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Savills Research
UK Residential

RESIDENTIAL PROPERTY FOCUS Q1 2012

A market built on equity

How the dominant source of funding moved from mortgage debt to equity

Market Snapshot

The total value of UK housing and five-year price forecasts

Prime: East & West meet in London

Mainstream: Gaps in value widen

Investment & development: Q&A

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This publication
This document was published in February 2012. It contains a review of all the key housing market indicators and news to the end of January 2012. 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.

The most commonly used abbreviations are:
■ CML: Council of Mortgage Lenders
■ FTB: First time buyer
■ HBF: Home Builders Federation
■ MIG: Mortgage Indemnity Guarantees
■ Peak: refers to the first half of 2007
■ PCL: Prime Central London

Foreword
THE NEW AGE OF GLOBAL EQUITY

For the housing industry to attract new forms of funding, an understanding of equity, and the cash it can generate, is fast becoming essential

It could be said that there is very little in global financial markets that can't be understood in the context of a surfeit of savings in the eastern hemisphere and a surfeit of debt in the West and the ongoing re-balancing that is needed between the two. This is reflected in real estate markets too; housing markets have been growing much faster in the equity-rich eastern hemisphere.

In the UK, as in much of the western hemisphere, mainstream residential property transaction levels remain mired at an all time low as the debt drought continues and activity is confined to the markets that can, and do, attract buyers with equity.

This means that purchases are highly discretionary. There has been a 'flight to quality' as buyers want the best properties: the most fashionable, the most accessible, the most prestigious, the best-performing. This is the 'prime era' and one where grade A stock has outperformed.

A wealth preserver

Real estate, particularly in world cities like London, has developed a status of a 'wealth preserver'. London's 'safe haven' status is constantly referenced in explanation of substantially increased values. When real estate is being used as a store of wealth like this, its income-producing qualities are of as little importance as that of gold in a bank vault.

Net yields may be seen as simply offsetting holding costs (arguably putting it at an advantage against costly-to-store gold) but not all equity investors are so oblivious of income. The task of many other global equity investors is to seek stable income streams over the medium and long term.

This seems to be something that the UK property industry has been slow to realise and adapt to. The valuation of residential property is still predicated on the old-world, mortgage-funded, owner-occupied model. The few investment portfolios available are still being appraised at a discount to open-market, vacant-possession value.

If UK housing (development, investment and owner occupation) is to attract new forms of funding, as it must in the new age of debt drought, we have to understand equity and the cash it can generate.

Cash-flow is King

Our analysis of Britain's housing value shows overall debt levels of only 29%. It is already a market rich in equity – but this has debarred entry to those with little or no equity to use as deposit.

Little wonder that demand for rental property is growing very fast indeed. More worrying perhaps is the poor prospects for this demand to be met. As investor portfolio ownership implies an immediate discount, it is no wonder so many potential large-scale landlords and housing providers are still waiting to enter the sector.

In future, it will be more important, we think, to understand net cashflows and their appeal to a global equity provider. It is these cashflows that will increasingly determine value outside the wealth preservation zones. The residential property industry must understand that, in the new age of global equity, cashflow is King.

Yolande Barnes
Head of Residential Research
020 7409 8899
ybarnes@savills.com

Executive summary

The key findings in this issue

- The shift to equity has favoured the housing markets of London and the South East. These two markets hold the greatest pool of housing wealth, and together account for 26% of the UK's housing stock but, at £1.55 trillion, 36% of its value. See pages 4/5
- London is operating as a global city – almost completely divorced from the surrounding nation. Unsurprisingly, the way that equity is flowing is reflected in London, which is acting as a wealth preserver in a sea of global uncertainty. See pages 8/9
- The underlying story is of a widening gap between market leaders and market laggers. Only the very strongest market leaders continued to deliver growth in 2011. See pages 10/11
- By 2016 we expect new housing completions to increase to 125,000 per annum as market capacity increases slowly, together with support from government measures. See page 12
- We expect the private rented sector to expand to 20%-23% of housing stock in England by the end of 2016. The two big questions are where the stock will come from and who will own it. See page 13

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Housing market dynamics

A MARKET BUILT ON EQUITY

Equity has replaced debt as the dominant source of funding of house purchase. It favours high value markets, particularly those in the South of England

Words by Lucian Cook

One of the key changes to the housing market in the past five years has been the shift in the dominant source of funding. Since 2008 equity as opposed to mortgage debt has become the major source of funding for housing transactions.

A shift to equity was evident prior to the credit crunch but has accelerated since. In 2001 mortgage debt funded 62% of the cost of all housing transactions, by 2006 that had fallen to 55% and in 2011 it stood at 46%.

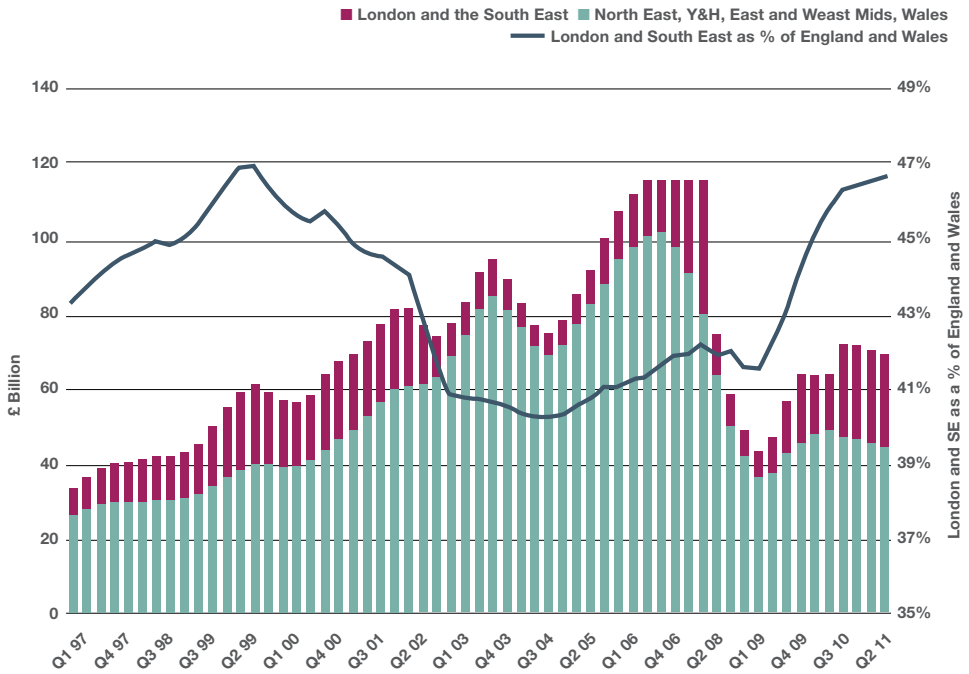
Constraints on mortgage debt have been the main catalyst. Higher deposits have been needed to access home ownership, there has been more vigorous vetting of mortgage applications and among home movers the equity rich have been able to fall back on a greater affordability cushion.

"47 pence in every £1 spent on house purchase in England and Wales is spent in London and the South East"

Lucian Cook, Savills Research

GRAPH 1

Annual value of housing transactions Favours London and the South East



Graph source: Savills Research, Land Registry

Shift to equity

Figures from the Land Registry suggest that across England and Wales as a whole £150 billion was spent on house purchase in the 12 months to the end of September 2011. This compares to a figure of £284 billion at the peak of the market and is some 47% less.

Generally the shift to equity has favoured the housing markets of London and the South East, where transactions and prices have been the most robust. These two markets hold the greatest pool of housing wealth and together account for 26% of the UK's housing stock but, at £1.55 trillion, 36% of its value.

Equity rich markets

At £69 billion, 47 pence in every pound spent on house purchases in England and Wales was directed at these two regions in the twelve months to the end of September 2011. This sum is 54% higher than the collective amount spent on house purchase in the Midlands, Wales and the three government regions that make up the North of England0.

By this measure the equity rich markets have fared the best. In inner London the amount spent on house purchase was 71% of its level at the peak of the market. In markets such as Surrey, Oxfordshire, Bath and North East Somerset and York that figure stood at 60%. By contrast in Blackpool the value of housing transactions was just 30% of its level at the peak of the market.

The shift to equity has also tended to favour higher value markets where it is most concentrated. The total value of sales in the £100,000 to £200,000 range, at £39 billion, was 52% below the £82 billion total in the year to the end of September 2007 prior to the credit crunch. Meanwhile, sums spent on property worth over £500,000 totalled £34 billion, just 18% below the pre crunch level.

TABLE 1

% of housing transactions financed by mortgage

£million England and Wales	Q3 2001	Q3 2006	Q3 2011
Annual Value of Transaction	140	243	148
Mortgage Lending for House Purchase	86	134	68
% Funded by Mortgage	62%	55%	46%
% Funded by Equity	38%	45%	54%

Table source: Savills Research

The only submarket to break new ground was the £1million+ market of London, where equity (a significant proportion of which is international) is perhaps at its most dominant. In this sector the value of housing transactions was 12% above the level at the previous peak of the market.

In the age of austerity this has undoubtedly worked to the benefit of the Treasury by sustaining stamp duty land tax receipts, given the higher rates of duty paid on higher value property and the introduction of the 5% rate with effect from April 2011. This should not be forgotten as the concept of a mansion tax is debated in the media and by politicians.

Mortgage reform

As far as the debt side of the equation is concerned, the Financial Services Authority published its latest package of proposed reforms in December. These enshrined three main principles, namely:

1. That mortgages should only be advanced where repayment of debt could be achieved without relying on uncertain house price growth.

2. Resulting affordability assessments should allow for the prospect of interest rate rises.

3. Interest only mortgages should be predominantly assessed on a repayment basis.

Such proposals are far less draconian than earlier consultative documents indicated. But combined with the prospect that both the restrictions on the availability of debt and the cost of funds will increase in the face of the eurozone crisis, this means that equity will reign for some time to come.

THE SHIFT FROM DEBT TO EQUITY

Whoever controls the £3.1 trillion of UK housing wealth is shaping a changing market

The majority of the value of UK housing stock is held as equity. In 2011 the total value of UK housing stock stood at £4.3 trillion. This compares to mortgage debt of £1.24 trillion, meaning equity accounts for 71% of the value of UK housing.

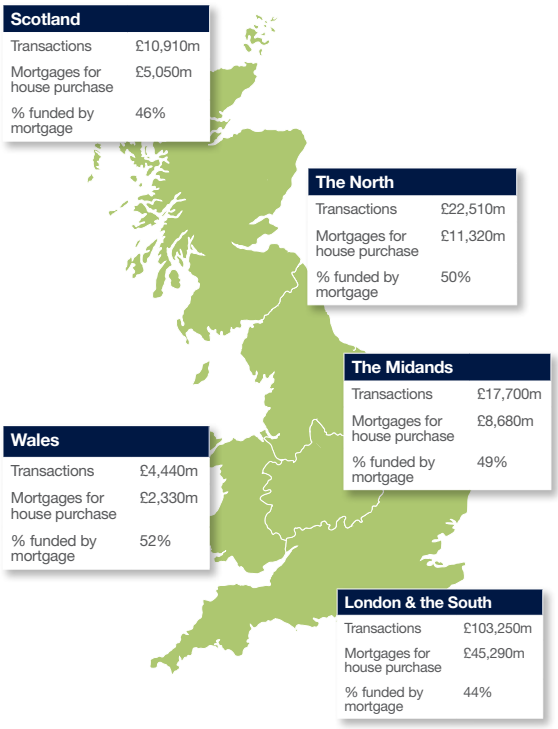
The biggest constraints are on the first time buyer (FTB). Research from the Council of Mortgage Lenders shows 64% of FTBs receive assistance from the equity bank of Mum and Dad. This figure has risen from 34% five years ago.

The numbers of these mortgaged FTBs are down by 51% over the same period, reflecting the fact that equity from the bank of mum and dad is not universally accessible.

As a consequence the shift from debt to equity has had the greatest impact in the private rented sector. Not only has it increased the demand for rented accommodation among occupiers but more equity has been directed at the residential investment sector among owners. The result is that the value of private rented housing stock in the UK has risen by 42% to just over £900 billion in five years.

MAP 1

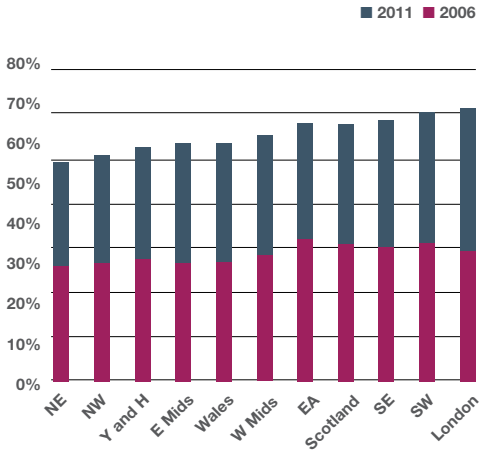
Mortgage reliance across GB



Graph source: Savills Research; Land Registry; CML; Registrars of Scotland

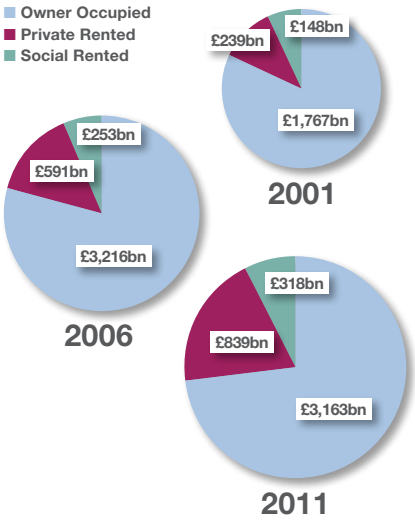
GRAPH 2

Percentage of first time buyers with parental assistance



GRAPH 3

Value of UK housing stock by tenure



Graph source: CML; Savills Research

Market snapshot
CAPTURING VALUE

The total value of housing in the UK stands at £4.3 trillion, and the value of sales in Great Britain is £160 billion. London and the South East punch above their weight by all measures

Scotland

Stock	2.495 m
Total Value	£302 bn
2006-2011	11%
Value of Sales	£11 bn
Versus Peak	-53%
5-year Price Forecast	-2%

North East

Stock	1.182 m
Total Value	£124 bn
2006-2011	-3%
Value of Sales	£3.5 bn
Versus Peak	-60%
5-year Price Forecast	-3%

North West

Stock	3.156 m
Total Value	£372 bn
2006-2011	-3%
Value of Sales	£11 bn
Versus Peak	-59%
5-year Price Forecast	-1%

East Midlands

Stock	1.978 m
Total Value	£256 bn
2006 - 2011	2%
Value of Sales	£8.4 bn
Versus Peak	-53%
5-year Price Forecast	9%

Yorks & Humber

Stock	2.327 m
Total Value	£280 bn
2006 - 2011	-1%
Value of Sales	£8.3 bn
Versus Peak	-58%
5-year Price Forecast	-3%

Wales

Stock	1.351 m
Total Value	£173 bn
2006-2011	-1%
Value of Sales	£4.4 bn
Versus Peak	-54%
5-year Price Forecast	5%

West Midlands

Stock	2.376 m
Total Value	£309 bn
2006-2011	0%
Value of Sales	£9.3 bn
Versus Peak	-53%
5-year Price Forecast	0%

East of England

Stock	2.539 m
Total Value	£475 bn
2006-2011	+10%
Value of Sales	£18 bn
Versus Peak	-46%
5-year Price Forecast	14%

South West

Stock	2.400 m
Total Value	£407 bn
2006-2011	5%
Value of Sales	£16 bn
Versus Peak	-48%
5-year Price Forecast	10%

South East

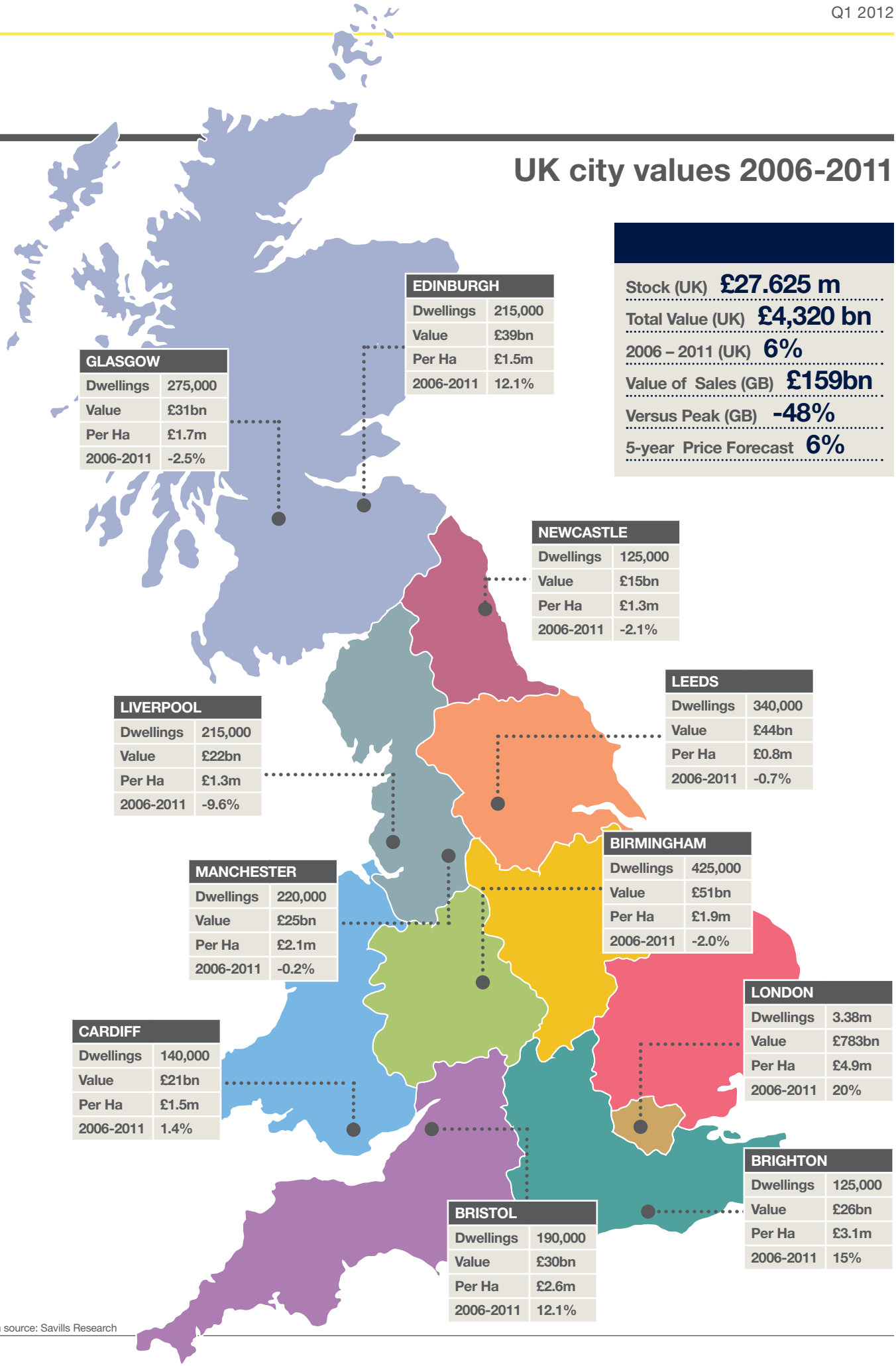
Stock	3.697 m
Total Value	£767 bn
2006-2011	10%
Value of Sales	£32 bn
Versus Peak	-45%
5-year Price Forecast	16%

London

Stock	3.381 m
Total Value	£783 bn
2006-2011	20%
Value of Sales	£37 bn
Versus Peak	-38%
5-year Price Forecast	19%

Notes
The boxes show the amount of housing in each region; its value, how that has changed over five years, the value of housing sales in the year to the end of September 2011; how this compares to the value of house sales at the peak of the market in the 12 months to September 2007 and finally our house price growth forecasts for the next five years.

UK city values 2006-2011



Stock (UK)	£27.625 m
Total Value (UK)	£4,320 bn
2006 – 2011 (UK)	6%
Value of Sales (GB)	£159bn
Versus Peak (GB)	-48%
5-year Price Forecast	6%

Graph source: Savills Research

Prime markets

ORIENTIAL EQUITY: OCCIDENTAL IMPACTS

Global East to West equity flows have boosted the London market. Yet the pattern is reversed when it comes to domestic equity, as more wealth is generated in the West End than the City

Words by Yolande Barnes

In London, the old drivers of value have, at least temporarily, ceased to be so important. Less wealth is being generated in the City's economy. It is international economy that is key – and equity is flowing from the cash-rich nations.

London is operating as a global city – almost completely divorced from the surrounding nation. Not surprisingly, the way that equity is flowing globally is reflected in London which is acting as a wealth preserver in a sea of global uncertainty.

Where locally-generated wealth is concerned, it is still originating largely in the financial sector but not so much from the big banks in the City and Canary Wharf. City bankers' bonuses have been curtailed – not just by the performance of the big banks but also by changing methods of remuneration and deferred payment.

It is the small hedge funds and private offices based in Mayfair and its environs that are generating the most cash to the property market now. In London therefore the global East to West pattern has been reversed, and equity is currently flowing out of West End, not the East.

GRAPH 3.1

City bonuses less important in market driven by West End and overseas equity

Table source: Savills Research

Bucking the trend

National newspapers are full of the news that London house prices are continuing to rise while the average UK property continues to be devalued by inflation and mired in low turnover and zero growth.

Central London has completely bucked the national trend. Our prime London index (covering all prime areas, from Hampstead in the north to Richmond in the south west and Canary Wharf in the east) grew by 8.7% in 2011, adding to the 27.9% gains it had already made since March 2009. It now stands 9.7% higher than its former 2007 peak.

Top properties in the capital are clearly driven by a different set of factors to the average British three-bed semi. We used to talk about the importance of differences in the London economy, particularly the strength of the financial sector, to explain this.

In 2006 and 2007, City bonuses were a key factor in the 47% growth in prime London over this boom period. We estimated that, in these two years, around £8 billion flowed into the market from this source. City bonuses are unlikely to reach this level again although other types of equity (share capital, profits and sale proceeds) could easily replace them when the economy prospers.

Equity migration

Growth in 2006 and 2007 wasn't just confined to London. City bonuses also found their way into the prime 'stockbroker belt' markets as well as second home markets such as the Cotswolds and parts of Cornwall. Prices in many of these markets grew by more than a third over the same two years.

The significant amounts of equity that have flowed into central London and prime markets are a 'missing link' in the picture of UK house price movements. We estimate that nearly £28 billion entered the housing market by this route between 2006 and 2011 as sellers used their proceeds to buy their next home.

To put this figure in context, it equates to the value of 137,000 'average' UK houses. It helped to forward fund the gentrification and regeneration of new areas both inside and outside London and helps to explain the growing disparity between average UK house prices and national

PRIME MARKETS
Five-year forecast values

Forecasts	Change from peak to date	2012	2013	2014	2015	2016
Prime Central London	15.6%	3.0%	0.0%	5.0%	6.5%	6.5%
Prime Regional	-16.6%	-3.0%	2.5%	4.0%	5.5%	5.5%

Data source: Savills Research

household incomes. Ours is an equity-fuelled market.

Prime regional's decline
While overseas wealth has more than compensated for the lack of city bonuses over the last three years, and especially in 2011, it seems to have stuck in London and not spread to the regions.

While the 2009 rebound has had some impact outside London and in the prime markets, it has not extended much beyond the South East.

Our prime country house price index still stands 17.1% below its 2007 peak. Prices in 2011 fell – even in the South East. The average fall across the UK was -3.3% with the South West, Scotland, Midlands and the North particularly hard hit.

Country house bargains
Price differentials between London and the country have never been greater and we do expect further small price falls in the country this year due to the weak economic outlook but there are signs that the stretched elastic between the two markets may snap back after this.

Our market strength indicator for prime property in the Home Counties (which is usually the first region to move after London) has improved – though is still below former average levels. We have also seen early signs of greater buyer interest in places such as Surrey, for example.

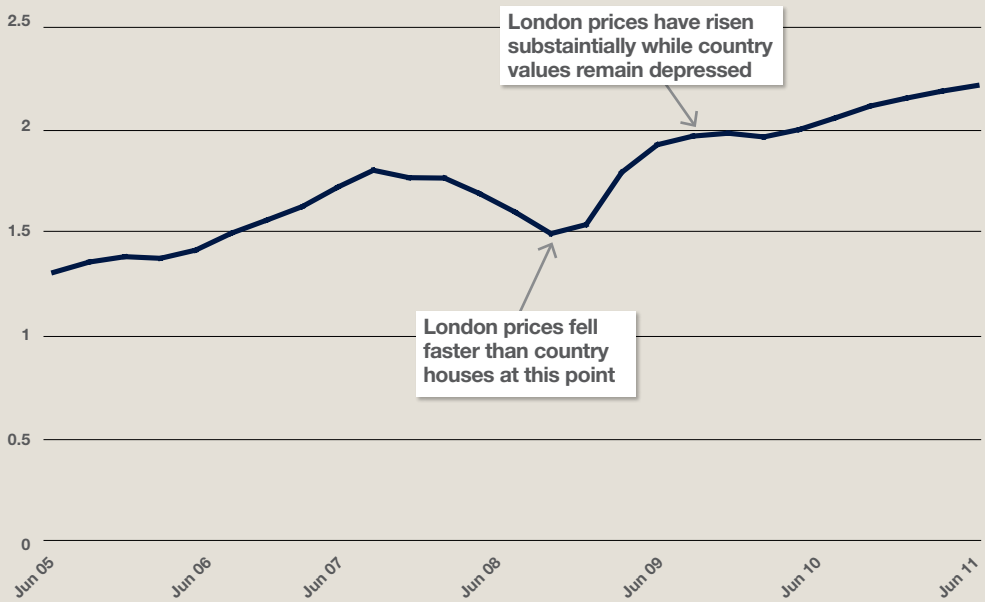
The graph below illustrates how 2012 presents unprecedented opportunities for buyers selling in London and moving to the country. In 2005, the sale of a prime house in Wandsworth would have bought a prime country house near Wimborne and a third of the proceeds to pocket. Now, the sale of the same property in Wandsworth will buy two prime houses in Wimborne Minster with 14% of the proceeds to pocket.

"Price differentials between London and the country have never been greater"

Yolande Barnes, Savills Research

GRAPH 3.2

The Wandsworth to Wimborne ratio While the price of South West London houses has risen, country properties have become relatively cheaper



2005
The sale of a prime house in Wandsworth would have bought a country house in Wimborne, plus a third of the proceeds

+33%

2011
The sale of the same property would have bought two country houses in Wimborne, plus 15% of the proceeds

+15%

Graph source: Savills Research

UK mainstream market

GAPS IN VALUE CONTINUE TO WIDEN

Overall the mainstream housing market moved sideways in 2011, but the gaps in value between the market leaders and market laggers became even more pronounced

Words by Lucian Cook

Key indicators of performance for the UK housing market suggested little, if any, change between 2010 and 2011.

At this national level house prices fell by 2% according to the Land Registry, while already suppressed transaction levels also fell modestly, by around 5%. Gross mortgage lending remained constrained especially at high loan to value ratios. In the third quarter of 2011, lending at loan to value ratios of 90% or more was down 20% compared to the same three months a year earlier.

The level of outstanding mortgage debt fell by less than half of one percent. On the one hand, households struggled to make in-roads into paying down their housing debt. On the other, both they and banks remained cautious about extending the nation's mortgage exposure. But headline figures do not tell the whole story. The underlying trend is of a widening gap between market leaders and market laggers.

Last year we took Land Registry data and divided the market into 10 segments according to their performance in the first or second half of the last housing market cycle. This accounted for the fact that in the South East the market of, say, Brighton behaves very differently to that of, say, the Medway Towns.

This categorisation shows that whereas roughly half the market saw price rises in 2010, the vast majority saw price falls in 2011. Only the very strongest market leaders continued to deliver growth.

In the markets typically weakest at this stage in the cycle – the 'laggers' – those price falls accelerated significantly in response to the weakening economic outlook. As a result the markets that have historically lagged in the early stages of a market recovery flagged in 2011.

This leaves a situation where prices in the ultimate market leaders – those markets that are the least constrained by the lack of mortgage debt – have on average returned to their peak of 2007, while prices in the ultimate market laggers have fallen to 24% below their 2007 peak.

Given little sign of a change in accessibility to mortgage finance or an improvement in the economy, we expect the resulting gap to widen further still over the next five years.

MAINSTREAM MARKETS

Five-year forecast values 2012-2016

Forecasts	2012	2013	2014	2015	2016	Inflation-adjusted 5-year growth	Nominal 5-year growth
UK	-2.0%	0.5%	1.0%	2.0%	4.5%	-11.0%	6.0%
London	-0.5%	1.0%	5.0%	6.0%	6.5%	2.0%	19.1%

TABLE 1

The UK's leaders and laggers House price growth and prices vs peak

Leader / Lagger Group		Examples	Annual Price Movement		Prices v 2007 Peak	
			2010	2011	Q1 09	End 2011
Leaders	Top 10%	Kensington & Chelsea, Windsor & Maidenhead	7.0%	2.8%	-16.6%	0.1%
	10% - 20%	Surrey, Brighton and Hove	4.5%	-1.0%	-16.0%	-7.3%
	20% - 30%	Hampshire, Bath & NE Somerset	4.1%	-2.1%	-17.6%	-11.0%
	30% - 40%	Milton Keynes, Suffolk	2.4%	-2.4%	-18.0%	-13.3%
	40% - 50%	Medway, Devon, York	1.3%	-2.4%	-16.5%	-13.6%
	50% - 60%	Cardiff, Lincolnshire, North Yorkshire	0.9%	-4.4%	-15.9%	-16.0%
	60% - 70%	Sheffield, Manchester	-0.3%	-5.5%	-17.2%	-19.5%
	70% - 80%	Nottingham, Newport	-0.9%	-3.5%	-16.7%	-18.9%
	80% - 90%	Newcastle, Merseyside	-2.2%	-5.2%	-16.4%	-21.3%
Laggers	90%+	Blackpool, Blaenau Gwent	-2.4%	-7.0%	-15.6%	-23.7%

Table source: Savills Research using Land Registry

London calling

The varying performance of the housing markets across London perfectly exemplifies the distinction between equity-rich and equity-poor markets

While there are significant regional differences in the performance of the housing market there are also strong localised differences, within the regions. Nowhere is this more evident than in London.

The driving force behind these differences is the concentration of equity within local housing markets. At the extreme the value of housing stock in Kensington and Chelsea has risen by over 40% to £65 billion over five years, while that of Barking and Dagenham has fallen by 2% to just under 7.5 billion.

The wealth gap

The amount spent on house purchase relative to the peak of the market lays bare the relative vibrancy or dormancy of these markets.

The five boroughs with the most spent on house purchase (Kensington and Chelsea, City of Westminster, Wandsworth, Camden and Richmond) are all rich in equity. 33 pence in every pound spent on housing in London in the 12 months to the end of September 2011 was spent in these five boroughs. Here the total value of house sales stood at £12.7 billion or 77% of that seen at the peak of the market.

By contrast the five boroughs with the lowest amount spent on house purchase* (Barking and Dagenham, Newham, Waltham, Bexley and Havering) accounted for just six pence in every £1 spent. In these boroughs the amount spent on house purchase was just 43% of the level seen in at the peak of the market.

More generally, our analysis of market turnover relative to peak shows an east-west divide between the equity rich and mortgage dependent markets. It also illustrates even more clearly the higher relative spend in central London and along the wealth corridors that run north and south-west out of London, something that we have looked at in more detail in our review of the prime markets.

Looking forward

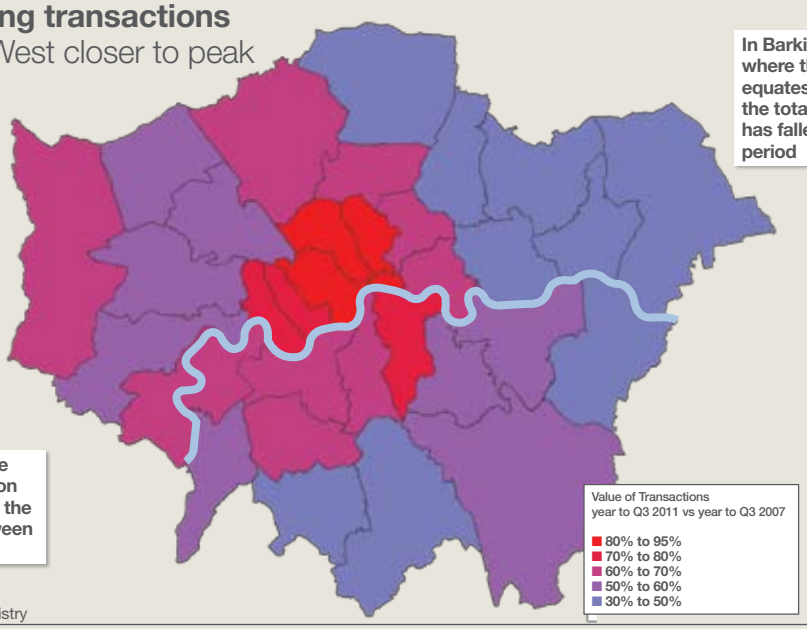
This performance measure gives a strong indication of the ability of markets to operate in the debt-constrained environment of the near future. It also suggests that whatever the forecasts for price growth across the capital as a whole, there will be considerable differences at a more local level. We expect value growth in the top five boroughs to be 20.5% over the next five years, compared to 16.20% in the bottom five.

*Excluding the City of London where the built environment is dominated by commercial property.

"Our analysis shows an east-west divide between London's equity-rich and mortgage-dependent markets." Katy Warrick, Savills Research

MAP 3.1

Total value of housing transactions vs peak of market West closer to peak



In Barking and Dagenham, where the value of housing stock equates to under £2m per hectare, the total value of housing stock has fallen by 2% over the same period

In Kensington and Chelsea, where on average there is over £50 million of housing stock in each hectare, the value has risen by over 40% between 2006 and 2011 to £65 billion.

Table source: Savills Research; Land Registry

Development

RE-LAYING THE FOUNDATIONS

With a number of initiatives launched to encourage development, the Government's Housing Strategy looks to get the housing market moving again and deliver much needed new homes

Words by Jim Ward

Q What impact will Housing Strategy measures have on housebuilding?

A A host of initiatives have been announced by the Government to promote housebuilding in England, alongside parallel initiatives in Scotland and Wales.

Mortgage Indemnity Guarantees (MIGs) will see the Government and developers share the lender's risk on 95% loan to value (LTV) mortgages on new build property, with provision made to facilitate up to 33,000 new home purchases each year until the end of this Parliament.

In addition, the £400m 'Get Britain Building' fund is designed to support building firms in need of finance. The intention is to unlock development of up to 16,000 new homes.

By 2016 we expect to see new housing completions increase to 125,000 per annum, as market capacity increases slowly, together with support from Government measures, partially offset by a lower volume of affordable housing under the new system of affordable housing.

"By 2016 we expect to see new housing completions increase to 125,000 per annum."

Jim Ward, Savills Research

GRAPH 5.1

Housing completions and forecast

Graph source: CLG, Savills Research

Q …and what influence will these fresh measures have on land value?

A Increased levels of housebuilding should increase demand for land. While this will continue to focus on smaller, more easily fundable sites, new housing strategy measures recognise the constraints on viability preventing many larger sites from being developed.

Proposals to allow developers to require local authorities to reconsider section 106 agreements that were agreed in more prosperous markets may unlock more land for development, while the £500m Growing Places fund will aid infrastructure delivery on land in Local Enterprise Partnership areas.

It is these large, infrastructure-heavy strategic sites that have suffered the greatest falls in land value. These initiatives should make more of these sites viable, in turn boosting market value to a point where development can take place.

Q Should the Community Infrastructure Levy (CIL) be considered an opportunity or a threat?

A The new CIL will be charged at a flat rate across a local authority, or at rates that vary by either type of development or defined market area. It is potentially a very good way of funding the major infrastructure that is needed for development, to include roads, hospitals and schools.

However, if it is set at too high a level it will stifle development, as once set it is non-negotiable at a site specific level. This 'one size fits all' approach means charging schedules will have to be tested with a robust viability assessment before being finalised. These assessments are proceeding now, as the existing Section 106 system for pooled funding of infrastructure cannot be used by local authorities after April 2014.

Those with an interest in seeing development happen, from both the public and private sectors, must ensure the viability assessment is based on realistic assumptions that reflect market realities.

Investment

LOOKING FOR THE RIGHT RETURN

Activity in the residential investment sector looks set to increase in 2012 with opportunities in the private rented market looking increasingly attractive

Words by Yolande Barnes

Q What is the outlook for residential rents and what does this mean for investors' yields?

A A growing proportion of UK buyers are unable to enter the owner occupier market, and have been forced into rented accommodation. This is fuelling rental rises at a pace in excess of capital growth, pushing out income yields, and making the sector increasingly appealing for investors.

Over the past ten years the average total return from residential investment stock of 10.1% has been driven by capital growth, which has averaged of 6.2% per annum. Looking forward we expect income yield to become more important. In certain markets it will deliver the majority of the investment return.

Already, investments in the North of England are to be acquired as long term holds on the back of current yields and future rental growth prospects. By contrast, in the South East they are more likely to be medium term holds based on prospective capital growth.

Q Where is the increased supply coming from?

A We expect the private rented sector to expand to 20%-23% of housing stock in England by the end of 2016. The two big questions are where the rental stock will come from and who will own it.

The private rented sector will expand to 20%-23% of housing stock in England by 2016.

Prior to the credit crunch the rise in levels of private renting in the lower rungs of the housing ladder was accommodated by the growth in the buy to let sector. However, the expansion of the buy to let sector has slowed as more restrictive buy to let lending criteria have been applied and debt-reliant investors have become more cautious.

Equity rich investors, including those from overseas, are currently leading the charge, but over the longer term greater institutional investment will be critical to deliver more rented accommodation.

Q We hear a lot about overseas investors, why are they so important?

A Weak sterling has made prices in the UK look cheaper, particularly to Asian markets. The UK benefits from few barriers to entry or exit for foreign purchasers, and a trusted legal system.

They have been attracted to prime new-build stock in London which has been critical to the residential development market.

Q What will make institutional investors grasp the nettle?

A To ensure that tenants do not have to resort to renting poor quality accommodation because of a lack of choice, we need an investor-friendly environment.

Measures such as the change in the stamp duty regime for bulk purchases, forthcoming changes to the REIT regime and limitations on further regulation go some way to overcoming the investment hurdles.

But improving the income yields is the key. To this end a new class of institutional investors are emerging with a focus on build to let, and this will have spin off benefits for house building in de-risking large sites.

Additionally, we are seeing institutions look to joint ventures with registered providers of social housing and student housing operators to provide the economies of scale that improve net to gross yield ratios.

Combined with the increase in yields that flow from the shift to renting, we firmly believe that institutions will become the new buy to let landlord.

Market insight
PROPERTY RADAR

A preview of the significant property topics to be covered in the next issue of Residential Property Focus

Debt availability

The availability of debt shows little sign of improving in 2012. The CML is forecasting that gross mortgage lending will fall by 5% this year.

The Bank of England credit conditions survey suggests that the cost and availability of funds continue to be the greatest drag on mortgage lending. According to the same report these factors, together with the changing economic outlook, are set to continue to curtail the supply of credit.

Buy to Let

The same survey suggests that demand for credit also remains relatively weak, with the exception of demand from buy to let investors. Demand for buy to lending has been supported by rising rents, particularly in London. Here asking rents rose by 8.4% on average in 2011 according to findaproperty.com, while the LSL Buy to Let index puts annual rental growth at 5.6%.

This growth is best explained by the fact that the average deposit for a first time buyer in London stands at some £58,000, up from £19,000 five years ago according to the CML.

Taxation of Prime Housing

As the budget approaches there is a focus on the taxation of very high value property. The avoidance of stamp duty has come under intense media scrutiny.

We would be surprised if that were not addressed in some form, even though the extent of stamp duty avoidance is likely to have been overstated in the press.

The more radical mansion tax proposal from the Liberal Democrats has a much greater capacity to unsettle the prime markets.

With both stamp duty and inheritance tax receipts heavily skewed to high value property, arguments that these assets make an unduly low contribution to tax take are hard to justify. A further tightening of stamp duty would weaken the argument for a mansion tax.

Savills research team

Please contact us for further information

Yolande Barnes
Head of Research
020 7409 8899
ybarnes@savills.com

"In London, the old drivers of value have, temporarily at least, ceased to be so important. Less wealth is being generated in the City's economy. It is international economy that is key."

Yolande Barnes

Lucian Cook
Director
020 7016 3837
lcook@savills.com

"In 2001 mortgage debt funded 60% of the cost of all housing transactions. By 2006 that had fallen to 55%, and in 2011 stood at 46%."

Lucian Cook

Jim Ward
Director
020 7049 8841
jward@savills.com

"The £400 million 'Get Britain Building' fund is designed to support building firms in need of finance. The intention is to unlock development of up to 16,000 new homes."

Jim Ward

Faisal Choudhry
Associate Director
0141 222 5880
fchoudhry@savills.com

Neal Hudson
Associate Director
020 7409 8865
nhudson@savills.com

Katy Warrick
Associate Director
020 7016 3884
kwarrick@savills.com

Paul Tostevin
Associate
020 7016 3883
ptostevin@savills.com

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