Savills World Research
UK Development

London Regeneration
Boosting housing supply beyond prime

May 2014

SUMMARY

The greatest economic demand for new homes is in London's mainstream markets

■ **London needs 50,000 new homes a year:** We estimate 82% of that economic demand is for homes costing no more than £700psf with the bulk of that requirement for homes under £450psf (including affordable housing of all types) p.2/3

■ **Housing shortfall:** An increase in the sales rate and planning applications means that an average of just under 35,000 new homes a year are set to emerge over the next five years. This leaves us with a shortfall of 15,000 homes a year. p.2/3

■ **Uneven supply:** The shape of the development pipeline does not match the shape of demand. The biggest gap between emerging supply and demand is in lower mainstream markets (under £450psf) where an annual shortage of 6,500 homes is likely. p.2/3

■ **Price growth spreads:** Biggest rise in value is no longer in the centre as growth ripples out. Over the last 12 months boroughs of Waltham Forest, Lambeth, Southwark, Islington and Hackney have seen biggest rises. p.8

■ **Potential to unlock value:** We map out how improvement in quality of place or reduced travel time could result in sustainable uplift in residential values. Biggest opportunities lie in the east although there are pockets of potential price growth throughout London. p.4/5

■ **New markets:** Placemaking and improved travel times are essential ingredients of regeneration. p.4/5

■ **Build to rent:** In the bulk of the mainstream market the demand for rental homes is greater than homes for sale. New homes are needed across all tenures. Involvement from local authorities and housing associations is essential to provide the right mix. p. 6/7

> "Biggest rise in value is no longer in the centre as growth ripples out" Savills Research

Housing market
REGENERATING LONDON TO MEET DEMAND

Developers must look to the mainstream markets beyond the centre, if we are to build the homes the city needs

The London property market lives by its own rules. Price growth in the capital continues to outpace the rest of the country, resulting in a widening gap in values. Prices in London rose by 12% in the year to March 2014 compared with 5.6% for England and Wales according to figures from Land Registry. Although house price growth has now started to ripple out of London, the average cost of a home in London is more than double the national average.

Lack of housing is largely to blame as demand far exceeds supply of available homes. London's population is booming, having risen to 8.4 million last year from 6.7 million in 1986. It is projected to surpass its 1939 peak by 2016 and reach nine million by 2020, according to the Greater London Authority (GLA).

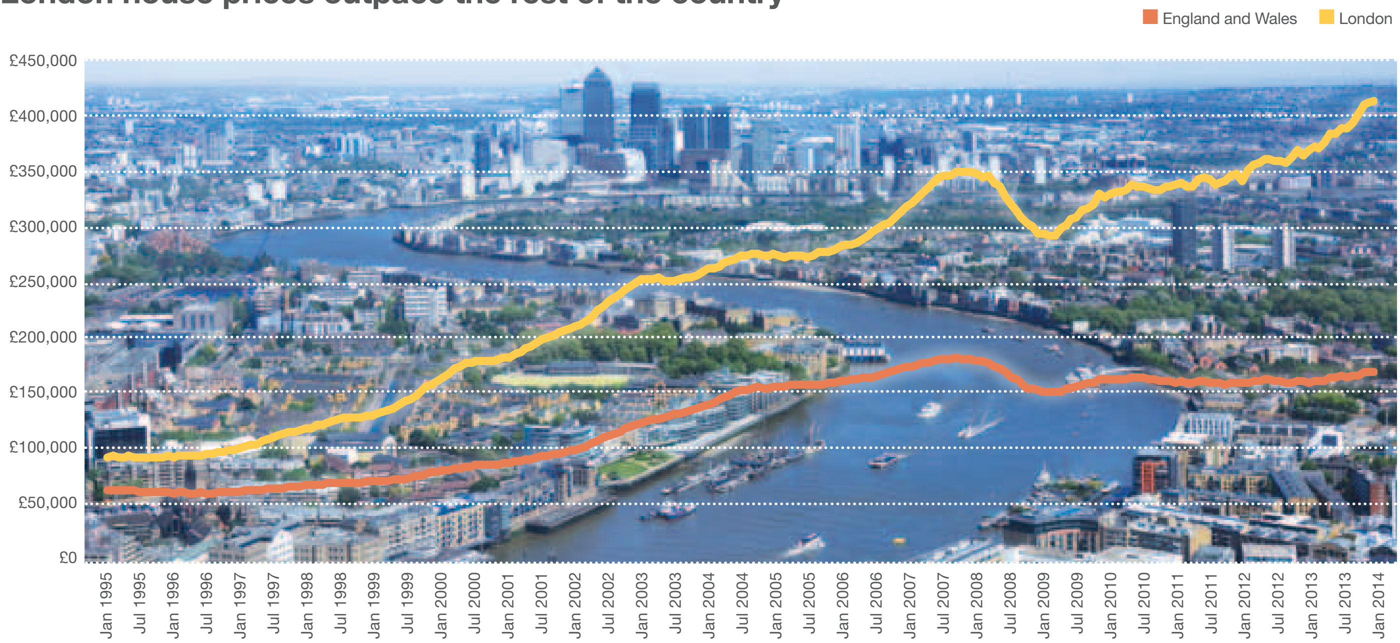
Building completions by contrast, remain down on their 2008/09 peak. In the year to March 2013, 22,000 homes were built, well below the revised target of 42,000 homes a year identified in the new draft London Housing Strategy.

We believe this target is too conservative. Savills research shows that there is need for 50,000 new homes a year across all tenures, even before we take into account the backlog of need that has built up over the years.

"The shape of the development pipeline fails to match the shape of demand"

GRAPH 1

London house prices outpace the rest of the country



Source: Land Registry

Furthermore, with 70% of households earning less than £50,000 a year, the bulk of that need lies in the mainstream markets. We estimate that 82% of that need is for homes costing no more than £700psf with the bulk of that requirement for homes under £450psf (including affordable housing of all types). (see Graph 2)

Our estimate is based on employment forecasts from Oxford Economics and is consistent with independent demographic analysis.

Mainstream demand

Developers are responding to demand. Since we first ran this analysis almost a year ago, the number of new homes coming through the pipeline has increased. Last year, we calculated that an annual average of 28,500 new homes was set to emerge over five years.

An increase in sales rate and planning applications has brought that number to an average of just under 35,000 a year, reducing the shortfall to 15,000 homes a year. This is good news.

However, the risk that mainstream markets will remain undersupplied is significant as the shape of the development pipeline fails to match the shape of demand.

We calculate that the biggest gap between the emerging supply and what Londoners can afford lies in the lower mainstream markets where a shortage of almost 6,500 homes is likely. Within that band, the bulk of the undersupply will fall into markets priced under £375psf where we expect to see a shortfall of 5,500 homes a year. This is in addition to a shortfall of 7,500 new affordable homes in the broadest sense.

However, the gap narrows further up the market. In the upper mainstream market (£700psf – £1,000psf) we have identified a gap of less than 500 homes a year.

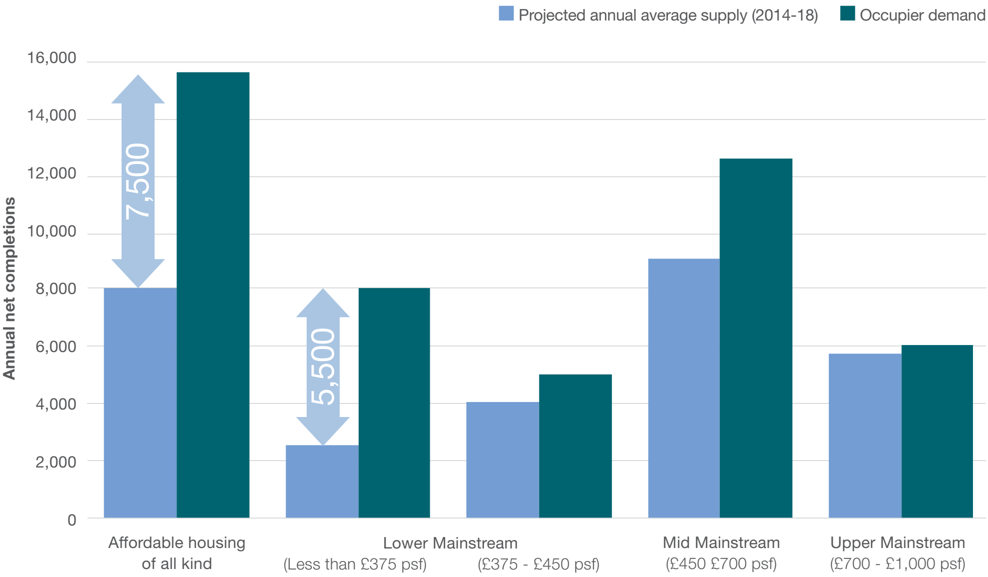
Beyond prime

In contrast, the prime markets (£1,000psf upwards) are now fully supplied, as a result of a shift towards higher value markets among developers seeking to secure sales to wealthier cash rich buyers and foreign investors with the potential to forward-fund schemes.

Furthermore, strong house price growth in London has enticed developers, which may have previously aimed their product at the top of the mainstream market, to pitch their prices higher up the price bands.

GRAPH 2

The biggest supply gap is in the lower markets



Source: Savills using Molior, CACI and Oxford Economics

Given the potential oversupply of prime property, if demand fails to keep pace with this increasing pipeline, and the unassailable demand for more homes in the mainstream markets, the case for building away from the centre is compelling. Now is the time to look beyond the prime markets of central London.

Regeneration opportunity

There are wide variations in prices within the London market. At just over £1.2 million, the price of the average home in Kensington and Chelsea is over five times the cost of the average home in Barking & Dagenham (£238,909), according to Land Registry data.

However, following five consecutive months of annual double digit house price rises, the biggest growth in value is no longer in the centre of town, as stretched London buyers seek better value for money further out.

In the 12 months to March 2014, Waltham Forest topped the chart with a rise of 23.5%. It was followed by Lambeth (21.9%), Southwark (21.1%), Islington (20.6%) and Hackney (19%). All massively outperformed the heady London average of 12.4% while values in Kensington and Chelsea rose by 12.8%.

The ripple effect is also reflected in transaction data. The east of London recorded the highest number of transactions in London last year, which at almost 29,000, represents a 23% rise on 2012. This compares with 27,000 in central London following a 19% rise.

The boroughs which have seen the biggest price growth, have also seen a degree of socio-demographic changes, infrastructure improvements and new development. As we illustrate in the map overleaf, these are all essential ingredients for creating best value.

London faces a shortfall of 15,000 new homes a year

Markets under £375psf will suffer a shortfall of 5,500 houses a year

Case studies

MAPPING LONDON'S MARKET VALUE UPLIFT

As our map illustrates, many areas still hold the potential for value growth through regeneration

The two key drivers of value in London are quality of place and travel time to central locations. The desire among London residents to live within easy reach of their workplace is balanced with the aspiration for high quality of life.

Demand for housing from central London employees is growing and supply is constrained in central locations. Places closest to central employment locations are therefore likely to see an uplift before more distant locations. Our analysis of the 2001 and 2011 Censuses shows that the locations that have undergone significant gentrification over the decade have tended to be on the edges of central London.

We have therefore constructed a model that allows us to assess how improvement in the quality of place or reduced travel time could result in a sustainable uplift in residential values. The model is most applicable outside established prime areas. It is also worth noting that travel time does need to be balanced against the frequency and cost of services. The model does not include other factors that affect residential value such as quality of retail, schools and leisure facilities.

It does, however, show the potential for value uplift. The darker the red areas, the greater the potential for regenerative development to unlock value. These areas are likely to suffer from barriers to value growth which might be removed by improvement in transport or high standard placemaking.

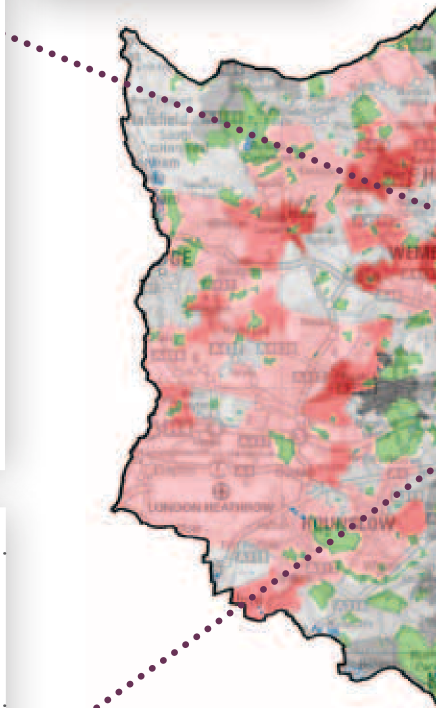
WEMBLEY MASTER PLAN

Developer: Quintain
Location: LB Brent
Total Units: 5,000
Size of Site: 85 acres
Max height: 20 Storeys

Site history: Previously used for a mixture of retail, commercial and industrial uses, in addition to parking for Wembley Arena and Stadium. Quintain's masterplan converts an industrial area around a visitor centre into a residential quarter with good transport links into central London.

Savills involvement: Savills has been advising and consulting for 10 years, with a direct involvement in the current residential phase for past 2-3 years.

Site future: 85 acres of development space with outline consent for 5,000 new homes. 1.5 million sq/ft of construction has been completed with a further 6 million sq/ft still to deliver.



ST LUKE'S HOSPITAL

Developer: Hanover HA
Location: LB Haringey
Total Units: 161
Size of Site: 6 acres
Max height: 5 Storeys

Site history: The site consists of the six acres of the former St Luke's Hospital on Woodside Avenue, Muswell Hill.

Savills involvement: Appointed to advise Hanover Housing Group on the acquisition of St Luke's Hospital, and to provide comprehensive services including project management, planning and sales agency over the lifetime of the project.

Site future: An innovative mixed use scheme of 161 homes including conversion of heritage buildings, focusing on the over 55s. 48 (30%) will be affordable, 30 will be co-housing dwellings.

Source: Savills Research

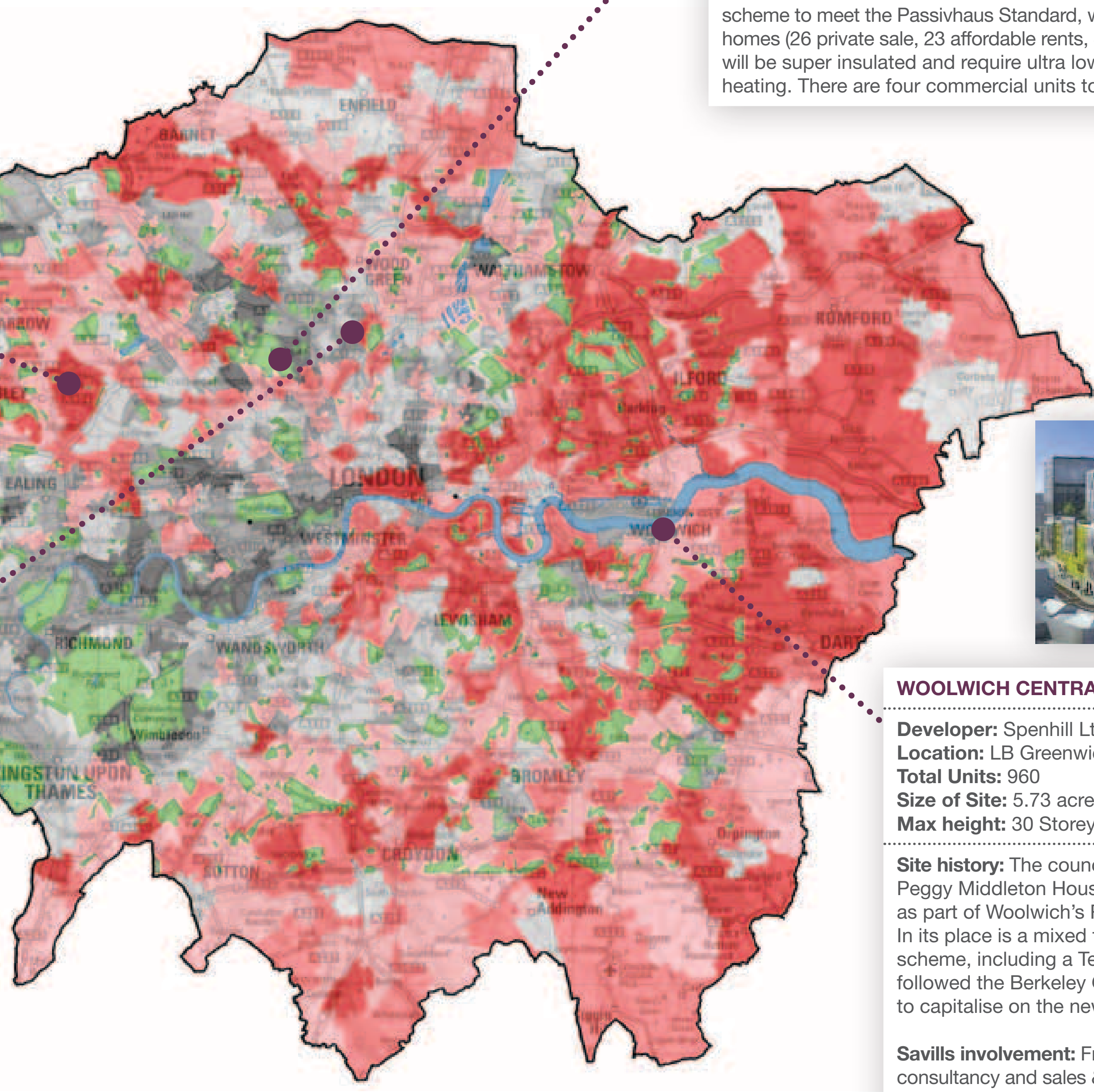
CHESTER BALMORE

Developer: LB Camden
Location: LB Camden
Total Units: 53
Size of Site: 0.54 acres
Max height: 6 Storeys

Site history: This 1970s estate included 25 homes and 12 commercial units many of which had been empty for some time. Planning permission to demolish the buildings and redevelop the site was granted in March 2011.

Savills involvement: Savills team instructed on development consultancy, sales and marketing.

Site future: This mixed tenure residential development is the largest scheme to meet the Passivhaus Standard, which means the 53 homes (26 private sale, 23 affordable rents, 4 shared ownership) will be super insulated and require ultra low levels of energy for heating. There are four commercial units to rent.



Value uplift potential

Higher — Lower

WOOLWICH CENTRAL

Developer: Spenhill Ltd
Location: LB Greenwich
Total Units: 960
Size of Site: 5.73 acres
Max height: 30 Storeys

Site history: The council office, which was Peggy Middleton House, was demolished as part of Woolwich's Regeneration in 2011. In its place is a mixed tenure and mixed use scheme, including a Tesco store. Spenhill has followed the Berkeley Group in investing here to capitalise on the new Crossrail link.

Savills involvement: From the planning, consultancy and sales & marketing stages up until completion and handovers of the 259 units (189 private, 70 affordable).

Site future: The next phase of 509 units is expected to launch in October 2014.

Development
NEW HOMES NEEDED ACROSS TENURES

Build to rent is an essential component of large scale regeneration and public sector involvement is key

London needs more homes of all shapes, sizes and tenures. Affordability pressures and constraints in the mortgage market are driving shifts in the pattern of tenures in London.

Homeownership declined by 5% between 2001 and 2011, while the number of households renting privately has risen by 75% over the same period. The private rented sector now houses a quarter of all London households. This is slightly more than the 24% living in social housing which has declined by 1% between 2001 and 2011. We expect the number the private rented sector to swell to 34% by 2021.

With more households driven into the private rented sector and staying there for longer, we estimate that the need for 50,000 homes a year includes a requirement for 21,000 privately rented homes and 15,500 for a variety of subsidised 'affordable' housing.

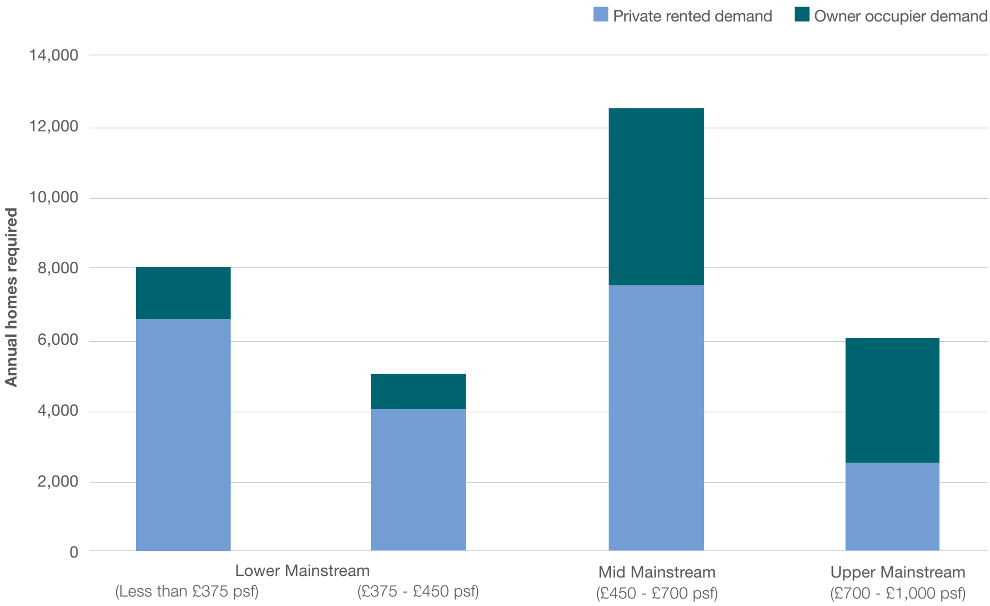
Pressures on welfare budgets has increased the movement of households from social housing into the private rented sector or other forms of intermediate housing. Stretched affordability among buyers in the lower portion of the mainstream markets means that rental demand exceeds purchaser demand in the mid to lower mainstream markets.

Hence increasing the supply of homes for private rent is critical to meeting demand in the mid to lower mainstream markets (sub £700psf), where there is also the greatest shortfall in the supply of new housing.

However, the burden of meeting London's housing requirement can not carried by the private sector alone. Encouraging a greater variety of players to deliver new homes across tenures is crucial. There is a growing consensus among registered providers that building for market rent can help create a more balanced portfolio and offer homes to those unable to buy or access social housing. With grant subsidy levels cut back over the last few years, building for market rent can also help address the lack of viability of affordable housing at large scale.

GRAPH 3

Rental demand is greater in lower value markets



Source: Savills Research

Housing delivery

The need to build for a wider range of tenures has been highlighted by the GLA. Its new draft London Housing Strategy identifies a target for 42,000 new homes a year for the next ten years, of which at least 15,000 should be affordable to rent or buy and 5,000 purpose built for long-term market rent.

The trend towards a broader definition of affordable housing to include various degrees of subsidised rent, as well as schemes to support affordable sales, is a reflection of the growing pressure to provide suitable housing to households on a wider

The number of households renting privately has risen 75% over the past 10 years

We need 21,000 new homes in the private rented sector per annum

The Greater London Authority owns 664 hectares of land

range of incomes not just the most vulnerable.

In terms of housing delivery, establishing which types of ‘affordable’ housing qualifies for planning purposes is key when calculating viability of a scheme. The GLA may need to support currently non-qualifying ‘affordable’ housing to reach its target of 15,000 homes or to encourage trade off between market rental and affordable housing in order to achieve viability.

Housing Zones are areas where planning flexibilities could be exercised, for example.

Public land

Access to public land and redevelopment of worn out housing estates are essential components of regeneration and increasing housing supply, particularly where the viability of schemes offering different tenures is an issue. The GLA owns 664 hectares of land which it says is being actively managed to achieve the best returns. This includes bringing forward land with a requirement to build for rent as well as or instead of affordable tenures.

Over 85% of this portfolio has either been developed or is earmarked for development. This leaves 15%. Although not all of these sites can be brought forward immediately, there could be further 29 hectares available from the London Fire Brigade, 27 hectares owned by the London Legacy Development Corporation and 102 hectares owned by the Metropolitan Police Service.

At borough level, redeveloping council housing estates at greater densities could contribute to regeneration and increasing housing supply. Since being given more control over their housing finance budgets, many local authorities are being much more pro-active about bringing forward land or estate regeneration projects.

HELP TO BUY

Supporting the delivery of schemes in lower value markets

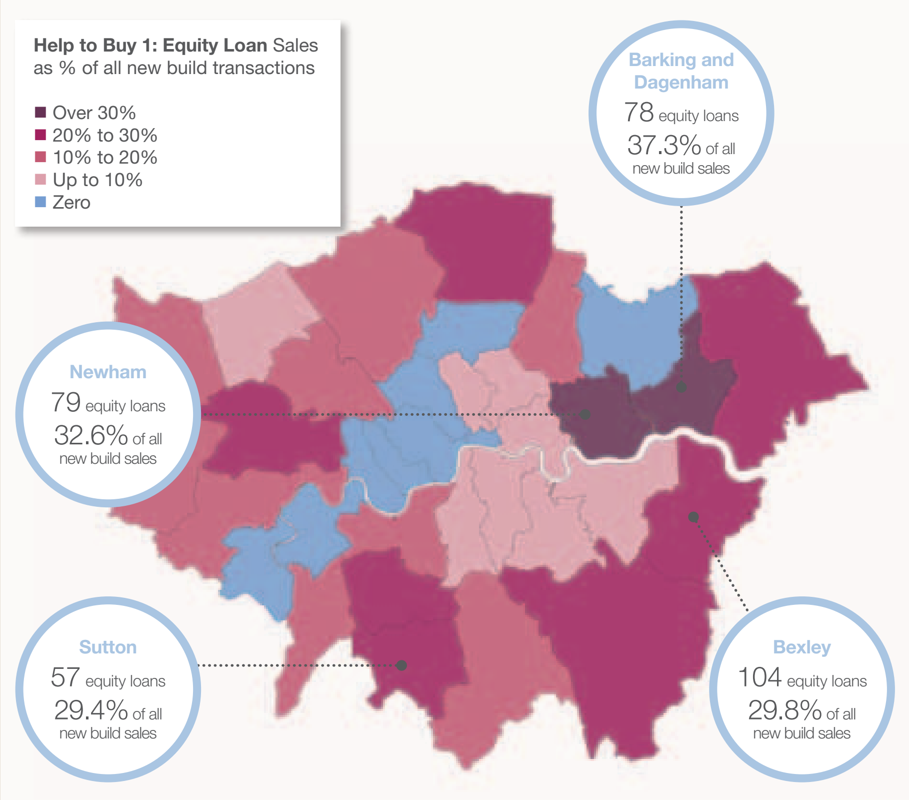
The controversial Government scheme has had limited impact on London. While the initiative aims to help buyers with small deposits to purchase homes, house prices in most of London are too high for it to work effectively.

Of the 20,000 Help to Buy equity loan deals completed to date less than 7% have been in London. Eight boroughs in the capital (including Kensington & Chelsea, Westminster and Richmond) have seen no deals at all.

However, there are some important exceptions. In Barking & Dagenham, where prices are still 5.8% below their 2008 peak levels, Help to Buy accounted for 37% of transactions up to the end of February. Newham, Bexley and Sutton also saw high levels of new build sales as a result of the scheme.

MAP 1

Biggest impact in more affordable boroughs



Source: DCLG, Land Registry (for completions up to 31st March 2014)

OUTLOOK

Working towards sustainable pricing

■ **London leads the way:** House price growth has been exceeding the rest of the country since the mid-noughties. Figures from the Nationwide show that London house prices are now more than double the UK level and much higher than in previous peaks in 1987 and 2001.

■ **What next for London property values?** Prices vary dramatically across the capital. Values in Kensington and Chelsea are now 134% above the 2005 level whereas those in Barking and Dagenham are just 10% above. Yet over the last 12 months, the biggest price growth has shifted from the centre to boroughs such as Waltham Forest, Lambeth and Southwark. This ripple effect suggests there is further potential for price rises in outer boroughs.

■ **Affordability constraints will bite:** With house prices in London now more than 10 times average income, we expect current levels of growth will slow. Our current forecast for the London mainstream market suggests house prices will rise by 24.4% over the next five years. This compares with growth forecast of 23.1% for prime central London. We expect to see most of the growth in mainstream markets in the short term. Affordability pressures, mortgage constraints and the eventual rise in interest rates is likely to slow the market in the medium term. However, our forecasts apply to the second hand market. New build values may not move at the same rate.

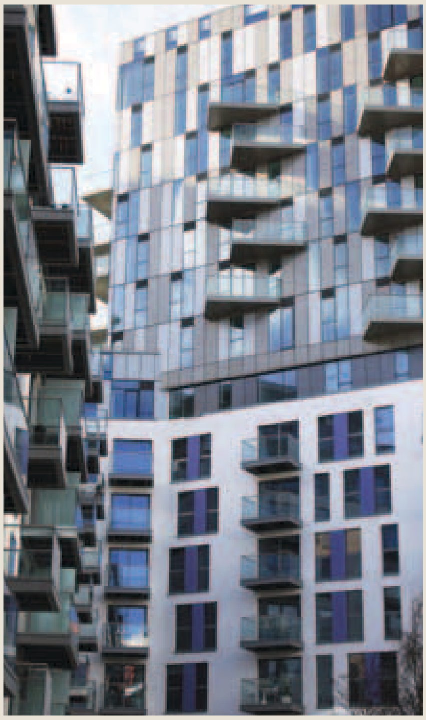
■ **New build premiums:** In London, most new developments exhibit a premium over existing second hand actual values. This may be for a number of reasons – higher quality of new stock, extra services and facilities provided not available in second hand and the wider reach of marketing.

■ **Sustainable pricing is key:** There is no uniformity when it comes to new build premiums, particularly in London. Sustainable price premiums are based on what both homeowners or renters will pay to live in alternative locations. In regeneration areas, this may differ significantly from the cost of surrounding second hand housing. However, the ultimate test is how prices compare with the cost of second hand housing in more established markets.

■ **Importance of place:** Emerging neighbourhoods and areas of regeneration carry the potential to drive occupier demand to new levels particularly if the degree of place improvement is great. However, there are risks to price premiums if speculative demand exceeds occupier demand.

■ **Help to Buy:** The equity loan part of the scheme aimed at buyers of new build, is playing a significant part in supporting the sales of new homes in lower value boroughs in London. In Barking & Dagenham the scheme is supporting 37.4% of all new build sales.

■ **Transport improvements:** The opening of the East London Line has had a lasting effect on premiums achieved in Peckham, Honor Oak and Norwood. Woolwich has benefited from Crossrail. Better infrastructure is an essential ingredient for creating sustainable value uplift. Further improvements such as Crossrail 1 and, if approved, Crossrail 2, have the potential to open up new markets.



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