

Spotlight on... New Build Housing

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Identifying viable schemes that meet a new profile of demand is the major challenge facing developers in a changing market

Executive summary

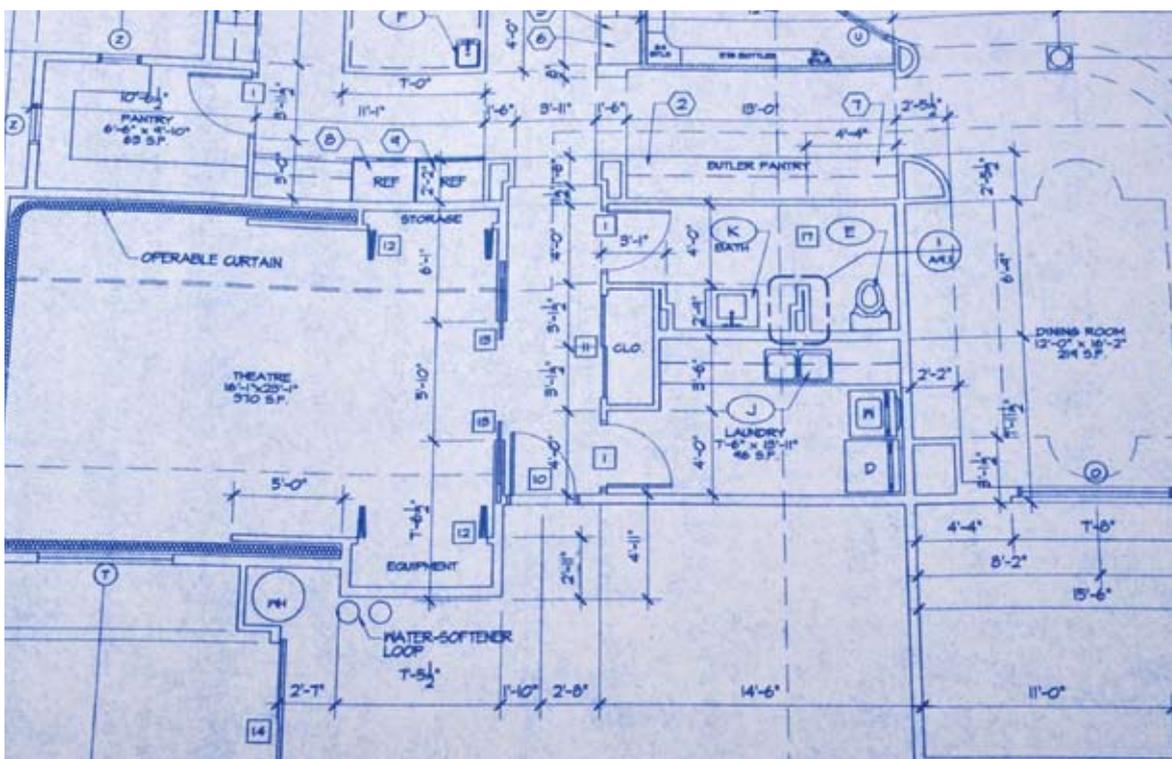
- Whereas the market was awash with new homes in 2008, sales activity in 2009 and early 2010 combined with low construction starts (now below half of peak levels) means new homes are becoming an increasingly scarce commodity.
- Lack of affordable debt finance continues to be a real constraint for the new build sector, in terms of financing for a development and also for purchasers requiring mortgages.
- In London the change in market conditions has been the most marked, particularly the prime markets of central and South West London, where shortage of supply and strong demand has seen buyer activity and prices back to peak levels.
- Owner occupier demand is dominated by cash and equity-rich upsizers and the fortunate first time buyers able to call on the 'bank of mum and dad'.
- Correspondingly, across all markets we are seeing a move to quality with buyers looking for schemes in established locations, which offer space and a good specification, capable of meeting an increasing pent up demand.
- Quality schemes are again able to command a new build premium.

- The investor market has been slower to recover, although overseas investors exploiting exchange rate opportunities are buying off-plan in London and have been a key driver in these prime markets. There is little foreign investor activity outside of the capital.
- The major challenge for developers going forward will be identifying and delivering viable schemes that meet this new profile of demand in order to achieve pricing and rates of sale that balance costs and debt constraints.

Market overview

The resurgence in activity among purchasers of new homes began with improvements in reservations in the second half of 2009. Activity and sales levels were most pronounced in the South of England, where issues over scarcity of stock in both the new and second hand markets led to price rises.

Although activity levels have improved, transactions remain near 50% below peak levels, with access to mortgage finance and availability of stock affecting the ability of purchasers to commit. With the reduction in turnover over the downturn we estimate 1.5 million households, who would have moved home in a 'normal' market have failed to do so. The resulting low turnover market creates real challenges, both in terms of rate of sale and sustained house price growth. Successful developers will need to create opportunities to add value.



New Homes Market Activity

Initial indicators suggest that during the election period a lull in activity took place, in common with many previous elections. According to Savills own market data, in the first quarter of 2010 reservations of new properties increased month-on-month and were 20% higher than at the same time last year.

Applicants looking for new homes are now more willing to commit and the applicant to reservation ratio for new property has halved since the first half of 2009. While increased activity and more positive sentiment are undoubtedly a good sign for the new homes market, the market place is not yet fully functioning and challenges still exist for new homes sales and new schemes in the development pipeline.

Who's buying?

One of the most significant shifts within the new homes sector has been in the types of buyers looking at new build property. From what was previously a market place dominated by investors (accounting for over two-thirds of Savills new homes sales in the run up to the downturn), owner occupiers are now becoming more dominant. This has had major implications for the saleability of current schemes as well as for the type of new developments, which will be most successful in the future.

■ Investors

In the first quarter of 2010 investor purchasers accounted for 16% of all Savills new homes sales. These investors are now looking at strong investment returns over the longer term as opposed to being vulture buyers looking to make a short term profit through buying at a substantial discount.

This demand is still strongest within the central London market, although it is increasingly noticeable in other regional city markets particularly in the South of England. Compared with the market pre-downturn these buyers are on the whole equity-rich, larger scale investors rather than mortgage reliant buy-to-let landlords.

Overseas investors, most prominent within the London market, are accounting for an increasing proportion of new home sales. Generally they view the UK as

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a relatively secure investment and are able to take advantage of house price falls in conjunction with favourable exchange rates. In London off-plan investors have returned to the market, where South-East Asian investors are actively purchasing property in many established and emerging London postcodes.

Outside of London both investors and owner occupiers tend to be domestic buyers, with overseas investors yet to invest in significant numbers in non-London schemes.

After the uncertainty pre-budget over the rise in Capital Gains Tax (CGT), the immediate implementation of the new 28% rate means that the feared sell off by investors and second home owners has not happened. While 28% CGT is undoubtedly better than the pre-budget speculation that it could rise to 50%, it could still act as a barrier for new investors coming into the market, who may look elsewhere for alternative and more liquid forms of investment.

With these measures potentially discouraging investment activity, and households finding it difficult to access the owner occupied sector, increasing pressure will be put onto the private rented sector as demand increases. This will inevitably push up rents and push out yields, and, in turn, will encourage more investors back into the buy to let sector with a focus firmly on yields.

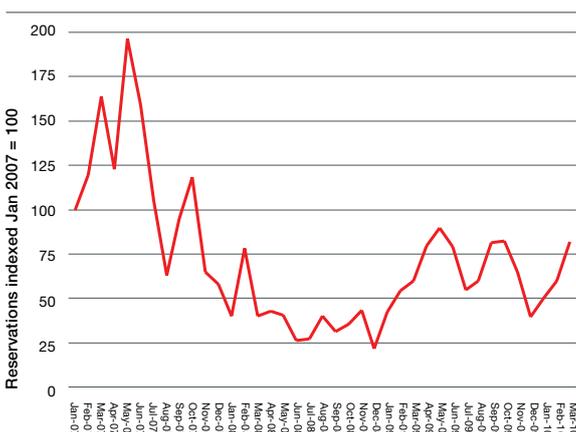
■ Owner Occupiers

Owner occupiers now make up the majority of new home buyers across the UK, accounting for more than 80% of Savills new homes sales in 2010. This shift in buyer type has major implications for the industry, with owner occupiers buying much later into the development process than investment driven buyers.

The historic dominance of investor purchasers in the flat market in particular, has previously excluded owner occupiers from new schemes, with off-plan sales pre-completion meaning that by the time developments near completion very few units were available for open market sale. The recent shift in the balance of buyer type means owner occupiers now have a better choice of completing schemes, but quality and space remain a prerequisite. Consequently it is the quality schemes in more established locations that are proving most popular with buyers in current market conditions.

Looking ahead successful developments will need to build to owner occupier requirements rather than building for yield driven investor buyers. Already this has resulted in a shift back in emphasis towards houses, but where flats are built an improved specification as well as a higher proportion of larger units will be required. This could mean the standard size, for, say, two-bedroom flats increases to 750 to 800 square foot rather than the investor model of 650 square foot.

Graph 1.
Savills new homes reservations



Source: Savills

■ **First Time Buyers**

First time buyers have historically accounted for a significant proportion of owner occupiers buying new homes. With constraints on access to mortgage finance, first time buyers were faced with loan to value barriers, as mortgage availability tightened through the downturn. Average deposits needed by first time buyers now total almost 100% of their average annual income, up from under 40% in 2007. Raising such significant deposits means that many first time buyers now require assistance to become owner occupiers.

As a result, an increasing number of first time buyers have help from the 'bank of mum and dad'. According to the Council of Mortgage Lenders 70% of first time buyers are now helped with deposits compared with 45% pre downturn.

In the current low interest rate environment many parents are choosing to invest in property for their children over deposit accounts. Analysis of our new homes purchasers reveals a high proportion of interest from parents buying outright for children of university age, as well as those giving older children a helping hand onto the housing ladder. This has been particularly prevalent in the south of England, where these types of buyers account for 35% of all purchasers.

Those first time buyers without parental assistance have been more reliant on equity loan schemes such as Homebuy Direct, which has been important in supporting new homes activity across the UK, by addressing issues of deposit affordability. However, the future of such government initiatives remains uncertain.

Looking ahead it will be important to continue to offer this type of product to give more first time buyers access to housing. Any easing of loan to value ratios is expected to be gradual and while Bank of England figures indicate this process has started, including the provision of new mortgage products that tap into the equity held by parents, further use of shared equity ownership will be needed to re-establish a high turnover market.

The regional picture

Results from Savills new homes indices have shown increased levels of activity in the southern markets of Bristol, Southampton and London, where scarcity of new build stock is helping to support growth in prices achieved. There remains a distinct difference between quality, best in class developments, which are achieving premiums, and standard schemes which still struggle to attract buyers.

More established markets, where demand remains strong, have also experienced impressive growth. In towns such as Sevenoaks in Kent best in class new homes are now selling at close to their 2007 peak value, which is due to scarcity of supply and strong local and commuter driven demand.

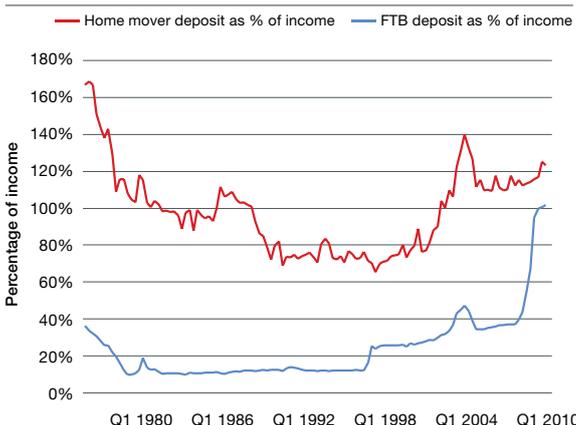
The new build market in established prime areas of London is buoyant. Scarcity of stock coupled with increased buyer appetite has led to prices nearing those of the 2007 peak and there are cases where sales are achieving or even exceeding peak prices.

International buyers dominate the upper end of this market, with high profile transactions taking place on those schemes which are able to offer units at, or close to, practical completion. Although this comprises only a fraction of the wider market, activity within central London has been filtering out into more mainstream London markets and the commuter belt where mortgage constraints are more of an issue.

In Scotland levels of new homes transactions are recovering, with reservations up 22% year-on-year and site visitors up 35%. Use of incentives has been widespread, with both part exchange and shared equity offered to encourage purchasers into new developments. New build prices in Scotland remain 13% below 2007 peak levels.

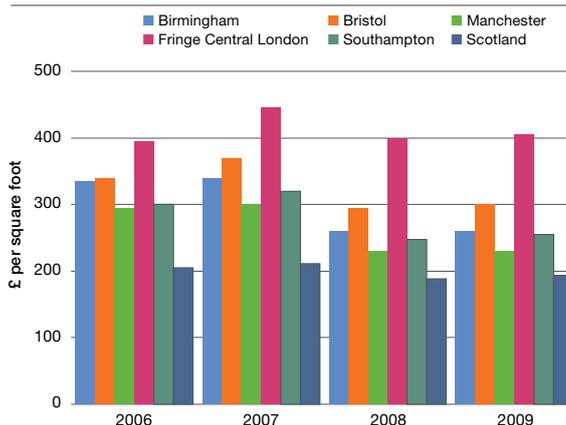
“In Scotland levels of new home transactions are recovering, with reservations up 22% year-on-year and site visitors up 35%.”

Graph 2.
First time buyer deposits



Source: CML / Savills

Graph 3.
Average £per square foot by location



Source: Savills





Although the new homes market in the Midlands and North of England have yet to see such a marked recovery as London and other Southern markets, the levels of buyer interest are increasing and well priced, quality stock is selling.

The impact of downturn mothballing means that new build schemes, even in areas where high levels of stock have been previously delivered, are becoming harder to find. Prices remain up to 20% off peak levels, however, the best schemes are managing to command a 'new build' premium once again. The schemes struggling to sell are either located in emerging residential areas, or built at sizes and levels of specification which appealed to pre-downturn investors.

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The future for new homes

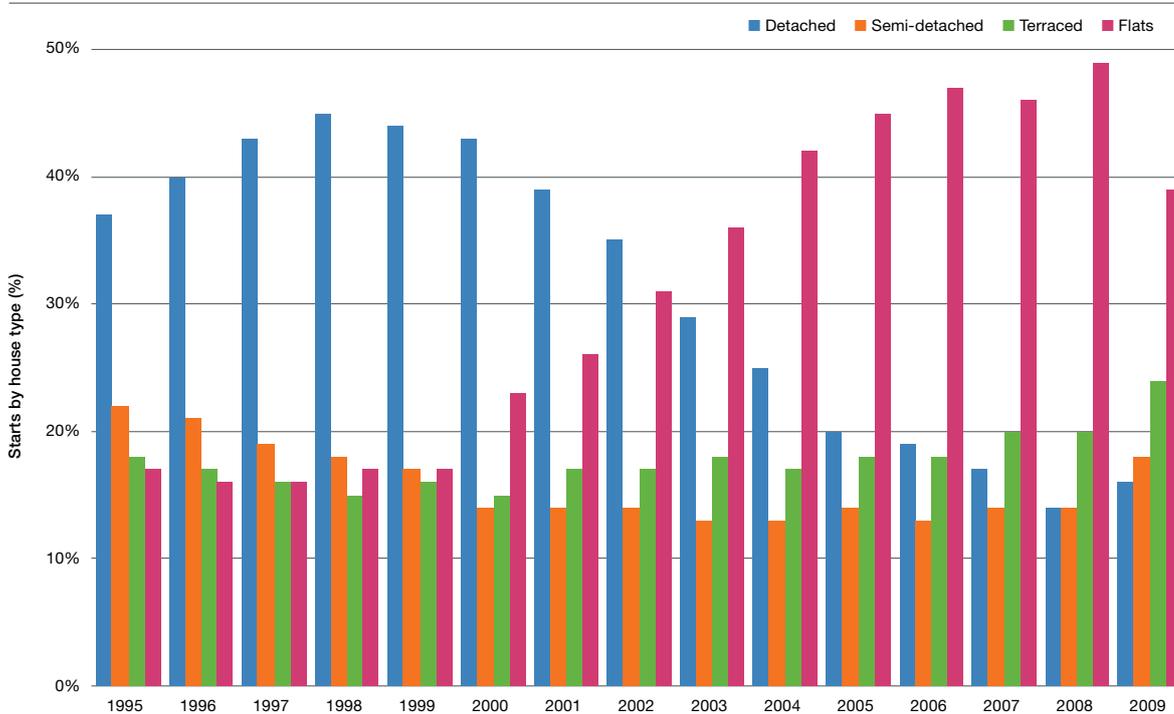
Although government targets for new housing appear high at a national level, the issue over where stock is delivered remains, and on a UK wide basis there is excess demand for housing. However, the supply demand imbalance is often in areas where the least stock is delivered. Even accounting for spill out demand, it is vital that demand and location are considered before development takes place.

London and the South East, where the imbalance is most acute, can absorb higher levels of supply and have been seeing the earlier signs of a return to more 'normal' market conditions. However, the speed and extent of the recovery have been both location and type specific. For example, houses in more established areas of prime South West London have outperformed flats in high supply areas to the east of the City including the Docklands and Canary Wharf.

We expect that the performance of new build property will differ in the North of England, where growth levels are likely to be lower, particularly in markets where future supply levels could be high.

Dwindling levels of new stock, (new housing starts in 2009 were 51% down on peak levels), mean that buyers have a limited choice, and although levels of demand remain below those of the 2007 peak, a lack of supply means that the days of large discounts are over.

Graph 4.
Housing starts by type



Source: NHBC

Future Supply

The stock issue looks set to remain for some time yet, with completions not forecast to return to peak levels for at least six years. In a more risk averse market place developers have been looking more closely at their land banks and permissions. For instance, the latest housing starts figures already show a reduction in the proportion of flats being developed.

The upfront costs of large flatted schemes, compared with housing developments, means that for many developers smaller house schemes are becoming the most viable option.

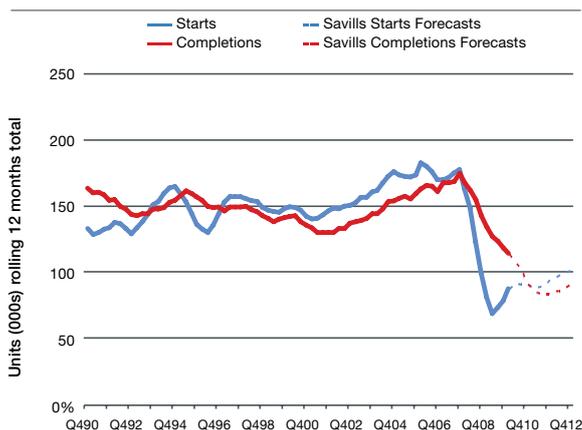
However, we do not believe this is the end of the new build flat, even if the development market is likely to be a more conservative one.

Access to debt will undoubtedly remain more difficult for some time, creating issues for less cash rich developers and those landowners with schemes which require high levels of upfront costs. Build costs, combined with increasing obligations and costs associated with Section 106 agreements and infrastructure will also challenge developers' viability calculations.

Even with the change in Government, the commitment to new sustainability codes look set to remain. The cost of meeting codes 5 and 6 is estimated to add between 13% and 26% to average build costs, a fact which will need to be addressed in order that future household projections are met.

Although viability challenges will mean that some flatted and house development remain unviable, there are a number of markets where development will make economic sense. It will be vital for developers to find places to deliver flatted and larger scale housing developments, not just small house developments in established locations.

Graph 5.
Starts and Completions – National



Source: CLG / Savills

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Summary and outlook

■ The lack of development finance continues to directly affect the new homes market and with the removal of initiatives such as Homebuy Direct and the increases in capital gains tax for investment properties and second homes, the new homes sector looks set to face other hurdles looking ahead.

■ It is vital for the health of the new homes sector that we can return to a fully functioning housing market. This will require the easing of financial constraints and incentives, rather than barriers, to developers, helping them to deliver higher volumes of product to meet demand.

■ Those developers in a position to take advantage of the improving market conditions must make sure they

maximise site potential and build product, which most appeals to the local market. However, this must be done without saturating markets, particularly given continued low transactions levels across the housing sector.

■ The return to quality offers a real lesson for developers, with good quality, well designed developments being able to maintain both rate of sale and build new build premiums.

■ To enable volume sales within the sector, a diverse spectrum of product, that pays more attention to the needs of the owner occupier, must be delivered in conjunction with new tenure models/sharing of equity to enable first time buyers to access the housing ladder.

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