Research report

Development outlook

Summer 2013

This bulletin examines changes in commercial and residential development activity and viability, new government initiatives and the overall effects on the outlook for new development. As an addendum we examine some of these factors in more detail in three parts of the country, London and the south, the West Midlands, and Scotland, illustrating how these factors will affect land values.

Executive summary

Development activity

- Over the last 12 months new retail development has decreased, new office development has stabilised, new industrial development has increased slightly and residential development has increased more noticeably. There are marked regional variations with stronger development in London and its hinterland than elsewhere.

Development viability

- The economic outlook is improving but the upturn will be patchy. Slightly below trend economic growth should be achieved by 2015, with similar growth expected in 2016 and 2017.
- For commercial property there remains an increasing differential between prime and secondary rental/capital value growth and between London and the rest of the UK. Outside London prime capital values are generally static or increasing slightly, but secondary values are still falling.
- Prime property leads the upturn as shortages of available space are starting to appear outside London, with significant rental increases expected in some locations in 2014. Capital value growth should be stronger due to some yield compression as investor demand improves outside London. As in recent years central London retail and office values will increase the most, but the gap between growth rates with the rest of the country should gradually narrow.
- UK house price inflation will accelerate to 4% pa in 2014 as the economy improves and the government's initiatives increase effective home buyer demand. Highest value growth will continue to be in London.
- Tender price inflation will increase as construction activity increases. 4.5% pa inflation is expected by 2017.
- Past evidence following major recessions suggests that bank lending on commercial development will remain restricted for many more years, but growth from other sources will partially offset this. Location, lease length, covenant strength and the need for pre-lets will remain as important constraints.
- Planning policy changes in support of a growth agenda will mean a more developer friendly environment. Increased permitted development, greater flexibility in the operation of the Use Classes Order and support for renegotiating affordable housing planning obligations will help new development, but the Community Infrastructure Levy (CIL) may well lead to increasing problems over development viability in certain locations.
- The plethora of government initiatives on the housing front, in particular the £3.5 billion package of equity loans and mortgage guarantees, is already increasing demand and increasing house prices. This should in turn stimulate an increase in house building, helped by the extended Funding for Lending scheme which should mean more lending at cheaper rates to house builders.

Development outlook

- The improving economic outlook and stronger rental and capital value inflation that will result should improve development viability and stimulate new development, provided that development finance is available. The plethora of government initiatives to free up planning restrictions and help provide finance to home owners and house builders/developers should provide further help to the market to ensure that increased new development is deliverable.

Development activity

Key drivers

With a weak economic upturn, occupier demand in the commercial sector and to a lesser extent in the residential sector has been subdued outside London and the south. Not surprisingly, new development activity outside London has remained at a low level generally over the last year, but has improved in the residential sector as the first chart shows. The lack of development finance and mortgage finance has also been a contributory factor.

Economic prospects are brighter over the next two years than over the last two years and, with a number of new government finance initiatives, a significant national increase in development looks to be in sight. This improved outlook is discussed in the following sections.

London is leading the way with a substantial increase in office and residential development in recent years. This can be put down to stronger occupier and investment demand (particularly from overseas), shortages of quality space and better availability of development finance for prime schemes built by the major developers and house builders.

Commercial and industrial sectors

Over the last year there has been a marked difference between the office, retail and industrial sectors but new development activity is still very weak in all three sectors as the second chart shows. Office development has been fairly stable, boosted by healthy occupier and investment activity in London. Retail development has fallen due to negative wage increases (in inflation adjusted terms) and continuing strong growth in on-line sales and industrial development has increased a little following positive orders and output growth in 2011.

New development activity should slowly increase nationally in 2013 and 2014 reflecting the gradual improvement in rental and capital values and the increasing shortages of available prime office and industrial property. Development finance will remain a constraint but increasingly less so as market conditions improve.

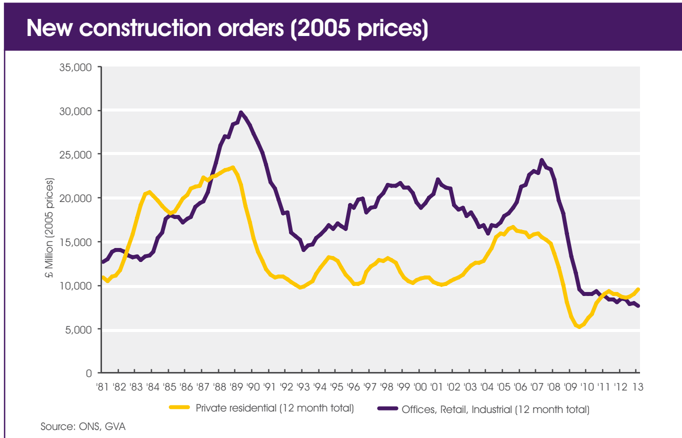
Residential sector

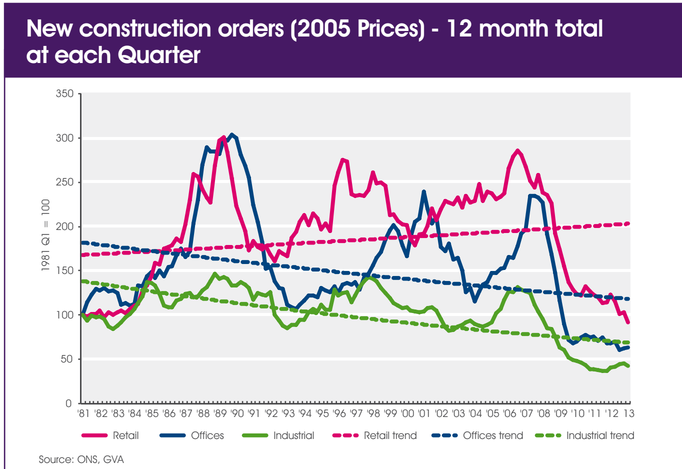
In the mid and late 1990s, despite a strong economic upturn, private sector house building remained remarkably flat overall with increased activity in some years but decreased activity in others, as the first chart above clearly shows. A similar pattern has been evident over the last few years although the overall level of activity has been noticeably lower than in the 1990s. There has been a noticeable improvement over the last three years.

Recent government initiatives such as the Funding for Lending scheme and the Help to Buy initiative should stimulate an increase in house building but the private sector will be wary of the potential risks of sustained expansion. A repeat of the mid/late 1990s fluctuations seems more likely.

As the table shows the total number of housing starts in England actually fell in 2012, according to local authority returns collated by DCLG, to a level 11% lower than in 2010 and 2011. According to these figures the fall was most pronounced in London, the South East and the Eastern regions!

Recent detailed scheme-by-scheme market analysis however shows very strong new development activity in central and inner London particularly, boosted by exceptionally strong overseas investor off-plan purchases. This will no doubt show up in the 2013 official figures.





No. of starts (All dwellings) Source: DCLG

Region	2007	2008	2009	2010	2011	2012
North East	9,110	4,420	3,300	4,920	3,960	4,470
North West	20,530	9,250	6,200	9,570	9,690	10,130
Yorkshire & the Humber	19,880	8,550	5,760	9,500	8,210	8,450
East Midlands	16,850	9,070	7,050	9,730	9,720	8,630
West Midlands	16,560	8,450	7,550	8,680	8,060	8,000
East	23,710	14,200	11,350	14,620	15,560	11,870
London	21,610	17,280	14,160	17,810	20,130	14,610
South East	33,350	21,570	18,120	20,030	20,030	17,530
South West	20,970	12,850	11,710	14,820	14,400	13,960
Total England:	**182,570**	**105,640**	**85,200**	**109,680**	**109,760**	**97,650**

Development viability – Value and costs outlook

Economic outlook

Over the last two years economic growth has averaged a very weak 0.5% pa. The construction sector has performed worse than any other sector with an overall decline of 10%, reflecting weak occupier demand, declining capital values (outside London), restricted development and mortgage finance and major public sector cutbacks.

The IMF recommends an easing of austerity policies with increased public spending on infrastructure to stimulate stronger economic growth. But without a similar change in policies being pursued in the Eurozone a significant improvement in UK economic growth looks unlikely even if this advice were followed.

The latest consensus forecasts are for a slow improvement over the next two years at least, reaching below trend growth of 2.1% in 2015 and similar growth for the following two years. Most sectors are expected to be affected similarly. However, whereas the economic sectors closely aligned to the office and retail property sectors will experience growth weaker than over the ten years prior to the onset of recession in 2008, the reverse is expected to be true for the industrial and construction sectors.

Commercial property outlook

Outside London rental value growth over the last year for prime properties is at, or just above, zero in all sectors. For secondary property, rental values are still falling as a general rule. In contrast, within central London office and retail rental values have risen over the last year by 5-10% for prime property and 0-5% for secondary property.

For capital values the picture is similar but more pronounced. For prime shopping centres and standard shops capital values have increased slightly but for secondary properties values continue to fall markedly. In other sectors prime property has seen a slight decline over the last year and secondary property has seen a much larger decline as yields have continued to increase. Central London offices and retail properties have seen capital values increase at a similar rate as rental values.

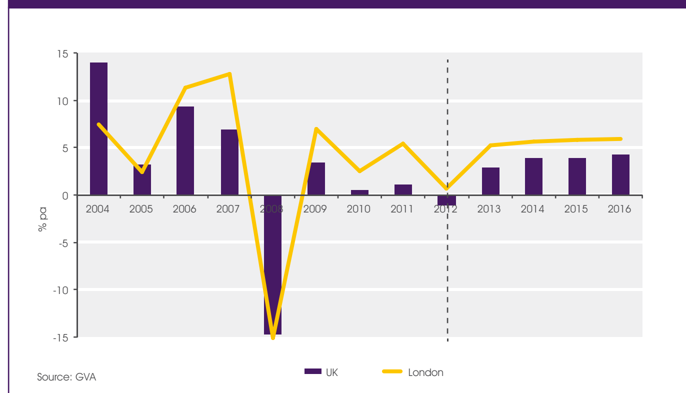
In all sectors and in most locations, whether for prime or secondary properties, capital values are still well below their pre-recession 2007 peak. Secondary shopping centres and provincial offices for example are as much as 60% below their peak value and prime provincial offices are on average 40% below their peak. Prime central London offices are only about 15% below their peak and West End retail capital values are more than 10% above their 2007 peak.

Occupier demand and rental value growth should gradually improve, moving into positive territory this year or next year. Prime property will lead the way as shortages of available space occur

Commercial and industrial capital value growth

Source: IPD, REF, GVA

Residential capital value growth



Source: GVA

and strong rental value increases are likely in some locations in 2014. Capital value growth will be in line with rental value growth this year but is likely to be slightly stronger in 2014 as some yield compression occurs. As in recent years, central London retail and office values will increase the most but the gap will narrow over the next few years.

Residential property outlook

Nationally house prices were flat over the last year, leaving prices 11% below their market peak in 2007. Within this UK-wide picture there was a marked North/South difference with prices increasing by close to 5% last year in London, by less than 1% in the West Midlands, falling by just under 2% in the North West and falling by 5% in Scotland. According to the Nationwide Building Society, prices in London are now marginally above their 2007 peak, whereas in Scotland they are 16% below their peak.

The latest consensus forecasts anticipate accelerating UK house price inflation, with 2.9% this year increasing to about 4% in 2014. As in recent years the North/South divide is likely to persist, reflecting the differences in economic outlook, but the gap should narrow. GVA expect a UK average figure of 4.25% inflation in 2016, with 5.5% in London, 4.5% in the South East and about 4% in the West Midlands and 3.5% in Scotland.

Building costs and tender prices

The BCIS building cost index increased by 1.4% over the last 12 months due to a rise in labour costs rather than the price of materials. A similar low increase is expected over the next 12 months, rising to just under 4% pa by 2017. Similar annual increases in materials costs and labour costs are expected.

The underlying trend in tender prices has shown little movement over the last 12 months. A relatively small increase of 2.2% is expected by BCIS over the next 12 months, accelerating to 4.5% by 2017 as construction output increases.

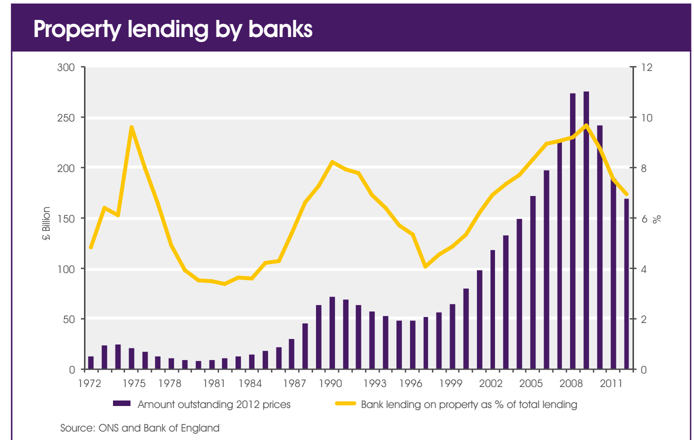
Finance

Stricter regulation and capital adequacy requirements have forced banks to deleverage and limit new lending. Now the better quality assets have been sold, the easier part of deleveraging has probably been achieved and the process will be slower from now on, particularly if many secondary property values continue to decrease. If history is any guide, restricted bank lending to property following a major recession will be with us for many years, as the chart illustrates.

Nevertheless, aided by the government's Funding for Lending scheme, bank lending on property is gradually becoming a little easier. For development in particular the quality of the asset and the borrower is key. Pre-lets, lease length and covenant strength remain important, as does equity input by the developer. A minimum of 35 - 40% of the costs for bank senior debt is usual. This can be reduced down to 15% if higher interest rates and arrangement and exit fees are paid.

Major publicly listed commercial developers and house builders may well have access to finance on a non-scheme specific basis. This is particularly so where there are longstanding personal relationships between borrower and lender, thus reducing risk.

Property lending by banks



Source: ONS and Bank of England

As a result of restricted lending by banks, alternative sources of finance – for example corporate bonds issues or investors providing debt - have multiplied. Nineteen new European debt funds have been launched in the last three years, however these funds are only lending on better quality, less risky, developments found mainly in London and the South East. Alternatively, joint venture agreements with insurance companies, pension funds, construction companies or local authorities, where the risks and rewards from development are shared, have increased.

For regeneration schemes additional finance is available from local authorities through Tax Increment Finance, loans, grants, prudential borrowing and asset sales. Local authorities are also helping by giving rent guarantees or by taking head leases. Help is also available from the HCA via the New Homes Bonus and loans from Get Britain Building and from some local authorities from the Growing Places Fund and the EU Regional Development Fund.

Development viability – Planning policy and government initatives

Planning policy

The National Planning Policy Framework (NPPF) provides greatly slimmed down national guidance for developers and a more positive approach to new development. The new Local Plan system gives devolved power to local planning authorities but only where an up-to-date Local Plan conforming to the NPPF is in place. This means a requirement to plan for future housing needs at the local level rather than having to adopt a top-down approach from regional planning bodies, as used to be the case.

Where there is no up-to-date Local Plan in place there will be a presumption in favour of sustainable development. As few local authorities are yet to have a Local Plan consistent with the NPPF, most do not have an agreed five year supply of housing land which makes it easier for developers to achieve planning permission on appeal.

There have been, or are being considered, a number of other changes to the planning system to help speed up or increase development.

Permitted development rights have recently been revised in England for the next three years, covering conversion of agricultural buildings to alternative uses, larger extensions permissible for residential, industrial and office buildings and office to residential conversions.

Office (B1a use) to residential change of use is now permitted providing there is no material external physical alteration and the building is not listed. Seventeen local authorities (or parts of local authorities) have been excluded from this change, mostly in central London.

In many other areas the viability of such a change is questionable although as no S.106 agreements are required this could help viability. In some areas, such as parts of inner and outer London, this planning change should help to increase the residential stock.

The Community Infrastructure Levy came into effect in April 2012 to simplify the negotiation of S.106 agreements by having a published local area levy on the net increase in floor space resulting from new development. This applies to all new development and should therefore be more certain for developers and raise more money than relying solely on S.106 agreements.

However, few local authorities have a CIL in place, the levy varies between local authorities, there is potential double counting of CIL and S.106 payments and there is no certainty when infrastructure will be built if at all. In response the government is proposing requiring more detailed evidence on viability be provided by local authorities, different CIL rates for different sizes of development of certain uses and the phasing of CIL payments for large, complex schemes.

The Growth and Infrastructure Act 2013 is also concerned with promoting growth, facilitating the provision of infrastructure and the viability of affordable housing requirements. It permits the renegotiation of planning obligations for affordable housing where there is clear evidence that there have been changes in the original assumptions on which viability was assessed and, as a result, a scheme's viability has been affected. The RICS Guidance Note (Financial Viability in Planning) provides useful advice on assessing viability.

Government initiatives

House building is considered by the government to be central to stimulating much-needed economic growth and consequently forms an integral part of the government's drive to kick start the economy. House building figures remain substantially below their 2007 peak and, although there was a dip last year in the gradual recovery that has been taking place since 2010, estimates for 2013 suggest a more marked rise in the number of starts.

This is largely as a result of a number of government initiatives put in place to free up mortgage lending and unlock development, which together are leading to an improvement in buyer sentiment. However it still remains to be seen whether these schemes will increase supply in any tangible way.

Launched in the March 2013 budget, **Help to Buy** is a £3.5 billion package comprising an equity loan scheme together with a mortgage guarantee which is expected to give a significant boost to the housing market. The scheme allows homeowners to buy a property valued at up to £600,000 with as little as a 5% deposit.

Unlike previous schemes such as FirstBuy & NewBuy, Help to Buy is available to all home owners and not just first time buyers. Although the equity loan is only available on new build properties in England, the government expects the scheme to help over 500,000 home buyers, boosting activity levels from 2014 onwards.

However there have been some concerns about the length of duration of the mortgage guarantee element which will be available from January 2014. At present the scheme will run for three years but the governor of the Bank of England has warned that if the scheme became permanent, it could expose taxpayers to billions of pounds in private mortgage debt, as happened in the United States.

Furthermore the scheme risks boosting an arguably already over-inflated level of house price growth. This may hinder potential buyers and could create a house price bubble before any significant increase in house building occurs.

The Bank of England's **Funding for Lending** scheme, originally launched in July 2012, was extended earlier this year and will now be operational until January 2015. The scheme benefits both businesses and households by incentivising banks through cheap loans to lend more to SMEs and home buyers.

Although there have been some doubts over its effectiveness, with falls in gross lending figures over recent months, on the whole there has been an improvement in the funding market since the introduction of the scheme. This has led to increased sales activity as potential home buyers are better able to access mortgages.

Another important government initiative is **Build to Rent**, a £1 billion fund to stimulate new private rented housing to meet a growing demand for those who cannot afford to buy their home. Attracting institutional investors is a key government aim and a number of institutional investors have been considering moving into the private rented sector for some years just as they have been attracted to invest in student housing.

The main potential benefits are the high investment return profile, stability of income and capital value, and the low correlation with other asset classes. But the main potential drawbacks to investing in the sector are management issues (short leases, voids, repairing obligations, lack of economies of scale etc), potential low income yield (but high return), lack of liquidity initially due to small market scale, and high pricing as price is related to open market vacant possession values.

Some of these drawbacks could be reduced by central government by tax incentives/relief, or the reduction in VAT on repairs and management fees. The Build to Rent Fund is a start and has so far involved 45 projects receiving £700 million funding which should deliver 8,000 – 10,000 new homes.

The HCA's **Get Britain Building** fund of £570 million continues to provide a boost to house builders by supporting construction activity at sites which already have planning consent but where development has stalled or is yet to start. Up to 16,000 new homes could be delivered as a result of this initiative.

So far it has successfully contracted 182 schemes, of which 170 have already started on site to provide in excess of 11,000 homes. The programme has had the dual benefit of stimulating economic activity whilst also providing additional new homes.

House builders are receiving further government support via the **Housing Guarantee Scheme**, under which they receive guaranteed debt from either the completion or purchase of units. Crucially these must be part of projects that deliver additional private rented homes or affordable homes not included within existing affordable housing programmes.

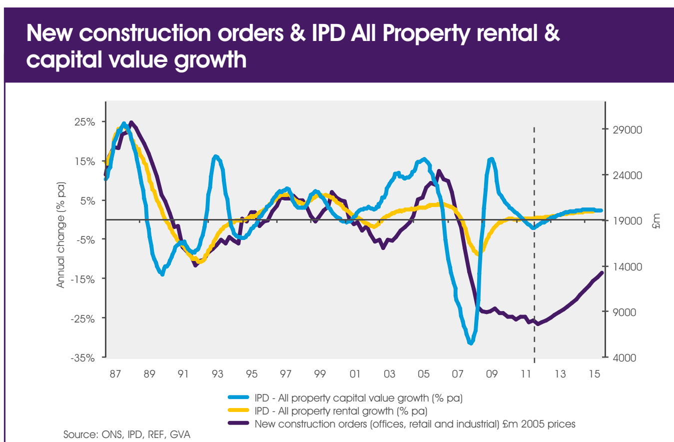
The £225 million grant is only being made available to schemes in England and these must complete by 31st March 2015 in order to qualify for the guarantee.

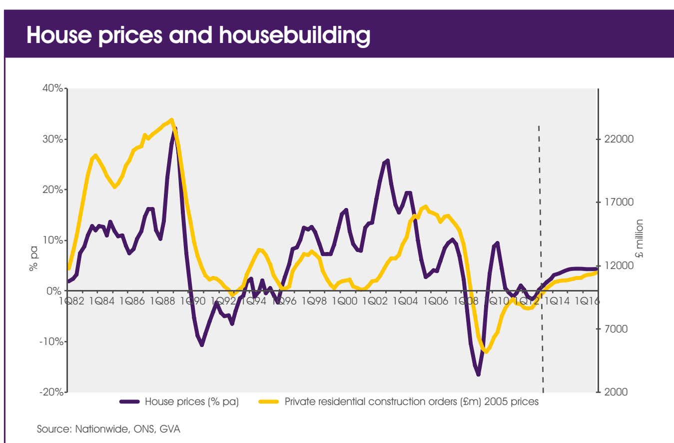
The government is also providing financial encouragement to local councils trying to increase the number of available homes in their authorities. **The New Homes Bonus**, introduced in 2011, is based on the amount of additional council tax revenue raised for new-build homes, conversions and long-term empty homes brought back into use. A further payment for the provision of affordable homes is also available.

Furthermore the government is targeting 11,200 problematic empty homes via £160 million worth of investment, aimed at making such properties fit for purpose, by providing practical information and advice to local authorities through the use of an Empty Homes Toolkit.

Development outlook

- The economic outlook is a little brighter now than it was at the beginning of the year but economic growth is still likely to be patchy over the next few years. London and the South will continue to outperform the rest of the UK, but the gap will gradually narrow.
- Occupier demand will slowly improve in the commercial sector with positive rental and capital value growth returning this year or next year outside London. The low levels of new commercial development outside London are beginning to cause shortages of grade A space in some locations, potentially leading to stronger prime rental and capital value growth.
- In London, commercial occupier demand will also increase but new supply is well underway. This is likely to put a lid on strong rental and capital value growth over the next few years.
- Development viability will improve as rental and capital values increase but commercial development activity will continue to be constrained despite the increase in the sources and availability of funds. Financiers will remain concerned with scheme location, income security and length of leases.
- Commercial development activity will increase but from a very low level as the first chart shows and with a continuing, but reducing, mismatch between the amount of development activity and the amount of occupier demand. This is shown by the large gap between the new construction orders line and rent/capital value lines, contrasting with the 1990s upturn.
- In the residential sector there has recently been a closer match between house price growth and development activity, as the second chart shows. Development activity correlates quite closely with house price inflation and has already increased significantly from its 2009 low point, and further increases are likely, although output levels will still be constrained.
- The plethora of recent government initiatives will undoubtedly help development funding and help increase the development of market housing and rented housing. But it will also stimulate housing demand and increase house price inflation. This in turn should help to increase the amount of house building, but how quickly and by how much is uncertain.
- House builders will be wary of house price bubbles developing and will initially show restraint just as they did in the 1990s, as the chart shows. Eventually this restraint helped cause the house price boom in the early 2000s and the house building boom (and slump) that followed. House builders will hopefully be wary of history repeating itself.





Annex 1. Viabiliy & Land values in London and the South

Offices (central London)

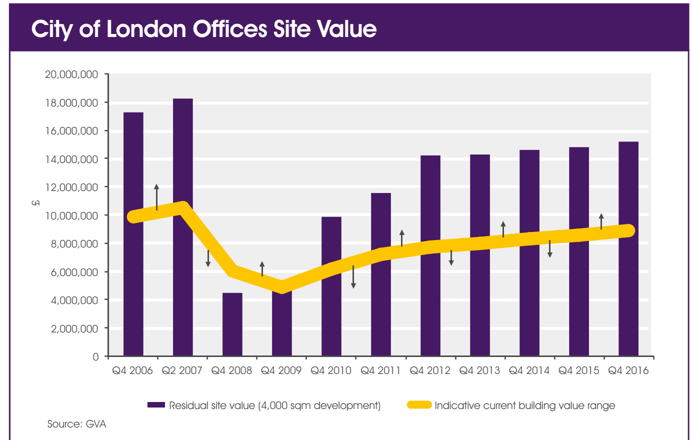
Since their low point at the end of 2009 prime office rents in central London have increased strongly by 35% in the City core and by 60% in Mayfair/St James's. This contrasts with the main regional cities where headline prime rents have been static or have increased only marginally.

What is less often commented on is that the fall in prime office rents when the recession hit was very much greater in central London than in the main regional cities. In Mayfair/St James's prime headline rents fell 45% between early 2008 and end 2009 and in the City core they fell 35%. In addition, tenant concessions like rent free periods increased. Prime central London office rents are now almost back to their peak level of five years ago.

This gyration in prime rents (and yields) in central London caused huge changes in development activity and residual land values, as the City of London site value chart shows. The buoyant occupier and investment market of the last 2 - 3 years has caused development activity and residual site values to increase significantly.

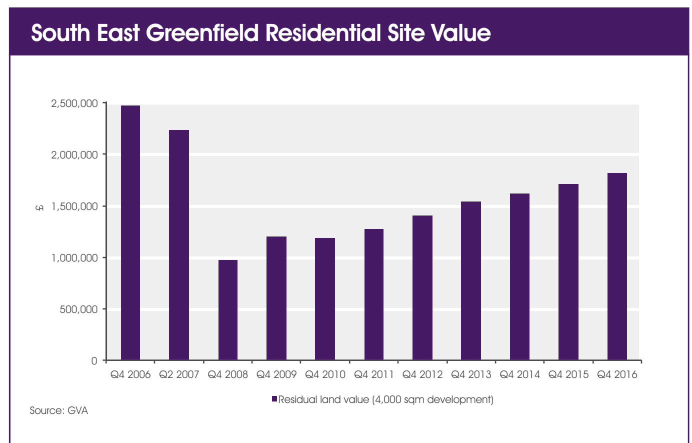
Occupier demand and take-up remain healthy, having slowed last year but increased strongly this year. With more space under construction than was the case a year or two ago, the increase in prime rents is likely to be more muted over the next few years with rents reaching their 2007 peak by 2017 in the City and exceeding it by about 10% in Mayfair/St James's. With development costs likely to increase more noticeably, residual site values are likely to increase marginally, as the chart shows.

City of London Offices Site Value



Source: GVA

South East Greenfield Residential Site Value



Source: GVA

Residential

London and the South in general are experiencing an increase in development activity particularly on greenfield sites. Development is focused more on family houses on smaller sites outside London. In central London there is an emphasis on flats, supported by strong overseas demand. London's residential market is very buoyant with prices rising strongly in central and inner London and residential planning permissions in zones 1 and 2 are now exceeding their 2007 peak.

Residential land values in London have increased much more than in the rest of the country. This dichotomy between London and the rest of the UK is underpinned by strong demand from overseas investors, attracted by London's safe haven status and strong growth in values. However this has created a dual market within the capital itself, whereby house prices and land values vary significantly between the prime central areas and inner London generally and outer London.

According to the Land Registry the greatest increases in house prices over the year to April 2013 were in inner London boroughs such as Camden (11.8%), Hammersmith & Fulham (11%), Wandsworth (10.8%) and Hackney (10.3%). This compares to a London average of 6.2%.

The rate at which prices are rising in central and inner London gives rise to worries of a bubble developing. However, as long as demand for housing outweighs supply, the exchange rate remains favourable to foreign investors and central London continues to be seen as a safe haven, prices and site values will continue to rise for the foreseeable future.

In the Home Counties there has been a ripple effect out from London and house prices and land values are rising, reinforced by a dearth of suitable sites. For example, according to the Land Registry, house prices have increased by 3.7% over the last 12 months in Surrey, although the increase in Essex has been just 0.2%. Land values are increasing similarly, primarily in the medium to higher value areas, depending on the precise location and size of site.

Annex 2. Viability & Land values in the West Midlands

Offices

Demand and take-up in the regional city centre and business park office market has continued to improve over the last six months. In some locations shortages of grade A space are now becoming evident.

In Birmingham the high level of speculative development at the end of the last economic cycle caused an oversupply of grade A floor space which persisted for some years, as take-up reduced during the recession and its aftermath. Only now, as demand and take-up has slowly improved, is an end to this oversupply in sight.

With many 25 year leases entered into during the late 1980s, and many 15 year leases of the late 1990s now close to expiry, further increases in demand for new space are likely. This will be reinforced over the next few years by gradually improving economic growth and decentralisation from London and the South East.

With no new speculative schemes in the pipeline, and with demand increasing, we anticipate shortages of grade A floor space beginning to emerge in 2014. Prime headline rents, which have been static for the last four years, are expected to show healthy growth from 2014 onwards, with investment yields reducing and capital value growth accelerating.

This shows up in the site value chart where strong increases in site values are expected in late 2014 and in 2015 particularly. As the chart also shows, site values have barely moved since the start of the recession. Some improvement is expected in 2013 before stronger increases occur in 2014 onwards. This should stimulate a new wave of development assuming that development finance becomes more freely available.

Residential

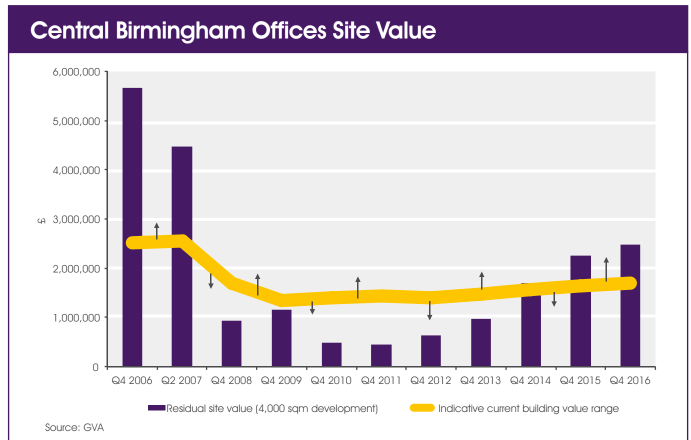
Land values in the region vary significantly depending upon demand and local attributes. Typical greenfield land values vary from £300,000 – £400,000 per net developable acre in former industrial and rural areas of the region, to £1.4 – £1.5 million per net developable acre in southern locations such as Harborne, Solihull, Leamington Spa, Warwick and Stratford-upon-Avon.

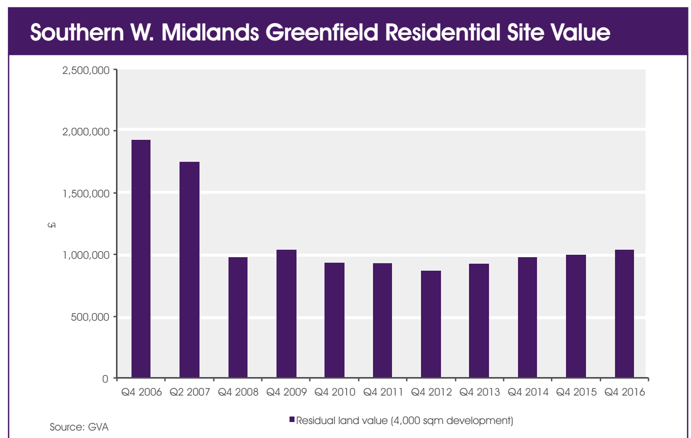
There are several challenges to development viability. In particular, the uncertainty over affordable housing provision, S.106 obligations and the impending CIL agenda have made house builders and developers cautious when considering acquiring land. Most have tended to focus on those areas where sales demand is strongest, where sales values are more robust and anticipated return on capital is more certain.

Sales demand is beginning to improve as a result of greater mortgage availability in the region and national government initiatives such as Homebuy and Help to Buy. Many of the national house builders have reported significant improvements in the rates of sales since the most recent swathe of incentives were promoted in the 2013 budget. As the economy improves these measures will stimulate greater sales demand and house price inflation, both of which will lead to the delivery of sites and schemes of marginal viability. This could include those sites which require considerable remediation or are of such a large nature that infrastructure prevents deliverability.

In recent years smaller schemes have proved more popular, as the associated risks of development are lessened by lower up front land payments and costs, which are preferable in an uncertain recessionary sales environment. Developments comprising a majority mix of houses rather than flats are preferred, as houses can be built at the same rate as they are sold thereby enhancing the developer's cash flow and reducing interest on debt finance. House builders have avoided the first-time buyer or starter home market due to the difficulties for target buyers in obtaining mortgage finance.

GVA's latest forecasts for house price inflation suggest that the West Midlands will lag behind the South East with a 2.75% increase in 2013, rising to 4% in 2016. With building costs increasing at a similar rate, residential land values are predicted to increase slightly, as the chart shows. However pent-up demand in certain areas, innovation to reduce house build costs and a requirement for house builders to acquire land in a competitive environment and reduce margins will lead to considerable land value variations across the region.





Annex 3. Viability & Land values in Scotland

Offices

In most regional cities a two tier office market exists. The backbone of leasing activity currently comprises a churn of secondary stock below 5,000 sq ft but there are also a fairly healthy number of Grade A floor space requirements. The time frame of many of them is shortening as lease end dates get closer, with the best space now in short supply.

In Edinburgh total office take-up over the last six months is very close to its average in recent years; whereas in Glasgow it has been lower, having experienced a fall in occupier demand in 2011. This fall in demand affected Grade A properties and prime headline rents fell back temporarily from £28.50 psf to £27.50 psf.

During the early part of the recession rents fell from a peak of £28.50 psf to £24.50 psf at the end of 2009, but quickly increased back to £28.50 in late 2010 as occupier demand held up well. This yo-yoing of prime rents and also yields over recent years affected residual site values, as the chart clearly illustrates.

The level of enquiries increased in the latter half of 2012 and a number of Grade A lettings reduced the availability of prime office properties to less than one year's average take-up. This triggered two development starts - 1 West Regent Street from Mountgrange/Prupim and BAM at 110 Queen Street - the first new private sector speculative developments to start since spring 2008. More recently Abstract Developments completed the purchase of a site at St Vincent Plaza on St Vincent Street for a proposed office development.

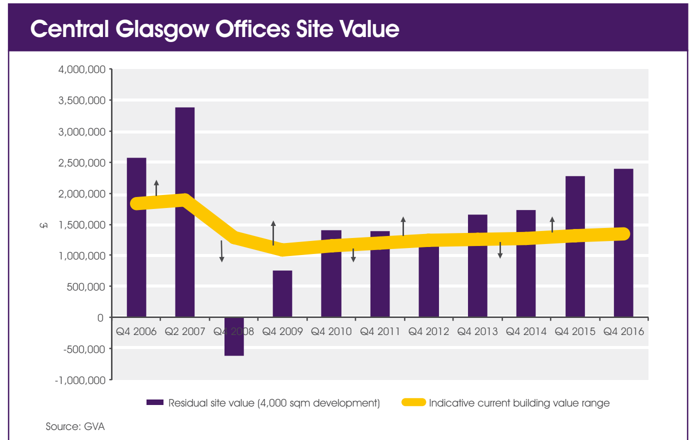
These new office developments are due to complete by the end of 2014/mid 2015 and total 477,000 sq ft, which is less than two year's average Grade A take-up. Prime rents and residual site values are therefore expected to reverse last year's fall and consistently rise in 2013, 2014 and 2015, as the chart shows.

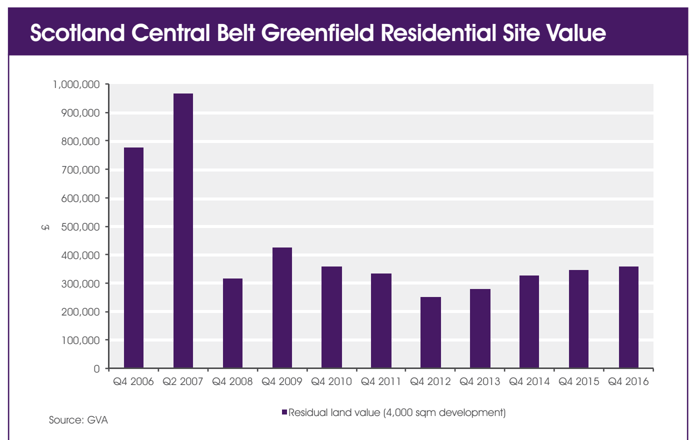
Residential

The southern regions of the UK are dominating development activity meaning that land values are generally lower in the north and in Scotland. However there is growing interest in land with planning consent, or potential for consent, in well-located desirable areas. Edinburgh in particular has experienced some significant growth in greenfield land values over the past year. As the funding environment improves and the economy begins to recover we expect land values in regional towns to gradually pick up.

Scotland's GDP growth is slightly weaker than the UK average. Earnings growth remains low, indicating a fall in real terms. This is likely to impede any increase in spending and household wealth.

Underpinning this is a flat housing market which saw prices decline by 5% between Q1 2012 and Q1 2013 (according to





Nationwide), making Scotland the poorest performing region of the UK over the last 12 months. The areas with the biggest decline in prices were Lothian and Falkirk (- 8%) and Renfrewshire and Inverclyde (- 7%). Glasgow and Edinburgh experienced a slightly lower rate of decline (- 6% and -3 % respectively).

Over the past two years Edinburgh has seen a trend towards greater declines in values of smaller properties. According to ESPC the average price of a one bed flat in Q1 was 8.7% lower than a year previously, compared to the average price of a four bed detached house which increased marginally over the year by 0.7%.

Activity levels are expected to pick up in coming quarters as demand increases due to improving economic growth and the improving funding market, particularly benefitting first time buyers. As affordability levels continue to improve this should gradually lead to an increase in prices and site values, but a dramatic change is unlikely.

London West End
London City
Belfast
Birmingham
Bristol
Cardiff
Dublin
Edinburgh
Glasgow
Leeds
Liverpool
Manchester
Newcastle

Published by GVA
10 Stratton Street, London W1J 8JR
©2013 Copyright GVA

GVA is the trading name of GVA Grimley Limited and is a principal shareholder of GVA Worldwide, an independent partnership of property advisers operating globally **gvaworldwide.com**

For further information please contact:

Valuation and viability assessment
Jacob Kut - 020 7911 2829
Craigie Marwick - 0131 469 6043

Planning, development and regeneration
Charles Holland - 020 7911 2108
Andrew Screen - 020 7911 2329

Land and development
Tom Marshall - 020 7911 2336

Building/project management
Mike Blinco - 020 7911 2571
Mark Astbury - 020 7911 2968

Research
Stuart Morley - 020 7911 2427

08449 02 03 04
gva.co.uk

This report has been prepared by GVA for general information purposes only. Whilst GVA endeavour to ensure that the information in this report is correct it does not warrant completeness or accuracy. You should not rely on it without seeking professional advice. GVA assumes no responsibility for errors or omissions in this publication or other documents which are referenced by or linked to this report. To the maximum extent permitted by law and without limitation GVA exclude all representations, warranties and conditions relating to this report and the use of this report. All intellectual property rights are reserved and prior written permission is required from GVA to reproduce material contained in this report. GVA is the trading name of GVA Grimley Limited © GVA 2013.

09253