
AYRSHIRE JOINT PLANNING STEERING GROUP
16 December 2009

Prospects for Future Private Sector House Building in Ayrshire

PURPOSE OF REPORT

1. To provide an analysis of recent private sector house building activity and examine the factors affecting current and future demand for owner occupied property and house building activity.

BACKGROUND

2. The approved Ayrshire Joint Structure Plan identified the requirement for a significant increase in housing investment and an increase in the rate of house completions to stabilize the population at current levels by 2025, and as both an economic driver per se and a necessary underpinning to support the economy.
3. To achieve a stable population by 2025, the Joint Structure Plan seeks an average annual completion rate of 1800 homes per annum. Historically, completions have averaged around 1200 homes per annum. In the two years immediately following the approval of the Structure Plan, total completions (private and public sector) increased to a peak of 1700 in 2006/2007 before falling slightly to just over 1600 in 2007/2008. Not surprisingly, house building activity in Ayrshire has been affected by the recent recession as it has throughout the rest of the country. The latest figures available for completions from the Housing Land Audit process show a further fall in total completions to circa 1200 homes in the period April 2008 to March 2009.

REVIEW OF RECENT PRIVATE HOUSEBUILDING ACTIVITY

4. In 2006/07, private sector housebuilding reached a peak in Ayrshire of circa 1500 units. Since then there has been a dramatic reduction to 862 units in 2008/09. Table 1 compares the actual private sector completions between 2008 and 2009, with the predicted output in the 2008 draft housing land audit audits for different sized sites.

Table 1 – review of private sector housebuilding progress

Site Size	Private Sector House-building		
	Projected 2008/09	Actual 2008/09	% difference
Small Sites (less than 40 units)	555	336	-40%
Large Sites (more than 40 units)	519	526	+1%
All Sites	1074	862	-20%

5. Two main conclusions can be drawn from the above analysis:-
 - (i) Private sector output has fallen 20% further than was predicted in 2008.
 - (ii) In all areas, smaller sites have been affected to a greater extent than larger sites.

OUTLOOK

The Ayrshire Perspective

6. Understanding developer intentions at the local level has been difficult since 2007 due to turmoil within the building companies. Feedback from individual developers on the 2008 Housing Land Audit was very limited. Draft 2009 Audits have been forwarded to Homes for Scotland for revised comments. In the meantime, a review of progress on the larger sites which are anticipated will be developed over the next three years has been undertaken. This exercise suggests that development is continuing on sites which were opened prior to the *credit crunch* but investment in new sites is limited, particularly where major infrastructure has not yet been committed.
7. Whilst a comprehensive review of prospects for all smaller sites (which are difficult to predict at the best of times) has not been undertaken, the officers' impressions are that development is being delayed on these sites as well. The latest available figures for NHBC registered builders¹, show a low level of new starts for Ayrshire at 164 units in the 1st half of 2009 compared to 430 in the first half of 2008 and 476 in the first half of 2007. It is quite likely therefore that output will fall further than predicted in the 2009 Audit over the short/medium term.

The UK/Scottish Perspective

Supply Side Considerations

8. Currently, the ability of house-builders to access credit to fund developments is severely constrained and is likely to remain so for many years to come². In the short term, at a UK level, lack of debt funding for development and aversion to risk are likely to:
 - Encourage development on low risk small sites (less than 50 units) in high demand areas for houses rather than flats;
 - Favour developers who are not heavily dependent upon borrowing money from banks;
 - Favour fully serviced larger scale sites compared to un-serviced large scale sites or restructure large sites into smaller components;
 - Encourage sale of serviced plots for self-builders/self procurers;
 - Larger, infrastructure hungry sites, particularly brownfield sites in high density urban areas are unlikely to be progressed for some time until cost-effective funding is available;
 - Large sites owned by public sector bodies (who may be more likely to sell land during a period of low land values) are more likely to be developed than privately owned un-serviced sites, paving the way for more joint public/private ventures; and
 - Drive up the quality of development.
9. A key factor on the supply side as to whether development will return to the levels previously witnessed will be the availability of development finance. It is uncertain whether in the foreseeable future banks will wish to expose themselves to "risky" property development activity, particularly for large scale developments which entail significant upfront infrastructure costs with no certainty over how long it will take to

make a return. Savilles PLC, in their June 2009 report on the current state of housing land markets, speculate that long term equity finance (i.e. where the funder retains long term ownership of both residential and non-residential elements of the scheme) may increase as a source of development finance to make up for the steep decline in debt funding by banks. Such investment is geared to the long term and would favour rental property in locations best placed for rental and capital growth.

Demand Side Considerations

10. Consumer demand for new build properties is inexorably linked to the operation of the secondhand property market. The typical private sector housing development in Ayrshire, sells at a premium compared to the secondhand market. Such properties are affordable to those households in the higher income groups or those with access to capital. As a general rule, therefore, the sale of new build properties relies on households moving up the property ladder and being able to release equity to fund the asking price for new build and to cover the costs of the property transaction. In order to understand the future demand for new build property it is, therefore, essential to understand what is happening in the property market generally and to identify key indicators which could signal a change in direction for demand for property, including new build.
11. A brief summary of the current state of the property market is that whilst mortgage interest rates are at an all time low, house prices have fallen and the volume of mortgage approvals and the number of property transactions have declined markedly since 2007. Ayrshire is no exception to this general picture and the local property market has experienced a steep decline in activity and a fall in average property prices since the third quarter of 2007.
12. Falling house prices and reduced volumes of transactions would normally be equated with reduced demand for housing. Yet, the projected number of new households continues to rise steadily, mainly as a result of the long term trend towards smaller average household size. Fundamentally, this latent demand for housing has not translated into rising activity and prices because of the ongoing *credit crunch* since 2007. Despite the UK Government's encouragement to increase mortgage lending, the reality is that banks and building societies are seeking to cut back their lending in order to protect themselves from existing and future bad debt. For many consumers, getting a mortgage is much more difficult now compared to the past decade and thus effective demand is greatly reduced from the peak in 2007.
13. First time buyers are the group most affected by the reduced availability of credit and tighter lending conditions since they tend to be younger, be in the lower earnings brackets and have the least capital. First time buyers are very important to the operation of the property market as they normally account for a large proportion of all property transactions each year and generally enter at the base of property chains, enabling transactions to proceed higher up the property ladder. At the UK level, the proportion of transactions accounted for by first time buyers fell from 50% in 1998 to around 33% in 2008³.
14. Inevitably falling demand for housing puts downward pressure on property values and nationally and locally average house prices fell between 2007 and 2009. There is evidence that prices have stabilized in recent months but it is by no means certain that they will not fall further³. Uncertainty over house prices represents a real risk for

purchasers and lenders as the value of property can quickly become less than the value of the loan secured on it. In such conditions, investing in property is seen as less desirable but particularly affects those who have only limited cash to put down as a deposit and those who are concerned about the security of their employment. The fall in demand created by uncertain property values adds to the downward pressure on prices.

15. Low demand for property and uncertainty over property values also have the effect of reducing the supply of secondhand properties offered for sale. Homeowners are less likely to sell at a time when values appear to be falling. The evidence that property prices have recently stabilized suggests that a new equilibrium between supply and demand may have been reached and it is one under which the volume of property transactions is far less than during the property boom. If this is the case then the prospects for new private house building appear very much reduced compared to recent years.
16. Whether and how long the apparent new equilibrium persists will depend upon the availability of credit, the lending criteria operated by institutions (particularly in relation to first time buyers), the extent to which property values fall, the ability of the UK Government to maintain stable interest rates and trends in unemployment.
17. Whether there is any easing in the supply of credit and relaxation of the lending criteria of banks and building societies will affect the level of activity within the property market. The easing of the supply of credit would create the conditions necessary for rising house prices and increased volumes of transactions. It remains to be seen whether more favourable credit conditions will be restored in full or in part to those of the last decade as increases in base lending rates seem likely in the medium to longer term³, which could undermine the effects of any easing in the supply of credit.

CONCLUSIONS

18. Ayrshire, in common with the rest of the UK has witnessed a sudden and dramatic reduction in private sector house building activity, the root cause of which is the reduced availability of cheap credit, both for development finance and property purchase. The prospects for private sector house building are closely linked to the condition of the wider property market and what happens within the secondhand market will influence the market for new build. Activity and prices are currently depressed within the wider housing market and the continued restricted supply of new mortgages, in particular for first time buyers, does not suggest any improvement in the near future. Future increases in interest rates and unemployment will impact upon affordability and will influence the future direction of the market. This, together with buyers reduced ability to pay through lower mortgage multipliers and larger deposits suggests an increased need for affordable housing and the likelihood of a change in the private and public sector housing supply that could persist for some time.
19. At the present time it is not known how long these depressed macro economic conditions will persist but the likelihood is that they will continue in the short to medium term. The implication is that public intervention will need to increase if

housing needs are to be met, yet in a time of heightened financial restraint in public sector spending it is difficult to see how the supply of housing will increase to the required level.

RECOMMENDATION

20. The Steering Group is asked to note the content of this report and ask the Joint Planning Unit to broaden its monitoring of private sector house building activity beyond the coordination of the Housing Land Audit Process to encompass monitoring of factors affecting the operation of the private property housing and financial markets and to produce a set of key indicators of change.

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References

¹New House Building Statistics” NHBC 2009 Quarter 1 and 2

²”Spotlight On The Future Of UK Residential Development Land”, Savilles Research June 2009

³”Recent Developments in the UK Housing Market” Economic and Labour Market Review, Vol 3, No8, August 2009

⁴”Scottish Housing Market Review October 2009” Scottish Government Centre for Housing Market Research
Council of Mortgage Lender figures for first quarter 2009