Spotlight on Development & Investment

A new dawn

The trends shaping residential development, investment and planning

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Foreword

Opportunities and threats

Residential businesses are showing signs of recovery, but significant changes are required to reshape the industry. **Yolande Barnes** identifies the three key trends

House builders and investors found 2008 a difficult year, in the UK. House prices fell dramatically, transactions dried up, new build became a dirty word among lenders and development land values plummeted. Price falls shrank the net value of residential investment portfolios and the withdrawal of buy-to-let mortgage finance left few able to cash in on the bottom of the market.

By late 2009 and into 2010 the residential industry showed signs of recovery. House builders worked through their standing stock, repaired their balance sheets and, on the back of a mini recovery in the housing market, re-entered, to a limited extent, the land market. New models of residential investment were also being touted, with large scale investors actively looking to step into the shoes of the now-disappeared buy-to-let landlord.

Today there remain significant issues for both developers and investors to contend with; not least the underlying weakness of the housing market. Despite the mini recovery of 2009, we believe the housing market is at a second tipping point and faces the prospect of short-term price falls or, at best, a period of low/zero growth.

Low interest rates should act as a safety net for house prices, so we expect this second slip in values to be relatively short-lived – but only if the economy continues its slow-but-sure recovery, as consensus economics currently predicts.

Such a prognosis means developers and investors will continue to behave cautiously while debt funders remain in hiding.

Three key trends

Beyond the short-term outlook though, there are a number of structural catalysts for change, which will reshape both the residential development and investment markets over the longer term. How the industry responds to them has far-reaching implications.

1. A shift in tenure

The age of ever rising owner-occupation is over. The number of owner-occupiers is shrinking, as market entry becomes more difficult – even for those on higher incomes. Renting will be the tenure of the future if support can be provided. We believe a move towards more private renting offers distinct possibilities for both developers and investors to diversify and mature.

2. Financial viability

The second trend is already beginning to be seen in land markets. A permanent rift seems to be opening up between the value of small, serviced sites and large strategic and regeneration sites, which require major 'pump priming' capital investment. The lack of credit availability and the cost of this has triggered a rift, which means virtually none of the more difficult sites are currently trading.

In future, land value uplift at grant of planning permission will not be automatic, it will be entirely dependent on the viability and profitability of the planned scheme with future market uncertainty heavily factored into valuations.

3. A broader investment climate

The third shift set to change the face of housing investment and development is the broader investment climate. The challenges of servicing the pension provision of an ageing population will require a shift to cash-flow investment.

We believe purpose-built residential property will play a large part in delivering this outcome. Some quasi-residential sectors, such as build-to-let student housing have already pointed the way to how investment models might look.

New rules of engagement

These key drivers present opportunities and threats, but what is clear is that new methods of delivery are needed if the homes people want and need are to be provided. The fields of residential development and investment have changed. We hope the insight provided here will help you to understand some of the new rules of engagement. ■

Inside this edition...

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Land markets

Embracing the financial sea-change

The value of development land has risen steadily since 2008. But, asks **Lucian Cook**, does this reflect improvements in the financial viability of residential development?

Our monitoring of residential development land values, shows that between June 2009 and June 2010, UK greenfield and urban land values rose by 17% and 14% respectively. These upward price movements, though important, must be judged in the context of the 55% falls in values over the preceding 18 months.

The price falls in this period, between the start of 2008 and the middle of 2009, reflected a combination of factors, but two, in particular, were significant.

First, the financial position of house builders weakened significantly as they found themselves heavily exposed to the downturn in house prices and, more importantly, lower transaction levels.

Second, even for those developers still in the market, and any house builders in a financial position to consider a land purchase, development finance became not so much scarce as virtually impossible to secure.

House builders and developers are competing for small, serviced, 'oven-ready' sites in prime areas with an identifiable housing demand.

However, over the past year, the financial position of house builders has improved as they have recapitalised. This has, in part, been made possible by the mini recovery in the housing market during 2009.

Developers have worked through their excess stock and realised much-needed cash through sales. Yet their improved position also reflects general cost-cutting measures and a reduction in capital-hungry, large-scale new house-building activity.

This painful process has caused house builders and developers to substantially reassess what type of development remains financially viable in today's post credit crunch environment. This, together with rationing of development finance, will see a selective approach to the schemes they will take on as they redress the shortfall in their development pipeline.

Scale is a major factor

As a result of this, the UK residential development land market has polarised. Easier to develop sites for houses in high-value, high-demand areas are reported to have risen rapidly in value, now standing just 20-30% below their former peak. This reflects that demand is heavily concentrated on such sites, but also demonstrates their relative scarcity, something that may be exacerbated in the short term by the ongoing changes in the planning system.

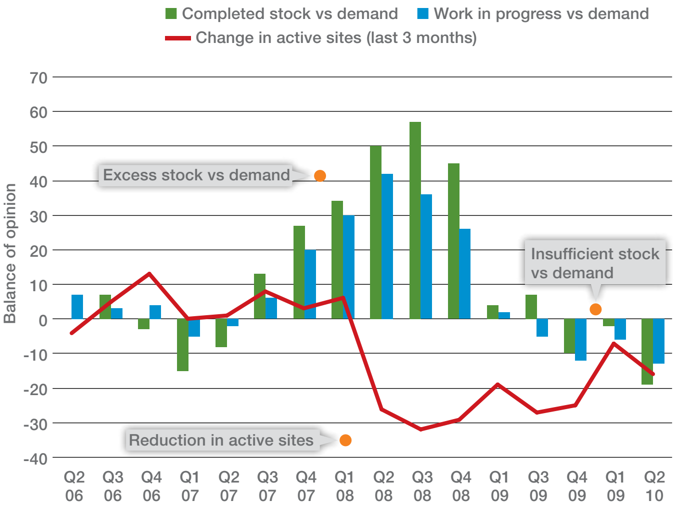
At the other extreme, the current values of brownfield sites in low-value, low-growth areas in northern parts of the UK are still some 70% below peak.

Scale is a major factor in this market. Risk-averse developers, focused on short-term liquidity, do not have the appetite, or funding capacity, to take on large-scale projects. Consequently, the value of bulk land remains suppressed, having seen little or no growth in value. Many sites remain mothballed, requiring promotional capital well beyond what is available in a fundamentally cautious market.

Oven-ready sites

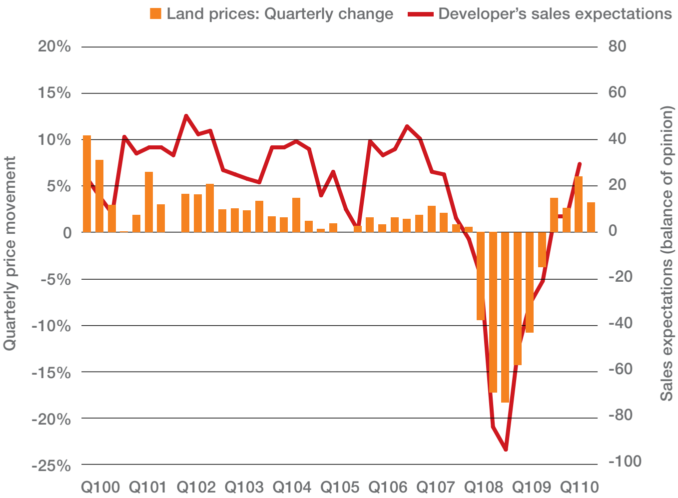
This leaves house builders and developers searching out and competing for small, serviced, 'oven-ready' sites in prime areas with an identifiable housing demand. It is a concern that the recent land value growth on these sites is as much, if not more, about short-term market confidence and a shortage in the supply of the right land in the right location creating intense

Graph 1.1
Development activity vs demand



Source: HBF

Graph 1.2
Land prices and developers' sales expectations



Source: Nationwide, HBF

price competition, than it is about residual values, which take account of completed development values and the costs of achieving these.

There is an established and strong correlation between land prices and developer sales expectations that reflects the close inter-relationship between anticipated housing demand and land-price growth. Despite the fact the housing market recovery is fragile, developers' sales expectations have improved significantly since the black days of 2008. This, and a need to feed a diminished development pipeline, has driven much of the recent land value growth.

Future activity

We anticipate the activity of mass house builders and developers will be focused on building out low-risk sites for cash flow in the foreseeable future. This means the greatest demand will be for small sites and serviced plots for houses, rather than flats, with activity being focused in high value, high-demand, low-supply markets.

As a result, we forecast value growth for these serviced plots over the next few years, although there is a real risk that if changing planning policy further restricts the supply of readily developable land, competitive bidding may lead to overheating in this part of the land market.

All of this has a consequence for housing delivery results overall, as these sites alone cannot deliver the volume of stock required to fulfil long-term housing demand, particularly given the depths to which new build housing delivery has now plunged.

Bulk land has traditionally been the key driver of volume housing delivery, but it is likely to continue facing significant challenges in an environment where debt finance remains limited and regulatory pressures are increasing. As a result, we expect the markets for serviced and bulk land to diverge as bulk land values remain static. This will, in turn, probably change the way development of these sites is delivered and funded.

Private-sector partnerships are becoming increasingly common as landowners bring on board specialised development partners.

Bridging the gap

There are three factors that are becoming increasingly important for developers and landowners to consider:

1. Phased payments
Where house builders are buying consented land, phased payments are increasingly common. There is also an increasing acceptance these funding models will continue to be required in order to aid liquidity.

2. Delivering serviced land
In other cases, landowners and developers are making greater efforts to bridge the gap between the value of bulk land and serviced plots. This is being done by focusing in more detail on the placemaking function required to deliver increased value and also fine-tuning the delivery of infrastructure to ensure that phased release of land effectively captures best value.

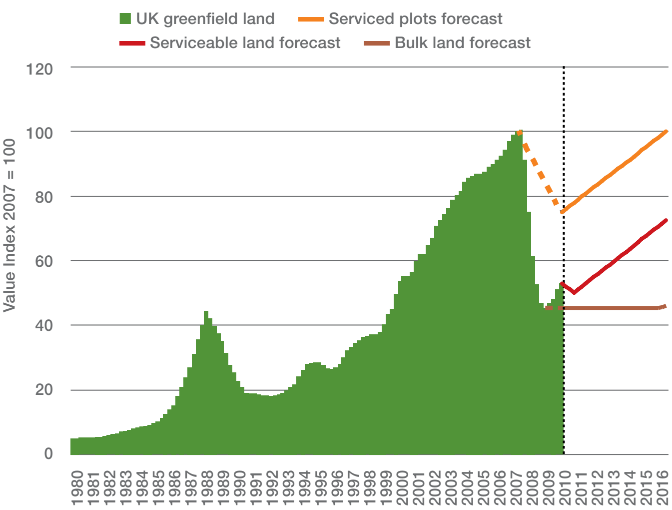
3. Development partnerships
Additionally, private sector partnerships are becoming increasingly common as landowners who wish to maintain a stake in the development process bring on board specialised development partners.

A recent Savills Research survey of strategic sites indicates such private sector partnerships account for 20% of large development sites, where construction is currently taking place.

The long-term challenge

The long-term challenge will be convincing more owners of bulk land to recognise the sea-change that has taken place in the development land markets. It is no longer possible to sit on unserviced land and simply wait for its value to rise, or indeed expect it to do so automatically on grant of planning permission. ■

Graph 1.3
Serviced plots to recover ahead of bulk land



Source: Savills

Localism

The brave new world of 'localism'

The abandonment of top-down planning will change the way the industry delivers housing, but there are plenty of opportunities, as **Yolande Barnes** explains

The revocation of Regional Spatial Strategies (RSS) so early in the life of the new government is a reflection of its keen desire to dismantle old centralised and target-led mechanisms for delivering new homes. The aim is to replace these with a decentralised local planning system.

The immediate consequence of Secretary of State for Communities and Local Government, Eric Pickles' first decisive move has created massive uncertainty in the planning system.

In this brave new world of localism, councils are set to take on a bigger role in balancing the housing needs of their local communities, and the financial incentives for meeting this need, against the strength of local opposition to development.

Developers may feel left behind in a policy void, unable to fall back on published house-building targets and unsure of how to prove housing need in order to secure planning consent. Plans for sites, even those proposed by the councils themselves for development in emerging Local Development Frameworks, are now at risk of gathering dust on planning officers' shelves until the new rules become clearer.

> To avoid the housing scarcity snowballing, the new planning system will need to deliver financially viable development schemes.

Due to its distinctive planning set-up, London alone will be little impeded by the changes. This should mean business as usual – subject to the challenges of funding major infrastructure projects (in the high-value, high-demand capital city).

Elsewhere, there is every prospect of a go-slow on site promotion until the policy void is filled. This risks prolonging the hiatus in house-building activity. Combined with reduced capacity in the construction industry post-credit crunch, our belief that housing output will remain low for at least 18 months has been further enforced.

Financially viable schemes

In the short term at least, household growth will continue to outpace the construction of new homes by a wide margin. This will increase current levels of housing scarcity in high-demand locations.

To avoid housing shortages snowballing, the new planning system will need to deliver financially viable development schemes swiftly. Many sites, either allocated under the previous regime or even with planning permissions, have now become unviable as a result of changing values and markets.

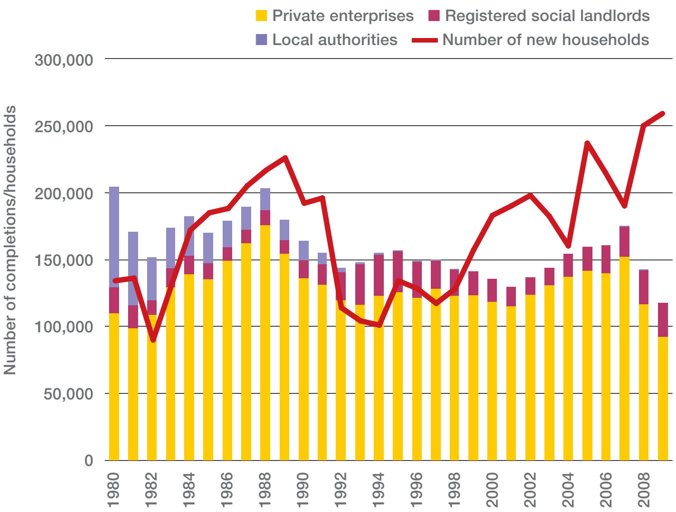
The move to localism presents the opportunity to bring forward sites, with community backing, which previously did not fit into the policy framework. Viable schemes already allocated under the old system should still remain the strongest development prospects though.

Compelling local housing 'need and demand' models will need to be developed in order to secure planning permission as running to appeal and claiming a housing land supply shortfall is unlikely to be enough in itself. Sites will need significant and sensitive promotion.

Community buy-in

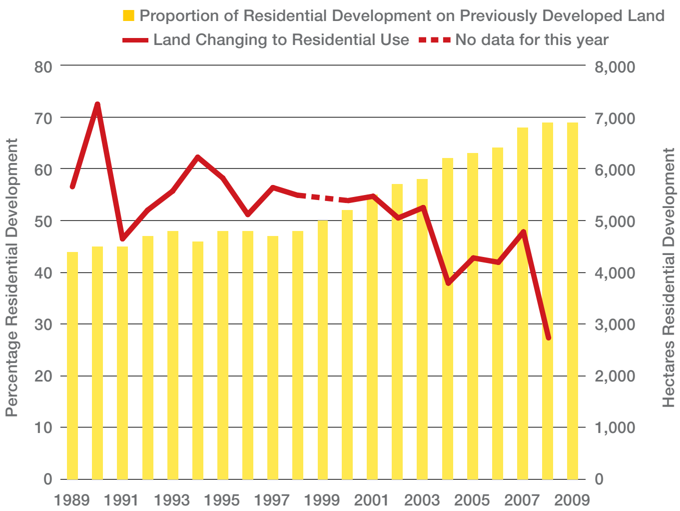
This means far more attention has to be paid to understanding the needs and desires of a local community. This will mean the provision of exemplary design, clear public benefits and quality assurance. Community buy-in will be a vital factor in maximising the prospects of gaining consent. Therefore even more effort will be spent on the pre-planning stages of

Graph 2.1
Housing completions vs new households



Source: CLG / ONS

Graph 2.2
Residential development on previously developed land



Source: CLG

Why does localism need to deliver more development?

Over the Noughties there was an increase in the proportion of development on predominantly urban brownfield land. To achieve financial viability that required housing to be built at increasingly high density. On these brownfield sites, average density increased by 75% between 1999 and 2009 from 28 to 49 units per hectare.

At the same time, as the profile of development changed, density increased on greenfield sites but not to the same degree. Collectively this meant that the physical amount of land given over to residential development continued to fall over the decade.

A simple comparison between housing completions and the formation of new households suggests that in this period a development shortfall emerged. This indicates that localism will need to bring forward more, not less, land to meet housing need. The demand for high-density housing is less certain in current housing market conditions, and finance for high-density development remains scarce. This makes it less easy to deliver. ■

the development process through community and stakeholder involvement. The use of techniques such as 'Planning for real' and 'Enquiry by design', for example may increase as a result.

All of this is likely to add to both the direct and indirect costs of development. This indicates that viable schemes, able to tick all the boxes and meet the additional costs, will become concentrated in the higher value areas of the country. The irony of the 'localism' agenda is that communities in these areas are often those most resistant to new development.

Yes In My Back Yard…

Unsurprisingly, in order to prevent localism being taken over by NIMBYism and, subsequently, development levels actually falling rather than rising under the coalition, the Government is relying on putting in place incentives to encourage YIMBYism (Yes in my Back Yard).

Such incentives will include the retention of council tax receipts by local authorities in return for accepting or encouraging housing delivery. Questions still remain over the level of the financial incentive needed to ensure local authorities receive sufficient economic benefit.

This could bring forward questions regarding the financial security of individual councils and their need for additional finance as a development consideration. It also begs the question of how rules regulating local government finances and, particularly, bond issuance, may need to be reformed. There are also questions over how neighbouring authorities interact and share the spoils from, and the pain of, new development and whether this will impede development in some areas.

It appears that localism has many implications, for example the need for new, funding structures and delivery models, which are as important as the planning regime itself. ■

Localism in practice?

The Community Right to Build scheme will give people the right to build new homes

The first indication as to how localism may work in practice has been provided by the Government's emerging proposals for a Community Right to Build. The new measure is targeted at the provision of affordable homes within villages to support rural services; but will only take effect after the promised Localism Bill has made its way through parliament, which is not expected until late 2011 at the earliest.

It would, in theory, enable community organisations to take forward development without planning permission – but only to the extent where it would allow settlements to increase in size by 10% over a ten-year period.

Vital to these proposals is the ability for community organisations to make use of any financial surplus from the sale or renting of homes for the benefit of the local community.

Quite what that financial surplus will amount to will be wholly dependent on the land value that owners of land require to release land. It also relies upon delivering design standards to secure a successful local referendum that is able to demonstrate overwhelming support for the development. ■

It would, in theory, enable community organisations to take forward development without planning permission.

Forecasts

The market in minutes

The road to recovery in development land, together with our outlook for the sector, plus the long-term forecasts for house price growth in the mainstream housing market

- Land values in the South East have rebounded strongly, reflecting a resilient underlying housing market and competition for sites, while the North has lagged.

- We forecast the value of serviced plots to see growth over the next few years, as the activity of housebuilders remains focused on building smaller low-risk sites, in high-value, high-demand locations.

- Serviceable land that is serviced to periphery, with no remediation issues and is readily developable, but at some scale, offers reasonable opportunity for value growth.

- The outlook for bulk land remains poor. The land opportunity lies in taking bulk land, masterplanning, guiding through the planning process, and installing infrastructure, in the delivery of a serviced product appropriate to today's market.

Road to recovery…

Residential development land % off peak (as at Jun 2010)

	Greenfield	Urban
All Regions	-47%	-52%
South East	-37%	-43%
Eastern	-48%	-60%
Western	-39%	-55%
Northern	-61%	-71%
Scotland	-54%	-50%

Source: Savills Research

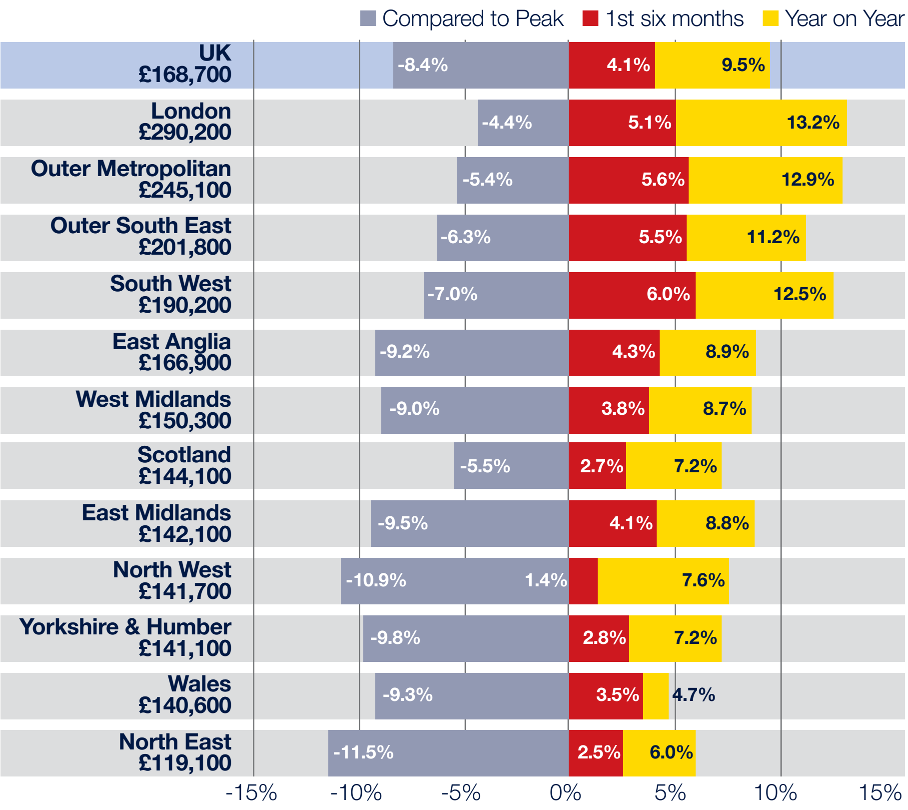
The land opportunity

	What is it?	Who is active & financing?	Outlook?
Bulk Land	Raw tracts of agricultural land, or large strategic brownfield sites	Strategic land, funds, some larger developers, targeted interest	Outlook poor in current form, many large sites unable to secure funding and unworkable, no significant value growth
		Add Value	
Serviceable Land	Land serviced to the periphery, readily developable without major remediation work, but at some scale	A broad range of developers, housebuilders, moderate demand	Reasonable opportunity for value growth due to medium-term focus. Return to peak value by 2023
		Add Value	
Serviced Plots	Fully serviced land parcels, masterplanned, design coded, requiring only the dwelling to be built	Housebuilders, both small and larger scale developers, strong demand	Funding readily available, and quickly developed for cash flow. Return to peak value by 2016

The mainstream residential market: Regional property value forecasts

Forecasts	2009 (Actual)	2010	2011	2012	2013	2014
UK	3.25%	-2.50%	-1.00%	3.00%	7.50%	7.00%
North	-2.00%	-3.25%	-1.75%	0.50%	6.50%	8.00%
Yorks & Humber	2.75%	-3.25%	-1.75%	0.75%	6.50%	8.00%
North West	2.75%	-3.00%	-1.50%	1.25%	6.75%	7.75%
East Midlands	2.50%	-2.25%	-0.75%	3.50%	7.75%	6.75%
West Midlands	2.00%	-3.00%	-1.50%	1.50%	6.75%	7.75%
East	4.50%	-2.00%	-0.50%	4.75%	8.50%	6.00%
South East	5.50%	-1.75%	-0.25%	5.25%	8.50%	6.00%
London	7.00%	-1.50%	0.00%	6.00%	9.00%	5.50%
South West	3.75%	-2.00%	-0.75%	4.00%	8.00%	6.50%
Wales	-0.25%	-2.50%	-1.00%	2.50%	7.25%	7.25%
Scotland	1.00%	0.00%	-0.50%	0.75%	3.00%	6.50%

2010 six-month performance



Source: Nationwide

■ Mainstream UK house prices showed no net growth in the three months to the end of July, according to the Nationwide monthly index.

■ Mortgage approvals in the first six months of 2010 were 10.8% lower than those in the last six months of 2009, according to the Bank of England.

■ Our forecasts for the mainstream markets have been pushed out by six months to reflect the price growth seen in the first half of 2010.

■ A widening gap between new stock coming to the market and new buyer enquiries witnessed in June suggests that prices will soften in the latter part of 2010 and early 2011.

■ Despite improved financial performance of the UK banking industry, the limited degree to which mortgage markets have improved and the prospect of greater lending regulation combined with a weak economic outlook, suggests a sustained housing market recovery may take longer to materialise than previously forecast.

New homes

A new wave for new build homes

Due to a shift in buyer profile, house builders have been forced to change the nature of the products they offer to market, as **Marcus Dixon** illustrates

The ability of house builders to ply their trade successfully, largely depends on their ability to sell the houses they build at a profit.

Regardless of what has happened to house prices, low transaction levels have made it difficult for the market to absorb new build stock, making it harder for developers to increase their rates of sale without impinging upon prices.

During the past two years, transaction levels across the UK residential markets have been just over half of the average seen in the preceding ten years, creating very real challenges for house builders.

In the first half of 2009, transaction levels rose steadily from record lows, before plateauing in the second six months, as the restricted availability of mortgage finance reasserted itself. Between January and June of this year those transaction levels dipped again and housing sales in the period were 20% lower than in the second half of 2009.

According to the Home Builders Federation, some 85% of home builders considered mortgage availability to be a constraint on demand. This has created difficulties for house builders, in particular, as they became reliant on investors and first-time buyers, the groups hardest hit by mortgage finance constraints who have been forced to withdraw from the market.

This shift in buyer profile has knock-on implications for the type of development that house builders can tackle. Many providers of development finance still insist on off-plan sales (often circa 30% of a scheme to generate cash flow).

Yet our figures indicate that investor buyers now account for less than 20% of all sales. With owner-occupiers more reluctant to buy off plan, preferring to see their potential new homes at or near completion, a stalemate between developers and lenders has emerged.

Change in target markets

Unsurprisingly, in this context, house builders are looking to change the nature of the products they offer to the market. There is now a greater focus on larger units for family buyers and downsizers who have the equity to operate in a mortgage-constrained environment.

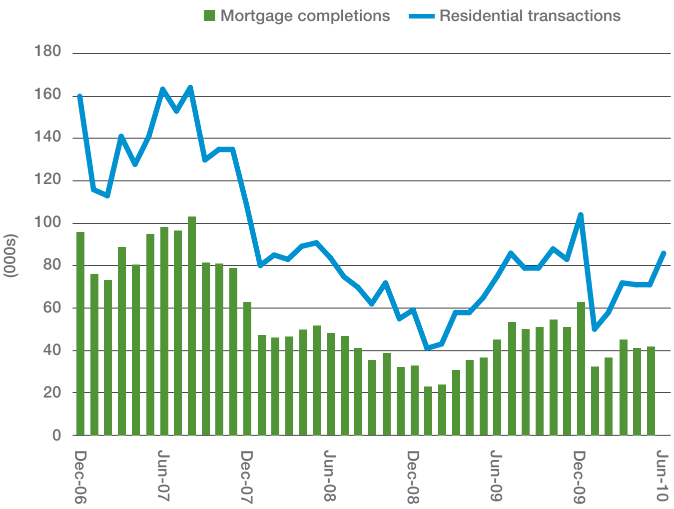
This change in the target markets is reflected in the average sale price, with increases reported by most house builders, exceeding the effect of annual house price growth. The desire to tap into higher value sectors of demand, becomes critical in areas where standard development forms have become marginal.

The combination of land, build, infrastructure and planning obligation costs means that few developers will be able to justify construction in areas where sales values are at or below £150 per square foot. Indeed many are wary at building below £180 per square foot. Around a third of all Local Authority areas in the UK currently have average values of less than £150 per square foot. At this level, regaining a new build premium is crucial.

Developers can, of course, take steps to make products more attractive to affluent buyer groups: groups who might have previously shunned new build properties and can be drawn in by the right offer. However, the pool of higher value buyers prepared to pay on identifiable premium is not inexhaustible. The reality is that proportionately most demand for new build will in the long run come from those on the lower rungs of the housing ladder.

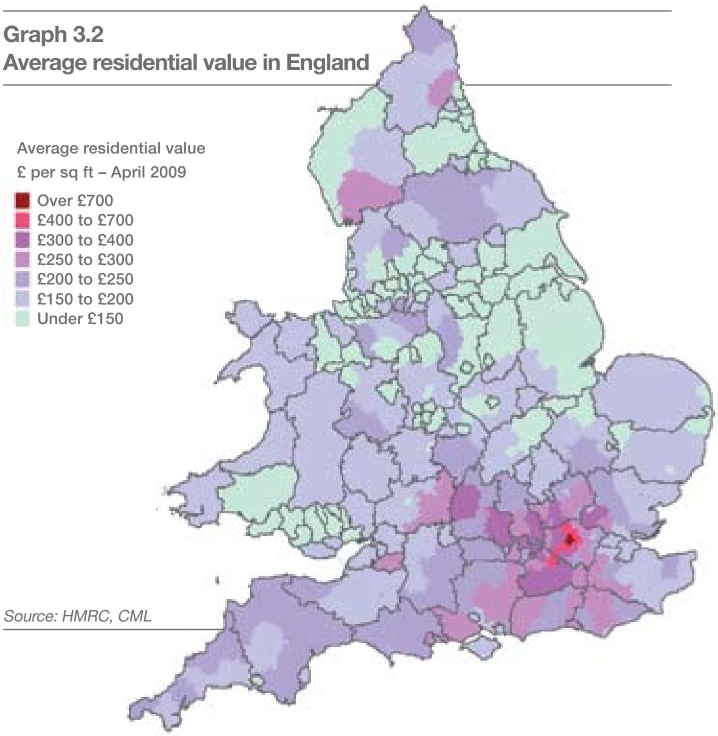
House builders will also need to embrace measures that address the issues of deposit availability faced by such entry level buyers. To date, this has taken the form of HomeBuy Direct and developers' own variations on interest-free loans to cover a proportion of the purchase price. These may become a permanent fixture of the new build market but with mortgage reform now coming down the track, house builders should be looking very hard at offering alternative forms of tenure. ■

Graph 3.1
Mortgage completions vs residential transactions



Source: HMRC, CML

Graph 3.2
Average residential value in England



Source: HMRC, CML

Investment

Where next for residential investors?

What opportunities are there for the investor in the development market? **Jacqui Daly** looks towards residential letting and student housing among others

The private rented sector has seen a significant renaissance in the last decade, making up approximately 13% of housing stock by 2009.

Over that period, private rented housing stock increased by 1.5 million, absorbing significant numbers who could not afford to enter the housing market as owner-occupiers; but who no longer qualified for the ever-depleting stock of social housing.

Increasing rental demand

Our forecast is that proportionately the number of owner-occupiers will continue to fall (unless there is substantial political/fiscal intervention). Young and transient households will continue to rent privately, but we believe there will also be a significant rise in rental demand from young families and relatively affluent households.

Access to mortgages, and a reduction in loan-to-value ratios, is unlikely to improve quickly. So, those households without access to sufficient cash or equity to raise a deposit are likely to remain within the rented sector for longer.

Even when a competitive lending environment returns, further regulation in the mortgage markets, which could take the form of the abolition of self-certification and the introduction of stringent affordability tests, is set to limit the availability of mortgage debt.

These trends all point towards a rise in demand for rented accommodation and, consequently, rental value growth. The question for the industry is whether rental stock supply can expand to match this predicted expansion in demand?

Servicing the need

Most of the expansion in privately rented stock numbers in the 90s and Noughties was down to a large number of small landlords helped after the mid-1990s by the advent of 'buy-to-let' mortgages.

Over the Noughties the number of outstanding buy-to-let mortgages rose from just 75,000 to 1.2 million. However, this type of investor is unlikely to return to the sector soon in significant numbers – largely because cheap, highly geared loans will not be available to them in the near future.

Accordingly, direct property investment will become more difficult for those without significant equity stakes. The future of the sector is therefore mainly dependent on the participation of corporate entities rather than individuals.

Yield considerations

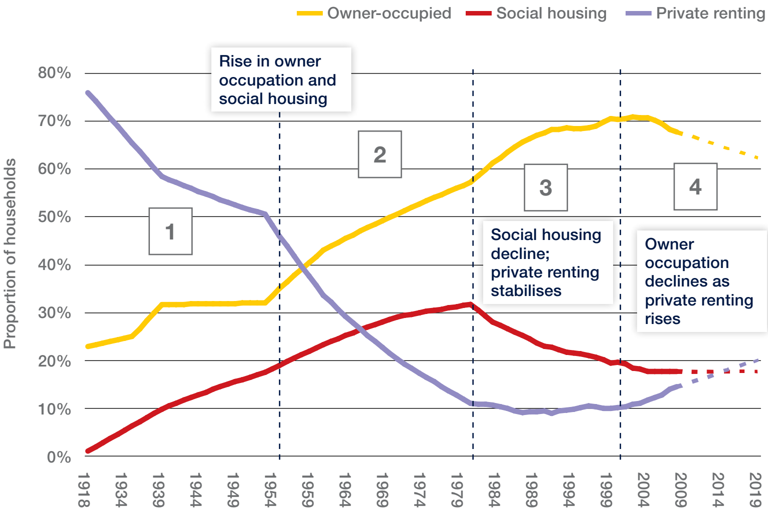
We have long argued for residential property's place in the spectrum of investment asset classes, but low income yields and the intensive management requirements have, too frequently, held back substantial investment.

At the beginning of the Noughties gross residential income yields stood at 8.8% (sufficiently higher than gross commercial yields to ensure that even after deductions for repairs, management and insurance, residential property offered a competitive return). However, as we ended the decade that gross income yield had fallen to just 5.3%, some 2.8% below the commercial property yield.

This yield varies by location and property type. Smaller properties in the lower tiers of the housing ladder consistently show the highest yields as the lower purchasing power of owner-occupiers in these sectors results in relatively lower house prices.

> The question for the industry is whether rental stock supply can expand to match this predicted expansion in demand?

Graph 4.1
Long-term tenure patterns



Source: Savills, CLG

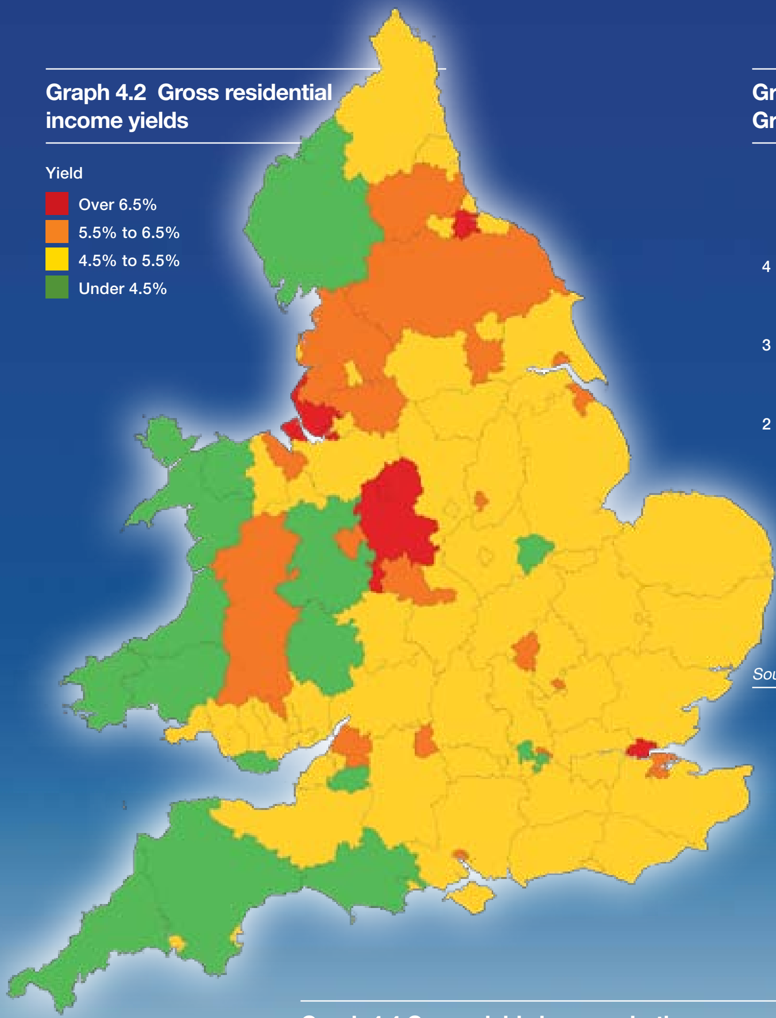
Private rented sector

Co-ownership opportunities are set for widespread adoption

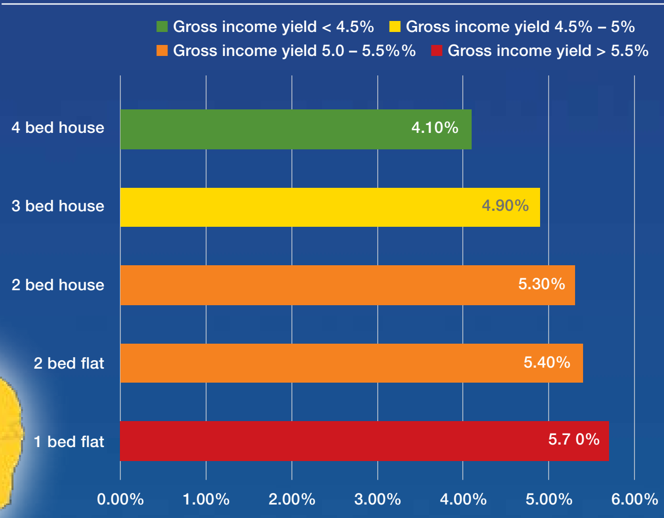
Continued expansion of the private rented sector will be one of several means by which the market responds to the reduced accessibility to outright home ownership.

Additionally, there would seem to be scope for the widespread adoption of co-ownership as a means of investing and overcoming the lack of equity barrier to ownership. The attitude of lenders and would-be owner-occupiers to this (not to mention investors) remains to be tested but small schemes are already attracting participants. ■

Graph 4.2 Gross residential income yields



Graph 4.3
Gross income yield by property type



Source: Savills / Globrix

Graph 4.4 Gross yields by conurbation

< 4.5%	4.5% – 5.0%	5.0% – 5.25%	5.25% – 5.5%	5.5% – 6.0%	6.0% plus
Bath	Bristol	Plymouth	Gr London*	Nottingham	Gr Manchester
	Edinburgh	Reading	West Yorks	Southampton	Merseyside
	Brighton	Portsmouth	Leicester	West Midlands	
	York	Cardiff	Glasgow		
	Bournemouth		Tyne and Wear		

This means that investors conscious of income yield, with a need to service debt, tend to focus on such properties and locations even though they offer lower capital growth prospects.

Meanwhile well-located family housing, where capital growth prospects can lead to higher total returns, still remains the domain of the cash-rich investor.

An example of the yield divergence is given by the diverse residential markets of London. In the five highest income yielding boroughs of Newham, Hillingdon, Redbridge, Barking & Dagenham and Merton, gross yields average 6.2%. Meanwhile, in the prime boroughs of Westminster, Kensington & Chelsea, Hammersmith & Fulham, Wandsworth and Richmond, where high levels of equity drive both the owner-occupier and investment markets, yields average just 4.3%.

Looking forward, we would expect these yields to diverge further. Capital value growth will be constrained by a lack of access to mortgage finance both in lower value markets and also the lower tiers of the market. Here the anticipated rental growth referred to above is expected to be strongest.

This may push out yields in a way that is not possible in the higher value markets where mortgages are likely to remain relatively cheap and, importantly, much more accessible.

While improved income yields are likely to increase the attractiveness of residential as an asset class, over the next few years, it is difficult to see yields for existing housing stock becoming competitive with, say, commercial property.

Corporate investment

This raises the question of whether, and in what form, corporate entities will now embrace residential investment. Importantly, the move to money-purchase pensions, where the size of an individual's pension pot is at the mercy of volatile equity and gilt markets, may well become a driver for investment in an asset class where values are far more stable and consistently show growth above the rate of inflation.

It was these factors that drove forward individual buy-to-let investors in the Noughties. The fact this private investment route is now much less accessible, does not mean that the underlying credentials of residential investment have been eroded. It does however mean that a different investment vehicle is now needed.

Equally, we expect the evolution of specialist residential investment sectors such as graduate sharers, young families, key workers and retirees, where the investment model is more weighted towards income yield and regular cash receipts.

To date, both healthcare and student housing have proved that an essentially residential offering can create significant, viable income streams, especially if purpose-built in bulk to satisfy institutional investors' needs.

Lessons to learn

Ultimately, lessons might be learnt from purpose-built private rented housing targeted at specific sectors of the market. Importantly though, the yield for student housing is far higher than mainstream residential as it is an income-driven business and is far less management intensive than private rented housing.

To deliver this model across a number of other sub sectors of the market would, in all likelihood, require the use of a build-to-let approach where development 'profits' are taken to improve the yield.

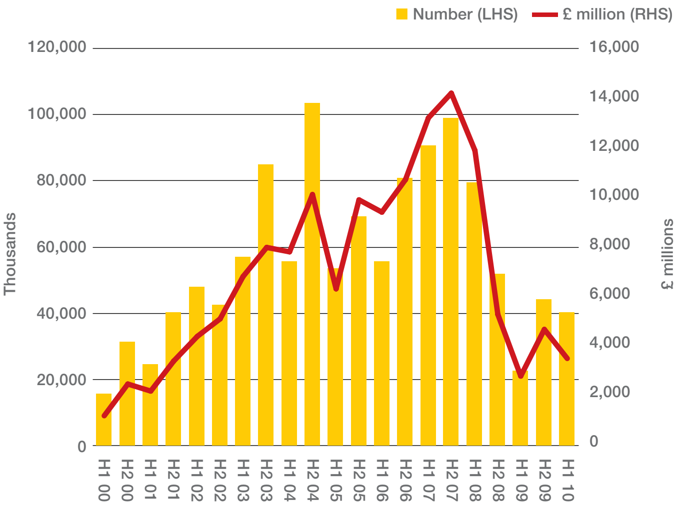
We expect significant appetite from large-scale investors for this type of rental asset, where the returns are closely linked to the income generated from the asset, and are less reliant on capital growth to enhance performance.

The house building industry will be at the forefront of the physical delivery of these units. Developers are already looking to move into these areas of demand to 'de-risk' larger development sites.

In this way the many challenges faced by the development industry may actually serve to become the catalysts for a wider investment market. ■

> Healthcare and student housing have proved that an essentially residential offering can create significant, viable income streams…

Graph 4.5
Buy-to-let lending



Source: CML

Mainstream rental

How the letting market is performing

Over the course of the downturn, the mainstream rental market remained more stable than the sales market. Although we have seen some rental price falls, the extent of these falls have been lower than experienced within the sales market. According to website findaproperty, the average UK asking rent fell from £870 per calendar month in January 2008 to £804 in January 2010 (an 8% fall). This fall reflected much higher levels of housing stock available to rent from accidental landlords.

However, a reduction in this stock from around the middle of 2009, combined with a strengthening of rental demand has resulted in a return to rental growth in the first half of 2009. This has allowed the average rent to return to within 4% of its peak by June 2010. ■

Summary

Land markets
House builders and developers need to substantially reassess what type of development remains financially viable in today's post credit crunch environment, and adjust to a different profile of home buyers.

Easy to develop sites for houses in high-value, high-demand areas currently rising rapidly in value. Therefore, house builders and developers are searching out and competing for small, serviced, 'oven-ready' sites in prime areas with an identifiable housing demand.

Despite the fact that the housing market recovering is fragile, developers' sales expectations have improved significantly since 2008.

■ *See pages 4 and 5*

Localism
The coalition government is keen to dismantle the old centralised and target-led mechanisms for delivering new homes and aims to replace it with a decentralised local planning system.

Localism will need to bring forward more not less land to meet the housing demand, particularly as the need for high density housing is less certain in current housing market conditions.

In the short term, growth in households will continue to outpace the construction of new homes by a wide margin.
To avoid the housing scarcity snowballing, the new planning system will need to be able to deliver financially viable development schemes swiftly.

There is uncertainty over the availability of public finance contribution as a result of current spending reviews. This means new partnerships, funding structures and delivery models could be as vital a part of delivery as the planning regime itself.

■ *See pages 6 and 7*

New homes
The Home Builders Federation states 85% of home builders considered mortgage availability to be a constraint on demand.

With owner occupiers currently more reluctant to buy off plan, preferring to see their potential new homes at or near completion, a stalemate has emerged between developers and lenders.

There is a greater focus on larger units for family buyers and downsizers who have the equity to operate in a mortgage-constrained environment.

■ *See page 10*

Residential investment
The private rented sector has witnessed a renaissance in the last decade, taking up 13% of housing stock in 2009. We believe that not only will young and transient households continue to rent privately, but there will also be a rise in rental demand from young families and relatively affluent households.

Direct property investment will become more difficult for those without significant equity stakes. The future of the sector is therefore mainly dependent on the participation of corporate entities rather than individuals.

Private investment is far less accessible, however, the underlying credentials of residential investment have not been eroded. It does mean that different investment vehicles need to be considered, where the model is more weighted towards income yield and regular cash receipts.

■ *See pages 11, 12 and 13*

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An in-depth look at the UK residential housing market, including long-term forecasts for house price growth.

Spotlight on… New Build Housing

The latest research findings relating to residential development in the UK.

Spotlight on… Student Housing

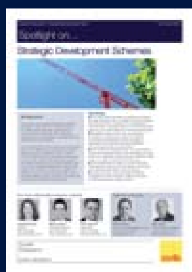
Trends and analysis relating to the performance of student housing in the UK.

Market in Minutes… Prime Residential

A performance analysis of prime residential markets in central London.

Market in Minutes… Development Land

As signs of stability emerge in the UK land market, residential and urban land values are rising.

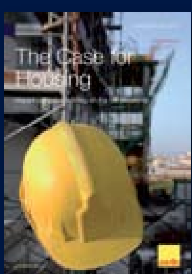


Spotlight on… Strategic Development Schemes

Providing insight into the changing state of the development landscape.

Spotlight on… The Prime Rental Market

Investigating the current market conditions of the prime rental market.



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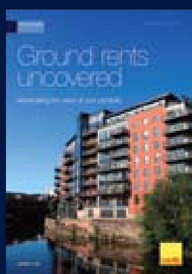

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