

FOCUS ON THE UNITED KINGDOM

Residential Property— Do You Own Enough?

BY BARRY GILBERTSON, CRE, PPRICS

THIS IS THE THIRD IN A SERIES OF FIVE ARTICLES providing my personal perspective on the state of the property market in the United Kingdom. The first article, which appeared in the Fall 2006 edition of *Real Estate Issues*, focused on some of the more generic key drivers and the macro-to-micro picture. The second article discussed the phenomenon of seemingly ever-rising values in the commercial property sector. The third article reviews the residential property market in several of its guises, the fourth will focus on affordability and the final article will highlight the seeds of doubt—key issues, words and phrases that trigger a response when they crop up in conversation and cause property funders, lenders and investors to stop and think about their assets.

One of the reasons for writing these articles is to draw, in the mind of the reader, a similarity or contrast between the UK and the property market in which the reader operates. It seems to me that property markets function in very similar ways around the world, and we can all benefit by experienced practitioners and commentators sharing their opinions and expertise. There are exceptions, of course, and the United Nations is doing what it can to help to create and re-order property markets in some of the globe's transitioning economies, especially those that are moving from a state-owned asset base to a freer market economy. From satellite mapping to comparable evidence, knowledge management in many of these developing

countries is rapidly becoming more efficient than in countries with mature economies.

SOMEWHERE TO LIVE

So, how big is the UK residential housing market? How is it funded? What are the key components? Are there more apartments or houses? How does the government intervene? Have rapidly rising prices made the market



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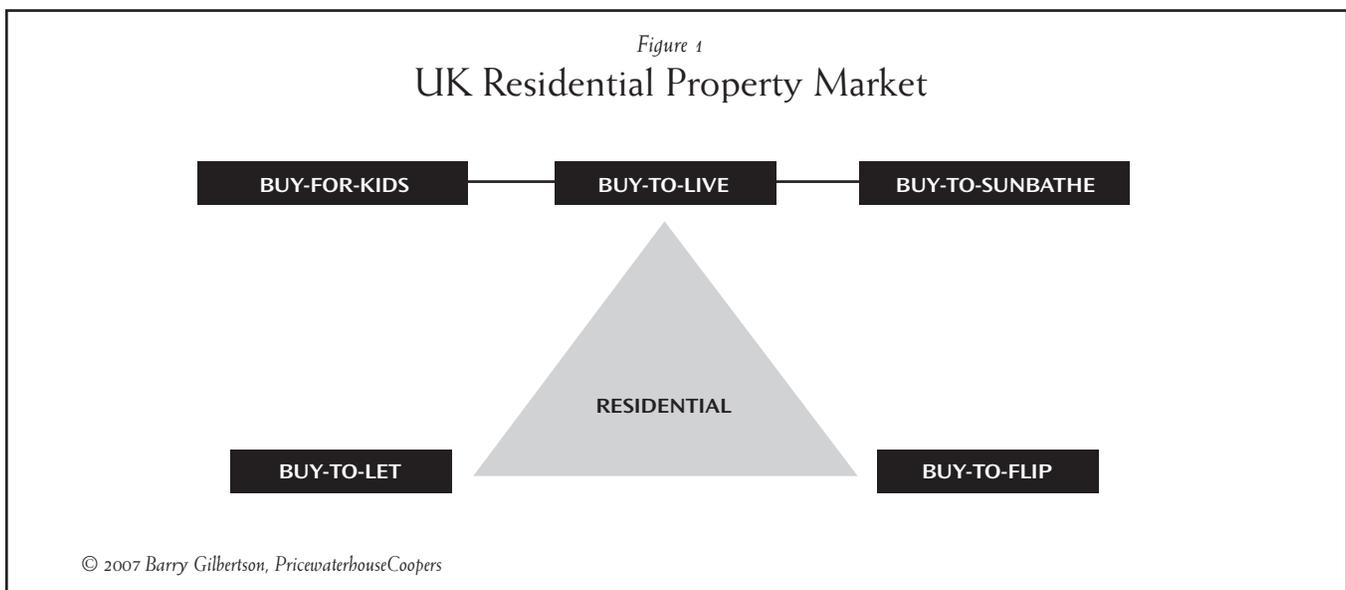
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unaffordable for first-time buyers? Where is the market going in the future? What about carbon-neutrality in housing design? This article addresses some of these questions; others will be addressed in the next edition of *Real Estate Issues*.

MILLIONS OF HOUSES

Recent estimates place the collective value of houses in the UK that are owned by the public at large—presumably excluding housing owned by national or local government, Housing Associations, etc.—at £3.8 trillion. In the past 12 months, that value has increased by more than

buy-for-kids, used as a way to get one's children onto the first rung of the housing ladder, perhaps near their university, and *buy-to-sunbathe*, particularly overseas, in sunnier climates than the UK. About 9 percent of UK adults now own property outside the UK. *Buy-to-let* is when an investor buys property with the twin criteria of rental income and capital growth; whereas *buy-to-flip* is when the investor buys property before construction and hopes to sell, or flip, it at a higher price before the project finishes construction and before the balance of the purchase price falls due on legal completion.



£400 billion because of soaring prices. Among the United Kingdom's four countries—England, Northern Ireland, Scotland and Wales—the strongest rise in prices has occurred in Northern Ireland. Though values started from a base lower than the other three countries, housing stock is now worth 165 percent more than it was five years ago. Over the past 10 years, the average UK house price has increased 120 percent, according to research conducted by the Royal Institution of Chartered Surveyors. The number of properties bought and sold in 2006 was 1.15 million, UK-based property research firm Hometrack reports. The number of borrowers who use more than half their monthly income to repay their mortgage is about 1.12 million.

One way of defining the residential property market is by the purpose of the acquisition. *Buy-to-live* is obvious—it is where we call home. The two subsectors are

Various data sources have tried to estimate the average house price. The Nationwide Building Society believes that in the last three months of 2006, the average price increased by 9.3 percent compared with the same period last year, to £172,065. However, government sources suggest that house prices in Britain—the UK excluding Northern Ireland—rose 8.9 percent to £199,467.

These figures are based on all types of housing, whereas the average price of a new-build home in Britain is now £260,924 and is 5.8 percent more expensive than at the start of 2006. The largest regional increase was in Greater London at 17 percent, followed by Scotland at 13 percent and East Anglia at 6.1 percent. The latter two increases started from a lower base, but given that London was already the market's highest average value, the gap is widening. Several areas saw small price

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decreases, when measured by asking prices rather than completed sales value.

In London, Hometrack indicates that prices rose by 12.1 percent, with the highest growth, at more than 20 percent, in Kensington and Chelsea. The borough was where Princess Diana lived and now is home to many celebrities from actors to footballers, some of the nation's highest earners. These figures will inflate further in 2007 amid rumors that more than 3,000 workers in London's financial district will take home annual bonuses of more than £1 million each. Many of these financial stars want to live in West London: Kensington, Chelsea and Notting Hill—home to the eponymous 1999 film starring Hugh Grant and Julia Roberts—are top choices.

HOUSE VS. FLAT

Though it has not been possible to track down statistics of the size, in square feet, of the average home, it is interesting to reflect on the different methods of pricing. Outside central London, the number of bedrooms has long been seen as a key driver of price, coupled with the fact that the dwelling was detached, semi-detached or terraced. Apartments, or flats as they are more usually called in the UK, have not entered into this general equation because there are relatively so few flats compared with houses. Whereas, in the very center of London, especially in the swanky areas of Kensington and Chelsea or Islington—where Prime Minister Tony Blair lived before his move to No. 10 Downing Street in Whitehall—it is much more typical to price properties per square foot of space, whether the home is a house or a flat.

In the past two years, prices have increased from about £800 per square foot to more than £1,000 per square foot. Imagine everyone's surprise when in February 2007 the developers of a new series of four blocks of flats overlooking Hyde Park announced that they were marketing four penthouses at a staggering £4,200 per square foot. The fact that these penthouses have all been pre-sold at around £84 million each suspends belief. In fact, it would be tempting to say that at these figures there is now ample proof that the very top end of the London residential property market has reached a level of unsustainable

excess. It is now considerably higher than Shanghai or even New York.

Such are the vagaries of property development and ownership that nearly 300,000 dwellings in England, about 1.6 percent of all privately owned properties, have been empty for more than six months, the Halifax Building Society reports. Why is that? Could it be related to affordability? With houses continuing to rise inexorably in price, it is clear that many youngsters are being priced out of the market. However, this particular statistic might be more connected with a phenomenon of the buy-to-let market.

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Some private landlords prefer to leave their investments empty, rather than have them damaged by inconsiderate tenants. This tactic would be uneconomic in a more traditional market, but today's capital growth more than compensates for the lack of cashflow, which is diminished when the property requires refurbishment after each year of a tenancy.

Recent research shows that up to half the new flats in Leeds are empty: 40 percent in Salford, an improving suburb of Manchester close to the sporting arena that is home to Manchester United Football Club, and some 10 percent to 15 percent in London. A regional government, the Greater London Authority, is so concerned about this trend that it has commissioned its own major piece of work looking into this aspect of the buy-to-let market.

BECOMING FAMILY FRIENDLY

To conclude, following are a couple of observations about the flats vs. houses debate. The National House Building Council's latest statistics show that 47 percent of new homes started in the UK in the first 8 months of 2006 were flats and maisonettes, two-story flats often built over neighborhood shops or retail units. This is a dramatic increase from about 18 percent just 10 years ago. Is the trend a response to demand or some other phenomenon?

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Certainly, some believe that the market does not want to buy studio flats or one bedroom apartments—or at least not as many as are under construction presumably because of the need to maximize, for profit, the number of dwellings on any development site. Perhaps the development is because of a desire to create more family-friendly homes. The UK government recently issued formal planning guidance—a document called PPS 3—designed to ensure access to gardens, playgrounds or parks. The guidelines mark the first time the government has put the needs of children ahead of granting planning permission or formal consent to build to a particular design, density or layout. It also creates kid-safe and pram-friendly environments for families.

In the past 10 years, the number of new three-bedroom homes has dropped from 54,100 per annum to just 44,000 each year, a 20 percent decrease. However, in London this movement toward housing with less room for children is even more dramatic. The Greater London Authority has calculated a 20,000 property shortfall of family-sized homes across the city. Stuningly, they have also calcu-

lated that 290,000 children live in overcrowded conditions in London.

“Under the new guidelines, developments will not be allowed to be just concrete jungles empty of trees, grass or any natural environment,” a government spokesperson reports. Maybe, in future, it will be more about parks and less about parking.

Still, even with these contrary indicators, the real estate market is a vibrant and challenging environment in which to earn a crust. Would you have it any other way? Why not email your views to me at barry.gilbertson@uk.pwc.com. ■

Sources: Halifax Building Society, Reed Business Information, The Times, The Sunday Times, www.smartnewhomes.co.uk, Hometrack, Inside Housing, King Sturge, RICS, National House Building Council

The author apologizes if any source believes that reference has been made to their material or data and, inadvertently, no credit has been given.