Residential
Northern England 2010

King Sturge

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Introduction

Welcome to our Northern England residential report. Our report covers the three regions Yorkshire and the Humber, the North West and the North East and looks into the economies and housing markets within these regions and Northern England as a whole.

We also consider how residential development markets, and the main city centre markets in particular, have scaled back construction in the wake of the global financial crisis and question when and how the development pipeline might begin again in light of a recovering economy, growing population and stronger housing demand.

Potentially, the next few years could see an exciting return to city centre development.

Stephen Hogg
Partner
Northern England Residential
March 2010

One Park West, 326 units, developed by Grosvenor

Executive summary

- The Northern England economy is forecast to grow by 1.4% in 2010. GDP growth is expected to accelerate towards 3% pa by 2013 despite weak public sector growth.
- The Northern region has seen strong house price growth over the past 10-15 years even withstanding the market decline in 2007-2009. House price growth has averaged 7.1% pa over the past 12 years.
- House prices in the North are typically 25% lower than the UK average. The average house price in the North is currently around £119,000.
- Residential development completions in Northern England have halved, falling from 45,500 units in 2007 to 23,350 units in 2009.
- The CLG are projecting that Northern England will see an average increase of 66,000 households a year over the next 10-20 years resulting from a combination of rising population and smaller household size.
- While there are question marks surrounding the short-term outlooks for UK and Northern housing markets, we expect housing demand to increase notably over the next few years fuelled by an expanding economy, growing population and rising household incomes.
- The lack of recent and planned residential development in Northern regions looks likely to present the region with an undersupply of housing compared to household projections.
- Unless the residential development industry, which includes local authorities and planners as well as developers, responds appropriately the demand and supply imbalance in Northern England is likely to become exaggerated and lead to significant upward pressure on house prices in the years ahead.

Economy

The distribution of employment across business sectors in the Northern region is broadly in line with that of the UK. However, there are a number of key differences.

The public sector is the dominant employment sector in the North and in the UK but at 26.8% of all employees in the North it represents a slightly greater proportion than in the UK. The second largest employment sector is distribution and hotels which accounts for around 23% in both the North and the UK.

The Northern region has a smaller proportion of employees in the financial and business services sector compared to the UK, 17.8% compared to 21.2%, and a larger share of workers in manufacturing industries, 12.4% compared to 10.2% (see table).

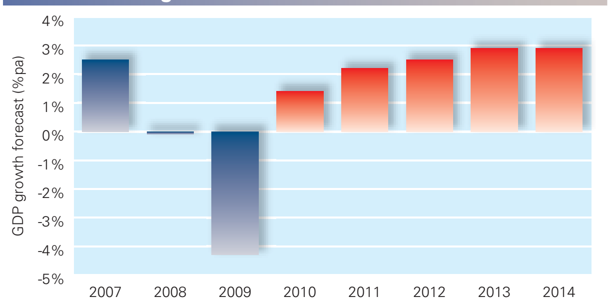
Employment by business sector (%)	North	UK
Public	26.8	24.9
Distribution & hotels	22.9	22.4
Financial and business services	17.8	21.2
Manufacturing	12.4	10.2
Construction	6.8	7.1
Transport & communications	6.0	6.0
Other	7.2	8.4
Total	100.0	100.0

Source : Oxford Economics

Following five years when the Northern economies expanded by an average 2.6% pa during 2003-2007, the economy suffered along with the rest of the country during 2008 and 2009 following the global financial crisis. The Northern economy shrank by 0.1% in 2008 and by 4.3% in 2009 (see chart).

However, with the UK economy recovering from recession in Q4 2009, we expect the Northern region economy to grow by 1.4% in 2010 before accelerating to growth of 2.9% pa during 2013 and 2014.

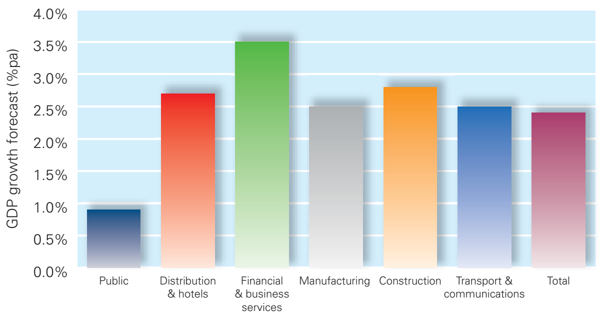
Northern GDP growth forecasts



Source: King Sturge, Oxford Economics

The business sectors likely to see strongest GDP growth over the next five years are financial and business services (3.5% pa), construction (2.8% pa) and distribution and hotels (2.7% pa). Notably, however, the public sector, having been the most resilient during the 2008-2009 recession, is only expected to grow by 0.9% pa during 2010-2014, significantly below the Northern region average of 2.4% pa (see table and chart).

Northern economic growth forecasts by sector 2010-2014



Source: King Sturge, Oxford Economics

GDP growth by time period (%pa)	2003-2007	2008-2009	2010-2014
Public	1.2	1.5	0.9
Distribution & hotels	3.0	-3.1	2.7
Financial and business services	7.2	-1.3	3.5
Manufacturing	1.1	-5.6	2.5
Construction	2.9	-7.0	2.8
Transport & communications	3.1	-1.2	2.5
Total	2.6	-2.2	2.4

Source : Oxford Economics

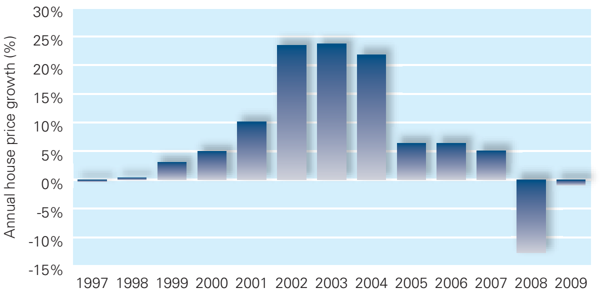
Housing markets

House prices in Northern regions increased by an average 10.2% pa during the ten years 1998-2007, equating to aggregate growth of 165%. During this time the average house price soared from a little under £52,000 to just over £137,000. Price growth was particularly strong during the 2002-2004 period when growth topped 20% a year (see chart).

However, after several years of strong growth, prices fell by an average 12.7% in 2008 and 0.9% in 2009 following the global financial crisis that began in 2007. From peak to trough the average decline in house prices in the Northern region was 17%, in line with the UK.

Significantly, having bottomed out in mid-2009 house prices have since risen strongly across the Northern region. Prices have increased by 3.8% during the second half of 2009.

Northern house price growth

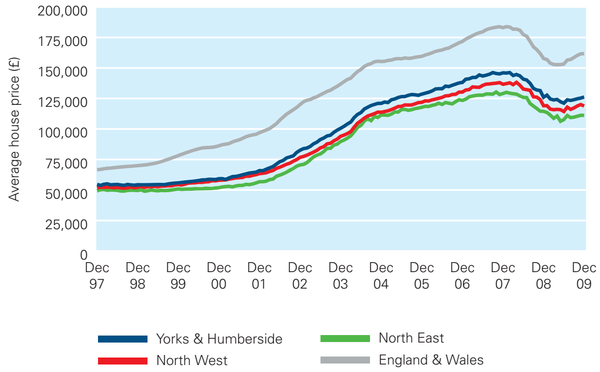


Source: King Sturge, Land Registry

House prices in Northern regions are typically 26% below the average in England & Wales. Interestingly, this ratio has altered notably since the mid-1990s when the average discount in a Northern location was just 10%. The discount increased to around 35% in the early 2000s before returning to circa 26% more recently. The average house price in Northern regions was close to £119,000 by end-2009, notably below the circa £162,000 average in England & Wales.

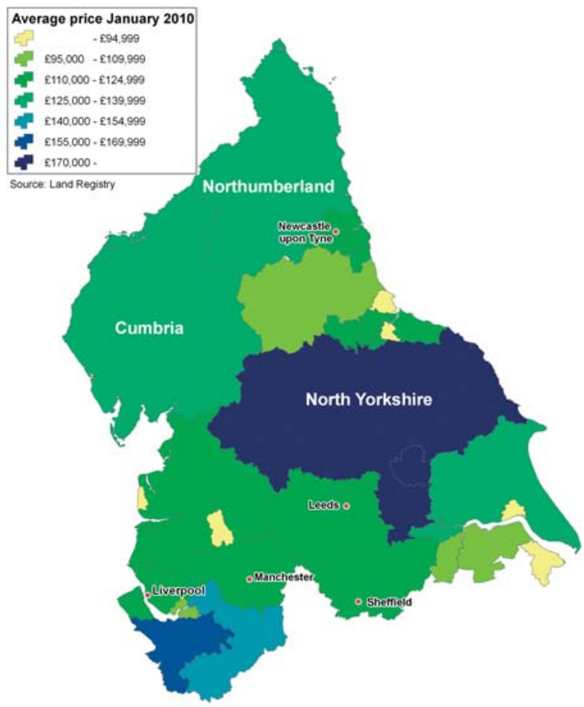
In broad terms the pattern in house price movements in each of the three northern regions Yorkshire & the Humber, North West and the North East have been similar to each other and to the average in England & Wales over the past twelve years. Perhaps the most notable difference is over the past six months when national growth has averaged 5.6%, led by London and the South East, while price growth in Northern areas has averaged 3.8% (see chart).

Northern house prices by region



Source: King Sturge, Land Registry

Average house prices across Northern England



Source: Land Registry

Housing demand

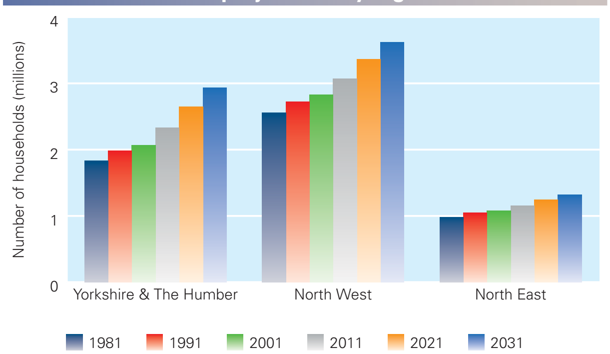
Housing demand in the North and in the UK was fuelled over the 10 years to 2007 through a combination of increasing population (both natural and net inward migration), higher household incomes, greater wealth and favourable mortgage availability and pricing. The onset of the credit crisis significantly dampened the impact of these influences on housing demand.

Looking forward, we expect each of these factors to have a growing importance again on the future demand for housing. The chart below shows how much faster the number of households is expected to grow between 2001 and 2011 when compared to the preceding two decades. Furthermore the chart shows that the stronger growth in household numbers is anticipated to continue over the next 10-20 years.

The number of households across all three Northern regions was 5.4 million in 1981 and increased by an average rate of 30,000 a year to reach almost 6.0 million by 2001. The anticipated growth between 2001 and 2011 is 58,000 additional households a year, but this growth rate is forecast to be even stronger in the 20 years post 2011 at almost 66,000 a year. By this time the total number of households in the Northern region is expected to be almost 7.9 million, some 2.5 million more than in 1981.

In aggregate and percentage terms Yorkshire and the Humber is forecast to see the strongest growth in household numbers over the next 20 years while the smallest region, the North East, is predicted to see the lowest growth (see table).

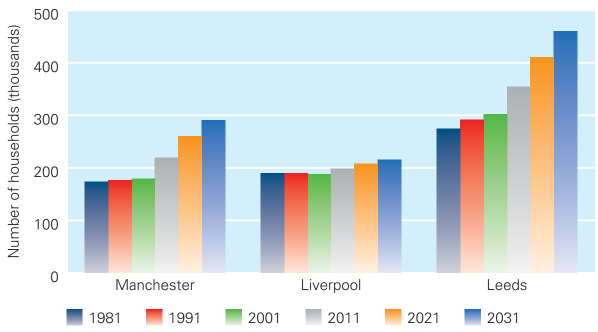
Northern household projections by region



Source: King Sturge, CLG

The cities of Leeds and Manchester are predicted to experience the highest expansion of household numbers. They are both anticipated to grow by more than 30% during the period 2011-2031 (see chart and table).

Northern household projections by city



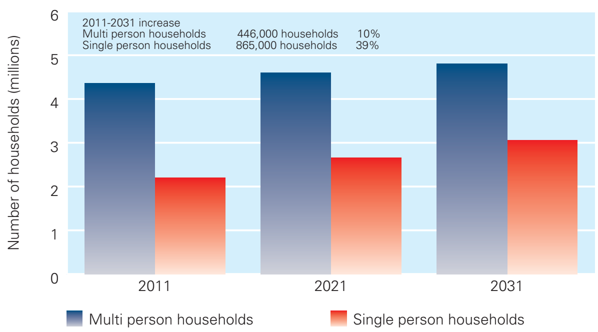
Source: King Sturge, CLG

Household projections	Average annual change (000s)		2011-2031 change	
	1981-2001	2011-2031	000s	%
Northern Region	30.2	65.6	1312	20%
Yorks and Humber	11.9	30.0	600	26%
North West	13.5	27.5	550	18%
North East	4.8	8.1	162	14%
Manchester	0.3	3.6	72	33%
Liverpool	-0.1	0.9	17	9%
Leeds	1.4	5.3	106	30%

Source : King Sturge, CLG

A key characteristic behind the forecast growth in household numbers over the next 20 years or so is the anticipated expansion in one person households. While in the Northern region there are currently around twice the number of multi person households, 4.4 million to 2.2 million, the number of one person households is forecast to rise by 39% to 3.1 million by 2031 with multi person household numbers expected to grow by a more meagre 10% to 4.8 million (see chart). The average household size in Northern England during this time is expected to shrink from 2.25 persons to 2.09 persons, having been 2.35 persons in 2001.

Northern household projections by type



Source: King Sturge, CLG

Manchester

There have been no new development starts in Manchester city centre since 2007. The oversupply of apartments that was evident then has now been soaked up, either bought by investors, as developers called for cash or placed into the lettings market by those developers with more secure funding lines.

A lack of available properties is a key feature of the Manchester city centre market and this is also contributing to lower transaction levels. There are currently around 20,000 residential units in Manchester city centre but there are only around 1,000 currently available for sale or to let. There are just three new homes sales sites with availability across the whole city centre.

Turnover in the city centre has fallen significantly over the past 2-3 years. At its peak, in excess of 5,000 units were being transacted each year, but this has reduced to less than 1,000 a year in 2009.

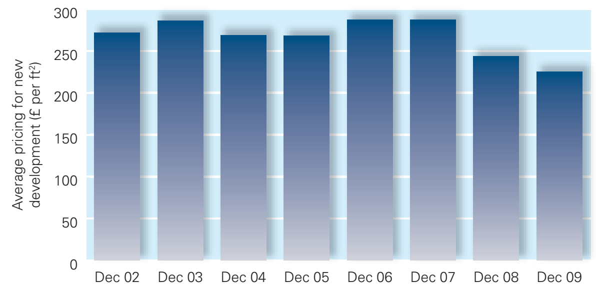
Furthermore, only Peel's Media City in Salford Quays, where 378 units will be delivered, is due to complete in the next twelve months. This will be the new home to the BBC with circa 1,500 staff relocating from London to Manchester. This influx of people will put additional pressure on an already restricted city centre property supply.

Prime residential values reached an average of £380 per ft^2 at schemes like Great Northern Tower at the peak of the market but now stand closer to £280 per ft^2. Current average pricing is now around £230 per ft^2.

With the reduced supply of mortgages there has been a sharp increase in the demand for rented accommodation. There are typically less than 300 units available on the rentals market with around 90% taken up on a monthly basis. With no new stock entering the market there is a reliance on managed stock becoming vacant to create new rental availability. Rental values have risen by around 5% over the last 12 months with one bedroom units typically renting for £625 pcm and two bedroom units achieving £850 pcm. Prime one bedroom units are fetching £800 pcm while two bedroom apartments in the city centre are commanding circa £1,200 pcm.

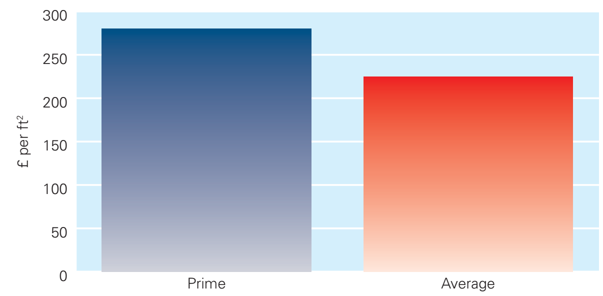
Looking forward the sales market conditions in the city centre have meant that several planned schemes have been put on hold and the understandably cautious approach by developers and their financiers has lead to a shortage of city centre apartments compared to current demand. Population forecasts suggest that the City is set for considerable expansion over the next decade and new city centre apartment schemes will be required in order to meet expected demand.

Manchester city centre pricing



Source: King Sturge

Manchester city centre pricing – prime and average



Source King Sturge

Media City in Salford Quays developed by Peel

Liverpool

Despite the impact of the global credit crisis and UK recession, Liverpool has prospered and progressed in recent years. The openings of major mixed use developments such as Met Quarter, Liverpool One and the Echo Arena & BT Convention Centre, as well as the boost from being European Capital of Culture for 2008, have all helped Liverpool's cause.

In property terms Liverpool city centre was not blighted with an oversupply of apartments following the housing market downturn in late-2007. This was largely because a number of planned schemes had not started on site when the credit crisis hit.

Indeed, several major schemes, including Lead Asset Strategies' 360 unit New World Square scheme, Windsor's L1 development and the HCA consortium led Kings Waterfront scheme of 1,500 units, are all currently on hold. A key trend for some of these schemes is that they are being returned to planning to be reworked to include larger shares of commercial use at the expense of residential.

Although there have been no new development starts over the past two years, Liverpool has seen a number of schemes complete. These include the Elysian Fields development where Iliad have built 104 apartments and West Tower, the Beetham Organisation's 40 storey tower which became Liverpool's tallest building housing 127 apartments. Grosvenor's 326 unit One Park West development also completed recently. Three schemes are likely to complete over the next two years. These are LAGP's 172 unit Kings Dock Apartments, Neptune Developments and Countryside Properties' 376 unit Mann Island and Vermont's 385 unit development The Quarter.

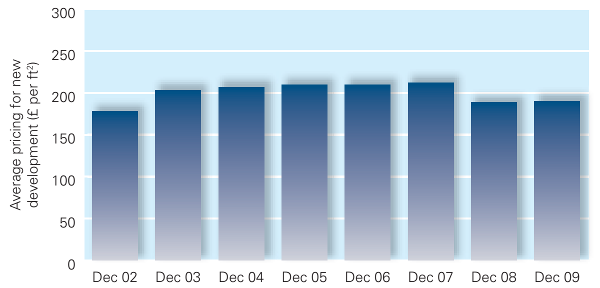
There are now just two city centre schemes on the market. These are at Mann Island and One Park West where prices being achieved are typically in the £250-300 per ft^2 range although average pricing for Liverpool city centre is more typically £180-200 per ft^2.

Prices for prime city centre apartments are presently averaging £275 per ft^2. Although this is notably lower than the £320 per ft^2 2007 peak, the prime market has remained fairly buoyant, mainly due to a shortage of top quality developments coming to the market.

The rentals market is presently strong with around 10 potential tenants for every unit available. As a result one bedroom apartments are now commanding upwards of £600 pcm with two bedroom properties demanding £750 pcm.

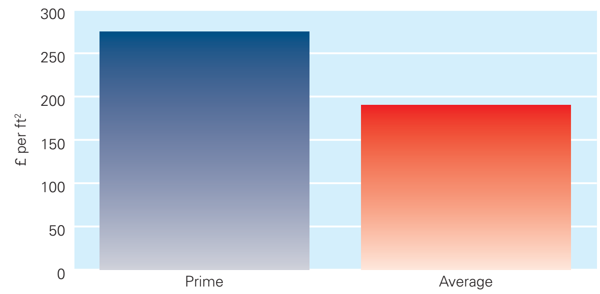
With a number of planned schemes now stalled or being reworked and with little in the immediate development pipeline, this could leave the way for the bolder residential developer to take advantage of an enhanced city centre, a more mature city centre residential market and a marketplace with significantly less competition.

Liverpool city centre pricing



Source: King Sturge

Liverpool city centre pricing – prime and average



Source King Sturge

Interior of One Park West

Leeds

The residential sales market in Leeds city centre witnessed very few transactions in 2008 but when values began to stabilise at the beginning of 2009 the number of sales slowly increased. Price falls were highest in the peripheral developments however they were significantly less in the more prime schemes.

The market began to improve in 2009 with an increase in transactions and a flight to quality. Developments such as Granary Wharf proved popular due to the superior quality, larger than average apartments and prime location. A total of 48 apartments were sold at Granary Wharf in 2009 and only four of these were to investors, illustrating that there is still a strong demand from owner occupiers in Leeds city centre.

Homebuy Direct has proved popular in Leeds, helping first time buyers onto the property market. Three developments, namely Granary Wharf, Saxton and Echo are currently offering this first time buyer initiative.

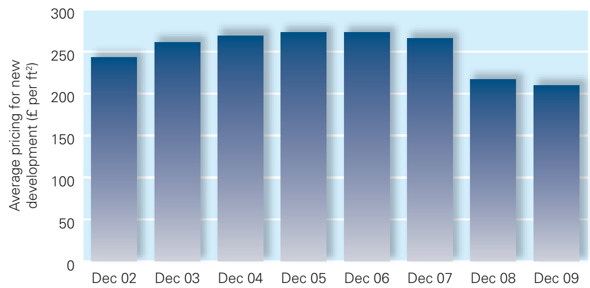
The second hand sales market in the city centre is currently characterised by a shortage of stock with many investors choosing to hold and rent their properties rather than sell. In addition, a number of developers have made the decision to rent unsold apartments with a view to selling once the market improves and this practice has further restricted choice for buyers in the sales market.

The lettings market has remained strong over the last two years with occupancy rates at high levels. A recent study carried out by The University of Leeds and five Leeds agents, including King Sturge, revealed that out of 3,153 apartments managed by the top six lettings firms in the city centre, more than 92% were presently occupied. Rents have remained static over the past two years although yields have increased following sales price reductions.

Much of the negative press coverage surrounding the oversupply of apartments in Leeds over the past few years focused on the supply pipeline. There are currently just over 9,500 apartments in Leeds with a further 100 under construction. In addition to this, approximately 10,000 have a planning consent. However, we do not envisage many of these will go ahead in their current form and certainly not within the next few years.

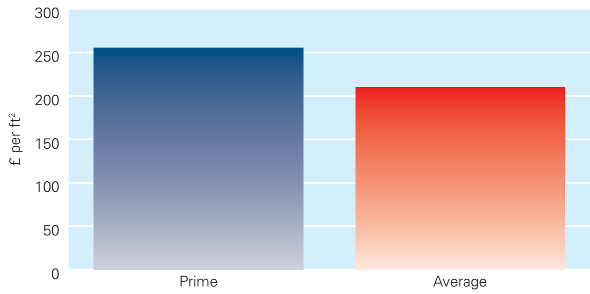
There is no doubt that the Leeds residential market has suffered in terms of values and reputation in recent years, however, it is clear from the continued success at Granary Wharf that there is a strong demand from owner occupiers in the city centre and we anticipate this will continue. We believe that future residential developments are likely to be successful if they are delivered in the prime areas and with owner occupiers, rather than investors, in mind.

Leeds city centre pricing



Source: King Sturge

Leeds city centre pricing – prime and average



Source King Sturge

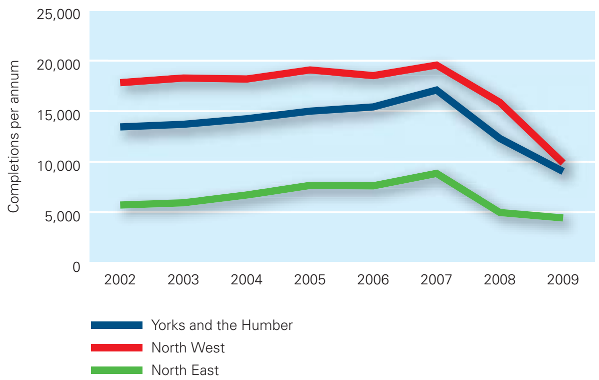
Watermans Place, Granary Wharf, 282 units, developed by ISIS

Development market

Perhaps the most significant impact on the UK housing market of the global financial crisis and domestic recession has been the abrupt slowdown in housing development. The chart below shows how quickly the number of completed units by region fell between 2007 and 2009.

All three Northern regions have seen a similar 50% fall in completions during this time. In absolute terms the starkest decline has been in the North West where annual completions of almost 20,000 in 2007 fell to just under 10,000 dwellings in 2009. Yorkshire and the Humber experienced almost as sharp a decline with completions of just over 17,000 units falling to a little over 9,000. In the North East, where completions have been notably lower, annual completions of circa 9,000 dwellings fell to around 4,500 between 2007 and 2009.

Northern housing completions by region



Source: King Sturge, CLG

During the most productive development year of 2007 the total number of residential properties built across all three northern regions was 45,500 with the previous few years generating a steady increase before reaching this peak. By 2009 this total had shrunk to 23,350 homes.

In the context of annual household projections of circa 66,000 a year covering the period 2011-2031 even a return to the most expansionary year of 2007 would not seem sufficient to deliver the requisite number of homes required by the expanding and changing nature of households in the Northern region.

Conclusions

Northern England benefited from a very strong housing market during the period 1998-2007. During this time house prices increased by an average 10.2% pa and residential development completions increased to average over 40,000 a year across the Northern region as a whole.

However, house prices, property transaction turnover and residential development all declined significantly following the global financial crisis and ensuing domestic economic recession. House prices in the North fell by 17% in 18 months and development completions halved between 2007 and 2009.

Having bottomed out in early-to-mid 2009, house prices in Northern England have risen once again during the second half of the year. Housing transactions have also increased substantially.

With the UK economy emerging from recession in Q4 2009 and with the UK and Northern economies forecast to grow more strongly over the next five years, the prospects for greater housing demand also look more positive.

In addition, household projections made by the CLG suggest that over the next 20 years the Northern region will form on average an additional 66,000 households a year. Furthermore, the projections suggest that a significant proportion of the additional households will be one person households.

Assuming that the CLG household projections are not wildly inaccurate, the Northern region will have to find some way to develop even more homes than it did during the recent housing boom years.

It will be interesting to see how all parties, from residential developers through to local authorities and planners, respond to this challenge.

If the response is insufficient or ill-timed it is likely to result in an undersupply of housing and a significant increase in house prices to reflect the widening demand and supply gap.

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