SAVILLS RESEARCH

Coronavirus and residential development

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Where are we now?

Seven weeks in to the UK's lockdown, slightly more clarity around the impact on development and the wider residential market is starting to emerge. The Nationwide house price index recorded 3.4% price growth in April. However, these values reflect sales that exchanged contracts before the lockdown began.

In the latter half of March, sentiment fell sharply; the RICS sentiment survey showed the biggest one month fall in new buyer enquiries and sales instructions. As these measures are falling in tandem, it suggests no substantial change in the relative balance of supply and demand. However, it does point to a sharp fall in transactions. Transactions were -11% below their five year average in Q1 this year. and -17% below average in March. The latest data from Twenty CI suggests a significant contraction in sales in April across the market as a whole, with agreed sales falling by about 80% year on year. Continuing lockdown measures mean we expect to see similar figures for May, and annual transactions to be around 620,000 in 2020, half of what we forecast in November 2019. We anticipate average values could fall up to -10% over the course of 2020, off a small number of transactions.

At present, there is little activity in the development land market, and its recovery will be linked to sentiment in the wider housing market and housebuilders' ability to resume construction. There are indicators that suggest longer term optimism; there remains significant appetite for strategic sites, and construction will recommence on around 100,000 homes across England and Wales in the first two weeks in May.

A pause in the land market

As the land market is based on longer time horizons, the effects of the lockdown have not been as abrupt as they have been on construction. The latest results of our land index showed land values remaining relatively flat, with UK greenfield land values growing marginally by 0.3% in Q1 after the 2019 election result brought more confidence to the market. This sentiment has understandably been muted by the current lockdown.

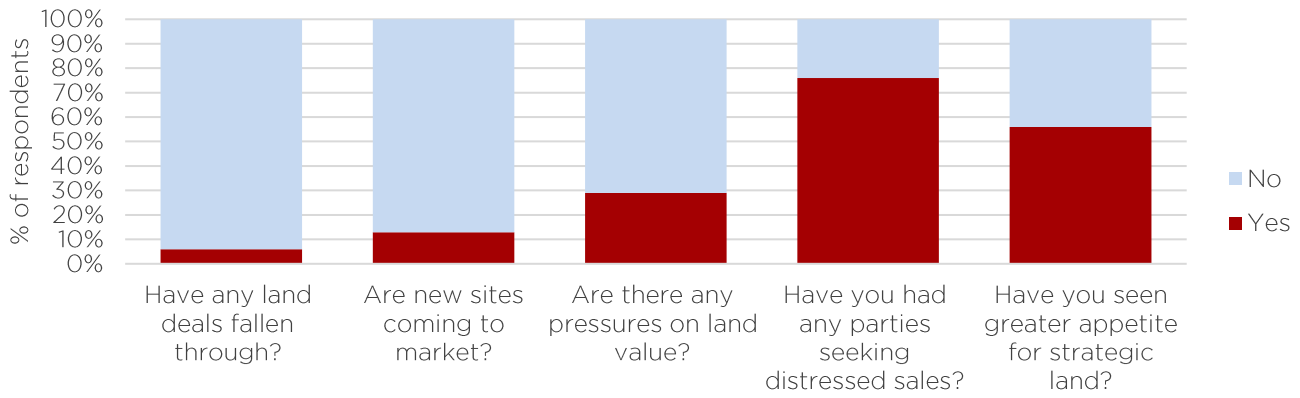
According to intelligence gathered from Savills Development agents across the country, deals are generally progressing at much slower rates and many have been paused due to lack of resource and uncertainty over the market. 94% of Savills agents surveyed reported no land deals had fallen through, but they are seeing more sites stalled, delayed completions and bid deadlines extended. New sites planned to launch for sale are being held back until the lockdown is lifted and there is confidence that new homes are selling again, according to 87% of Savills agents. This means there is likely to be a large supply of sites ready to be brought to the market when activity resumes post-lockdown. However, the pace of land release will be dictated by the pace at which housebuilders are able to resume building out and selling new homes.

Land values are largely holding up, with deals achieving the same values as agreed before the lockdown. 31% of agents reported pressures on land value but there isn't sufficient transactional activity yet to measure the magnitude of any fall in value. There is greater caution around the timing of deals rather than discounted values as many seek to push payments out and look for lower risk payment structures with lower upfront costs. Deferred payments and purchases subject to planning have become more attractive as parties can retain cash and minimise risk.

Interest from opportunistic buyers

Although 76% of agents reported appetite from opportunistic, cash rich investors for distressed sales, there is no evidence of forced sales yet. Furthermore, there has been no increase in cases of bulk deals to Build to Rent operators or housing associations than prior to the Covid-19 outbreak, but these bulk deals are likely to become more common the longer the new build market takes to recover.

Figure 1 Impact of shutdown on the land market



Source Savills Research agent survey

While the major listed housebuilders have largely paused new land spend and are focusing on cash preservation, privately funded housebuilders are still active and searching for good deals in the land market. Although there is still appetite for the right type of site, the major housebuilders are constrained by a lack of resource due to furloughed land and technical support teams. Where housebuilders are gearing up to returning to site, resource is being further diverted away from new land spend.

Some housing associations remain active in the land market, especially those supported by Homes England funding for additional affordable housing. However, there are some providers that have scaled back their land spending due to uncertainty over rent policy, exposure to sales risk and the need to direct funds towards improving existing stock to meet new safety standards.

Due to its long term nature, strategic land is less impacted by short term fluctuations in the market than immediate land. 53% of agents reported greater interest in strategic opportunities and more willingness from parties to consider longer term opportunities with less upfront capital expenditure.

Development activity

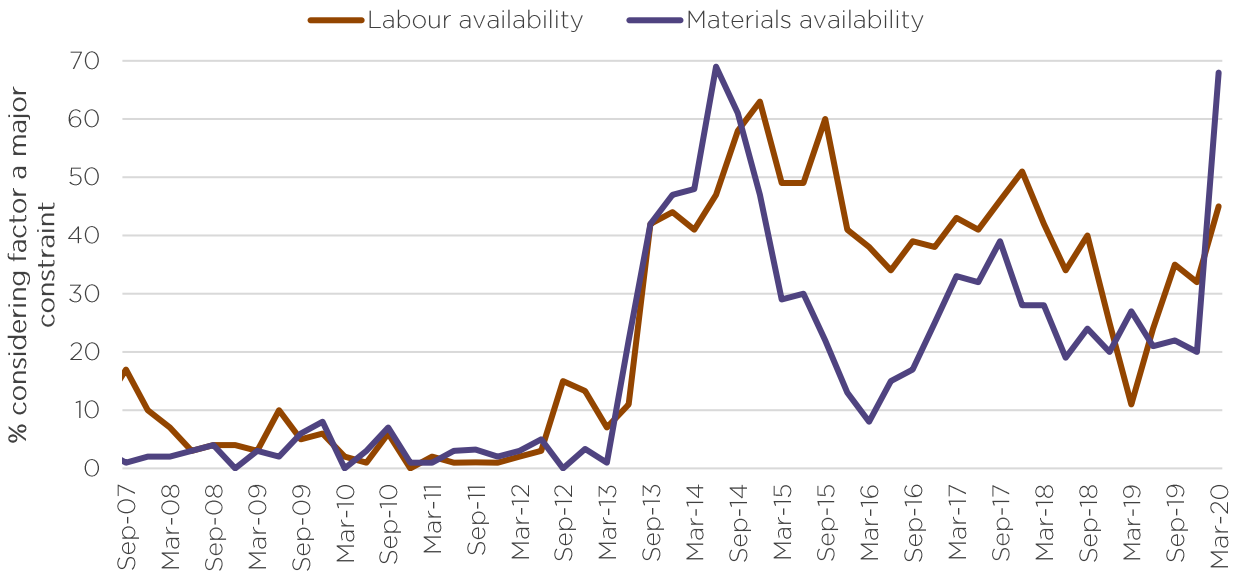
At the start of April, 59% of private housebuilding sites were closed, but the situation has been changing rapidly. Sites that have closed across the UK have capacity for 349,000 homes, but developers and contractors are increasingly confident that they can reopen sites while adhering to social distancing guidelines. In England, sites with capacity for 95,000 homes are planned to reopen within the first two weeks in May, up from 7,000 homes in the last week in April. Sites with capacity for 5,500 homes will open in Wales.

Clearly the suspension of development in April will have a knock on effect on housing delivery and new homes sales this year, and it remains to be seen how far social distancing measures will impact build periods, but these figures show that the fall in delivery may be less drastic than had been previously feared. Assuming housebuilders are able to work back up to 80% of their previous capacity by the end of the year, we would expect the rate of delivery to be 30-35% below 2019 output.

The main exception is Scotland, where all non-essential construction sites have remained closed. We have identified sites with capacity for 37,000 homes that are closed, equivalent to 1.7 years of housing supply.

As housebuilders prepare to open construction sites, they face the challenge of ensuring social distancing on site but more so disruption to their supply chains. Availability of materials has rapidly risen as a major constraint for major housebuilders as reported by the HBF Survey, jumping to 68% considering it a major constraint in March, up from 20% the previous quarter. Difficulty securing materials will continue to serve as a major constraint as more construction workers resume activity on site.

Figure 2 Impact of shutdown on the development capacity



Source HBF

Planning and land supply

Planning consents held up well in March, but the flow of consents being granted has slowed in April. In England, the number of sites gained permission fell by 7% month on month to 326 sites. The falls in Scotland and Wales were much sharper, at 32% in Wales and 60% in Scotland. Some of this fall is likely to be attributable to delays in local authorities adjusting to virtual planning hearings.

There is however still a steady flow of applications, implying positive sentiment around the longer term outlook. Planning Portal reported that all planning applications were down 3.5% year on year in March, which is in line with the levels for January and February. Outline applications increased by 12% year on year in March, demonstrating the same appetite for long term opportunities as we have seen in the land market.

New build sales demand

Understanding how sales value and rates are performing will be an influential factor in housebuilders' land buying activity. However, only limited information is available at this stage.

Reservation rates for new homes have reduced due to sales centres being closed and prospective buyers unable to view properties. Site visitors and net reservations for new homes were down in March compared to a year ago according to the HBF, with a net balance of -58 and -42 respectively.

Persimmon have reported reservation rates of 50% normal levels whereas other developers have reported receiving a handful of reservations over the phone. Off plan sales are continuing to a limited degree, typically for schemes where these are common anyway, mostly in London and second home locations.

Although this is partly due to inability to view properties, it is also the result of buyer confidence and ability to get a mortgage. At the end of March, 59% of housebuilders surveyed by the HBF considered buyer confidence a major constrain on development. 40% stated mortgage availability also posed a challenge, an increase from 6% in Q4 2019. Reports from housebuilders on sales and cancellation volumes have been limited. Persimmon have reported that cancellation rates remain at pre-Covid-19 levels whereas Bellway have reported cancellation rates increasing to 27%.

In the medium term, new build sales could benefit from displacement of demand from the second hand market, as empty new build homes will be easier to view, value and move into once the lockdown is lifted but while social distancing measures remain in place. If buyer confidence is slower to return, we anticipate Build to Rent and affordable housing will play a greater role in absorbing supply.

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