Spotlight on… Scottish Residential Development Land

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Small, easily developed sites set to outperform strategic land

■ **A degree of stability is returning to the Scottish residential development land market, driven by both an easing of homebuyer constraints in the housing market and a shortage of housing stock.**

■ **Land value growth still remains subdued, with land purchasers recognising serious long term constraints on the market.**

■ **Limited availability of debt funding remains the biggest of these constraints, with levels of lending by UK banks for development still falling.**

■ **A polarised land market has emerged in Scotland, with activity restricted to the smaller, readily developable, equity-funded sites that can be turned around quickly, creating cash flow.**

■ **The appetite for large, strategic sites is far more limited. The level of funding required for these is restricted. In addition, the cost of community infrastructure provision will increasingly be passed on to the developer as public austerity measures begin to bite.**

■ **We forecast that fully serviced ('oven ready') plots will see some renewed value growth in the coming years.**

■ **The value of bulk land is forecast to take even longer to grow. This is because a permanent, structural change dividing this type of capital and infrastructure hungry, long term site from the more easily developed and financed, less costly, oven ready site has emerged. The market for each type of land will be very different going forward and will involve different players.**

■ **If the Government wants many large sites to get off the ground in coming years, then carefully thought out and far reaching measures will need to be instigated to enable this.**

Scottish home builder sentiment has improved significantly

The UK and Scottish development land markets are emerging from a period of dramatic falls. As we embark on a new decade, we find ourselves in a very different land market to that of the noughties.

At the end of 2009, Scottish land values stood some 58% below their 2007 peak in the case of greenfield land, and 62% for urban land. These falls are slightly steeper than the UK average falls of 54% and 58% respectively (although not as severe as in some UK regions, such as the North of England). It should be noted that local conditions in high value areas are now significantly improved over the Scottish average. With some improvement in economic conditions, home builder sentiment has improved in certain situations and some renewed value setting is occurring. A stabilisation of the land markets has gone hand in hand with an easing of homebuyer constraints in the housing market and a lack of newly built housing supply, following the very low output of recent years.

The housing market context

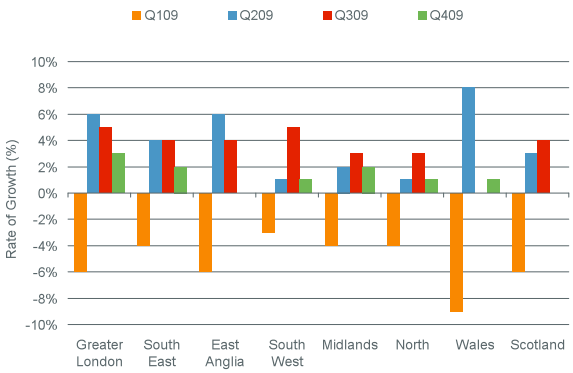
House prices saw modest value growth from the second quarter of 2009 (Figure 1), with values in 2009 ending 3.4% higher in the UK, 1% in the case of Scotland, according to the Nationwide index.

On the back of this, Scottish housebuilder sentiment has improved significantly since the second quarter of 2009 and, in turn, land values in Scotland saw a slight rise (Figure 2). The strong correlation between land prices and developers' sales expectations reflects the close inter-relationship of anticipated housing demand and land price growth.

Development debt funding remains constrained

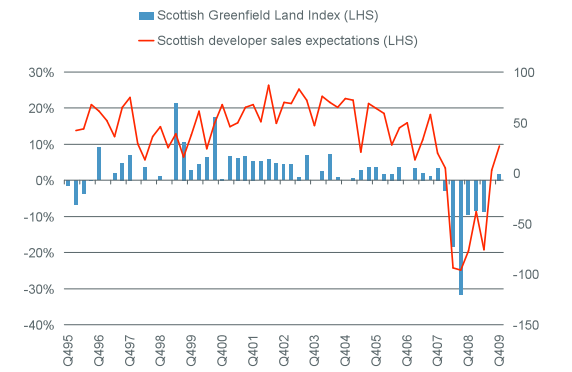
The development boom of the mid to late noughties was fuelled by easy access to debt funding. Lending for development activity by UK banks saw steady growth between 1997 and the market peak of 2007. The credit crisis and subsequent recession curtailed this source of finance, leading to a drying up of development activity. The amount of new lending in 2008 was 41% lower than in 2007, as shown in Figure 3 (across all property sectors). Despite the recent fall in levels of lending, the amount of outstanding debt stands at record levels.

Figure 1.
Residential values continue modest growth



Source: Nationwide

Figure 2.
Scottish housebuilder sentiment versus land prices



Source: Savills Research, HBF

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At mid-year 2009 the value of outstanding debt secured by property across all sectors in the UK was estimated to be approaching £300bn, with that in Scotland around £20bn. Of this, 10% of the value of the aggregate loan book was attributed to residential development.

In a lending market that has almost ground to a halt, combined with a significant debt burden (a third of which is due for repayment by the end of 2011), the outlook for new lending is poor.

The lack of debt finance is going to continue to limit the demand for land, especially sites needing extensive and long-term investment. With UK banks already extensively exposed to property from this period of high lending activity, it will be some time until appetite returns. Where debt funding can be obtained, securitisation will be an issue. This will be easier for schemes delivering houses, but very difficult for those with permissions for flats, with the market for such a product so diminished. In common with the rest of the UK, the biggest constraint on development activity in Scotland is the lack of development finance (Figure 4).

This has been cited as the most significant constraint by Housebuilder Federation Members since June 2008. Compounding this further, planning delays have once again been cited as a major constraint on development in the most recent HBF survey. Many developers are looking to renegotiate permissions granted before the credit crunch to more favourable terms.

An unsettled policy outlook

Government grants and assistance are likely to fall away significantly in the coming years, as public sector austerity measures take hold after the General Election. At this point, Section 75 pressures will really start to bite on viability and delivery of sites.

Operators will need to look towards channelling Section 75 payments effectively so that they add to the value of the site as well as fulfilling social and local needs. This will be particularly important on the largest sites, where these costs will be greatest. The best operators going forward will be those who can turn otherwise adversarial relationships into partnerships working toward a common goal.

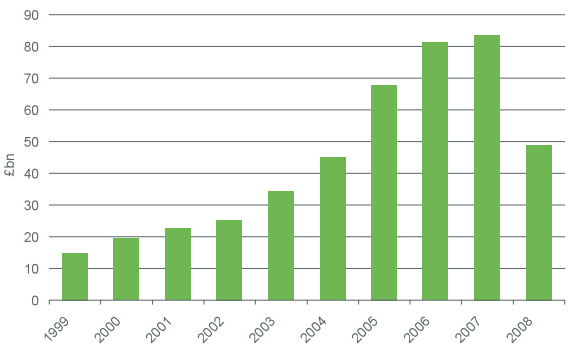
Polarised land market

Against this backdrop of restricted debt funding and an uncertain policy outlook, we anticipate a polarisation of development land markets over the coming years. Land activity will be limited to the most readily developable sites, often with infrastructure and planning permissions already in place. Large strategic sites, by contrast, will see limited interest as sources of funding remain restricted.

National urban land values rose by 2.7% in the last quarter of 2009, above the UK average of 1.9% for larger Greenfield sites. In Scotland this trend was even more pronounced, with urban values up 6.2% in the fourth quarter of 2009 and greenfield values up just 1.7%. This reflects increased interest for small sites in urban and urban fringe locations, which are ready-serviced and require little remediation. Critically, these plots are less cash intensive and can be turned around quickly, assisting cash flow. Development on these sites is very different to the large city centre flatted schemes which were common before the downturn.

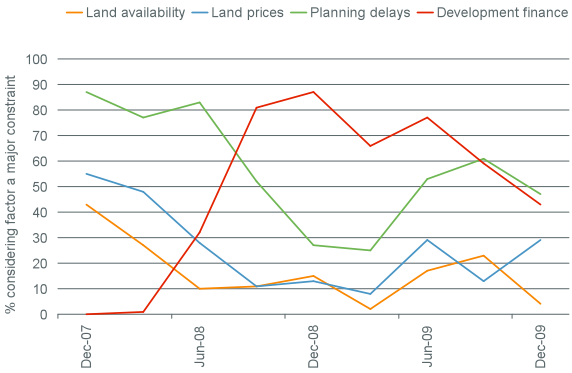
The outlook for large, strategic sites is less positive. In the fallout of the credit crunch, availability of debt finance will remain limited, with banks cautious about

Figure 3.
Property lending levels fall significantly



Source: De Montfort University

Figure 4. Development finance the major constraint on development in Scotland



Source: Housebuilders' Federation

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lending for real estate and development investment. The number of players with the capability to take on this kind of site will be few as Government increasingly passes the provision of community infrastructure to the private sector. Meanwhile, recognition that future permissions will be burdened with costs of sustainability will hinder viability. These factors will keep values of this type of land suppressed for some time to come.

Many developers are looking to renegotiate pre-credit crunch permissions

Stock levels

In the Scottish new homes market, housebuilders have benefited from a lack of second hand stock. Consequently, housebuilder stocks have been snapped up by the cash rich buyers active in 2009. However, despite demand picking up, new completions continue to languish (Figure 5).

As a consequence, total completions remain well below Scotland's requirements. Pressures on supply are set to increase, with the number of Scottish households predicted to grow by 4.4% between 2010 and 2015.

With household growth in mind, in 2007 the Scottish Government set an ambitious target of 35,000 completions per annum by 2015. These are levels not seen since the public housebuilding boom of the 1960s and 70s. By contrast, there were 22,044 completions in 2008, and even during the 2007 market peak only 25,748 were achieved. Significant government intervention will be required if completions are to reach anywhere near this target.

Total completions remain well below Scotland's requirements

Local and regional impacts

In Scotland, urban plots and small greenfield sites are already seeing activity, and strongest associated value growth (Figure 6). Although historically this type of land has seen more modest value growth compared with large greenfield sites, in today's more cautious market it is these lower risk, easy to develop sites that have recovered soonest. For instance, small sites have dominated transaction activity in and around Edinburgh, particularly those under 1 acre in size.

Trends in land value growth within Scotland suggest some variation in the patterns of recovery (Figure 7). This is particularly apparent when focusing on Scotland's two largest cities. Edinburgh saw total value falls from peak for greenfield land of -57%, and -60% for urban land, while Glasgow saw falls of -62% and -62% respectively. In the last two quarters, Glasgow has failed to register growth, while Edinburgh has picked up by 3% (greenfield) and 7% (urban).

Edinburgh's stronger underlying demand profile and more buoyant housing market is at the root of this. Glasgow meanwhile has suffered from oversupply of large flatted schemes in recent years, which has suppressed appetite for new investment.

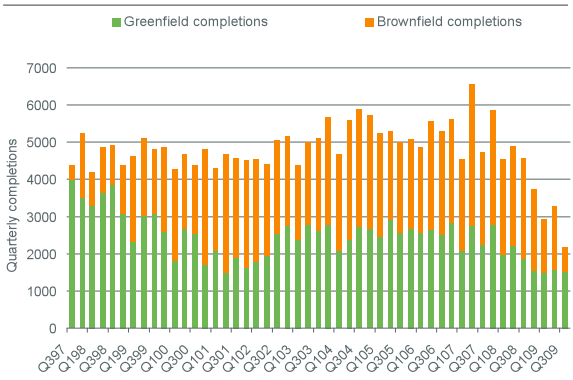
Furthermore, Edinburgh has stronger long term employment prospects than Glasgow, with 10.6% growth in employment forecast between now and 2020, compared to 5.2% for Glasgow over the same period, according to Oxford Economics.

Scottish Development Land Forecasts

We forecast the value of serviced plots will see growth over the next few years, while bulk land values will remain static, as the markets for serviced and bulk land diverge (Figure 8). In a constrained lending environment, and with an increasingly uncertain policy outlook, developers will concentrate on easy to develop sites as a secure cash flow stream.

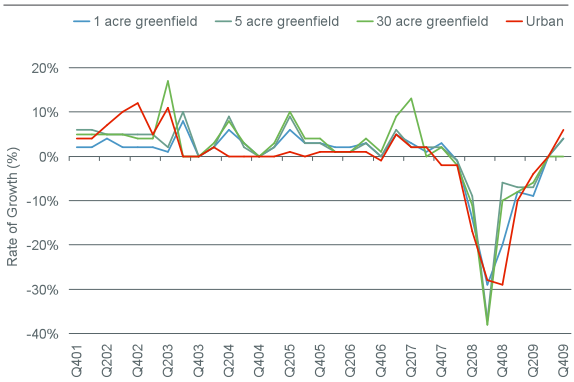
We expect the value of bulk land in Scotland to remain static at low levels for several years to come, as constraints on developing large strategic sites resonate. Debt finance will remain extremely limited, while regulatory pressures will only increase. When modest growth does resume towards the middle of the decade, levels will remain subdued. By this time, some astute players may have found ways to deliver this type of site (through the parcelling up and selling on of serviced plots) but their numbers will be small. ▶

Figure 5.
Scottish residential completions



Source: Scottish Government CAS

Figure 6. Urban land and small greenfield sites now strongest performers in Scotland



Source: Savills

- Without some significant policy changes and government intervention, the market for this type of land will never truly recover.

The case for investing in land

The difficult medium term outlook for bulk land does present some opportunities. For those with cash, there is potential to purchase clean land now, service and mature the consent and sell on to a housebuilder on a planned basis.

While bank lending remains restricted, competition for the longer-term sites will be limited and the best deals can be done in this window.

The challenge will be convincing land owners to recognise the sea change in the development land markets. It is no longer possible to sit on unserviced land and simply wait for its value to rise. Active investment and place management are required to deliver a serviced product appropriate to today's market

This means delivering family housing, not flats, on the outskirts of Edinburgh and other Scottish cities.

Summary and Outlook

Current Trader

Activity in today's development land market is limited to the most readily developable, de-risked, fully serviced sites. With debt funding for large development projects scarce, and likely to remain so for some time, appetite for strategic sites and bulk land is limited. A potential change of UK government means an unsettled planning and policy outlook, while ambitious sustainability targets may render many projects unviable.

Sites that are trading in the current market are small, typically less than 100 units, either equity driven, or with phased payment terms. In our view, this is a sign of a longer term trend. For the foreseeable future, the activity of mass housebuilders and developers will be focussed on building out low risk sites for cash flow. This means small sites and serviced plots for houses, rather than flats. Consequently, the market value of these types of sites will grow faster than that of bulk land, reflecting their de-risked nature.

This will translate to strong growth for small, easily developable sites in high value, high demand, low supply markets.

To develop strategic sites, a long term placemaking approach will be necessary

A new model will emerge

With the absence of ready debt financing, the outlook for bulk land or strategic sites remains poor, unless operators are willing to innovate and break from the 'current trader' model. To develop strategic sites in the current climate, a long term placemaking approach will be necessary.

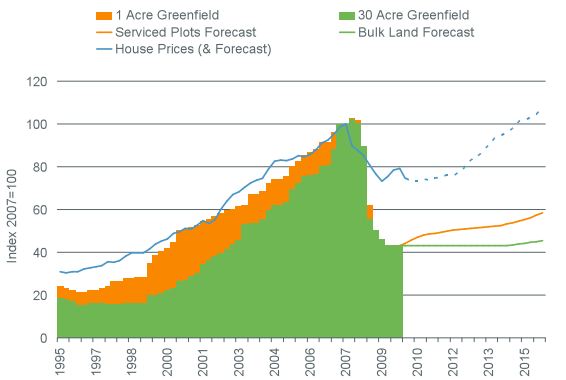
Landowners or lenders will need to take a long term interest, retaining property over a longer period in some form of co-ownership, or gradually releasing serviced sites in a phased manner. This approach will reap the benefits of early investment in place, via high quality layout, infrastructure, mix of uses and public realm.

Getting the design detail, financing and management structures right is key to this approach, as is effectively channelling Section 75 payments for the benefit of the developer. Only the most able players will be successful here.

Figure 7.
Return to land value growth, Glasgow lags

Source: Savills Research

Figure 8.
Serviced plots to recover ahead of bulk land



Source: Savills Research

Residential research services

Savills has had a dedicated residential research team for the past 18 years. Based in London, the team provides advice and analysis to clients, on all aspects of the residential market. The department has built up a strong reputation for producing accurate, well-informed and independent analysis and commentary on the UK's housing market.

The team is a leading national commentator on housing market trends. The success of the department has been built on its market insight, provided by the Savills network, in conjunction with a significant external consultancy business.

This market-led approach to our research is vital to our clients. Through the provision of analysis, commentary and forecasting we can add value to both assets and businesses. The department has been involved in a wide range of consultancy projects for public and private sector organisations across the UK. Typical consultancy projects include:

- Local area supply and demand analysis
- Research to support planning applications and development feasibility studies
- Investment strategy and advice
- Place-making site studies and research into housing-led regeneration
- Forecasting rents and capital values
- Research to inform policy making and statements of best practice
- Research for property finance and business planning purposes

Scottish development and planning

The Scottish Development team concentrates on providing inclusive advice and transactional services to both landowners and developers, ranging from one unit through to major mixed-use development schemes. Current clients include limited companies, PLC's, banks, residential/mixed use development and private individuals.

Working closely with our Commercial, Valuation, New Homes and Research teams we are able to offer our clients a completely comprehensive service.

Savills is the market leader in the development sector. We offer one of the very few genuinely mixed development services, which is carefully researched and expertly delivered. It is an integrated service, which progresses development from the identification of an opportunity through to the implementation and letting or sale of the completed project.

The Development team provides incisive advice to landowners, developers, operators and occupiers. Expertise and experience of mixed development schemes are combined with the specific skills relevant to residential, leisure, retail and commercial development.

Our services include:
- Development consultancy
- Sales and acquisitions
- Valuations
- Strategic development
- Planning
- New homes

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Savills plc
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A unique combination of sector knowledge and entrepreneurial flair gives clients access to real estate expertise of the highest calibre. We are regarded as an innovative-thinking organisation backed up with excellent negotiating skills. Savills chooses to focus on a defined set of clients, therefore offering a premium service to organisations with whom we share a common goal. Savills, which is synonymous with a high quality service offering and a premium brand, takes a long-term view on real estate and investing in strategic relationships.

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