Residential Property Focus

Changing times

What next for the property market?

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This publication
This document was published on May 18th. It contains a review of all the key housing market indicators and news to the end of April 2010. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document.

Glossary of terms
■ **Mainstream**: mainstream property refers to the bulk of the UK housing market with, for example, price movements monitored by reference to national and regional average values.
■ **Prime:** the prime market consists of the most desirable and aspirational property by reference to location, standards of accommodation, aesthetics and value. Typically it comprises properties in the top five per cent of the market by house price.
■ **S.108 obligations:** allows a local planning authority (LPA) to enter into a legally-binding agreement or planning obligation with a landowner in association with the granting of planning permission

The most commonly used abbreviations are:
■ Q110: refers to the first quarter of 2010
■ H209: refers to the second half of 2009
■ PCL: Prime Central London (Mayfair, Knightsbridge, Belgravia, Chelsea, Kensington, Holland Park, Notting Hill, Regents Park, St Johns Wood and Hampstead)
■ PEL: Prime East London (Wapping and Shad Thames)
■ PSWL: Prime South West London (Putney, Fulham, Wandsworth, Richmond and Barnes)
■ Peak: refers to the first half of 2007

Foreword

Appearances can be deceptive

With low transaction volumes and mortgage constraint, **Yolande Barnes** explains why it's never been so important to understand the dynamics of the housing market

With the latest house price indices showing annual house price growth, it is tempting to think that everything is back to normal in the housing market. The problems of repossession, plummeting house prices and negative equity which some gloomy economists were predicting during 2008 have not come to pass. Does this mean that nothing has really changed and the British can resume their long standing love affair with owner-occupation?

Appearances can be deceptive. Taken as a whole this housing market is far from 'normal'. Transaction volumes, as well as lending volumes, remain at historic lows. While low interest rates make mortgages affordable, the difficulties for many in actually obtaining one have never been greater. It is easy to foresee that a long-term shortage of property of the right type in high-demand locations will push house prices permanently higher than general inflation. But short-term market conditions suggest that 2010 will see increasing numbers of stock on agent's books and decreasing buyer numbers.

Market demand faltering

In the mainstream market, demand is beginning to falter as household incomes and wealth are diverted elsewhere in the economy and the uncertainty over income growth, taxes and spending persist beyond the general election. House prices may be higher on an annual basis (and off a low base) but the rate of price growth has already slowed dramatically over the first quarter of the year and we expect it to turn briefly negative in the second half and into the first quarter of 2011.

This mainstream market isn't completely out of danger yet and is looking exposed both in mortgage-reliant markets and locations furthest away from the economic revival of London and the South East, as well as in locations where there is less housing equity in play.

Conversely, the prime, equity-rich markets of London and the South are benefiting from sterling's weakness and investor appetite for real estate assets in prime world locations. Following a quieter start to the year, more recent indications are that the election jitters affecting the mainstream market did not materialise in the prime sector, where demand indicators remained in line with the medium-term average.

Who will house them?

More important yet are structural changes in tenure within the mainstream UK housing market. With housing deposits constituting more than the average first time buyer's annual income, it will take most would-be home buyers a long time to enter owner-occupation. We will see increasing numbers of renters in the coming decade. Many of these renters will start to be middle aged families as well as the archetypal singles and couples in their 20s. The big question is 'who will house them?'.

Capital values are too high for investors seeking net yields on a par with commercial properties and stock is not available of the type and in the quantity they need. We are bullish in our forecasts for rental growth but foresee it will be difficult for people to obtain any kind of housing if more rental or co-owned stock outside the social housing sector cannot be supplied.

The treasury has issued a consultation paper on ways of encouraging institutional money into the private rented sector but, right now, there are significant barriers to widespread investment in rented housing.

All three political parties declared before the election that increasing housing supply was a priority, but none of them made many headlines out of the housing issue. We think this situation will be different by the end of the decade when housing could be a very hot political topic. Unless we see investment in the private sector, many of those who voted for the first time in this election, could be both homeless, or at least under-housed, and very disillusioned the next time they go to the polls.

Rarely has it been so important to understand the dynamics of the housing market. By understanding the shortcomings of supply, the interaction of debt, equity and demand and the needs of the investment sector, it may be possible to begin acting now to stave off potential crisis. The new political regime will have a big part to play in enabling a supply-side response. Such a response could have a prolonged and lasting effect on the stabilisation of the wider economy. ■

Inside this edition

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Housing turnover

Turnover a bigger issue than house prices?

On average one in 16 houses sold in each year of the last decade. Over the past two years this figure has fallen to just one in 25. **Lucian Cook** assesses the implications

House prices tend to dominate the media's coverage of the UK housing market, but it is, in fact, transaction numbers that provide the better indicator as to the health of the residential property market. These figures determine the ease with which homeowners can move, the pace at which they can work their way up the housing ladder and the frequency of the steps required to do this.

Relationship with house prices

Historically house prices and turnover rates go hand-in-hand. When prices fell by 14% in 2008, transactions fell from 1.6 million to just over 900,000. In 2009, it was a different story and mainstream house price growth was disconnected from transactional activity. When the Nationwide quarterly index of UK mainstream house prices showed a 3.4% increase, transaction levels remained below 860,000 and values were driven upwards by low stock levels, in what remained a partially functioning market.

Over the past two years transaction levels have been 30% less than the previous low of 1992 when confidence in the housing market reflected three years of price falls.

The fall in turnover was initially a function of the squeeze on mortgage finance, although, over the course of 2008 and early 2009, it became a function of negative buyer sentiment, fuelled by uncertainty regarding the economy and the (as yet unknown) potential extent of house price falls.

Thankfully, as sentiment improved so did turnover, rising from 41,000 transactions in January 2009 to 86,000 in July. However, over the next five months, transaction rates hovered between 80,000 and 90,000 per month, before increasing in December as the end of the stamp duty holiday approached.

Short-term indicators

Mortgage finance remains the biggest constraint on the market and the short-term indicators give us little room for optimism this year.

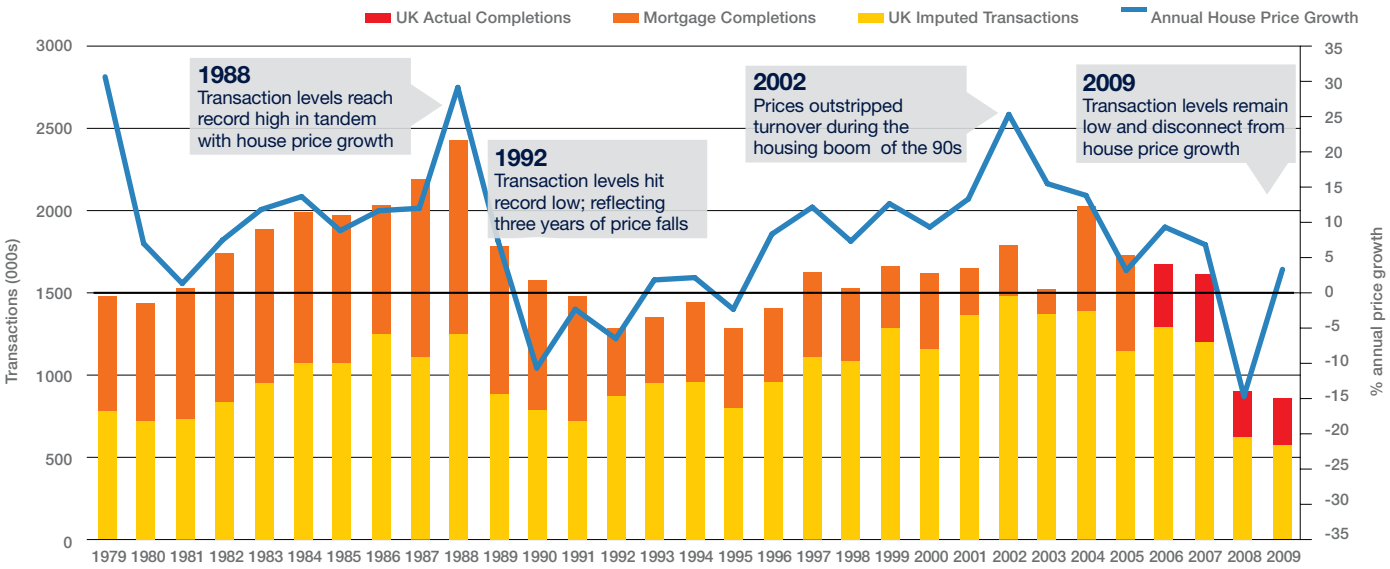
Transaction rates fell back to below 60,000 in both January and February 2010. This can partly be explained by the time of year and also the weather conditions, but, nonetheless, the rates were nearing 50% off the norm for these two months. Mortgage approval figures, which are a lead indicator of future transactions, remain heavily suppressed, and while transactions in March improved they remained well below the monthly average for the second half of 2009.

> In just the past two years the number of housing transactions has been down by 1.5 million when compared to normal market conditions.

Perhaps more of a concern is the fact that political and economic uncertainty has pushed the balance of opinion within The Bank of England Credit Conditions Survey for the first quarter of 2010 towards a marginal softening of demand for secured lending. This comes at a time when, irrespective of whether this is pre-election jitters, the Royal Institution of Chartered Surveyors reports that more stock is coming to the market, pointing towards further short-term volatility in house prices.

Nationwide figures for the first quarter show that there has already been a slowing of house price growth in the mainstream market throughout the UK

Graph 1.1 Transactions vs price growth in the UK housing market



Source: HMRC, CML, Nationwide, Savills

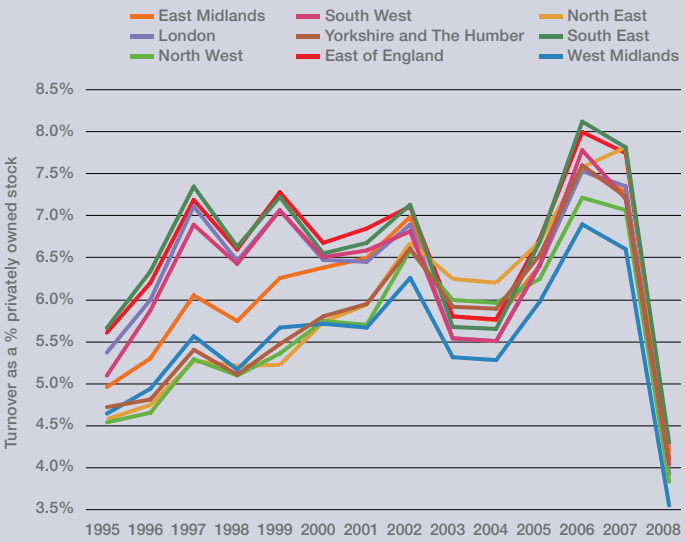
Geographical differences

Transaction levels on a regional basis illustrate significant variations

By looking at transaction levels over the past 10 years, significant geographical variations have emerged in terms of the proportion of privately owned housing stock that sells in each year. These include regional differences, and also more frequent transactions in urban areas, where new development is more concentrated and younger households work their way up the housing ladder.

At one end of the scale are locations such as Swindon and Milton Keynes where an average of over 8% of private housing stock has changed hands annually, at the other Staffordshire where the average falls to just 5.5% (or one in 18 properties). ■

Graph 1.2 Housing turnover by region



Source: Land Registry, HMRC, Savills

and a return to price falls in the three regions of northern England.

Mortgage lenders emerging

Yet significantly, according to the Bank of England, for the first quarter of 2010 there are signs of improvement in loan to values and, in some cases, lenders' margins are reducing in response to the emergence of some competition in the lending market.

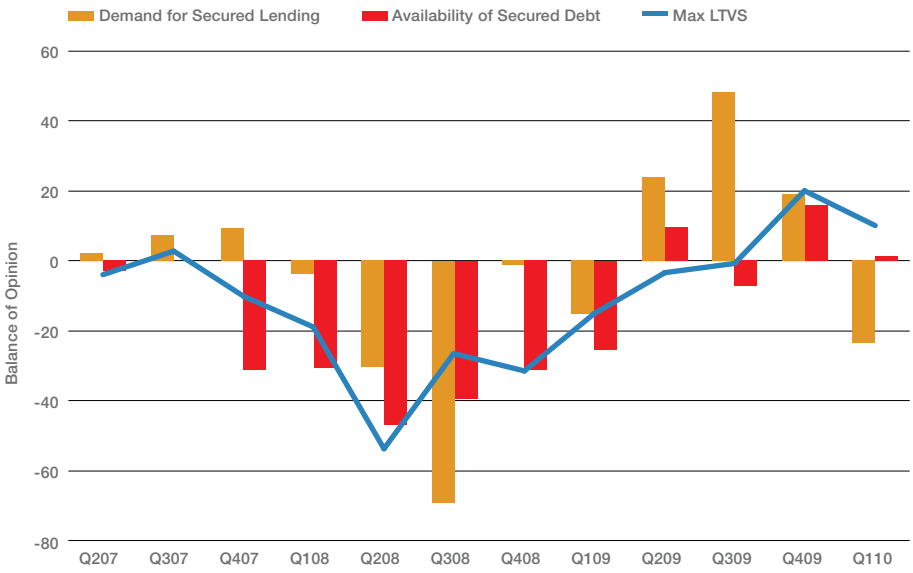
This is an important change, even if the immediate impact on transactions is negligible, because we expect a buyer's ability to obtain a mortgage to be the primary driver in the housing market over the next decade. For as long as this market remains inaccessible to many, it will drive a wedge between the equity-rich and equity-poor markets.

The distribution and timing of price growth will be dictated by the speed at which pent-up demand builds and is released into the home ownership market.

In the past two years the number of housing transactions has been down by 1.5 million when compared to normal market conditions. This is measured against the 10 and 30-year averages for housing transactions in the UK. This is a much larger figure than we have seen before.

Some pent-up demand will be pushed sideways into the private rented sector; most noticeably in the lower tiers of the market but also increasingly toward smaller family houses. The simple laws of supply and demand dictate that this is likely to lead to rental growth.

Graph 1.3 Demand and supply indicators and the mortgage market



Source: Bank of England

The geographical wedge

As far as owner-occupiers are concerned, the progressive ability of potential buyers to meet lenders' mortgage requirements is likely to see a repeat of the geographical transaction patterns that emerged between 1995 and 2002.

During the first half of the last housing cycle a significantly higher proportion of owner-occupied stock changed hands in the South of England compared to the North, with corresponding house price differentials. If anything, the effect will be more pronounced in this decade. ■

According to the Bank of England, for the first quarter of 2010, there are signs of improvement in rates and ratios of loan to value.

Prime London markets

London's prime residential markets

Focusing on three of London's prime residential sub-markets, Central, South West, and East of City, **Yolande Barnes** outlines the underlying differences between them

The equity-driven prime residential markets of London have seen a much stronger rebound in transaction levels over the past year than the mortgage-constrained mainstream market. Within this market there are noticeable differences between the international sub-market of Prime Central London (PCL), the family-orientated market of South West London (PSWL), and the less mature, development-led prime markets of Docklands and Canary Wharf (PEL).

The underlying differences in the make-up of these markets affect the levels of market activity in them. They respond differently to economic and political conditions; though each is affected by the relative weakness of sterling, plus earning, and employment levels within the business and services sector, which contributes to half the demand in all of these three different sub-markets. ■

Graph 2.1 Prime London transaction levels

Source: Savills

Prime Central London and the overseas buyer

Within Prime Central London, transaction levels over the past year, have been running at approximately 80% of their 2006/07 peak, having fallen to just 25% in the first quarter of 2009. A higher than normal proportion of this demand (55%) has come from overseas buyers in the past year. This compares with 45% at the peak of the market.

The weakness of sterling and the subsequently strong purchasing power of foreign currency buyers undoubtedly fuelled this rise. Whereas sterling prices were 10% lower than their peak by the end of March 2010; in US dollar and euro terms they remained 33% and 30% below their peak over the past year respectively.

Foreign buyers have traditionally been most active in the top tiers of the market, but their presence has been most significant in the middle and lower tiers of the Prime Central London market over the past year. This marks a shift towards investment-related purchases which have driven price growth of 16.9% during the 12 months to the end of March, even though price growth slowed during the first quarter of 2010 (3.0%).

By contrast, in the ultra prime market (where values average around £15 million), buyers have been rebuilding wealth. Transactions over the past 12 months, have been slower to recover and price growth has been more subdued than in the lower tiers of prime.

The buying opportunity presented by the weakness of sterling has disincentivised existing overseas owners from bringing their property to the market. Stock shortages, a feature of the market for the past year, remain, despite easing in other prime London markets.

The tax changes for non-doms have done little to bring stock to the market. Any global city will see a certain amount of international traffic both in and out of its prime residential markets, and London is no exception. Around 8% of prime London residential property sellers were looking to leave the UK in 2008/09. This figure increases to 11.5% in the more international markets over £4 million and 17% over £8 million. These percentages have not changed much since 2006/07, which means that we continue to see a net inflow of overseas buyers to the Prime Central London market. ■

Outlook

Stock shortages and continued overseas demand (given that the value of sterling may fall with the current political instability) will protect prices in the short term and drive market-leading growth in 2011 and beyond.

Central London	2009	2010	2011	2012	2013	2014
	9%	-1%	7%	11%	8%	6%

Key: Annual house price growth

Prime SW London and the domestic family buyer

Market activity has been strong in the prime South West London markets over the past 12 months and transactions were at 2007 levels in the second half of 2009. In comparison to central London, the proportion of overseas buyers is low. The resurgence in demand has come from wealthy domestic buyers – often acquiring their main residence.

Over the past three years, these markets have become the bellwether for the rest of the prime London market, with key demand indicators weakening much earlier than in PCL, causing transaction levels and prices to become more severely hit during the downturn of 2008.

Because buyers in this market are needs-driven, for example growing families or schooling, the fall in 2008 transaction numbers created a larger pool of pent-up demand. When this returned to the market in 2009, stock shortages became the biggest driver of house price rises. PSWL markets have therefore seen the highest price growth (26.9%) during the 12 months leading up to the end of March 2010.

This growth weakened in the first quarter of 2010, but values still grew by as much as 4.4%. In Fulham, Wandsworth and Barnes, where recovery was first evident, quarterly price growth fell to 2.7%. So far this price growth has been achieved without a significant injection of City bonus money, but with supply levels starting to ease and demand indicators softening, City employment and earnings are likely to play a key part in the market in 2010.

Figures from the Office of National Statistics suggest that, to date, bonuses in the financial sector continue to be suppressed. Taxation and the payment of bonuses in deferred shares are also likely to dilute the spending power of financial buyers. At a time when bonuses are at the forefront of the political agenda, this market was always more likely to be influenced by the political uncertainty surrounding the general election.

Correspondingly, key demand indicators including new buyer registrations, viewings and deals agreed, which were 45% higher than the norm in the last quarter of 2009, all softened relative to the level of supply on the market over the first quarter of 2010, bringing them in line with the average. ■

Outlook

This market is more exposed to higher levels of income tax, fewer bonuses and the threat of higher stamp duty. Consequently, we expect it to suffer more than central London in the next two years but rebound more strongly afterwards.

	2009	2010	2011	2012	2013	2014
South West London	18.5%	-3%	1%	10%	12%	6%

Prime East of City – bankers and investors

Compared to the other prime London markets, Docklands and Canary Wharf have been slower to recover, both in terms of transactions and price growth.

Owner-occupier demand is heavily concentrated amongst those working in the financial and business services sector, who also tend to be in the earlier stages of their career, with less accumulated wealth and a greater reliance on income than capital. Historically, demand has been supplemented by relatively high proportions of domestic investors and pied-à-terre buyers, but these groups have been less evident recently.

The less diversified nature of existing stock, which is dominated by one and two-bedroom flats, and the sizeable supply of available new-build stock has also played a part in keeping price growth to just 6.5% over the past 12 months to the end of March 2010. However, unlike other markets, the strongest price growth during this period was seen in the first quarter of 2010 (3.3%) as investors, both domestic and overseas, and second home owners began to return to the market. ■

Outlook

The market is likely to be highly dependent on the position of London as a world financial centre, as well as the role of Canary Wharf within this context. Latest estimates from Oxford Economics suggest a further 6,000 job losses still to come in London's financial sector over 2010, but this is a significant improvement on the 21,000 losses that were being predicted six months ago. Employment prospects are expected to be much more favourable in 2011, after which we expect growth to be supported by a relative dearth of new-build products as the development emphasis in the East of London shifts to Stratford.

	2009	2010	2011	2012	2013	2014
East of City	6.5%	-1%	4.5%	10%	8%	6%

Prime regional / Second homes

The capital connection

The UK's prime regional markets, specifically those associated with second homes, are inextricably connected with London. **Lucian Cook** explores further…

The relative strength of the relationship between the prime regional markets and the capital has been one of the key drivers of market strength during the past 12 months. This is ably illustrated by the fact that annual price growth in the South East England prime markets reached 10.4% by the end of March 2010, much higher than in the mainstream markets of that region.

In contrast, annual price growth in the other prime regional markets averaged just under 4%, which was less than the growth recorded for just one quarter in South West London.

Capital comparisons

Beyond the South East, the prime markets most connected with the capital have tended to be the second home markets. Much like London, 55% of demand in the £1-to-£2 million second home markets originates from the financial and business services sector, although, unlike London, it is far less international and the domestic buyer accounts for as much as 87% of the market.

Second home values rose by 8.3% in the year to the end of March, clear evidence of this relationship with prime London. This was fuelled by the high transaction levels in the last quarter of 2009, when second-home sales were 40% higher than the average for the past three years.

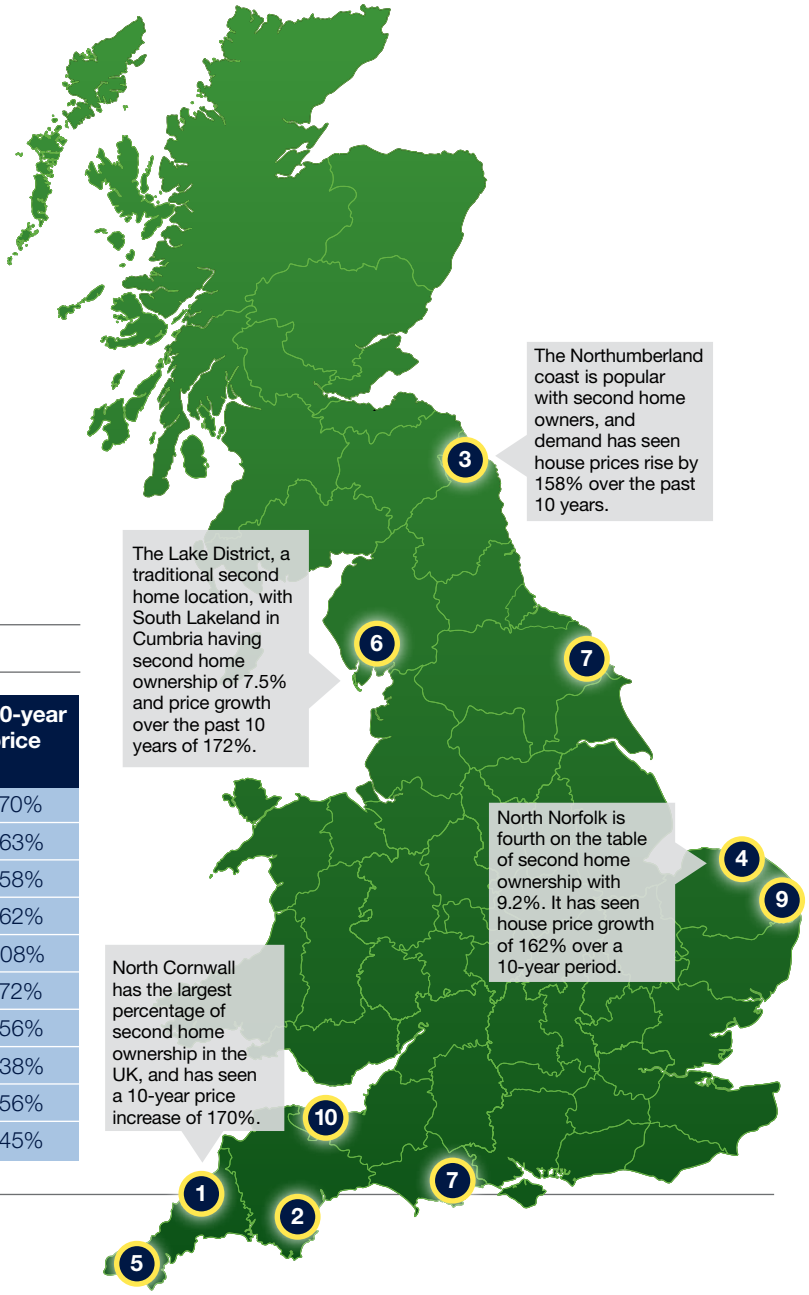
This outperformance was greatest in Cornwall, where second home buyers accounted for more than four out of every ten prime property transactions, and values increased by 16.5% year-on-year, followed close behind by Devon with growth also into double digits.

By its very nature, the demand for second homes tends to be highly discretionary, particularly in those locations where second homes are used as a holiday home, for instance Devon and Cornwall, as opposed to a more regular weekend retreat locations, such as the Cotswolds or Suffolk. As such, these markets usually show much more short-term price volatility than the prime regional markets as a whole.

Table 3.1: Second home ownership by Local Authority

	Local Authority	County	% Second homes (2009)	10-year price
1	**North Cornwall**	Cornwall	10.1%	170%
2	**South Hams**	Devon	10.1%	163%
3	**Berwick-upon-Tweed**	Northumberland	10.0%	158%
4	**North Norfolk**	Norfolk	9.2%	162%
5	**Penwith**	Cornwall	8.9%	208%
6	**South Lakeland**	Cumbria	7.5%	172%
7	**Scarborough**	North Yorkshire	7.5%	156%
8	**Purbeck**	Dorset	7.2%	138%
9	**Great Yarmouth**	Norfolk	6.0%	156%
10	**West Somerset**	Somerset	5.7%	145%

Source: CLG / Land Reg



Beyond the South East, the prime second home markets have the closest connections to the capital.

Local Authorities

Based on the past decade, we know some of the highest rates of house price growth are in locations with the highest proportions of second home ownership (see Table 3.1). In the Noughties, price growth in the top ten local authorities by second home count topped 160%, compared to just 117% on average across the UK, according to Land Registry data.

We expect future demand to be sustained from equity-rich upsizers buying their main residence. Over the next five years this is likely to mean price growth will be more consistent in the prime South East markets than the second home hotspots further afield, even if both continue to attract demand from City generated wealth.

In contrast, the prime second homes market is more dependent on the accumulation of disposable wealth, which is likely to be much harder to achieve in a post-recession environment. Certainly this will have an impact on the lower value second homes markets, and is also likely to put some pressure on transaction levels in the upper tiers of the market. ■

Stamp duty

The impact on the property market

One of the key proposals in Alastair Darling's pre-election budget was a two-year stamp duty holiday on property bought by first-time buyers for less than £250,000, as well as a 1% increase in the rate payable for properties sold for more than £1 million.

Curiously, whereas the first measure was implemented with immediate effect, as things stand, the latter is only due to take effect from April 2011.

The one-off increase in turnover that occurred in December last year, immediately prior to the end of the preceding stamp duty holiday, demonstrates the short-term distortions, which these types of measures can have on the market. However, looking at the year as a whole, transaction levels were severely constrained suggesting that in isolation these measures are rarely market shifting.

Our analysis of stamp duty receipts, transaction levels and average residential values indicates that the average stamp duty paid on a transaction in England and Wales increased from £1,500 per property or 1.33% of the average property value in 2000/01 to £4,900 per property or 2.21% of the average property value in 2007/08.

For first-time buyers stamp duty savings will help towards raising a deposit, but according to the Council of Mortgage Lenders, the average deposit is now near to 30% of the purchase price. Therefore, unless first-time buyers are able to draw upon 'the bank of Mum and Dad', this measure is unlikely to open up the market to those households currently excluded from the mortgage market.

Arguably, a more effective measure in meeting the requirements of these households would have been to review stamp duty on the acquisition of residential investment portfolios, which are essential providers of the type of rental accommodation these households are most likely to occupy.

At the other end of the scale, delaying the increase in stamp duty for transactions over £1 million is likely to bring some additional property to the market this year and into early 2011. Realistically the increase will have little bearing on affordability, but human nature is such that buyers will look to avoid a tax liability where possible. This could support the prime country house market in a year when values may soften in the wake of underlying market conditions. ■

Wealth generated by the City has lead to increased levels of second home ownership in areas of North Cornwall (such as Padstow).

PHOTO: SHUTTERSTOCK

Forecasts

The market in minutes

Key: Annual house price growth

-5% & below | 0 to -5% | 0 to 2% | 2 to 4% | 4 to 6% | over 6%

Mainstream markets Regional property value forecasts

Forecasts (as at Jan 2010)	2009 (Actual)	2010	2011	2012	2013	2014	2015
UK	3.4%	-6.6%	2.7%	5.5%	8.0%	5.7%	5.5%
London	7.0%	-4.1%	2.1%	5.6%	7.3%	7.0%	5.8%
South East	5.9%	-3.1%	3.8%	6.7%	6.9%	6.0%	6.0%
South West	3.8%	-2.8%	3.0%	5.7%	6.6%	5.5%	5.5%
East	4.5%	-4.2%	3.3%	6.6%	9.2%	5.5%	5.5%
East Midlands	2.5%	-4.5%	2.9%	5.8%	7.7%	5.4%	5.3%
West Midlands	2.1%	-5.2%	2.5%	4.5%	7.3%	4.8%	4.8%
North East	-2.0%	-7.0%	0.0%	3.8%	6.5%	4.5%	4.5%
North West	2.7%	-6.7%	1.7%	3.6%	6.3%	4.8%	4.8%
Yorks & Humber	2.7%	-6.7%	2.0%	3.8%	7.4%	7.1%	5.0%
Wales	-0.3%	-6.8%	1.4%	3.3%	7.3%	7.2%	4.5%
Scotland	1.0%	-2.0%	1.0%	1.0%	2.7%	4.3%	4.3%

Prime markets Forecast values

Forecasts (as at Jan 2010)	2009 (Actual)	2010	2011	2012	2013	2014	2015
Prime Central London	8.9%	-1.0%	7.0%	11.1%	7.5%	6.3%	6.3%
Prime Regional	1.3%	-1.0%	5.4%	8.9%	7.2%	6.1%	6.1%

£ per sq ft

A better measure of value

Assessing the viability of a location by £ per sq ft rather than average house price is increasingly being used by potential buyers, **Lucian Cook** explains why

Why is £ per sq ft important?

Historically, average house prices have been the yardstick for gauging property values, but this method can sometimes be distorted by the make-up of the housing stock in an area. The alternative is the £ per sq ft measure, which is increasingly used by potential buyers, mortgage valuers and developers looking to ascertain whether or not a particular location could be viable for development.

Analysis of listings data from property search engine Globrix separately identifies values by property type and bedroom numbers. It enables a more accurate identification of average values per sq ft at a Local Authority level.

So what are the differences?

This analysis shows the extent of the disparity between the most and least valuable locations. For instance, in London there are three boroughs (Kensington & Chelsea, City of Westminster and City of London) where average values exceed £1,000 per sq ft, and four boroughs where values average less than a quarter of that figure (Croydon, Havering, Bexley & Barking and Dagenham).

Outside of London the disparity is slightly less severe with the highest value Local Authorities commanding values roughly two and a half times those of the lowest; whether that be in the South East (Elmbridge, Surrey £405 per sq ft versus Swale, Kent £154 per sq ft), the West Midlands (Stratford upon Avon £250 per sq ft versus Stoke-on-Trent £100 per sq ft) or Yorkshire and the Humber (Harrogate £224 per sq ft versus Hull £93 per sq ft).

What does this tell us about future price growth prospects?

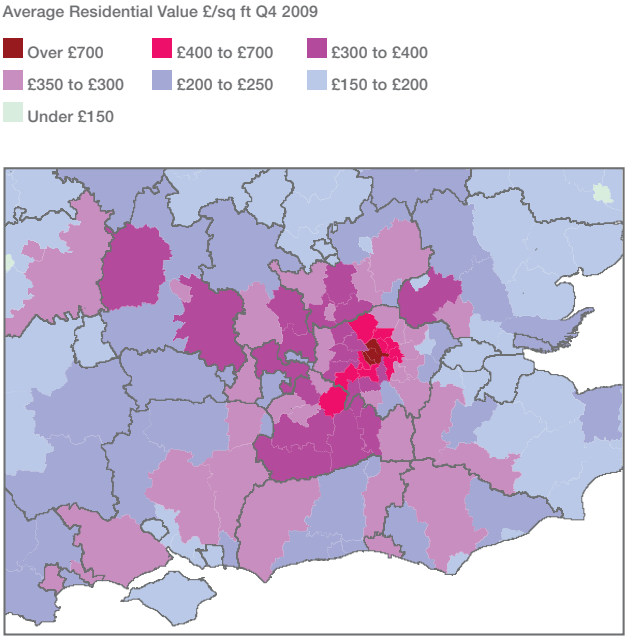
Usually these divergences in value per sq ft reflect the difference between the equity-rich and mortgage-dependent locations. As a result they are a useful indicator of the likely house-price growth that can be expected in an area.

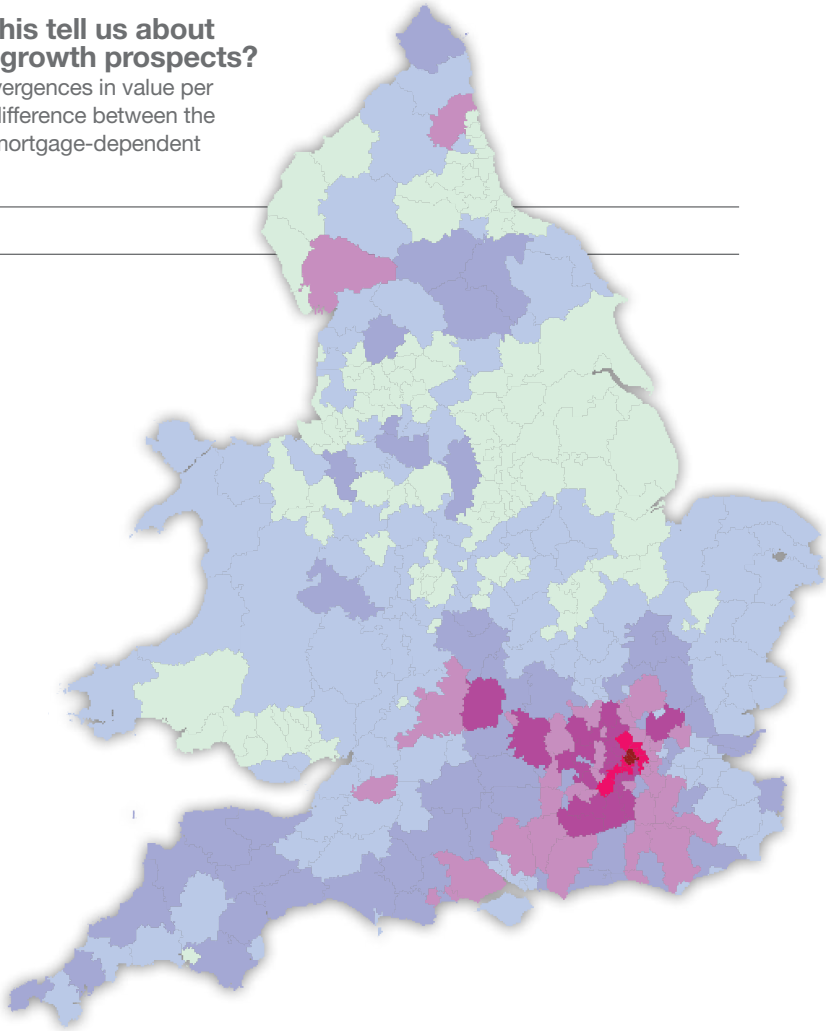
Why is this of relevance to future housing development?

This is useful to housebuilders and developers who are striving to achieve the highest returns possible for new schemes.

With concerns over development viability in areas where values are less than £150 per sq ft, this analysis indicates that just under one-third of all Local Authorities may struggle to support widespread development, especially on brownfield sites with remediation costs or high Section 106 development tariffs. ■

Average Residential Value of Properties in £ per sq ft





Source: Globrix/Savills Research

Development

The challenge of viability and volume

The prospect of a shortfall of one million homes by 2016 means fresh approaches are required to deliver new homes. **Marcus Dixon** appraises the situation

New-build housing transactions were hard hit in 2008 and 2009, peaking at 52% below levels of 2006 and 2007 as buyers sat on their hands, unable or unwilling to move.

This lack of transactional activity also had an impact on the new development market, particularly in terms of stock appealing to first-time buyers and investors pre the downturn. These buyers, in particular, have been hardest hit by a tightening of lending criteria.

In many cases, developers with stock under construction have become 'forced sellers', which has eroded the new-build premiums, which existed pre-downturn, on all but the best new-build schemes. The premium, which averaged 15% by the end of 2006 had fallen to a new-build discount of -8% by the end of 2009.

The talk, however, of an ongoing legacy of thousands of unsold new-build properties has proved unfounded. Schemes were put on hold and those already being marketed either found buyers or were absorbed into the rental market. Although there were headline-grabbing discounts, this was the exception rather than the norm and by mid 2009 speculators looking for heavily discounted new-build stock were disappointed.

Instead, an influx of cash buyers combined with a pent-up demand led to the beginning of a recovery in sales for both new and second-hand property, particularly within the south of England. Today new-build flats and houses are selling again with properties in well-established areas appealing to owner-occupiers, 'the bank of Mum and Dad' and some cash-rich investment buyers.

The land market

One of the biggest casualties of the downturn was the development land market. Doubts over the availability of finance, achievable pricing, a sustainable rate of sale, infrastructure burdens and other planning obligations led to land value falls of in excess of -51.4% off peak (Sept 07) for greenfield land and -56% for urban land (Sept 04). For many sites, already challenged on viability, site appraisals were creating zero or negative land values.

Despite this, although there were some land sales by distressed landowners and lenders releasing sites onto the market, this rapid drop in land values effectively stalled the land trading market. Landowners unwilling to trade at these levels and those speculating on land purchases were having difficulty finding sites to purchase.

So far this year, land transactions have improved, with prices for smaller more 'oven ready' development plots seeing more marked increases in value than larger bulk land purchases. Looking ahead we expect these serviced plots to outperform. This presents landowners with an opportunity to package up larger sites to appeal to developers and satisfy the more risk-averse lending criteria as the market recovers.

Implications for the future

With many developers and funders hit hard by the downturn we are likely to see a change in the approach to development in the future. Already the smaller, less cash-intensive sites have become the most attractive option for many developers and housebuilders, and indeed for those funding the development. Many of these schemes will be houses rather than apartments, although there will always be a place for flatted development in areas with good levels of demand. Undoubtedly, more phaseable schemes will still attract interest, although the scale of some developments in the pipeline may prove difficult for funders to stomach.

While prospects for smaller sites in higher demand areas remain positive both in terms of viability and land values, issues do arise on some of the larger sites, particularly those located in lower value regeneration areas. With high levels of upfront costs and rates of sale, which dictate a longer build out, finding funding for such a scheme may prove difficult as the payback period may be in excess of 25 years. A change of approach on the large sites will undoubtedly be needed, but this will take time, meaning further delays on many schemes already mothballed during the downturn.

Where will be viable?

For developers and housebuilders looking to bring forward sites, either from their current land banks, or through acquisition, viability, more than ever, will be at the top of their agenda. With erosion of new-build premiums and price falls since the peak of the market, many areas will still prove challenging in terms of scheme viability. When taking into account build cost, infrastructure, S.106 agreements and affordable housing, we expect areas where values are currently below £150 per sq ft to be unattractive to all but the most bullish developer.

The areas sub-£150 per sq ft (many of which are located in the Midlands and North of England) are also, on the whole, located in areas within which we expect price growth to be lower during the recovery. This could therefore mean many schemes are challenged in terms of viability for some time yet. For more see page 11.

New-build scarcity?

The availability of built or nearing practical completion stock will, we believe, become an issue as the market recovers.

The combination of access to funds, mothballing and viability challenges mean we expect both starts and completions in

The expert perspective
Associate Director Marcus Dixon provides the answers

Will new-build premiums return?
Pre-downturn the appetite of investor purchasers in particular supported double figure premiums for new build stock. As the market recovers we do expect this will return, but only on those schemes that can offer high levels of specification, design and space to appeal to more discerning owner- occupiers.

What about affordable housing?
With high levels of affordable housing delivered alongside private housing as part of Section 106 agreements, the downturn has also impacted on the affordable housing sector. We expect viability issues for private developers may mean that many agreed Section 106 thresholds will now be considered too high by developers, especially if availability of grant funding is limited.

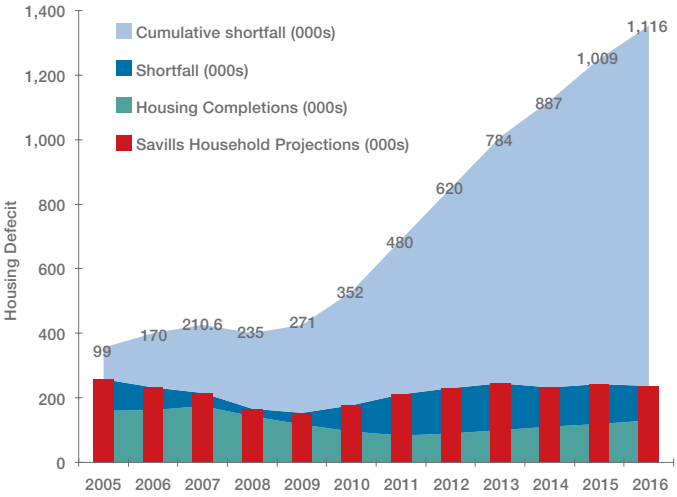
PHOTO: ISTOCKPHOTO.COM

2010 across the UK to be just 50% of their 2006 peak. Recent surveys by the House Builders Federation suggest that since mid-2009 levels of both completed stock and work in progress have been insufficient to meet demand. This supply-demand gap will, of course, be location specific, with the highest levels of demand and relative lack of supply being in areas of London and the South East.

Impact on Government targets

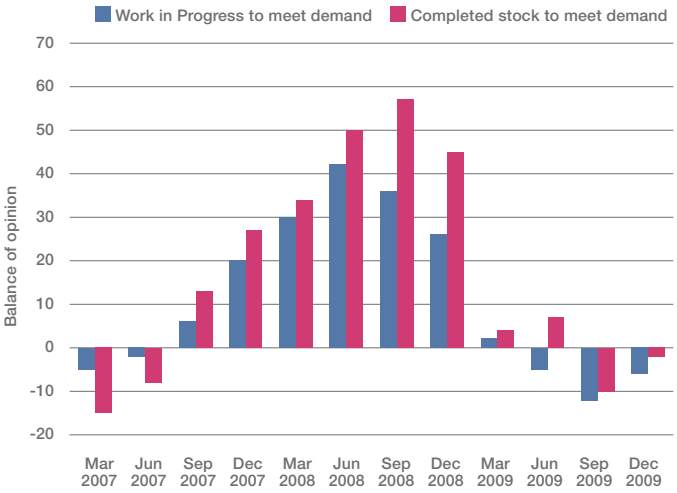
The reduction in levels of new-build activity, coupled with our forecast for lower levels of new-build completions as the market recovers, have major implications for Government housing targets. Housing completions, which historically have not equalled the growth in the number of new households (on which targets are based) are expected to remain lower than new household formation. This creates significant housing scarcity over time, with the prospect of a shortfall of a million homes by 2016. New approaches to enable the delivery of the volumes of stock will be require to meet these targets. Alongside the Government's pledge for greater localism towards development and planning new approaches will be required for large schemes. This is likely to mean a movement away from short term profit to longer term funding and scheme stewardship to ensure new developments remain successful, and indeed profitable over the whole build out period, which in some cases could be decades rather than years. To maintain rates of sale developers will need to appeal to the widest possible range of occupiers by offering a much more diverse portfolio of housing types at different pricing points. ■

Graph 5.1 Future housing shortfall



Source: DCLG/Savills

Graph 5.2 New housing – supply and demand



Source: HBF

Election snapshot

With a coalition Government in place for the first time since 1974, the consequences for the property market remain uncertain, as **Lucian Cook** observes

Throughout this publication we have acknowledged how in some sectors and regions of the UK pre-election political uncertainty has affected the housing market. Until the first budget of our newly formed coalition there is little to suggest that in the short term, at least, householders and the property industry have little from which to gain in confidence.

Putting to one side the likelihood of this coalition standing the test of time and the uncertainty that this engenders, the most significant policies to the UK housing market are those relating to how the national debt is handled. A picture will, we suspect emerge in the run-up to the first budget – expected 50 days after the formation of the coalition.

We expect the new coalition to front up to the economic problems sooner rather than later looking to deliver the bad news as soon as possible. Austerity measures and higher taxation achieved perhaps through a rise in VAT to say 20%, could easily impact on what remains relatively fragile sentiment in the mainstream market pointing to continued volatility within this market.

The depth of cuts in public spending, and the ensuing impact on regional economies, will undoubtedly affect the extent by which the already emerging north south divide continues to widen in the housing market. Equally a close eye will be kept on bond yields and correspondingly whether the current benign prognosis for interest rates holds good.

In the prime markets a sigh of relief followed the decision to archive the Liberal democrat proposals for a mansion tax over £2 million. Of course the political horse trading led to the Conservatives having to drop 'an equivalent' proposal, which in this case means an increase in the Inheritance Tax Threshold.

Most people were prepared to accept some degree of tax rise but the proposed changes to bring Capital Gains Tax rates more in line with those for income tax, have set the pulses racing among second home owners unable to rely on main residence relief, as well as residential investors and owners of development land.

Already we have seen those with houses on the market rush to push exchanges through before budget day. Only a further stay of execution until the beginning of the next fiscal year would open up a window for those yet to market their property to make a dash for lower tax rates. This could distort the properties available to buy in some localised markets in the short term while in the longer term the prospect of a higher tax charge on disposals could make assets less tradable – a concern for investors where capital returns are all important.

More generally across the prime markets, the strength of sterling will be critical to the strength of overseas demand especially in London, meaning the reaction of international money markets to the larger economic issues will probably have the biggest impact in this sector.

Summary

Housing turnover

Turnover of housing stock it proving currently to be a bigger issue than house prices. On average one in 16 houses sold in each year of the last decade, but over the past two years this figure has fallen to just one in 25 or in other words the number of housing transactions has been down by 1.5 million when compared to normal market conditions. This is measured against the 10 and 30-year averages for housing transactions in the UK. This is a big figure, much larger than we have seen before.

■ *See page 4*

London's prime sub-markets

The equity-driven prime residential markets of London have seen a much stronger rebound in transaction levels over the past year that the mortgage-constrained mainstream market. In Prime Central London transaction levels over the past year have been running at approximately 80% of their 2006/07 peak with a higher than normal (55%) of this demand being from overseas compared to 45% at the peak of the market. We expect stock shortages and continued overseas demand (particularly if sterling remains weak) will protect prices in the short term and drive market-leading growth in 2010 and beyond.

■ *See page 6*

Housing completions

The combination of access to funds, mothballing of schemes and viability challenges mean we expect starts and completions in 2010 across the UK to be just 50% of their 2006 peak. Housing completions, which historically have not equalled the growth in the number of new households are expected to remain lower than new household formation leading to the prospect of a shortfall of a million homes by 2016.

■ *See page 12*

Research publications

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A performance analysis of prime residential markets in central London.

Market in Minutes… Q110 Farmland

A comparison of rural land values for the first quarter of 2010 against alternative investment options.

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In-depth analysis on performance of leisure operators.

Global Residential Review 2010

Trends in overseas property investment, covering traditional and emerging markets.

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Reporting on the market for new-build homes in prime Scottish locations.

Spotlight on… Scottish Residential Property Market

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