Assessing the landscape for new homes, planning and development

London Residential Development

H2 2020

knightfrank.com/research

LONDON IN CONTEXT

London's new homes market proved resilient throughout the second half of 2020, during an unprecedented period which saw a second national lockdown, vaccine breakthroughs, the US election result, and Brexit trade negotiations dominate the news agenda.

Ten months on from the outbreak of the pandemic, there is a strong momentum in the London residential development market as housebuilders replenish their supply pipelines while low interest rates and a stamp duty holiday boost demand.

During the second half of the year, the property market was open for business leading to a strong recovery for London's housing market over the summer period. The market will remain open during the latest lockdown period to contain Covid-19, which will allow the momentum to continue.

Property prices in London rose 2.5% during the third quarter between July and September, according to the ONS, while in Prime Central London they grew 0.2% over this time frame – the first quarterly price growth in the prime market since February 2020.

Pricing in the new homes market is likely to be supported by more limited supply in the aftermath of the pandemic, with the building hiatus during the first lockdown set to impact delivery as firms catch up after construction halts, supply chain disruptions and risks to their labour force.

Longer term, the strength of the economy will have a bigger bearing on the housing market.

And despite the immediate economic effects of the pandemic, fundamentals such as low borrowing costs, schemes like Help to Buy – with a new version of the equity loan scheme running from 1 April until March 2023 – and ongoing upgrades to infrastructure in the capital have continued to underpin the development market. Furthermore, the implementation of a Stamp Duty Land Tax holiday between 8 July 2020 to 31 March 2021, and the extension of the furloughed workers scheme, where the government pays 80% of salaries to retain workers, have supported deals at all levels of the market, from Help to Buy-backed transactions to £10 million-plus sales.

Longer term, the strength of the economy will have a bigger bearing on the housing market. Now the prospect of a no-deal Brexit has been averted by the signing of a trade deal between the UK and EU, and a vaccine roll-out is underway, some economists say a recovery is in sight. Capital Economics expects the UK economy to regain its pre-crisis level by Q2 2022, and forecasts an economic contraction in Q1 of about 3.5%, well below the 18.8% GDP fall during Q2 2020. However, uncertainties remain over the impact of the ending of the stamp duty holiday this year, with the government having confirmed in December it does not plan to extend the holiday beyond 31 March. Indeed, new forecasts from the Office for Budget Responsibility, published after the chancellor's spending review in November, suggest the UK economy will now be 3% smaller in 2025 than the spending watchdog expected back in March – before the real impact of the pandemic was clear.

Looking to the future, London and the South East are forecast to lead economic growth over the next five years due to their strengths in professional services and technology, according to Oxford Economics. Although London's Gross Value Added – a measure of the value of goods and services produced in an area – will fall in 2020, it is forecast to rebound to 5% growth in 2021.

In this report, we will look at the fundamental market drivers of the London new homes market, the development pipeline, planning reforms, construction costs, new homes delivery, and the strength of domestic and overseas demand.

KEY TAKEAWAYS

London is to lead regional UK growth with its GVA re-bounding to 5% in 2021.

Covid-19 will suppress housing delivery into 2021 with new starts in the capital 9% lower in 2020 than in 2019.

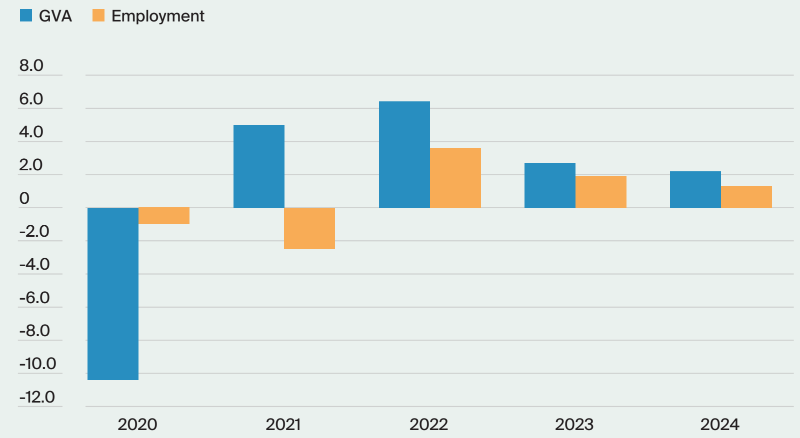
London new homes sales remain resilient with the total for Q3 2020 almost matching pre-Covid-19 figures.

Significant planning reforms on the horizon remain a source of delay and uncertainty for developers.

2.5%

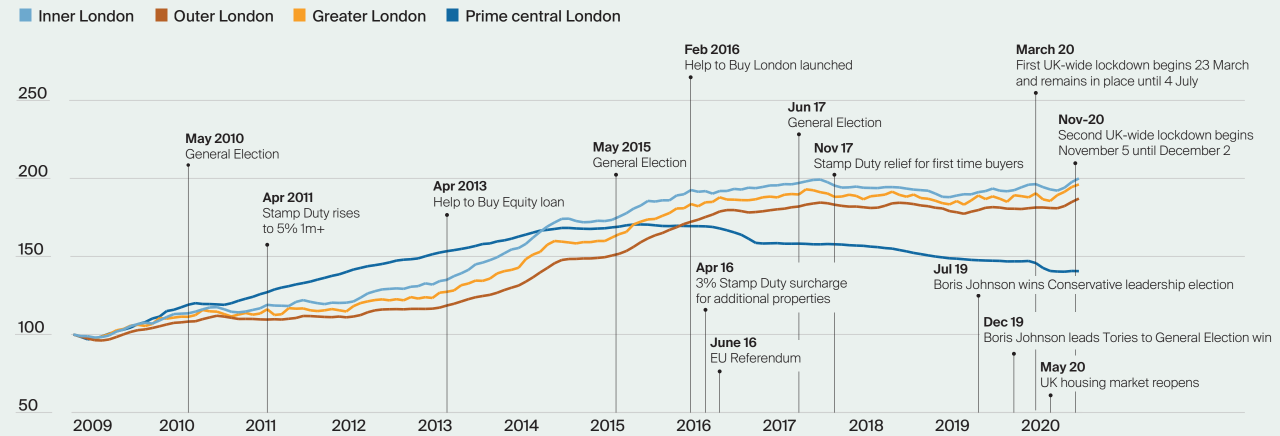
House prices in Greater London rose 2.5% during the third quarter between July and September, while in Prime Central London they grew 0.2%

London's five year recovery
Growth rates for GVA in London



Source: Knight Frank Research, Oxford Economics

Long-term price movements
Indexed 100 = January 2009



Source: Knight Frank Research, ONS

LONDON RESIDENTIAL DEVELOPMENT H2 2020

New homes delivery

There remains a clear shortfall of new homes in London and across the UK and the ongoing pandemic is likely to suppress delivery in the short to medium-term.

In London, 41,718 homes were added to the city's housing stock in the 12 months to 31 March 2020, according to net additions data from the Ministry of Housing, Communities and Local Government (MHCLG), up 14% from 36,618 the previous year.

This increase in delivery is still below Mayor Sadiq Khan's revised ten-year new homes target, which came down from 65,000 to 52,000 a year in December 2019.

Data from Molior, which includes projects of 20 or more private units, shows the number of units that started construction in 2020 was 17,856, which is 9% lower than 2019, and 47% down compared to the 2015 high of 33,797.

London's delivery of high-density schemes (those with 20 units or more), peaked in 2016 and despite a slight rise in 2018 has tailed off since.

Furthermore, other forward-looking indicators suggest the latest net supply figure will likely represent a peak in new homes delivery in London.

The number of Energy Performance Certificates (EPCs) awarded for new homes in London, which has previously acted as a good forward indicator of new delivery, reached 42,507 over the 12 months to 31 March 2020 (see chart).

However, in the second quarter, just 6,007 EPCs were allocated to new homes in London, 48% lower than Q2 2019.

How did Private Sale, Build to Rent and Senior Housing markets perform?

Molior data shows the sales total for Q3 2020 almost matched the pre-Covid-19 Q1 2020 figure. In total, 5,918 new homes were sold across London during Q3 2020 – compared to 6,132 during Q1 2020 and a quarterly average of 4,950 during 2019. In Q4, sales fell 29% on quarter to 4,190. However, for 2020 as a whole, sales rose 1% to 20,092 compared to 2019. The data suggested that 60% of all new homes sales in London in schemes selling 12 plus units between July and September were driven by Help to Buy or build to rent, with 18% driven by the overseas market.

Examples of successful launches last year include The Verdean in Acton, W3. Comprising 160 for private sale units, the first phase was all reserved and exchanged within two weeks of launching in June, four-years off plan. Elsewhere, all six apartments at 14 Brook Street in Mayfair, W1S, were reserved within one week in September at full asking price.

Institutional investors spent more than £4 billion in the build to rent sector last year and £1.2 billion on age-targeted senior housing.

Included within these figures were a number of landmark portfolio sales, including AXA IM's acquisition of Dolphin Square in central London. It is the largest single private residential complex in the UK and includes 1,233 units on a 7.5 acre site.

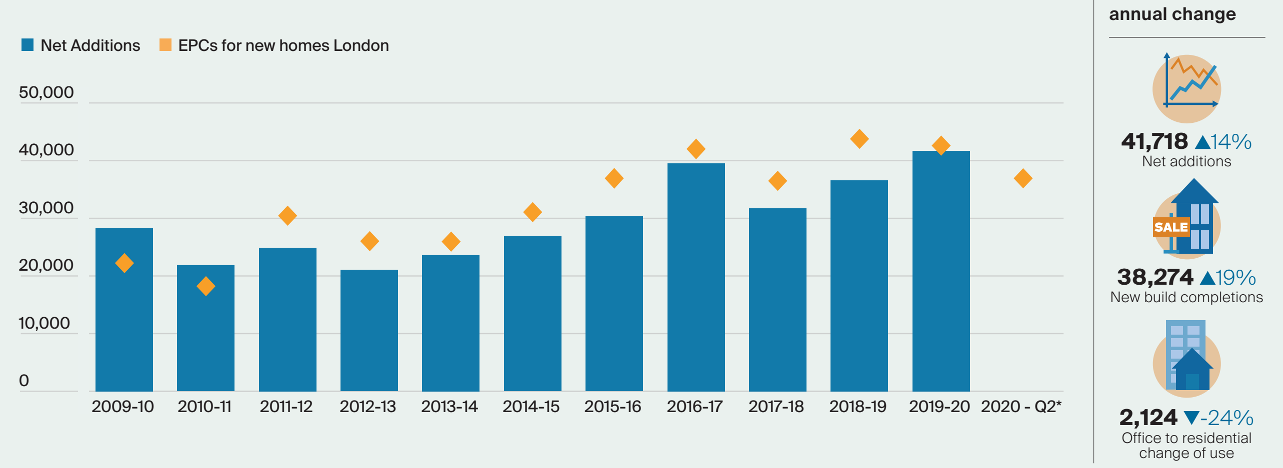
More such deals are expected in 2021 as consolidators grow platforms and new entrants look to buy into the market at scale. London will remain a focus for investors largely thanks to its favourable demographics which mean there remains an urgent and growing need for purpose-built accommodation for all age categories.

Reflecting this, nearly 80% of respondents to our recent **Residential Investment Survey** picked it as their favoured city for investment this year.

Longer-term, as tenant priorities change as a result of Covid-19, the service-driven BTR model is expected to emerge as offering clear advantages over the traditional buy-to-let sector.

We also expect the number of senior housing units across the UK to rise by 10% over the next five years, driven by demand from our growing senior population.

Net additions and EPC registrations for new homes



Source: Knight Frank, MHCLG *Rolling four quarters

Planning

The planning environment in the capital faces significant new challenges considering Covid-19. Official statistics on planning applications state 87% of major applications were decided within the 13-week statutory time limit during Q2 2020. However, there has been a decline in the number of residential units entered for planning permission in projects of 20+ private units. This number amounted to 29,431 for 2020, down 20% from 36,723 in 2019.

The number of units entered for planning permission in large schemes in the capital has been falling since 2017, according to Molior. Meanwhile, the number of units granted permission in large schemes in 2020 was well below the 2015 peak of 48,242 standing at 25,709.

Sadiq Khan's London Plan now looks set for sign-off, over a year after the Mayor's 'intend to publish' version of his planning blueprint for London was submitted to housing secretary Robert Jenrick for approval.

The publication version London plan, released in December, contains a number of amendments, following Jenrick's request for changes last month. However, the headline figure of 522,870 new homes inspectors recommended last year for delivery in the 2020s remains intact.

The plan widens the definition of tall buildings in development plans, indicating that all buildings of six storeys or 18m height at the uppermost floor will be considered to be 'tall buildings' unless otherwise defined by a Development Plan policy. This compares to the previous plan's threshold of 30m and thus means that tall buildings policy will apply to a wider range of applications than was previously envisaged.

The Mayor has also scrapped the previous policy of 'no net loss' of industrial floorspace within designated Strategic Industrial Locations and Locally Significant Industrial Sites.

Furthermore, significant planning reforms on the horizon remain a source of delay and uncertainty for developers. Permitted development rights may increase the supply of small housing schemes without the need for formal planning permission and further Planning Reform announcements are expected on housing need and affordable housing provision.

Residential Development Land

In prime central London, land values rose 4.7% in Q3, returning to levels seen in the first quarter of the year. The increase reflected a marked recovery in the capital's housing market since the UK emerged from its first national lockdown, which contributed to a drop in central London land values earlier this year. Values were flat on an annual basis.

Knight Frank's urban brownfield index, which measures the average price of urban brownfield land across the country rose 3.8% between July and September, while greenfield values remained stable, ticking up 0.3% on the quarter. On an annual basis, greenfield values fell 6.7% while brownfield values eased downwards by 1.8%.

Prices in London continue to be supported by a lack of supply in the market, with few sites coming forward due to the current uncertain economic climate and a shortage of allocated sites due to delays in the adoption of Local Plans.

However, PCL land values remain about 20% lower than the peak of the market in Q3 2015.

Labour costs continue to edge up, rising 23.1% across the construction sector in Q2 2020 compared to Q2 2019, according to official statistics. This is in part due to the furlough scheme, which has helped support the cost of labour despite the fall in productivity.

Construction costs for new housing have climbed 8% in the three years to October 2020. Rising costs have caused developers to increase their margins, which is suppressing growth in land values in both inner and outer London.

Most are looking to maintain their balance sheets and preserve cash. For this reason more land deals are being agreed on a conditional basis or with deferred land payments.

Construction costs: 10 year change
Indexed 100 = January 2010

Source: Knight Frank Research

Residential development land prices
Indexed rebased 100 = Sep 2011 (Urban Brownfield = Dec 2014)

Source: Knight Frank Research

TRENDS TO WATCH IN 2021

1

FAST-FORWARD ON HOMEWORKING

In just a few months, homeworking has been embraced with a totality that was expected to take years. Our *Global Development survey* reveals developers' plans to give more consideration to connectivity and usable workspace – be it within the homes – with three-quarters more likely to consider advanced technology and space for offices either within the home, or within the wider development.

2

A DIVIDED HOUSING MARKET?

It is the wealthier, equity rich section of the market that is driving transactions. Home movers represented a third of all borrowing in Q3 2020 – above the 31% in Q3 2019 and higher than the 27% and 23% shares in Q1 and Q2 of 2020 respectively, official mortgage lending statistics show. One of the immediate consequences of the Covid-19 outbreak in the spring was the withdrawal of the highest loan-to-value (LTV) mortgages, as lenders sought to reduce their risk exposure. Now, as the banks start to relax a bit, these are returning to the market. First-time buyers can get on the property ladder with a deposit as low as 10%. The roll out of the government's First Homes initiative could provide some support.

3

A RISE IN HELP TO BUY AND SHARED OWNERSHIP

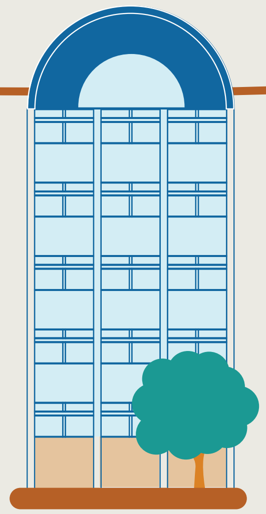
As a result of first-time buyers facing difficulties in accessing mortgages, take up of Help to Buy and shared ownership is expected to rise.

Help to Buy was a key driver of sales in the new build sector in the third quarter, according to Molior, representing 30% of sales in schemes of 12 units or more. The revised Help to Buy scheme, which will replace the current scheme, will come into place from 1 April 2021 and run until March 2023. The new scheme is restricted to first-time buyers only and introduces regional price limits, though in London this remains £600,000.

4

A WINDOW FOR FOREIGN BUYERS

Many foreign investors are looking to capitalise on the current stamp duty holiday. They are also seeking to buy London residential property before an additional 2% stamp duty surcharge for non-UK buyers is introduced this April. Transacting before 1 April will therefore save money for overseas buyers. For a £1 million transaction, the combined saving from not paying the 2% surcharge and benefitting from the stamp duty holiday is £35,000. For a £5 million property, the equivalent sum is £115,000.



5

MORE MIXED-TENURE HOUSING

A range of housing stock for the future will become increasingly essential, from build-to-rent, to student and retirement housing as well as build-for-sale stock. People aged 35 to 44 years were almost three and a half times more likely to be renting in 2017 than in 1993, according to ONS data. Furthermore, we forecast the number of private senior living rental properties in the UK will increase, from almost 5,000 currently to more than 13,000 by 2024.

6

GREATER FOCUS ON THE GREEN RECOVERY

The shocks created by the Covid-19 pandemic are impacting mindsets and cultural narratives, and these changes are likely to be reflected in the key decisions made by policymakers. In November, the government published a 10-point plan to kickstart a green economic recovery, including a point on developing greener buildings. For investors, more sustainable buildings provide several practical, benefits, not least in reducing the potential risk of obsolescence or costly retrofitting as the UK moves towards 'net zero' carbon by 2050. At a time when development trends have rapidly accelerated, so too has the emphasis on more efficient and sustainable homes. In the rental space this could help drive greater tenant retention, demand and, ultimately, income resilience.

7

WELLBEING AT THE FORE

It's not just about how buildings are built, but also how they operate. Alongside sustainability targets, focus has increased on health and wellbeing and promoting social value. Healthier and greener living is now a top priority and developers are seeking to support more active lifestyles.

8

THE EVOLUTION OF MIXED USE

A third of global developers are considering adjusting the mix of residential and commercial elements in schemes. But what will this look like in practice? We interviewed hundreds of developers as part of our *Global Development survey* and found they are looking at options ranging from rentable desk space to having more offices and workspaces within residential developments. A third of global developers said they were considering adjusting the mix of residential and commercial elements in schemes.

9

MORE RETAIL TO RESI

The number of landlords pursuing retail-to-residential opportunities has grown in recent years. Now with coronavirus compounding retail difficulties, this could be the opportune moment for them to accelerate these plans. Development proposals will ultimately go beyond the model of re-providing retail space, historically supermarkets, on the ground floor of a residential scheme. Instead, developers will adopt more innovative designs to create residential in place of or alongside existing uses. Key to the design process is establishing a phased approach to allow continued income and avoid having to pay existing tenants to break their lease.

LONDON RESIDENTIAL DEVELOPMENT MARKET

January - July 2021

JANUARY 1
New UK/EU relationship begins

JANUARY 31
A new visa becomes available to Hong Kong British National (Overseas) citizens (BNOs) and their close family members. Under the new route, the UK government estimates that 5.4m Hong Kong residents will be eligible to move to the UK and eventually become British citizens

MARCH
Spring Budget

MARCH 31
– Stamp Duty holiday ends
– Final deadline to apply for an initial or a further mortgage payment deferral
– End of Help to Buy in its current form

APRIL 1
– The government's revised Help to Buy scheme comes into place, and runs until March 2023. Under the new scheme, the government will lend buyers up to 20% of the cost of a newly built home, and up to 40% in London.
– 2% Stamp Duty Land Tax overseas buyer surcharge introduced

MAY 6
London Mayoral Elections: With Shaun Bailey in the running for the Conservatives, Sadiq Khan for Labour and Luisa Porritt for the Liberal Democrats
– England (non-London) Local Council Elections
– Scottish Parliamentary Elections

APRIL 30
Furlough ends

30 JULY 2021
Deadline for European nationals and their family members living in the UK prior to 31 December 2020 to apply for status on the EU Settlement Scheme

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

Research
Anna Ward
+44 20 3861 6991
anna.ward@knightfrank.com

Planning
Stuart Baillie
+44 20 7861 1345
stuart.baillie@knightfrank.com

Land and Consultancy
Justin Gaze
+44 20 7861 5407
justin.gaze@knightfrank.com

Research
Oliver Knight
+44 20 3861 6991
oliver.knight@knightfrank.com

Land and Consultancy
Charlie Hart
+44 20 7718 5222
charlie.hart@knightfrank.com

New homes
Raul Cimesa
+44 20 7718 5227
raul.cimesa@knightfrank.com

Knight Frank Research Reports are available at knightfrank.com/research

Knight Frank

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.