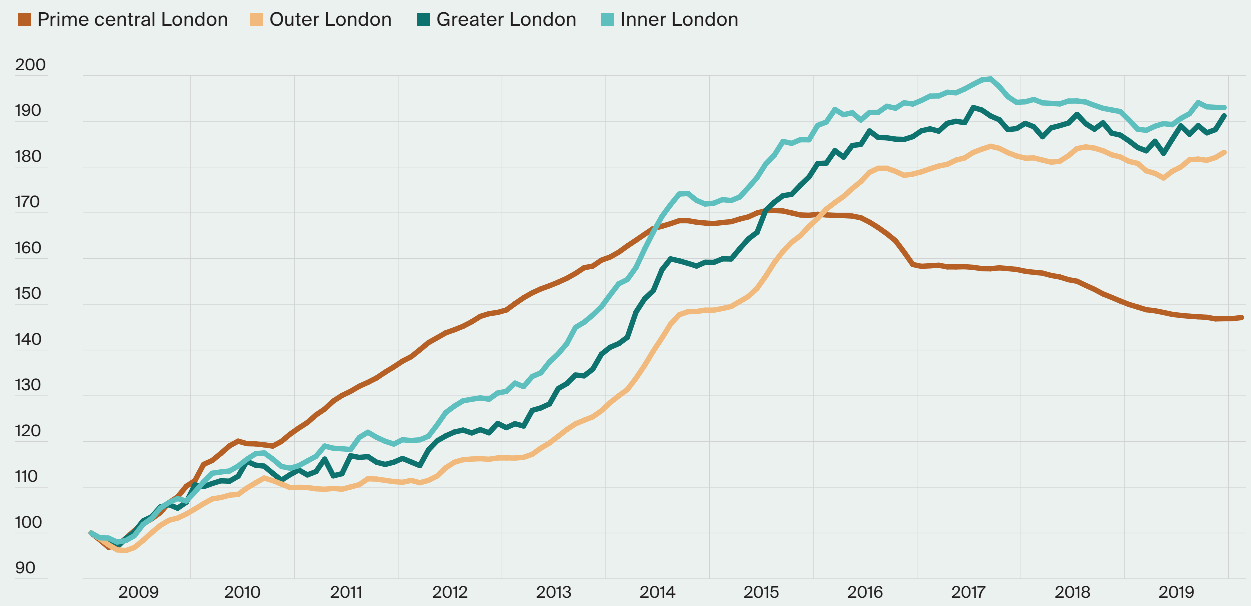
Long-term price movements Indexed 100 = January 2009



Source: Knight Frank Research, UK Land Registry

Other challenges ahead

Uncertainty persists over the Help to Buy Equity Loan scheme, which is being scaled back from March 2021 and is expected to end in 2023. The Budget did not shed further details on how the government's new First Homes initiative, which would lower housing costs for first-time buyers by 30%, will work in practice.

Elsewhere, the pace of housebuilding had already begun easing, with data from Molior showing construction starts in 2019 were more than 60% below their 2015 peak in inner London.

And Brexit remains an omnipresent threat, given the country is still in a transition period and the final details of its relationship with the EU remain unclear. Furthermore, despite the government publicly restating its pledge to finalise the UK's transition out of the EU by 31 December, the coronavirus crisis may well trigger a delay.

Amid all this, London is still seen as a safe haven for residential investors, with its shortage of housing and rapidly rising population.

Against a backdrop of record low interest rates and strong underlying fundamentals, there are signs the market could bounce back and in the meantime the industry is pushing ahead with existing deals while the more entrepreneurial seek out opportunistic purchases.

18%

New build completions grew 18% in the 12 months to March 2019 to 31,645.

Housing delivery

In Greater London, 36,161 properties were added to the city's housing stock in the 12 months to March 2019. This marks a 14% increase compared to the previous year.

In 2018-19, there were 5,070 instances of change of use, down 7% from 5,480 the previous year. In this timeframe, conversions increased 12% to 1,710, according to the Ministry of Housing, Communities & Local Government.

New build completions grew 18% to 31,645.

The increase in delivery is still below Mayor Sadiq Khan's revised ten-year new homes target, which came down from 65,000 to 52,000 a year in December, in line with recommendations from planning inspectors reviewing City Hall's draft new London Plan.

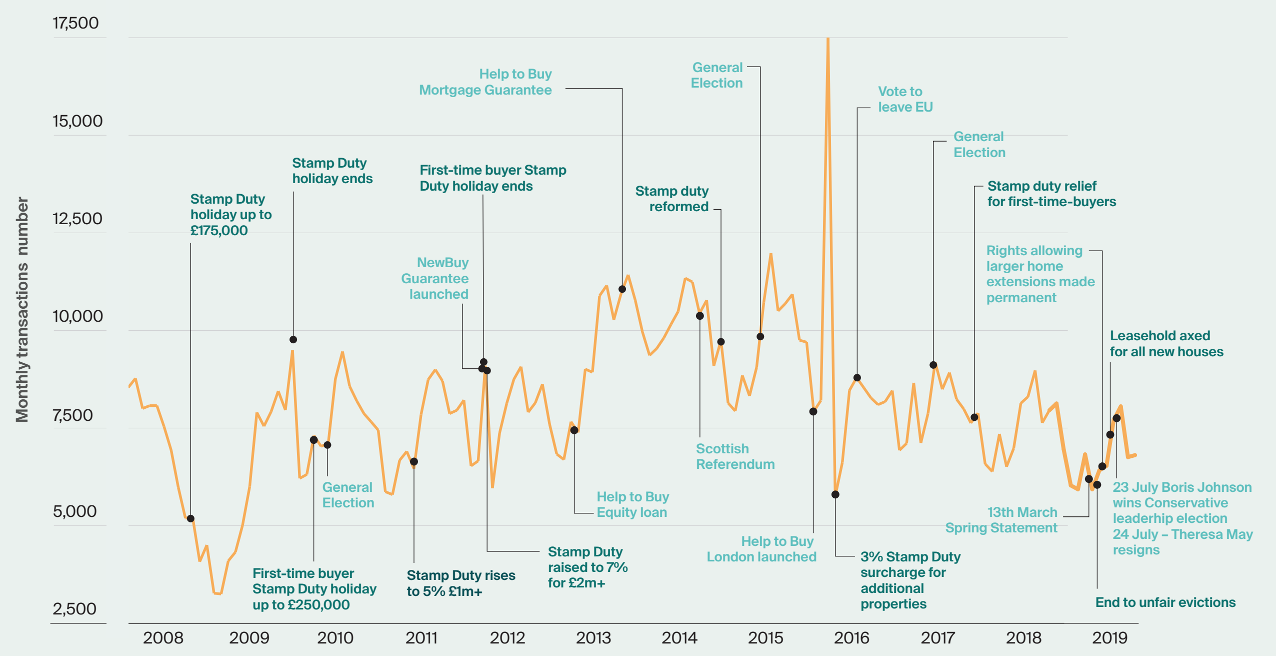
Data from Molior, which includes projects of 20 or more private units, suggests the undersupply of housing is likely to continue. It shows the number of units that started construction in 2019 was 19,166, down 43% compared to the 2015 peak. For inner London, this figure was just 6,049, more than 60% fewer than in 2015.

Moreover, coronavirus will inevitably lead to a pause in new homes delivery. Crucially, this cessation of activity comes at a time when completions volumes in England have been steadily ticking upwards, and just weeks after the government reiterated its ambition to build 300,000 homes a year by the mid-2020s.

The latest figures show that just over 240,000 homes were added to housing stock in England in 2018/19, up 9% on the previous year, but some way below that target figure. Energy Performance Certificates (EPCs) issued for new homes, which are an unofficial leading indicator of housing delivery, show this uptick has continued through the calendar year, though they remain stubbornly below 300,000.

It is clear that meeting that stated goal requires decisions that go beyond the next few weeks or months.

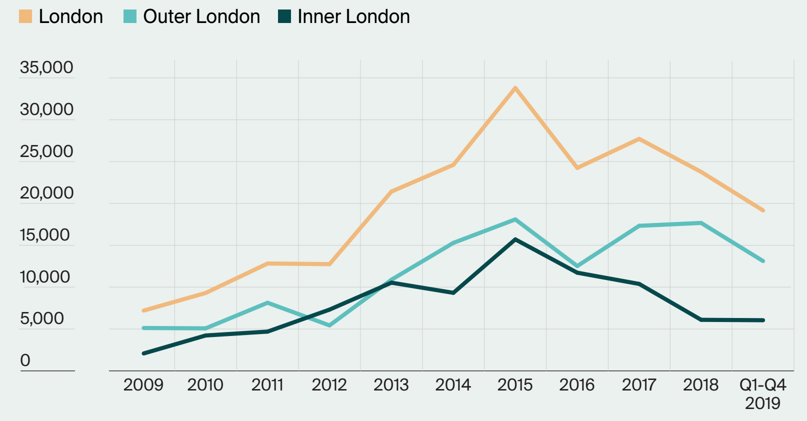
Monthly sales, Greater London



Source: Knight Frank Research, Land Registry

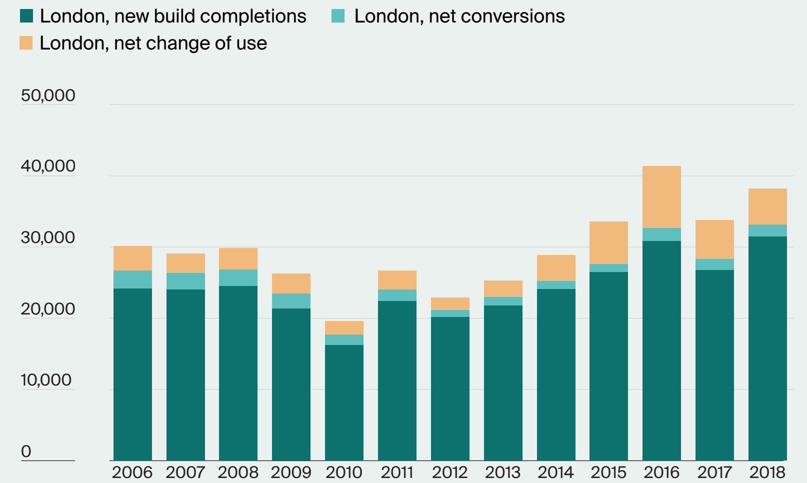
Housing construction starts

Developments of 20+ private units



Source: Molior

Net additional dwellings, Greater London



Source: MHCLG

Tom Bill – *on PCL*

Sales data for the prime London property market show the 'Boris bounce' was more than an alliterative soundbite.

While 2019 was the strongest year for transactions since 2014, this recovery began to accelerate in the three months between the general election and the lockdown.

Prices in prime central London grew by 0.2% in the first quarter of 2020, according to data collected before lockdown measures were introduced. It was the biggest Q1 increase in five years. Meanwhile, in prime outer London, average prices rose 0.5% over the same period, the largest growth in four years.

As a result of this stronger trajectory, the annual decline in PCL was 1.1% in March, the lowest figure in two years, and an equivalent drop of 0.6% in prime outer London was the smallest since September 2016.

Anticipating what prices do next is not straightforward given the uncertain duration of lockdown restrictions.

Weaker economic activity, deteriorating consumer sentiment and higher unemployment in the first half of 2020 will undoubtedly have an impact. At the same time, the potentially finite timespan of this crisis will limit any sustained and material downward pressure on prices.

Following declines in excess of 20% in some markets since 2014, we believe average prices will remain unchanged in prime central London in 2020. Our expectation is that they will recover sharply in 2021 and we have pencilled in 8% growth for next year.

Meanwhile, the weakness of the pound will continue to drive demand. Effective discounts of more than 30% are available for a range of overseas currencies compared to mid-2014.

LONDON RESIDENTIAL DEVELOPMENT H1 2020

PLANNING FOR THE FUTURE:

FROM THE EXPECTED TO THE SURPRISES

Housing secretary Robert Jenrick shed some light in March on how the government proposes to reform the planning system.

As expected, increasing housing delivery was the primary focus. Plans to digitise the planning system, build upwards, convert land to residential use and empower councils to use compulsory purchase orders were among measures announced to this end.

In a sign of the government's priority to meet its housebuilding targets to build 300,000 homes a year by the mid-2020s, it is also consulting on expanding permitted development rights to include the upwards extension of existing residential premises and the repurposing of empty commercial, industrial and residential blocks as 'new build' housing.

The government is set to launch a national brownfield map in April 2020 and make a call for proposals for building above and around rail stations.

With a view to accelerating planning decision making, councils are being ordered to have adopted Local Plans by December 2023. A new housing need assessment formula is to be introduced. Councils are also being encouraged to fast track planning approval of 'beautiful' developments and planning application fees will be increased to assist local government resourcing but only where local planning authorities are performing to an acceptable level.

The ideas will form part of a Planning White Paper to be published in the Spring as well as an Affordable Housing White Paper and a series of Bills dealing with Building Safety and Rental Reforms to be published later in the year.

The announcement followed a raft of measures already floated during the March 11 Budget, and much of the announcement was an extension of these proposals. The Budget promised more investment in affordable housing, over £1bn of allocations from the Housing Infrastructure Fund to build nearly 70,000 new homes in "high demand areas" across the country, £5.2bn towards flood defences and £400m to regenerate brownfield land.

Four new development corporations are proposed along the route of the Oxford to Cambridge Arc to help facilitate growth.

Stuart Baillie
Head of Planning at Knight Frank

Despite the Budget promising reform to the planning system that would 'bring it into the 21st Century', the announcement by Rt Hon Robert Jenrick MP was decidedly less radical than we might have expected – or hoped for. In a clear indication of the government's priorities, the key driver was on housing supply, almost to the exclusion of other land uses.

There were a number of elements in the proposals that, while we cautiously welcome them, will require detailed guidance. This includes a commitment to amend the National Planning Policy Framework, with more focus on design and placemaking, and the creation of new natural light standards. Permitted development rights will also likely be expanded to include upwards extension of existing residential premises and the repurposing of vacant commercial, industrial and residential buildings.

This potentially flies in the face of other planning policies for the protection of industrial land and will need to be carefully managed to ensure quality and affordable provisions are maintained. It was somewhat surprising to hear that the government is going to further amend the methodology for calculating housing need and delivery; this is presumably the reason behind why the recently published Housing Delivery Test results were significantly delayed.

The more unexpected, perhaps radical, elements of the proposals included a commitment to considering 'zoning' as an alternative to the current land use planning system and creating transparency on "land options" – likely a move that attempts to expose businesses that are in control of development land and not bringing it forward for development. We were disappointed not to hear any specific mention of green belt review and any alterations to the Use Classes Order – for example around build-to-rent or co-living. We hope this will be included in the much-anticipated Planning White Paper due later this year.

Build costs

Residential constructions costs are expected to rise significantly, fuelled by regulation changes, labour shortages and potential supply disruption. According to the BCIS, build costs are forecast to rise by 23.6% over the next five years.

New housing costs eased at the end of the fourth quarter ahead of the general election but are expected to climb sharply.

Over the past four years, build costs have been on an upwards trajectory, climbing around 15% between January 2016 and summer 2019, according to the UK Department for Business, Innovation and Skills, before levelling off towards the end of last year.

Going forward, the introduction of new building regulations could put upwards pressure on costs.

Last year, the government launched a consultation on proposed changes to Part L (conservation of fuel and power) and Part F (ventilation) of the building regulations for new homes. The changes form part of the Future Homes Standard, which is due to be introduced in 2025.

Housebuilders are already under pressure to move in the right direction, given homes being built now will still be around in 2050, the UK's net zero target. The new regulations are expected to be in force before the end of the year.

The consultation, which ran until 7 February, proposed two options including a 20% reduction in carbon emissions compared to the current standard, by using higher fabric standards such as triple glazing, which the government has calculated would add £2,557 to the build cost of a typical home.

The second option is a 31% reduction in carbon emissions compared to the current standard, by encouraging the use of low-carbon heating or renewable energy but with lower fabric standards than the first option. The additional build cost is calculated as £4,847 per home.

Furthermore, coronavirus could have implications for supply chains. For many years, China has been a global production centre for many industries, but this could be set to change as companies seek to diversify supply sources to minimise disruption risk in the future.

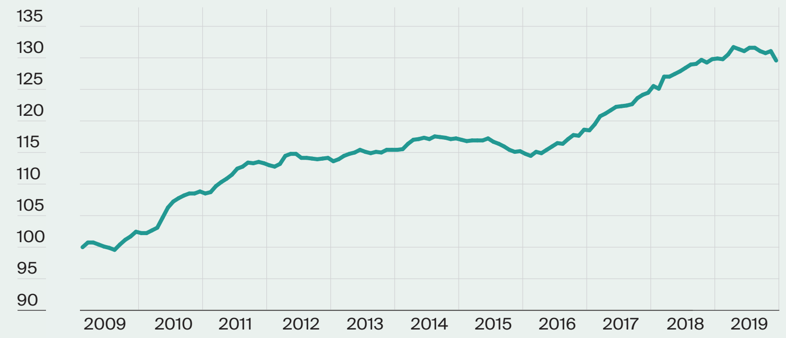
Justin Gaze, Head of Residential Development Land at Knight Frank, commented: "When we come out of this, do we end up working differently? Will companies shorten supply lines? If we become more reliant on UK supply lines, then building will be more expensive. People are looking at their global supply chains, and instead of sourcing product from China they might look to obtain building material from Europe or preferably locally in the UK."

Other factors influencing build costs include potential labour shortages as the UK pulls up the drawbridge to low skilled workers in EU countries. The construction sector was among several industries to have lobbied for greater access to EU migrant workers.

However, new rules due to come into force from January 2021 dictate that there will not be an immigration route specifically for low-skilled workers. Instead, a points-based system will come into force, where jobs on offer to migrants will have to be at a required skill level equivalent to A-level or above.

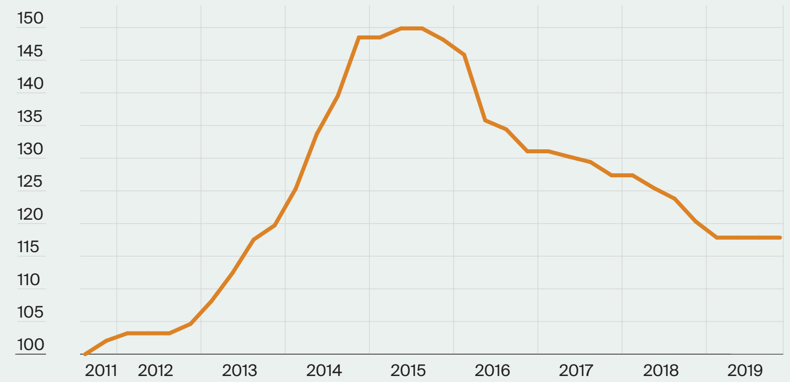
The sector faces a skills gap which will take time and investment to address.

Construction costs: 10 year change
Indexed 100 = January 2009



Source: UK Department for Business

Residential development land prices



Source: Knight Frank Research

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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