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Spotlight
London Residential Development: Where next?

February 2013

Developers and planners must work together to build for Londoners

London needs at the very least 50,000 new homes a year, twice as many as we are currently building and 20,000 more than the Mayor's minimum target, to keep pace with demand.

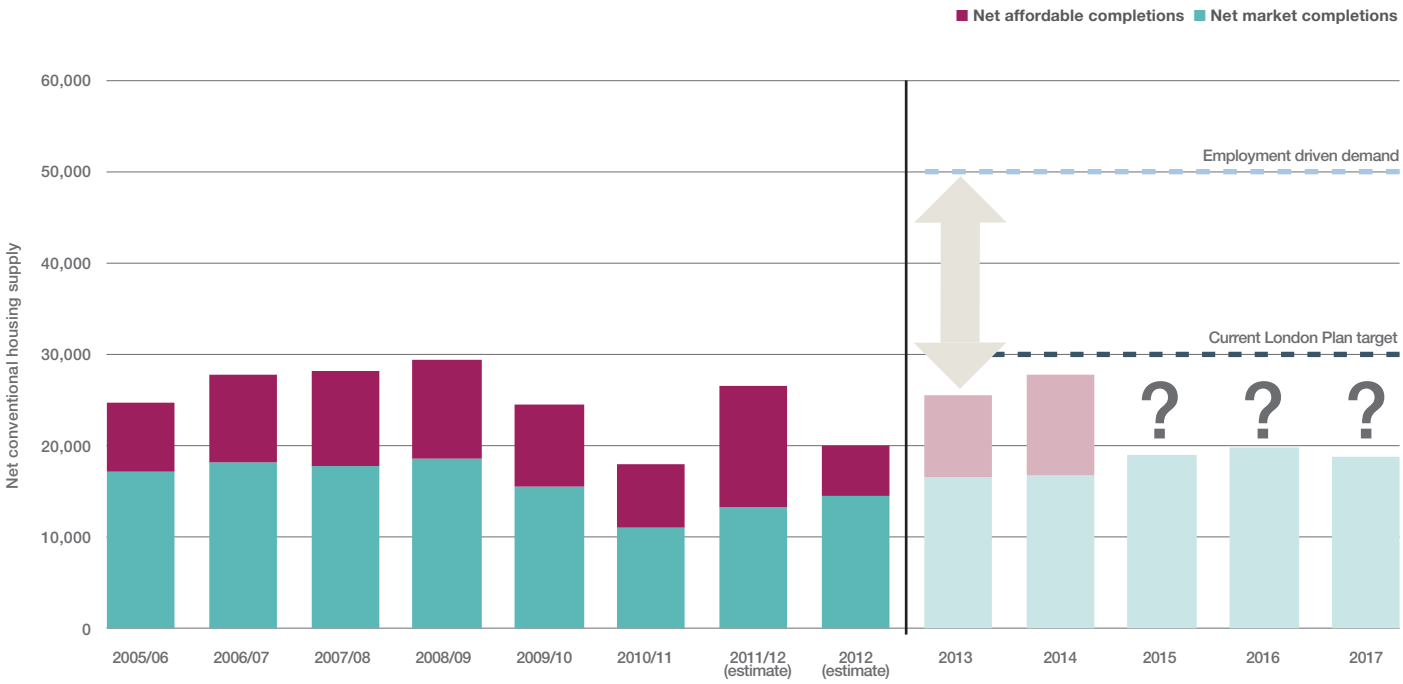
Failure to deliver would dent London's competitiveness as ordinary people are priced out. The city's economic standing depends on its ability to house those who make it tick.

The flight to prime among developers has left big gaps lower down the market. Builders must expand into more affordable areas to deliver necessary volumes. The planning system must allow the sites to come forward.

"Growing demand for homes exceeds the Mayor's minimum housing target, which should be at least 50,000 new homes per annum" Jim Ward, Savills Research

GRAPH 1

The Supply Gap



Graph source: London AMR, Savills Research

The housing shortfall

London's population is growing faster than the rest of the country. It is expected to exceed its previous 1939 peak of 8.6 million in less than five years.

Growing demand for homes exceeds the Mayor's minimum housing target which should be at around 50,000 new homes per annum to meet London's needs, based on the levels of employment growth that are forecast by Oxford Economics.

Boris Johnson says that City Hall is on track to deliver 100,000 affordable homes over his two mayoral terms. So far 56,000 affordable homes have been built since the Mayor took over in 2008. There are 31,000 more in the pipeline between now and 2015. But funding for affordable housing has not been agreed beyond March 2015.

We forecast a supply gap of 115,000 homes over the next five years across all tenures, assuming that funding for affordable housing is forthcoming at current levels. In this context, the Mayor makes a resonating case for London's stamp duty receipts to be ring-fenced, to provide affordable housing funding.

Plugging the funding gap

But the scale of the funding gap is massive. To build this many extra homes, an annual funding gap of almost £14 billion needs to be plugged. Developers must find £6 billion of development funding a year to build and buyers require a further £7.5 billion to purchase those homes. Given that mortgage lending for house purchase in London is currently running at about £17 billion a year, banks would have to increase lending by 40% to meet that demand, which is not realistic in the short term.

We expect housing demand in the market rented sector to continue to take up this slack, expanding to more than one third of London's housing stock by 2017. The international source of much of central London's expanding workforce only accentuates this trend.

The good news story for London is the substantial investor appetite for London's residential market, as demonstrated by international investment in development projects, such as Battersea Power Station and Greenwich Peninsula. In addition to this, the institutional residential investment market is currently trading at annual turnover levels in the order of £2 billion, constrained by the availability of stock, particularly in London and the South East. Given the strength of rental demand in London, there is investor appetite for this to multiply in scale.

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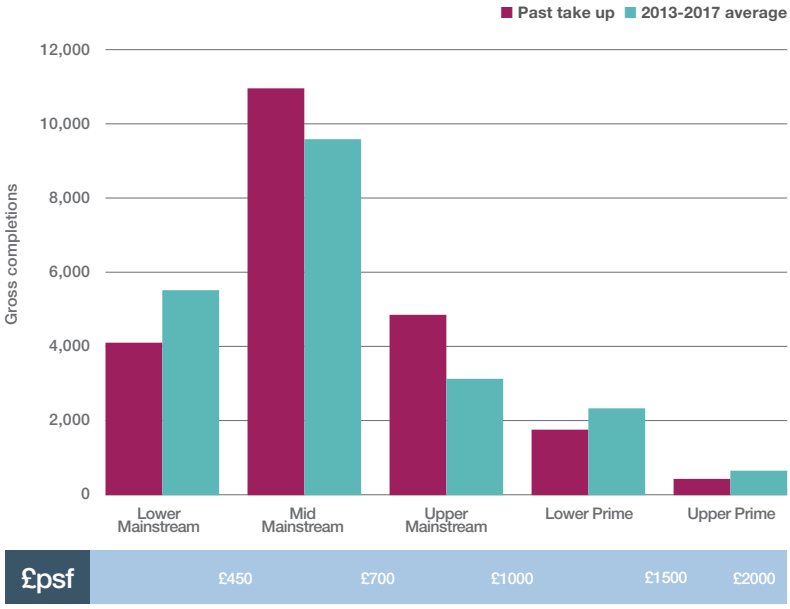
With both bank lending and government spending constrained, these are the sources of residential investment that can bring forward the scale of supply that is needed. There is also political appetite for this to happen, using schemes such as the government debt guarantee and the Build to Rent fund.

Viability in planning

In addition, financial viability at planning is crucial. This is highlighted by the Mayor's new planning guidance, which recognises the distinct

GRAPH 2

Supply Gaps by Pricing



Graph source: Savills Research

economics of private renting, when undertaking viability assessments.

The mainstream market

The prime market attracts great interest, but it accounts for only around 15% of market supply. It should not be allowed to distract attention from the gaps that need to be filled, in all parts of the mainstream market, but particularly at less than £450 per square foot, where the volumes of unsatisfied demand are greatest.

More than 80% of Londoners outside the social rented sector can afford no more than £300,00 for a two bedroom flat (£450 per square foot). The average house price in London is currently around £425,000, according to Land Registry, but this is a mean average price that is skewed upwards by prices at the top end. The median average price is a better indicator of what ordinary Londoners can afford – this stands at £390,000 in Inner London and £275,000 in Outer London.

What will fill the gaps?

Most of the sites coming forward on the edge of central London are feeding into the lower end of the prime market and the upper end of the mainstream market. Areas located a few stops further out, such as Wembley, Stratford and much of Docklands, feed into the mid mainstream market, at between £450 and £700 per square foot. But the big question is which sites will boost supply in the sub £450 per square foot market.

More pipeline

Much of London's supply pipeline is held in large sites in lower value markets that need investment in place to make them work. However, the scale of investment required varies considerably. Sites of up to 100 homes, close to tube stations, require much less investment proportionately, than sites of more than 250 homes.

Our analysis shows the potential for place improvement of areas across London – the darker colours on Map 1 indicate places where there is the greatest potential to unlock market capacity through investment – before adding in the catalytic impact of improved transport links.

Landowner return

A word of caution at this point – Community Infrastructure Levy works well to fund infrastructure and unlock sites, when it is set at an appropriate level that allows for a competitive return to both developer and landowner. Trying to deliver more housing by screwing down either or both of these is counter-productive, a point which is now recognised in national planning policy.

Which sites?

So which are the sites that are going to fill the gaps? It must now be Croydon's time to arrive, as a new hub of activity and development. It has major potential to be delivering more housing at these more affordable price levels, as a commercial centre in its own right, alongside its ready access to expanding commercial centres at Victoria and London Bridge. Likewise, access to these centres will enhance residential market capacity at Bromley.

Closer to London Bridge, Deptford is well placed to deliver more. On a parallel theme further north, the emergence of Kings Cross as a commercial centre will increase market capacity at Hendon. These are some of the places where there is potential to unlock development at scale.

Transport improvement

New transport is the game changer for market capacity, as we are currently seeing in anticipation of Crossrail opening in 2018, plus the Northern Line extension at Nine Elms. Much is already priced in, but there is more potential market capacity to be unlocked around Crossrail, at all price points. There are many examples, including Farringdon, which will become a major central transport hub, and Southall, which has great potential for place improvement. The completion of the south east corner of the Overground orbital line is less of a transformational event, although the connectivity is a positive for market capacity. New transport to Barking Riverside would unlock capacity. Looking further ahead, Crossrail 2

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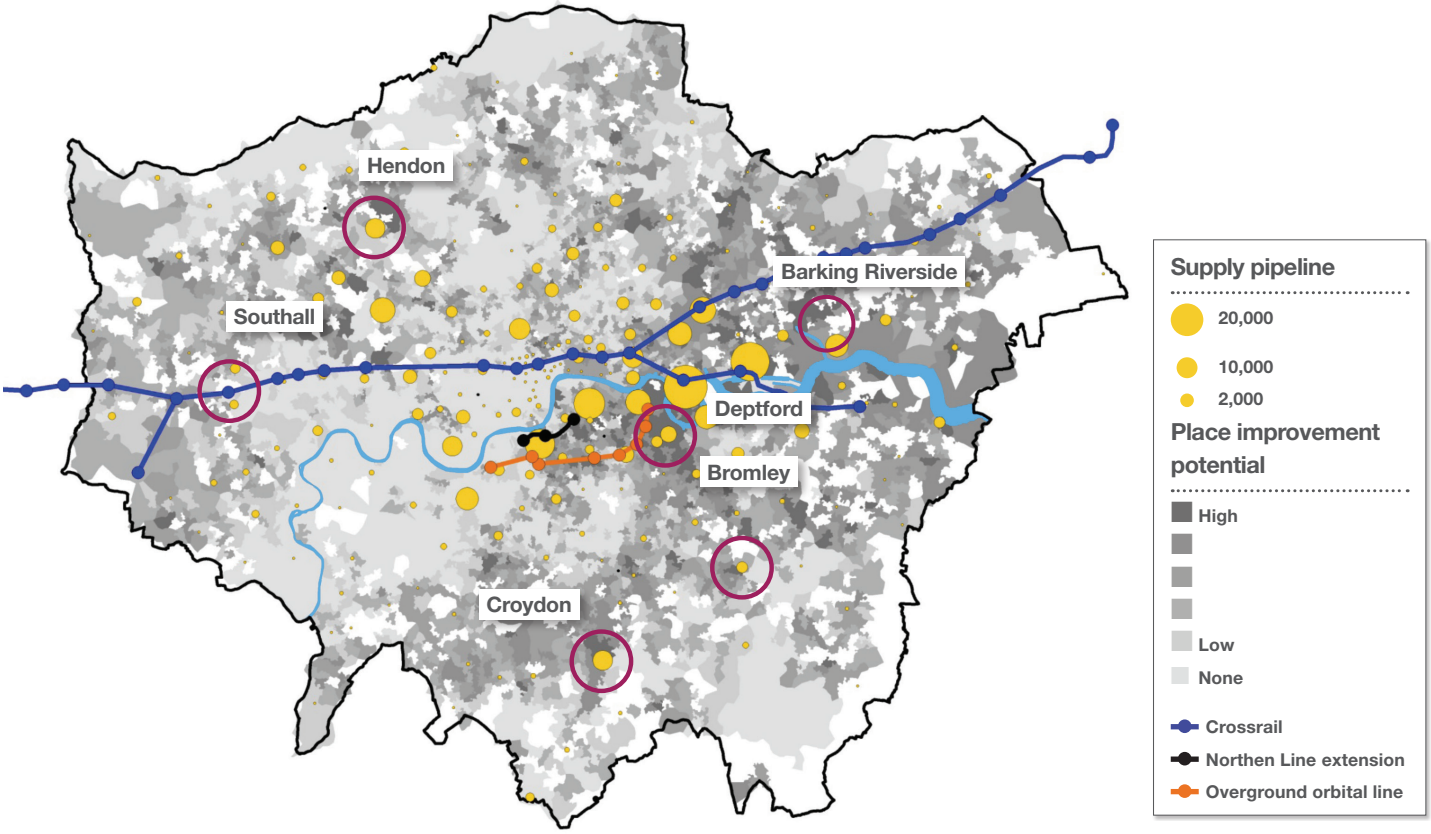
MAP 1

Place Improvement Potential and Site Capacity (market homes)



Map source: Savills Research

and High Speed 2 (HS2) are still a long way off. But taking just one aspect, the prospect of a Crossrail to HS2 link at Old Oak Common is a mouth watering prospect for place improvement.

Investment and planning

We can start to see some of these changes happening, but there is further to go. We need public investment, private investment and planning policy to be aligned around these common themes, if the supply gaps are going to be filled, unlocking the market's appetite for London residential property.

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