Savills Research
London Residential Development

Spotlight
London's Housing Supply

Summer 2012

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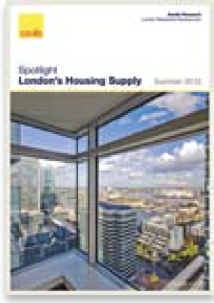


Spotlight
London's Housing Supply

SUMMARY & OUTLOOK

Land, sales and completions. Where are the gaps?

■ In this report we review the supply of land for new housing in London, when the land is likely to come forward for development and the market segment in which each scheme is likely to be launched. This allows us to take a view on the future balance between London's housing supply and demand, by market segment and locality.

London's supply

■ The starting point is that housing supply in London remains one third below the Mayor's minimum target which, as the London Plan acknowledges, is at the lower end of estimates of future housing requirements, given London's growing population.

■ We have reviewed the prospects for development and phasing of 2,250 sites across London, with a capacity of 500,000 units for market sale. We expect 600 of these sites to deliver new homes over the next five years, with around one third of their total capacity of 137,000 homes being delivered by 2017.

■ More than half of the supply pipeline is held in sites with a capacity of more than 500 market units. This concentration of supply limits sales volumes, as does the economic viability of many of these sites which require significant investment of scarce development finance.

■ Taking account of these limits, we expect net market completions to reach an average of 13,300 per annum over the next five years, 35% below the Mayor's minimum target. This equates to a supply shortfall over the next five years of at least 37,000 homes for market sale and, if affordable housing delivery does not increase, a total supply shortfall of 50,000 new homes.

■ For this supply gap to be closed, ways need to be found to release extra market capacity via the private rented sector and to attract extra investment into large development schemes. Investment in build to let requires scale, so this is the key that could unlock both aspects.

■ Affordable housing supply has fallen to around 30% less than target of 10,000 new homes per annum, net of demolitions and acquisitions. Local authorities will have a crucial role in closing the gap, using their new financial freedoms and their own land holdings.

Market segments

■ The greatest supply shortfall, relative to past sales, is in the mid mainstream market, between £450 and £700 per square foot. Development schemes selling into this market tend to be within or on the edge of Zone 2 of London's public transport system.

■ The market segment that ranks second in terms of scarcity is the upper mainstream, between £700 and £1,000 per square foot. We expect one in six sales to be in this segment, on sites that are generally in the higher value parts of Zone 2.

■ If potential demand is added in as a factor, then the greatest shortfall is in the lower mainstream market (at values up to £450 per square foot, generally further out from central London). This segment accounts for just one fifth of supply, compared with more than 60% of London's 3.4 million households who have an income of less than £70,000 and are not housed in the social rented sector. Although these households may be eligible for shared ownership, they may well prefer to buy outright in less expensive markets, further from central London.

■ The supply of new developments in the super prime (£5m+) market is set to more than double to over 100 sales in 2014. In an expanding market, there are precedents for absorption of this market share.

■ The prime and super prime markets account for some 10% of London's new residential development sales by the number of properties delivered, but more than 30% by value. This is an expanding segment, driven by London's global city status, in particular international buyers and London's 90,000 higher rate taxpayers, who account for less than 3% of households.

■ Many of the sites that will be delivered into the prime markets during the next five years are in riverside locations, which will allow the new properties to be differentiated from the bulk of the second hand market, capitalising on views, open spaces and added services.

Outlook

■ High demand from equity rich buyers and scarce supply has driven a V-shaped recovery in London, in contrast to the UK average. We expect this divergence to continue, although overall market capacity in London remains constrained by the availability of mortgages and development finance.

■ Continued housing scarcity in London supports our forecast of 19% house price growth in London over five years, including 23% in prime central London. We expect housing demand to continue to outstrip supply, driven by employment growth, above average income generation, expansion of world class higher education and London's global city status.

Under supply of housing in London

The supply of new housing in London has recovered from its low point in 2010, reaching 20,000 additional homes in the year to March 2012, according to our latest estimates.

However, this remains one third below the Mayor's minimum target of just less than 30,000 per annum, taking account of vacant homes returning to use.

The London Plan acknowledges the evidence that housing requirements are higher than this minimum; indeed the latest household projections indicate an annual requirement of 36,000. More new homes are needed to house London's expanding population which could increase by 1.2million people to 8.6million by 2031, according to the London Plan.

> "The supply of new housing in London remains one third below the Mayor's minimum target of just less than 30,000 per annum"
>
> Jim Ward, Savills Research

GRAPH 1

Housing Supply and Requirements in London

Graph source: Savills using GLA, CLG and MoliorLondon

Since publication of the Plan, the most recent population projections from the Office for National Statistics have put London's population in 2031 at a staggering 10 million people.

Development for market sale

The shortfall in supply in 2010 was most dramatic for market housing, following the market downturn of 2009. Since then, we have seen a strong V shaped recovery in the London market, such that the average London house price is 2% less than peak levels in 2007, compared with a gap of 12% at a UK level. The recovery has been strongest in the prime markets of central London, where the average price is 21% above 2007 levels.

We expect this divergence to continue, with high demand and scarce supply in London leading to forecast house price growth of 19% over five years in London (including 23% in prime central London), compared with an average of 6% for the UK.

However, market capacity remains constrained by the availability of mortgages, with residential transactions across the whole London market still 44% below 2007 levels.

The added factor operating in London has been the strength of demand from equity rich buyers. As part of this, international purchasers have bought more than 50% of new property in the prime markets over the last three years and more than 30% of new properties in the non-prime markets.

This strength of demand has led to a sharp bounce back in starts, sales and completions, which we expect to peak in 2012 at around 17,000 additional homes. This will still leave a supply gap of at least 15% against the Mayor's target.

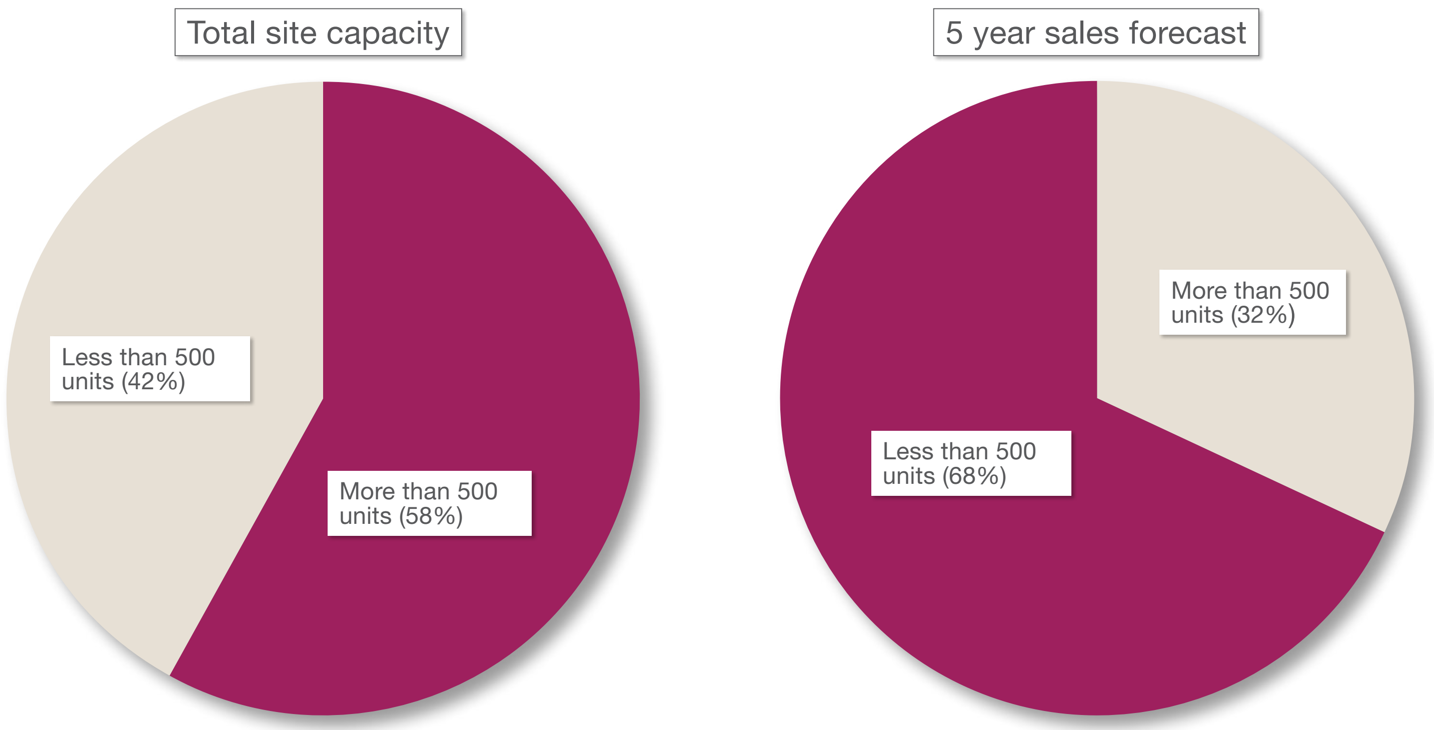
GRAPH 2

Market and Affordable Supply against Targets

Graph source: Savills using GLA, CLG and MoliorLondon

GRAPH 3

Significance of Larger Sites to Housing Supply



Graph source: Savills

Affordable housing

Delivery of new affordable housing has been falling steadily since its high point in 2008. The London Plan target is to provide an additional 13,200 affordable homes annually. Taking account of the rate at which Registered Providers acquire existing stock, this equates to a target of around 10,000 additional new homes per annum. That leaves a current supply gap of 30%.

New finance for affordable housing is limited; the loss of social housing grant is substantial in London and the capacity to replace this with higher rents is limited by the caps on Universal Credit that are due to take effect in 2013.

The more pro-active Registered Providers are continuing to issue bonds to finance new development, but to achieve the extra scale of housing required, more resources are needed. It is no coincidence that local authorities now have much greater financial freedom to use their own land holdings to fill this gap.

Land Supply Pipeline

How have we assessed development potential?

We have reviewed the prospects for development and phasing of 2,250 sites across London, with a capacity of 765,000 units, including 505,000 for market sale. This is based on a combination of data from MoliorLondon and Savills market knowledge from our land agency, development consultancy and planning activity across London.

Of the 2,250 sites, 26% have a planning consent and 14% are within the planning system, leaving 1,340 sites which are pre-planning. We have taken a view on the likelihood of each site coming forward with a start on site during the next five years, with phasing in line with market capacity and a best estimate of achievable pricing. Of these sites, we expect 600 to deliver units to the market over the next five years and estimate that 37% of their total capacity of 137,000 homes will be delivered by 2017.

The reasons for sites not coming forward more quickly include the planning process, the need for vacant possession, site viability, market capacity and the assembly of funding.

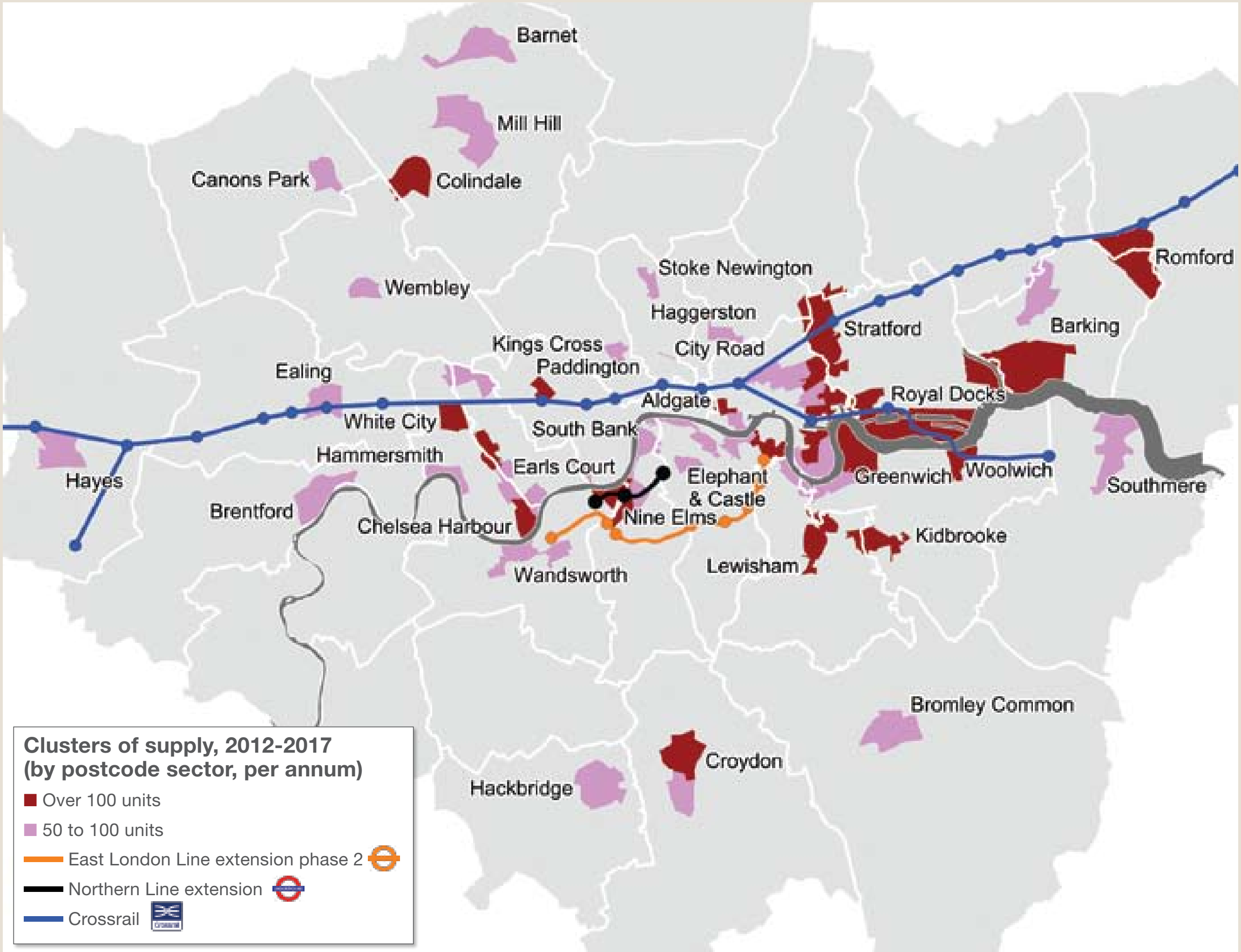
In addition, we have considered the five year supply that is likely on smaller sites of less than 10 units in prime boroughs, less than 20 units in other parts of inner London and less than 50 units in outer London boroughs.

"Of the 2,250 sites identified, we expect 600 to deliver units to the market over the next five years"

Jim Ward, Savills Research

MAP 1

Clusters of Supply and Forthcoming/ Planned Major Transport Improvements



Map source: Savills

The role of larger sites

Larger sites (with a capacity of at least 500 market units) account for a very substantial proportion of potential housing supply, namely 58% of total supply pipeline capacity. Many of these are large capital intensive regeneration sites on the fringe of central London, particularly in eastern boroughs such as Newham, Tower Hamlets, Greenwich and Barking & Dagenham (see Map 1).

Regeneration potential and sales capacity on such sites rely on there being investment in place, including retail and leisure uses and the public realm. The financial viability of such investment is boosted significantly by investment in new infrastructure, particularly new or improved transport routes to centres of employment.

New transport

New Crossrail stations that are close to significant clusters of new housing supply, and where travel times will be enhanced significantly, include Hayes, Ealing, Whitechapel and the Royal Docks.

Phase 2 of the East London line extension will enhance connectivity at Clapham Junction and to the south of Nine Elms. Proposed investments that would open up capacity include the Northern line extension to Nine Elms and a new Crossrail station at Woolwich.

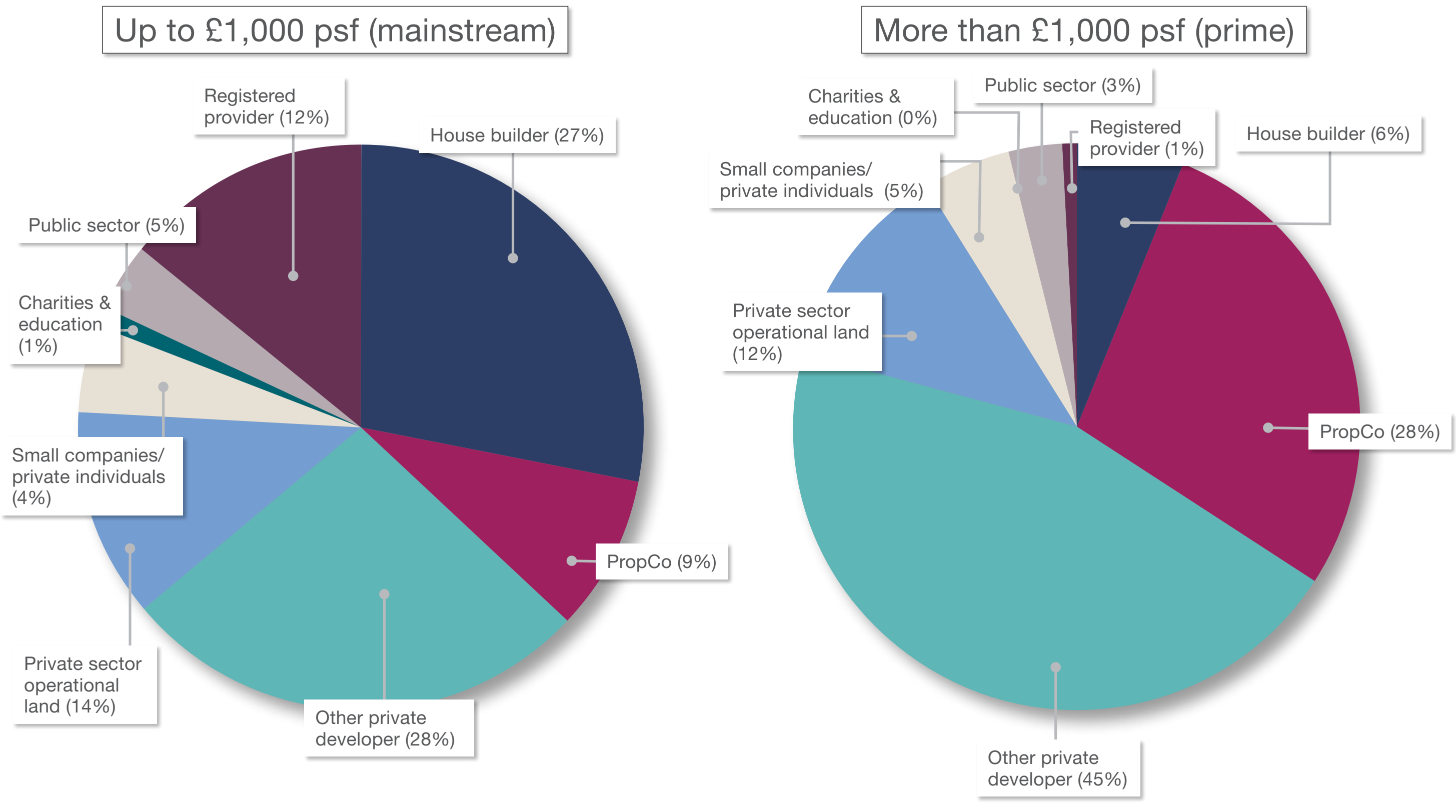
Control of land supply

House builders (notably Barratt and Bellway) control over a quarter of the five year supply pipeline in the mainstream market, but only 6% of prime. Within the prime markets, 28% of the supply is controlled by property companies, such as Land Securities and Capital & Counties.

Other private developers, including London specialists, account for 45% of the prime market (including Native Land and CIT) and 28% of the mainstream market (including Ballymore and Mount Anvil). Berkeley, classified here as a London specialist, features as a major player in both prime and mainstream markets. Around one quarter of the supply

GRAPH 4

Who Controls London's Housing Land Supply? 2012-2017



Graph source: Savills

pipeline in mainstream markets is controlled by organisations whose main business is not development, so there are opportunities for developers to extend their involvement here.

Forecast sales and completions

Our projected sales volume in 2013 is 50% more reliant on larger sites (of more than 500 market units) than the very strong sales year of 2011. This concentration of supply capacity is a limiting factor to rates of market absorption into the owner occupied markets, particularly in the fringe of central London in which many of these sites are located. International investors do buy in these locations but there are limits to the volumes of such demand.

Our view of future rates of completions are based on a view of when construction is likely to start on site and the rate at which new homes will be brought forward into each market. Aggregating all projected sales rates and completions, we expect delivery of market homes to settle at 13,300 per annum over the next five years, 35% below the Mayor's minimum target.

> "Aggregating all projected sales rates and completions, we expect delivery of market homes to settle at 13,300 per annum over the next five years"
> Jim Ward, Savills Research

Institutional investment in build to let would unlock extra market capacity from the rental markets. Demand from frustrated first time buyers is pushing up rent levels which have shown double digit annual growth during the last two years. Short term rental market indicators remain positive in the upper mainstream markets, albeit that lower value markets exposed to cuts in Housing Benefit are showing some signs of weakness.

Lower mainstream (up to £450 per sq ft)

Around one quarter of sales are expected in the lower mainstream market, at less than £450 per square foot, in locations that are mostly further out from central London. This is the market segment in which the mortgage constraint is most pressing, such that schemes like NewBuy (offering a mortgage indemnity guarantee to any buyer of a new home up to £500,000 value) and FirstBuy (offering an equity loan to a first time buyer of a new home) have most impact in boosting market capacity.

This is also the market segment in which there should be the greatest volume of demand from London's workforce, subject to the availability of mortgages. More than 60% of London's 3.4million households have an income of less than £70,000 and are not housed in the social rented sector. Although these households may be eligible for shared ownership,

London's Market Segments

The capital's five market segments by size, value and household income

Market sector (£ per sq ft)	Typical unit (size)	Typical unit value	Typical household income required	Typical occupier
Lower mainstream (up to £450)	2 bed flat (700 sq ft)	£280k	£40,000 - £45,000	Young professional (renter or with bank of Mum & Dad)
	3 bed semi (1,100 sq ft)	£400k	£50,000 - £70,000	1.5x income working family
Mid mainstream (£450 - £700)	2 bed flat (750 sq ft)	£490k	£70,000 - £80,000	Young professional (renter or with bank of Mum & Dad)
Upper mainstream (£700 - £1,000)	2 bed flat (900 sq ft)	£750k	£95,000 - £125,000	Pre-family professional couples/downsizers
Prime (£1,000 - £2,000)	2 bed flat (1,200 sq ft)	£2m	£200,000 - £350,000 +50% equity	CEO/Senior banker
Super prime (£5m + unit price)	3 bed apartment (4,000 sq ft)	£12m	n/a	International super-rich

they may prefer to buy outright in a cheaper area.

Mid mainstream (£450-£700 per sq ft)

We expect almost half of sales and market completions to be in the mid mainstream market, selling at between £450 and £700 per square foot. The greatest scarcity of supply (relative to past sales volumes, inflation adjusted) is in this market segment. Development schemes selling into this market tend to be within or on the edge of Zone 2 of London's public transport system.

Upper mainstream (£700-£1,000 per sq ft)

The market segment that ranks second in terms of scarcity is the upper mainstream, between £700 and £1,000 per square foot. We expect one in six sales to be in this segment, on sites that are generally in the higher value parts of Zone 2.

Prime (£1,000-£2,000 per sq ft)

The prime and super prime markets account for some 10% of London's new residential development sales by the number of homes delivered but more than 30% by value, on sites in the highest value markets of central London, centred on Westminster and Kensington & Chelsea.

These are expanding markets, shaped by London's creation of individual wealth within the London economy and more widely in the global economy. Around 90,000 people in London pay higher rate income tax (on annual earnings in excess of £150,000), according to HMRC, equivalent to less than 3% of households.

We expect wealth in London and the global economy to continue to increase, albeit that employment in London's finance and business services sector has contracted during the last year.

Political decisions such as the recent increases in stamp duty and proposed annual charges on houses in the £2million+ market are a threat, but the market appears to have absorbed the changes so far.

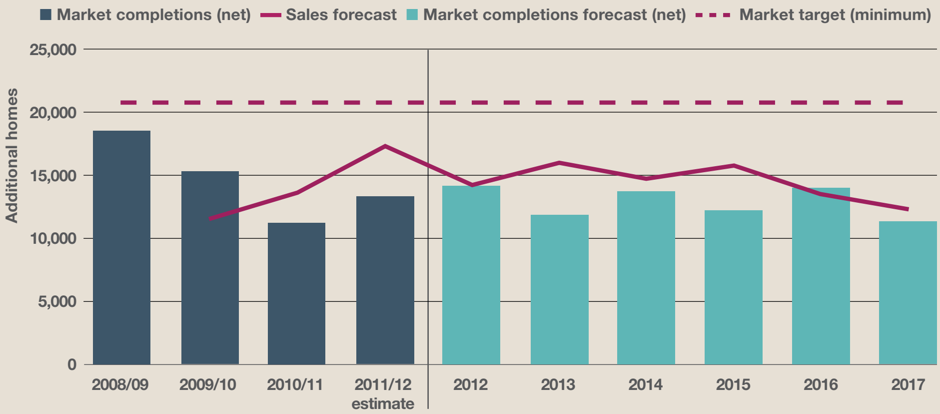
Many of the new properties in this market are differentiated from

New Build Projections in London

Five-year forecasts for sales, completions and volumes

GRAPH 5

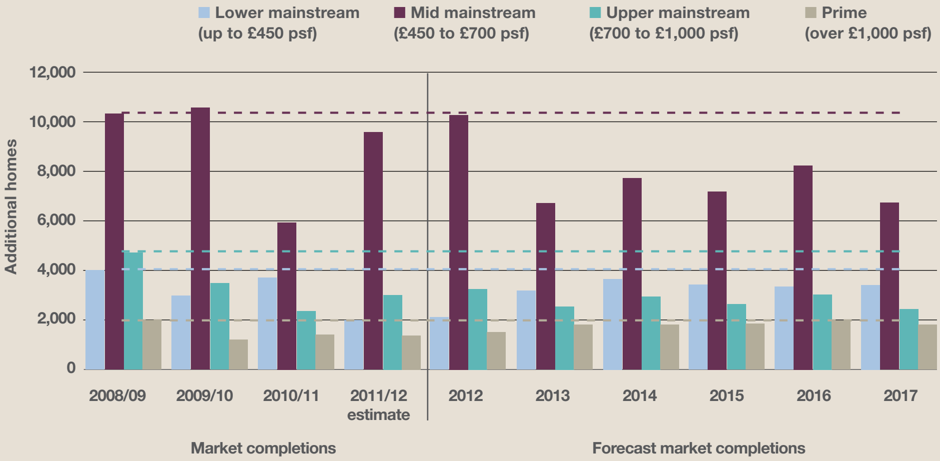
Projected New Build Market Sales and Completions



Graph source: Savills

GRAPH 6

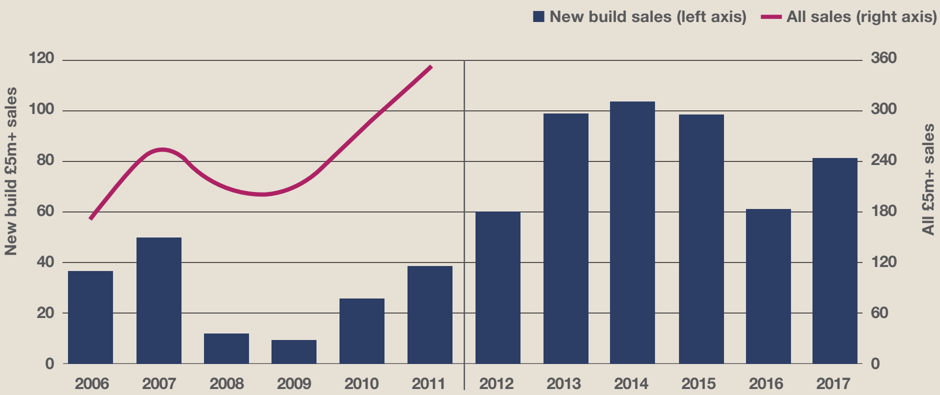
Projected New Build Market Completions by Market Segment



Graph source: Savills

GRAPH 7

Projected New Build Sales in the Super Prime (£5m+) Market



Graph source: Savills

MAP 2

Clusters of more than 100 units of Prime and Super Prime supply

(by postcode sector, 2012-2017)

Map source: Savills

second hand stock by the provision of services, design and views, so there is potential to increase the new build share of an expanding market.

Many of the sites that will be delivered into the prime markets during the next five years are in riverside locations, so developers will be able to capitalise on this product differentiation.

Super prime (£5m+)

At the very top end of the market, the annual supply of new residential properties selling at prices of £5million or greater is set to more than double to over 100 sales in 2014. However, in 2011 there were twice as many transactions in this market, including second hand sales, compared with 2006, as a result of strong demand from a growing number of global billionaires and house price inflation in this segment.

At 2011 sales volumes, absorption of these properties would equate to a new build market share of around 30% of the whole super prime market, which could be in the same order of magnitude as the 20% share in 2006 and 2007 if the market continues to expand at its current rate.

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