Residential Research

Knight Frank

Surging South

South East residential development review • 2007

Contents

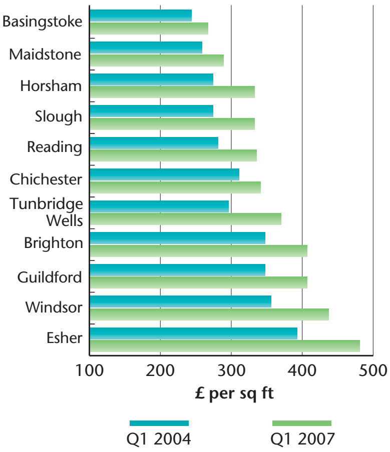
The Beacons, Chelwood Gate

Executive summary

- A combination of wealth generation, severely restricted land supply and sustained market confidence are together diminishing the gap between new build prices in London and the rest of the South East. In the past three years new build prices have risen substantially with property in an increasing number of the South East's towns achieving over £350 per sq ft.
- This report highlights those towns that have witnessed the highest growth in London commuter residents. Historically, commuter towns were those within an hour's journey of the capital, but increasingly London workers are willing to trade proximity to work for rural, and particularly coastal, residences further afield.
- We provide a detailed assessment of two of the region's prime markets namely Guildford and Tunbridge Wells and analyse SEERA's housing targets against projected demand whilst highlighting top schemes in the area, current values and affordability.
- A severe lack of land supply, exacerbated by Special Protection Areas (SPAs) in the Thames Basin Heath area, has led to rising land values and lower margins for house builders. As a result, mergers and acquisitions have risen and even the larger house builders are becoming involved on smaller schemes.

Willow Park, Kings Hill
(computer generated image – details may vary)

Figure 1
New build pricing in South East England



Source: Knight Frank Residential Research

Mosaic Apartments, Slough
(computer generated image – details may vary)

The draw of the South

Economic expansion

In the last four years the price gap between the South East and London's housing market has narrowed. Three years ago £350-£400 per sq ft was achievable in only a handful of markets in the region. This level is now rapidly becoming the norm, as the South East's housing market becomes increasingly homogenised in terms of price. Locations such as Reading, Brighton and Tunbridge Wells are now achieving £50-£75 more per sq ft than three years ago.

Why has this trend occurred? There are a number of contributory factors, such as the region's quality of life, the combination of coast and countryside and growing wealth. The most significant factor has been the driving force of London over the past few years. A recent report by the Department for Communities and Local Government (DCLG) into the role of city-regions, showed that the greatest level of wealth creation of (GVA growth) in the South East occurred along the main road and rail links to London, the M23, A3, M20 etc.

According to the Greater London Authority (GLA), "The London effect is huge, geographically widespread and growing; that is to say the increasing wealth and vitality of the most 'connected' places within a 60-100 mile radius of the capital is not simply coincidental but is dependent upon a range of economic, labour and housing market interactions that tie their fortunes to those of the city".

The strength of London's economy, its strong financial services sector and burgeoning labour market provide employment for around 371,000 of the South East's eight million residents, this equates to over 11% of the region's economically active residents. The net benefit for the South East is considerable, the South East England Development Agency (SEEDA) estimates that the gross income of commuters from the South East to London totals £22 billion, roughly one sixth of the South East's GVA.

Growing housing demand in the South East is not solely attributable to the proximity of London. The South East's own economy and infrastructure are generating significant wealth. Inward migration to the region, to some extent fuelled by lifestyle moves out of London, higher disposable incomes and the region's own expanding labour market are all adding to demand. Disposable incomes in the region are 14% above the national average and the South East currently ranks 15th out of the European Union's 86 regional units in terms of economic productivity.

Commuting trends

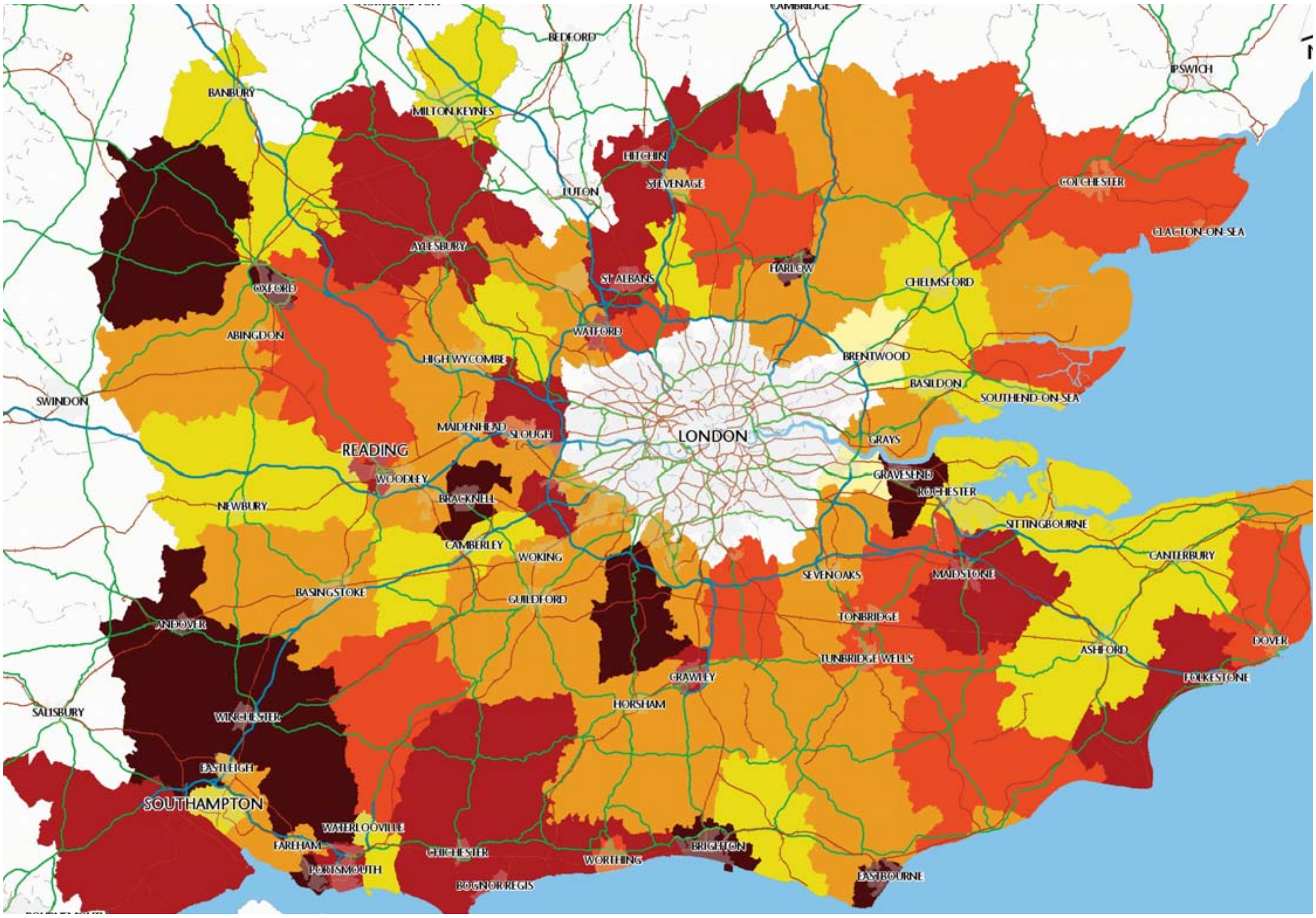
The map on page three highlights those Local Authorities in the South East that experienced the largest rise in commuter numbers between the two most recent census dates. We have extracted data for commuters working in the three London Boroughs which are the largest employment centres – the City of London, Westminster and Tower Hamlets (Canary Wharf).

The map highlights some interesting trends. Commuters were attracted to a range of locations across the South East during the period analysed; from the affluent Surrey Hills to Sussex coastal towns and some more industrial centres in Kent.

The largest rise in commuters (85%) occurred in Mole Valley an area that covers Leatherhead and Dorking, closely followed by Eastbourne (82%) and then Gravesham (72%). The development and further expansion of Eastbourne's marina, improved road links in the form of the A27 and large retail expansion have improved the town. Gravesham, for its part, represents a more affordable area and one that is set to expand further as development in the Thames Gateway takes shape.

Substantial growth in commuter numbers has also been witnessed along the south coast in areas such as Brighton and Hove, Adur (Shoreham-by-Sea), Chichester and Arun (Littlehampton). Journey times from some of these locations to the capital can be upward of 90 minutes suggesting more London workers are willing to trade proximity to work for rural, and particularly coastal, residences.

The change in commuter numbers by local authority



Source: ONS/Knight Frank Residential Research

Legend

Commuters travelling to 3 London Boroughs* (% change 1991-2001)

- 45% +
- 25% to 45%
- 15% to 25%
- 0% to 15% (Increase)
- 0% to -20% (Decrease)
- -20% to -40%
- -40% +
- Motorways
- A Roads
- A Roads Non Primary

* City of London, Westminster and Tower Hamlets (Canary Wharf)

Beyond Brighton

Higher new build values are not only pushing southwards from London, but also to the east and west of Brighton, a city which has long been the traditional favourite with those Londoners opting for a lifestyle change.

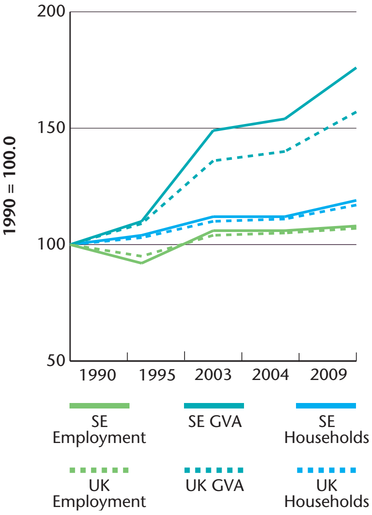
To the west of Brighton, the housing markets in Shoreham-by-Sea, Angmering and Littlehampton are facing high demand. Here, the market is considered to be more accessible with average house prices 9% - 17% below the South East's average.

To the east of Brighton, and inland, the land market has been particularly active suggesting an improving development pipeline. Regeneration opportunities in areas such as Newhaven and Hastings have acted as prime catalysts. In Saltdean, Explore Living has acquired the Grand Ocean Hotel and planning has been granted for 300 new apartments. In Eastbourne, a range of schemes are coming to the market including niche developments such as Koala on the town's seafront, the larger scale Harbour Club consisting of 24 units which will complete in September 2008 and the King Edward's Parade development which is currently awaiting planning consent.

Harbour Club, Sovereign Harbour, Eastbourne
(computer generated image – details may vary)

Figure 2

Economic and household projections – South East vs. UK
(1990-2009)



Source: DCLG/Eurostat/Cambridge Econometrics

Closer to London, both Mole Valley and Elmbridge districts continue to appeal to wealthier buyers coming from London. Many of these buyers want to swap city life for a semi-rural lifestyle whilst remaining in close proximity to London (in particular the Square Mile) as well as major transport links; both Heathrow and Gatwick are less than 25 miles away. The Surrey Hills meet all these prerequisites and at the same time offer highly rated restaurants, shops and private schools.

In terms of future expansion, Ashford in Kent is arguably set to see the largest transformation over the next few years. Two major developments are set to impact on the town. In 2003, as part of the Sustainable Communities Plan, Ashford was named as one of the Government's four growth areas. As a result, the town is forecast to double in size and population by 2031 providing 31,000 new homes and 28,000 new jobs over this period. Around £45 million has already been allocated to the town from the Growth Area Fund and this appears to have lifted market confidence. The year after Ashford achieved Growth Area status the number of sales in the town rose 49% and average house prices rose 26%.

The completion of the Channel Tunnel Rail Link (CTRL) will be an important driver of future housing demand in Ashford. In 2009 the launch of the high-speed domestic rail service from Ashford to London St Pancras will commence reducing journey times from 83 minutes to 37 minutes boosting the town's commuter population. Further north, the area around Ebbsfleet near Dartford will also see significant growth. Here, the connections from the new Ebbsfleet station on the CTRL route will reduce journey times to London St Pancras to 17 minutes. The new station will provide over 9,000 car parking spaces, an indication of the volume of commuters anticipated to use the service.

Future trends

According to SEEDA, the South East's economy looks set to remain advanced, high cost, high income, broad based and service oriented. Forecasts suggest an additional 90,000 people will be employed in the region by 2009. South East residents will continue to be London's main external source of labour, a factor which we have seen adds significant wealth. On the downside, the main risks to the region's housing market remain further interest rate rises, a slowing London economy, escalating land values and a widening affordability gap.

An expanding commuting population will not only place greater pressure on the region's infrastructure which will require significant investment, but the South East may well be the region most affected by any future discussions regarding road charging. Greater disparities are likely to emerge between those towns with good transport links and the region's more isolated towns with less diverse economies. The coastal areas account for around 27% of total GVA in the region compared to the inner areas which provide 43% of the region's GVA. Conscious of this widening gap, SEEDA have started targeting greater investment into coastal areas as well as rural Kent.

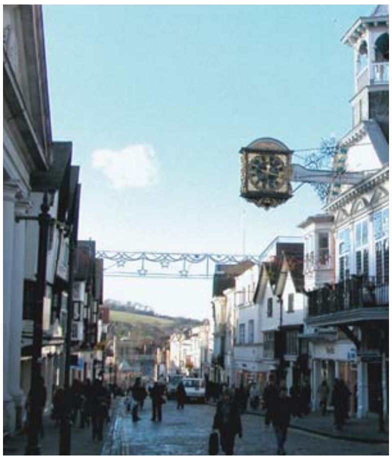
Implications for developers and house builders

Protected greenbelts, affordability pressures, a scarcity of land and historically high build densities are all contributing to the growing homogeneity of the South East's towns. What started out as a retail phenomenon with identical stores occupying high streets across the country is now being mirrored from a residential angle.

Why is this happening? Most new build schemes are now town centre developments close to good road and rail links, shops and bars. Developments are predominantly flats or townhouses due to density guidelines, this attracts young professionals or buy to let investors who are generally more concerned about price than specification. The result is a swathe of largely identical schemes which lack the edge in terms of architectural design but are themselves determined by policy and affordability constraints.

If developers are to maximise their returns in a climate of tightening land supply their research into their target market will need to be increasingly thorough, analysing local market demand drivers such as transport links, economic forecasts, purchaser profiles, accessibility for first time buyers and investor activity. Successful schemes will increasingly be those that either differentiate themselves from the market via design or location or those that identify a new source of demand. Several niche developments in Lewes for example, many with a strong design bias and a live/work functionality, have attracted a steady flow of design conscious purchasers happy to leave Brighton behind for the benefits of a quieter market town behind the South Downs.

"Successful schemes will increasingly be those that either differentiate themselves from the market via design or location or those that identify a new source of demand."



Guildford High Street

Guildford focus

Demand

Guildford is Surrey's most populous town comprising 29,490 households. This figure is forecast to rise by 16% in the next five years, partly as a result of the city's declining household size, but also due to strong inward migration. This growth will mean the wider Guildford Borough will be home to 138,000 residents by 2021 or 57,500 households. The 45-64 age group will witness the highest level of growth. Across the county as a whole foreign migration accounts for a growing proportion of demand. In 2001 12% of Surrey residents had moved home in the previous year and 10% of these had arrived in the county from abroad.

Guildford's popularity and affluence is largely explained by its location. Situated within a short commute of London (38 minutes to London Waterloo by rail), it benefits from easy access to the M25 as well as the coast and the countryside via the A3. The lifestyle on offer in Guildford has spawned high demand particularly from wealthy individuals. Above average price inflation has led to rising affordability concerns as well as an active private rented sector which partly services the housing needs of the University of Surrey's 15,900 students, located in the city.

Supply

SEERA's South East Plan has set a housing target of 4,750 new homes for the Guildford Borough between 2001 and 2016. The council, in its Local Development Framework has confirmed it is confident that the urban areas of Guildford, Ash and Tongham and the surrounding villages can accommodate this new growth. Guildford's completion rates have risen significantly since the millennium; from 178 units in 2000/01 to 479 new homes in 2005/06.

Parkhill, Esher

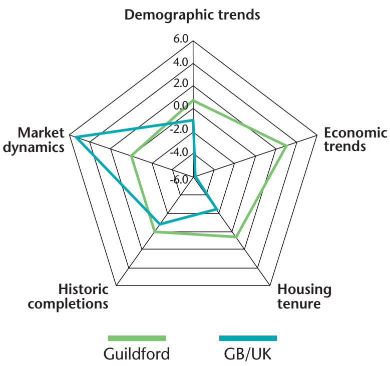
Pricing

Whilst Guildford's average house price (£335,307 in 2006) is 62% higher than the average for England and Wales, average household incomes are only 29% higher than the national average. A new two bedroom two bathroom apartment in Guildford town centre currently stands at £275,000, having witnessed capital growth of 17% since 2004. A number of new developments in the city centre are now exceeding £400 per sq ft.

Affordability

Affordability is arguably the Borough's most pressing concern. High housing costs have the potential to limit economic activity, reduce labour market flexibility, increase commuting times, and reduce the competitiveness of the town. In 2005 Guildford's Housing Strategy focused heavily on the increased provision of affordable homes and aimed to lift completions from 200 units per annum in 2003 to 950 by 2008. In line with the Local Plan all schemes over 15 units, or on sites larger than 0.5 hectares, in the Guildford urban area must currently provide 35% of affordable homes. This is set to change with the implementation of the Council's Core Strategy which will lower the qualifying threshold significantly to schemes of five or more units or those larger than 0.13 hectares. Knight Frank's Affordability Index, based on a single person household and measuring lower quartile household earnings against lower quartile house prices, records an affordability ratio of 8.3 for Guildford.

Figure 3
Guildford market conditions spidergram



Source: Knight Frank Residential Research

Note: The larger the spider the better the market conditions.

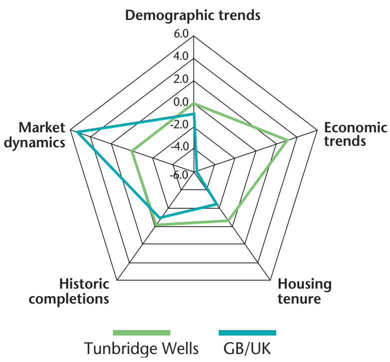
Market outlook

In a housing market largely financed by debt the future trajectory of interest rates is likely to determine the health of the market. The HM Treasury survey indicates that even the most 'bearish' of forecasters do not predict interest rates will break the 6% level in 2007. We believe that affordability issues will cap price growth in Guildford at c.6% per annum over the period to 2009. The planned improvements to the A3 in the form of the Hindhead Tunnel should relieve congestion in and around the Devil's Punch Bowl by 2011. The new road is likely to boost Hindhead's housing market at the same time as improving access from London and Guildford to locations such as Haslemere, Petersfield and beyond to Portsmouth.

Balmoral House, Tunbridge Wells

Weavers Place, Tenterden
(computer generated image – details may vary)

Figure 4
Tunbridge Wells market conditions spidergram



Source: Knight Frank Residential Research

Note: The larger the spider the better the market conditions.

Tunbridge Wells focus

Demand

Tunbridge Wells is home to 23,762 households, 65% of which are owner occupied and 28% of these are owned outright with no mortgage. Around 7,000 residents commute into London daily, taking advantage of the 50 minute journey time to Charing Cross. Demand from first time buyers and downsizers is strong, particularly those choosing to split their time between a smaller UK base and a second home abroad. Around 78% of the town's households fit within CACI's top three socio-economic categories (Wealthy Achievers, Urban Prosperity and Comfortably Off) compared to 64% in Great Britain. Economic activity in the town is high, 2.1% of the population is unemployed compared to 5.1% nationally.

Supply

According to the Tunbridge Wells' Annual Monitoring Report, the combined total of completions, outstanding consents and remaining Local Plan allocations means that some 2,108 dwellings have already been identified towards SEERA's South East Plan requirement of 5,000 dwellings for the town, leaving 2,892 to be accounted for between 2006 and 2026.

Prime schemes in Tunbridge Wells include Balmoral House, a Victorian conversion consisting of 22 apartments, within easy reach of the station and located on the town's common. Prices start at £170,000 and the scheme has proved popular with first time buyers and attracted a number of parents looking to invest as a means of helping their children onto the property ladder. Bellway's Linden Fields is now 60% sold and is attracting mature couples wanting a central location. Further afield Weavers Place in the village of Tenterden has recently been launched consisting of 23 homes, a mix of apartments and houses with prices starting at £240,000.

Pricing

Top specification new build apartments are achieving £370 per sq ft in central Tunbridge Wells, the average two bedroom two bathroom flat is now valued at £250,000. Demand for one bedroom apartments has been particularly strong with those priced at £160,000 selling well. According to the Land Registry the average home in Tunbridge Wells rose 13% or by £35,772 in 2006. Semi-detached properties saw the highest capital growth at 16% followed by detached homes and apartments at 12%.

Affordability

In 2006 residents in Tunbridge Wells had, on average, the highest full time income across all Local Authorities in Kent. The average full time wage in the town now stands at £38,607, 7% higher than a year earlier and 32% above the UK average. Based on Knight Frank's Affordability Index, which calculates mortgage costs for single households based on lower quartile indicators, Tunbridge Wells has an affordability ratio (house price to income) of 8.4, marginally higher than Guildford, but significantly higher than the South East's ratio of 6.7.

Across the Borough of Tunbridge Wells there are currently 395 affordable units with consent, the vast majority are for rent or shared ownership.

Market outlook

Products suited to buy to let investors and first time buyers are in short supply in the town centre although a number of land sites have changed hands in the past year suggesting an improving pipeline. The area east of Tunbridge Wells, near Tenterden and across to Ashford, is expected to see rising demand in the run up to the completion of the Channel Tunnel Rail Link in 2009 when faster services will run across East Kent into London. The new village community at Kings Hill near West Malling which has already witnessed rising demand is set to see further expansion. There are approximately 450 houses still to be built as part of Phase I and Phase II will bring a further 750 houses. The proposed expansion of the community's primary school is testament to the popularity of the development.

Table 1 – Wealthy Achievers & Urban Prosperity (% of households)

Guildford	60.9%
Tunbridge Wells	48.4%
Sevenoaks	69.3%
Horsham	44.8%
GB average	36.4%

Source: CACI

Prime locations

Sevenoaks

Sevenoaks, situated three miles from the M25, represents a prime commuter suburb. Over 17,000 residents of working age commute into Greater London. Strong economic activity provides the town with a high level of affluence; over 43% of the town's households are defined as Wealthy Achievers (compared to just 23% nationally) and 40% of the town's housing stock is comprised of detached homes. In 2006 price inflation was marginally above the average for the South East at 9%, market activity was also higher than the regional average with sales volumes 3% higher. The emerging South East Plan allocates the District a housing requirement of 3,100 units between 2006 and 2026. Across the Sevenoaks District over 93% of land is designated Green Belt making development opportunities scarce despite growing demand. Affordable housing provision is reliant on the implementation of Section 106 Agreements on larger private developments and on rural exceptions sites.

Horsham

Summers Place, Billingshurst

Horsham is home to a population of 42,708 residing within 18,168 households. An affluent area, the median full time salary (£28,637) is 10% above the regional average and 21% above the national average. Around 5,000 residents commute daily to London with Crawley, Mid Sussex, Mole Valley, Brighton and Worthing representing other prime workplaces. The renewal of the town centre began in 2003 with the redevelopment of Blackhorse Way which provided a new town square, retail units, department store and crucially 65 new residential units (affordable and shared ownership). At nearby Billingshurst, the former Sotheby's HQ, Summers Place, has now received planning for 37 units, including 11 refurbished apartments in the former Manor House, commercial office space and 26 houses set in private landscaped gardens.

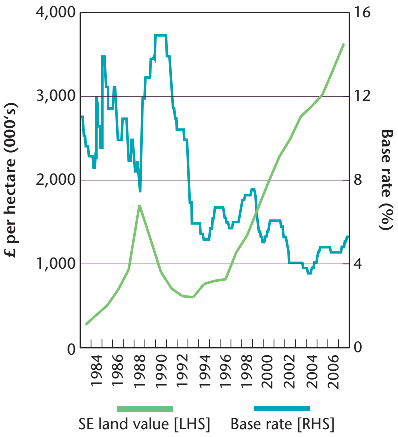
Land market

The land market in the South East is witnessing significant activity despite land values, build costs and interest rates all increasing. The rise in average land values (218% in the past decade) and the growing number of mergers and acquisitions within the house building industry, both hint at the scarcity of land across the region. Against this backdrop the South East Plan, currently under public consultation, has set out its new target, 28,900 new homes to be built annually over the next twenty years. This represents a steep challenge particularly given the number of obstacles faced by developers in the region.

Figure 5

Land values vs. base rate

(1983-2007)



Source: Valuation Office/Bank of England

The introduction of Special Protection Areas (SPAs), set up by the British Government in 2005 under an EC Birds directive and policed by Natural England, has led to a virtual moratorium on development across eleven local authorities within the Thames Basin Heath area. Some local authorities, such as Woking and Guildford, have mitigation schemes in place whilst others such as Surrey Heath have yet to determine their position. The contradiction remains, however, that house builders are being asked to meet Government targets that EU legislation is prohibiting. Elsewhere, other Boroughs including Tandridge, maintain that they have identified their housing allocations and are thereby permitting only small scale development, often limited to ten units or less.

On a positive note, Planning Policy Statement 3 (PPS3) which came into force on 1 April 2007 has a more relaxed attitude to housing density, allowing local planning authorities additional freedoms to set a range of densities within their local development documents. Thirty dwellings per hectare remains the national indicative minimum but local planning authorities can deviate from this provided they can justify they are acting in line with the council's overall spatial vision as specified in paragraph 46 in PPS3.

Knight Frank is acting on a number of the region's major site disposals including two significant English Partnership (EP) hospital sites; surplus land at Southlands Hospital in Shoreham-by-Sea and the former Graylingwell Hospital in Chichester. A development partner is being sought for both sites. It is hoped that the 4.38 hectare site at Shoreham will provide a sustainable community consisting of 200 new homes. The larger site at Chichester will ultimately provide a further 600-700 units. Here, EP want to encourage proposals from developers with a strong commitment to eco-construction and energy efficiency.

Residential Research

Residential Research
Liam Bailey
Head of Residential Research
+44 (0) 20 7173 4966
liam.bailey@knightfrank.com

Kate Everett-Allen
+44 (0) 113 297 2435
kate.everett-allen@knightfrank.com

Residential Development
Stephan Miles-Brown
Head of Residential Development
+44 (0) 20 7173 4903
stephan.miles-brown
@knightfrank.com

Andrew Jones
+44 (0) 20 7173 4949
andrew.jones@knightfrank.com

Guildford
Paul Hogarth
+44 (0) 1483 564660
paul.hogarth@knightfrank.com

Hugo Stuttaford
+44 (0) 1483 564660
hugo.stuttaford@knightfrank.com

Tunbridge Wells
Bianca Longfield
+44 (0) 1892 512006
bianca.longfield@knightfrank.com

Charles Rosling
+44 (0) 1892 512006
charles.rosling@knightfrank.com

Linden Fields, Tunbridge Wells

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Registered office: 20 Hanover Square, London W1S 1HZ

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