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London Housing Supply Update

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Despite a sharp and expected fall in housing delivery, London's supply has been more robust than the rest of the country

The second quarter of the year was unsurprisingly very subdued for the new build market. The construction industry was hamstrung by social distancing guidelines and the housing sales market essentially put on freeze due to social distancing guidelines during the peak of the pandemic.

While completion numbers are down across the entire market, the trend in construction starts varies drastically across price points. Mainstream (below £1,000psf) starts have continued on their downward trend, while prime (above £1,000psf) starts have shown remarkable resilience, reaching their highest levels since the start of 2018.

The latest completion numbers in London show current housing delivery levels remaining well short of the draft London Plan identified need of 66,000 homes per annum.

Data from Molior, which tracks the number of completions across schemes with more than 20 private homes in London, shows 21,092 completions in the year to Q2 2020. This represents an annual fall of -10.5%. In Q2 alone, there were just over 3,000 completions recorded, which is the lowest quarterly number of completions since Q3 2014, and half the number seen in Q1 2020.

In 2020, we expect private completions as recorded by Molior to be around -8% below their 2019 levels.

Energy Performance Certificates (EPCs) for new homes suggest a larger fall in completions with just 6,007 EPCs issued in Q2, marking the lowest quarterly number since Q3 2013. In the year to Q2 2020, 36,956 EPCs for new homes were issued in London representing annual fall of -13.7%.

The fall in housing delivery is a clear illustration of the impact that Covid-19 has had on the construction industry. The lockdown which came into place in mid-March put the brakes on the construction industry until 11th May when construction workers were encouraged to return to site.

However, London has proven to be more resilient than the rest of the country in terms of housing delivery during Q2. The number of EPCs for new homes fell by -39.2% quarter-on-quarter in London, compared to a drop of -50.0% across the whole of England.

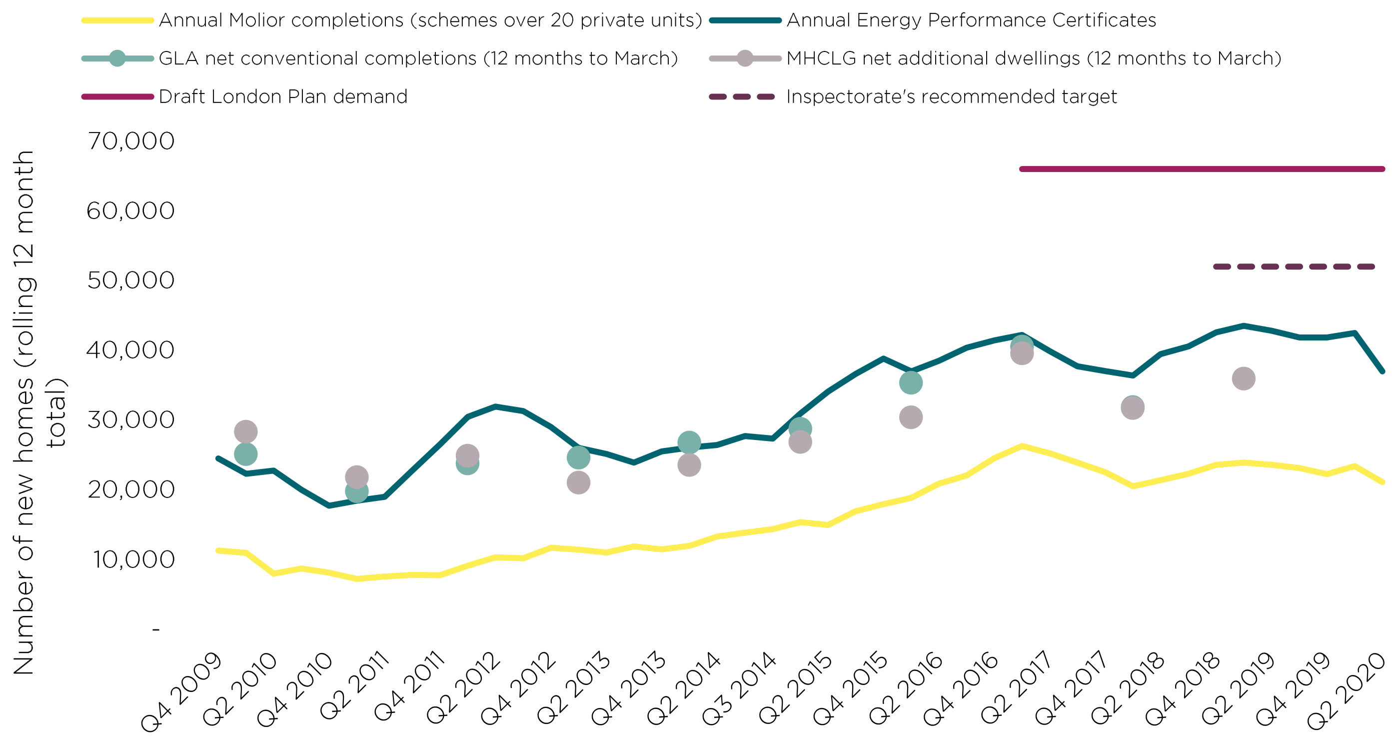
Whilst the short-term impact of Covid-19 on construction is evident, there remains a significant pipeline of over 61,000 private units under construction (on sites with more than 20 private homes) in London which, assuming we avoid further lockdowns, will translate into increased housing delivery in the medium term. Total delivery will still fall short of the 66,000 homes needed per annum, particularly as the number of starts on site has fallen by -34% over the last two years.

Delivery is also falling well short of the proposed Standard Method 2 for calculating housing need, which was set out in the recent consultation on "Changes to the Current Planning System" and calculates that London requires 93,500 homes a year.

Despite the number of affordable starts on GLA housing programmes reaching a record high of 17,256 in 2019/20, affordable completions remain someway below what is required, with just 7,775 affordable homes completed in 2019/20.

With the greatest demand for housing in London being for more affordable homes, local councils have stepped up their efforts in building these homes. A number of local authorities have their own housing companies with significant development pipelines for the next few years. Despite this, there is still expected to be a large shortfall in sub-market housing in London over the next five years.

Figure 1 London housing delivery



Source Savills, GLA AMR, EPCs, MHCLG

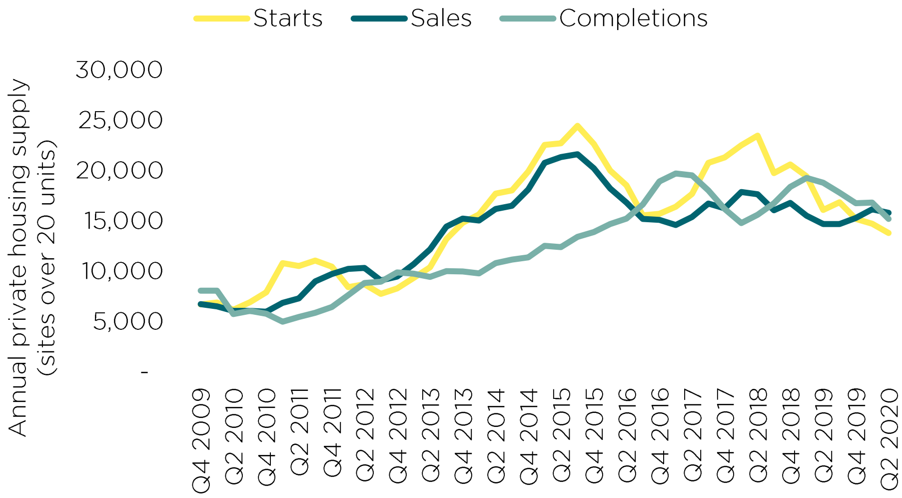
Mainstream starts continue to plummet to lowest levels since 2013

The mainstream market (below £1,000psf) saw starts on site continue to fall in Q2 2020. Under 14,000 mainstream units started construction in the 12 months to Q1 2020, the lowest annual total since 2013.

While annual mainstream sales in Q2 2020 are higher than at the same point last year, they saw a -2.1% fall compared to the year to Q1 2020.

Like starts, completions have continued on their downward trend, with 15,225 mainstream completions in the year to Q2 2020, which is -19.0% below the same point at last year. However, there are still over 41,000 mainstream units under construction as of Q2, and so completions look set to pick up in the medium term. In the longer term, the significant fall in mainstream starts will lead to fewer mainstream completions.

Figure 2 Mainstream starts, sales and completions



Source Savills, Molior

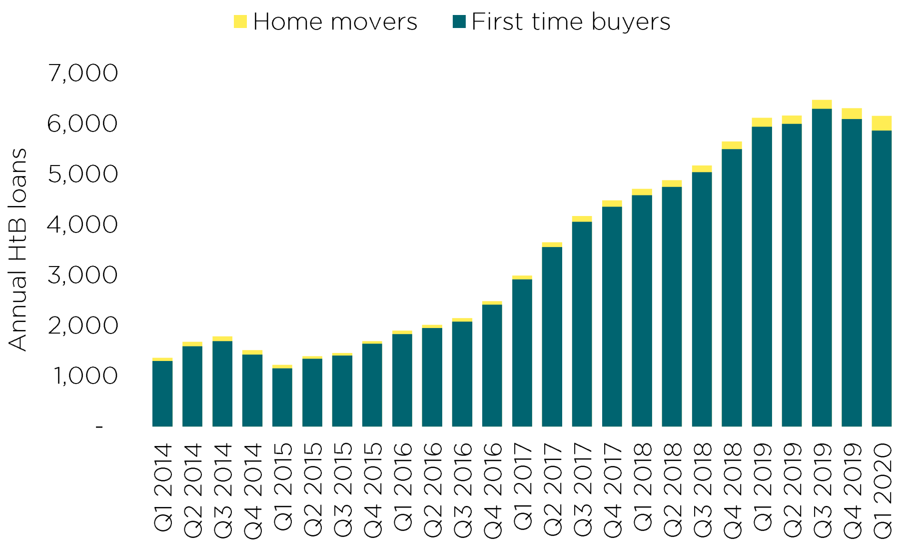
Help to Buy sales fall slightly but will be boosted by the stamp duty holiday

There were 6,155 Help to Buy (HtB) loans recorded in the capital in the year to Q1 2020, with 95% of these being issued to First-Time Buyers (FTBs).

The government has announced an extension to the practical completion deadline to 28th February in order to qualify for the current scheme. After the 31st March, only FTBs will qualify for HtB, though they already make up the majority of HtB users in London.

The introduction of the stamp duty holiday until 31st March 2021 is expected to increase HtB demand in London more than the rest of the country. This is because SDLT saving makes up a greater proportion of the deposit than elsewhere in the capital. For the average value of a London HtB property in Q1 2020 (£455,000), the SDLT saving would be £12,750 for a home mover and £7,750 for a FTB. A full note on the stamp duty holiday's impact on development can be found here.

Figure 3 Help to Buy loans in London



Source MHCLG

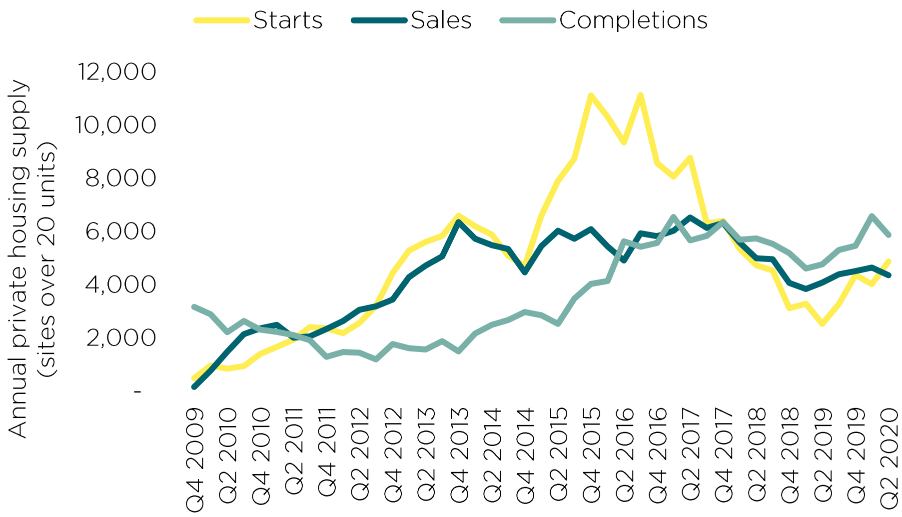
Prime starts see a significant rise despite the surrounding uncertainty

The annual number of starts in the prime market (£1,000psf+) saw a significant increase in Q2 2020, up by 93.0% compared to the same point last year, and 21.3% versus the year to Q1 2020.

Conversely, prime annual sales saw a decrease of -6.0% compared to the year to Q1 2020, though are still 7.0% above their level at this time last year. Since the reopening of the market there has been strong demand from overseas buyers, which is likely to continue through into the second half of the year. Buyers will look to take advantage of the stamp duty holiday and get in ahead of the introduction of the 2% stamp duty surcharge for overseas buyers on 1st April 2021.

Around 5,900 prime units completed in the year to Q2 2020. Whilst this represents a fall compared to the previous quarter, it is still 23.0% above the number of completions seen in the year to Q2 2019.

Figure 4 Prime starts, sales and completions



Source Savills, Molior

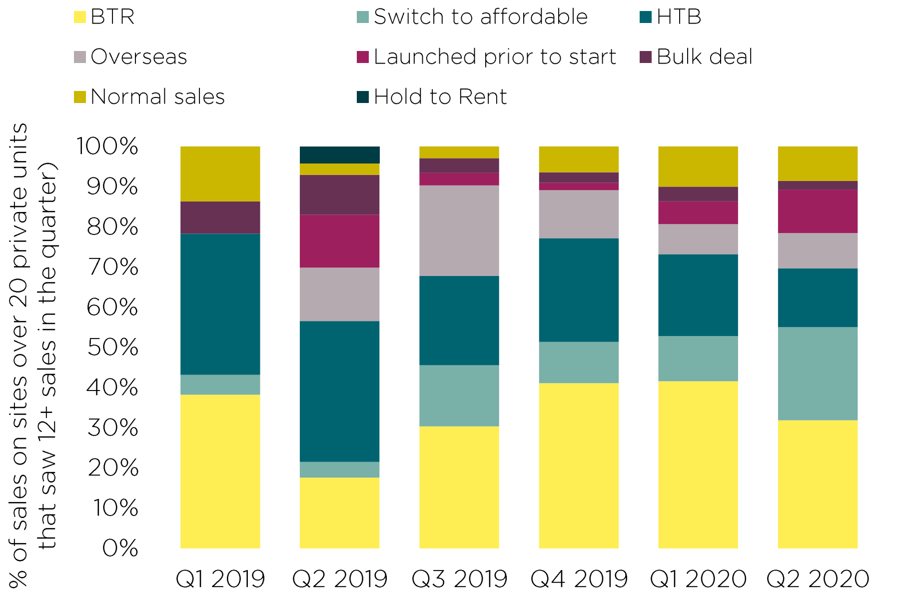
The introduction of the stamp duty holiday has been vital in supporting sales after lockdown, and the incoming 2% SDLT surcharge for overseas buyers in Q2 2021 could mean we can expect a busy market towards the end of this year and at the start of next.

Beyond this, the pandemic will undoubtedly leave its mark on London's new build market, with varying impacts for different sales groups.

Research from Molior already acknowledges changes in the patterns of sales in Q2 2020. Switching to affordable accounted for 23% of sales amongst schemes that saw more than 12 sales in Q2. This is up from an average of 10% over the previous four quarters.

Sales rates will inevitably slow down once the current release of pent-up demand subsides. Furthermore, when the government furlough scheme ends in October, unemployment is expected to spike, which will also contribute to slower sale rates as household incomes become less secure. The table below outlines the impact that Covid-19 is likely to have on the key buyer groups.

Figure 5 Main driver of sales



Source, Molior

Figure 6 What Covid-19 means for different new build sales groups

Sales group	Impact of Covid-19
Help to Buy	Developer concerns over meeting completion deadlines for the current version of HtB have been assisted with the extension of the practical completion deadline to 28th February 2021. If this additional legroom is enough, there may be increased demand for HtB as lenders take a more cautious approach to conventional higher LTV mortgages. Furthermore, the stamp duty holiday, which will benefit home movers more than FTBs, may result in a further spike in demand if these households wish to take advantage of HtB before it transitions to FTBs only after 31st March 2021.
Unsupported owner occupiers	Lenders have temporarily withdrawn high LTV mortgages from the market, and some have more recently restricted how much support the Bank of Mum and Dad can provide. Saving for a deposit has been the biggest hurdle facing this group, and this will have only been amplified by this lender caution.
Build to Rent	Rental demand has proven to be more resilient in times of uncertainty in the past which will support the BTR market during the recovery phase. Once we emerge from this crisis, we expect investors to continue to increase their exposure to real estate assets that offer secure and stable income streams. Exemption from the SDLT 3% surcharge would encourage investment in the Build to Rent sector and expedite the recovery in the delivery of new housing.
Domestic / Overseas Buy to Let	Stamp duty can make the difference between a profitable or loss-making purchase for many so there may be a short-term flurry of demand from investors. However, mortgaged investors may face constraints if they've taken a mortgage payment holiday to help their tenants. When travel restrictions are lifted, we expect overseas investment demand will return to London's new build market. There is already evidence of successful overseas launches, with the prime market in particular looking good value compared to historic levels and the stamp duty holiday will only strengthen London's appeal to overseas investors.
Tenure switch to affordable & bulk sales	Slowing sales rates following the release of pent up demand will contribute to an increase in switching tenure to affordable and bulk sales. The latest reports from Molior already provide evidence that switching to affordable is more prominent in Q2 2020. As further periods of uncertainty look to be around the corner, this trend is likely to continue.

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