COMMERCIAL BANKING

Housebuilding Report 2018

By your side

LLOYDS BANK

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FOREWORD

David Cleary
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Welcome to the third annual Lloyds Bank survey of the UK housebuilding industry, which comes at a time when interest in the sector and its ability to deliver new homes has never felt higher.

If 2016 was defined by the UK's referendum vote to leave the European Union, the industry will look back on 2017 as a year when the spotlight shone brightly on the continued housing shortfall and the ability of young people to buy their first homes.

Politicians from all parties, along with regionally elected Mayors, have expressed their commitment and support to solving problems in the housing market which, in addition to realising a significant economic benefit, will also have a substantial social impact.

The market has long been subject to political intervention and action, which has increased in recent years in an attempt to support home buyers.

More recently, we have seen that focus transition from largely demand-led solutions to supply-led policies, as demonstrated in the last Budget, when the Chancellor presented £15bn of additional support, with particular help aimed at smaller builders and developers.

In addition, organisations and investors alike have been working together to support the sector, including the Housing Growth Partnership, a social impact investor backed by Lloyds Banking Group and Homes England (formerly Homes & Community Agency).

The important role that housing associations are playing in building homes to rent and private developments for sale cannot be ignored, with many making significant contributions towards the volume of new homes being built.

The availability of skilled labour remains a perennial pressure and this research reveals an industry that holds genuine concerns about access to labour and an acute skills shortage once the UK leaves the EU. This, combined with long-term issues such as an ageing workforce, planning restrictions and the availability of land, has created a unique set of conditions for housebuilders, developers, housing associations and their supply chains.

That said, the sector is investing in modern methods of construction as one way to address the challenges it faces, and it is inspiring to work alongside an industry focused on innovation and overcoming multiple challenges as it looks to deliver sustainable growth and the new homes the nation badly needs.

In utilising modern methods of construction, housebuilders must be prepared to change, adopt an open mindset and learn from other industries. This became clear to me following a recent visit to the Manufacturing Technology Centre in Coventry that focused on production techniques and advanced manufacturing processes.

During the last 12 months we have also seen innovation and enhanced appetite for funding solutions from the capital markets, giving housebuilders the ability to access long-dated debt finance. When combined with continued support from the banking sector, this is helping to support the industry's ambition for growth whilst contributing to the Government's goal of building more new homes.

As Stewart Baseley, Chairman of the Home Builders Federation, highlights in his closing statement of this report, the industry continues to make good progress, increasing net supply to 217,000 in the year to March 2017. There does however, remain significant work to be undertaken on all sides to increase this number to 300,000 by the middle of the next decade.

I hope that by sharing the insight in this report we can help to inform firms' decision making at a time when the sector is facing significant challenges but, importantly, also great opportunities.

It is inspiring to work alongside an industry focused on innovation and overcoming multiple challenges as it looks to move past the uncertainty caused by Brexit to deliver growth and the new homes the nation badly needs.

GROWTH & INVESTMENT

Five-year growth forecasts have edged up slightly year on year, from 28% to 29% of current turnover

The housebuilding sector operates to far longer lead times than many other industries, so is especially sensitive to political and economic uncertainties.

Therefore, it is reassuring to hear that, despite these obvious uncertainties, five-year growth forecasts have edged up slightly year on year, from 28% to 29% of current turnover.

That includes a significant uplift in SMEs' (firms with a turnover of less than £25m) perceived growth prospects, which jumped from 18% to 28%, while the largest firms, with a turnover of £750m or more, said their growth expectations have fallen back from 39% to 34%.

When we asked firms how the number of homes they would complete this year would compare with last year, 55% said there would be no change, while 26% predicted a year-on-year increase, of an average 15%. Just six per cent forecast a decrease.

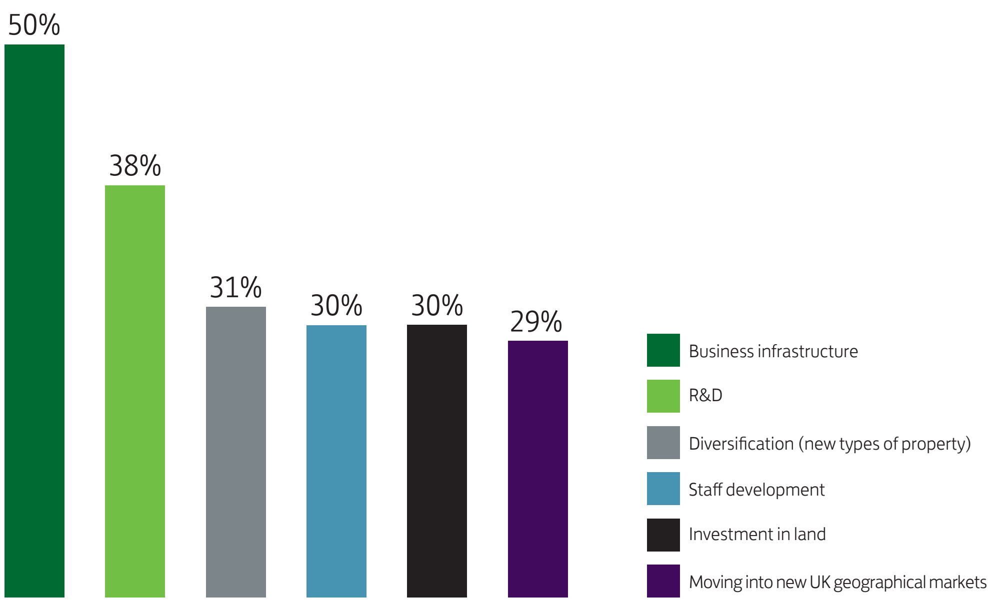
Five-year house price inflation forecasts have held firm since 2016 at 11%, with the average price of a home in 2022 predicted to rise to £249,024, from the current £225,021, as reported in the Halifax House Price Index for January 2018[1].

When it comes to achieving growth, the most popular routes remain diversification, with 31% holding plans to do this in the next five years, followed by building properties in more affluent areas, investing in people and investing in business infrastructure (all 29%).

Prudent firms are sensibly looking to share risk when funding growth, with 33% pursuing partnerships, 32% seeking investment from external investors and 31% relying on their cash reserves.

1 Halifax House Price Index
https://www.halifax.co.uk/media-centre/house-price-index/

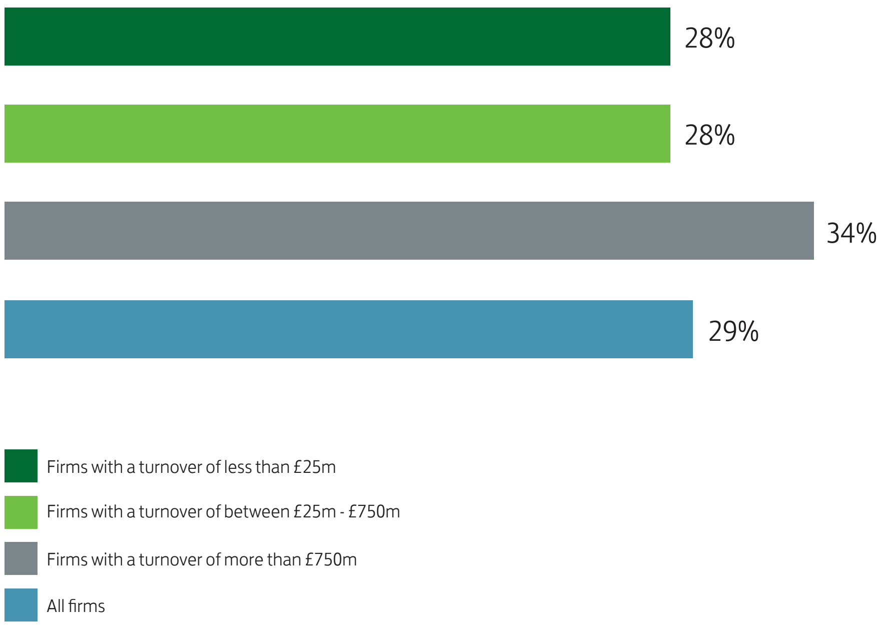
Which of the following do you predict will be the focus of your investment?



It is heartening to see that firms are planning to invest in activities that should make them more robust and drive growth, led by business infrastructure, R&D, diversification and training.

Overall, firms' average investment intentions over the next five years are steady, with plans to invest 31% of current business turnover back into their business, down only slightly from 35% last year.

What is your total expected business growth forecast for the next five years as a percentage of current annual turnover?



EMPLOYMENT

Firms told us they plan to create more than 139,000 new jobs in the next five years

Housebuilders are substantial employers, and the sector as a whole is estimated to support more than 660,000 permanent and subcontractor jobs[2].

Even without the exacerbating factor of Britain's EU exit, the workforce is forecast to shrink by 20% to 25% over the next 10 years, because employees are ageing and a lack of young people are entering the industry[3], likely attracted to alternative technology focused businesses.

This seems to have resulted in a shift in strategy from the industry, which is scaling back its recruitment intentions, while committing an increasing amount of resources to ensuring that new entrants to the sector are as productive as they can be.

Firms told us they plan to create more than 139,000 new jobs in the next five years, which although significant equates to more than 40,000 fewer jobs in the pipeline than a year ago.

On average this equates to 19 new jobs for each firm over the next five years, down from 22 jobs each planned this time last year, though SMEs are actually planning a small uplift in recruitment, from an average of nine jobs a year ago to 11 now.

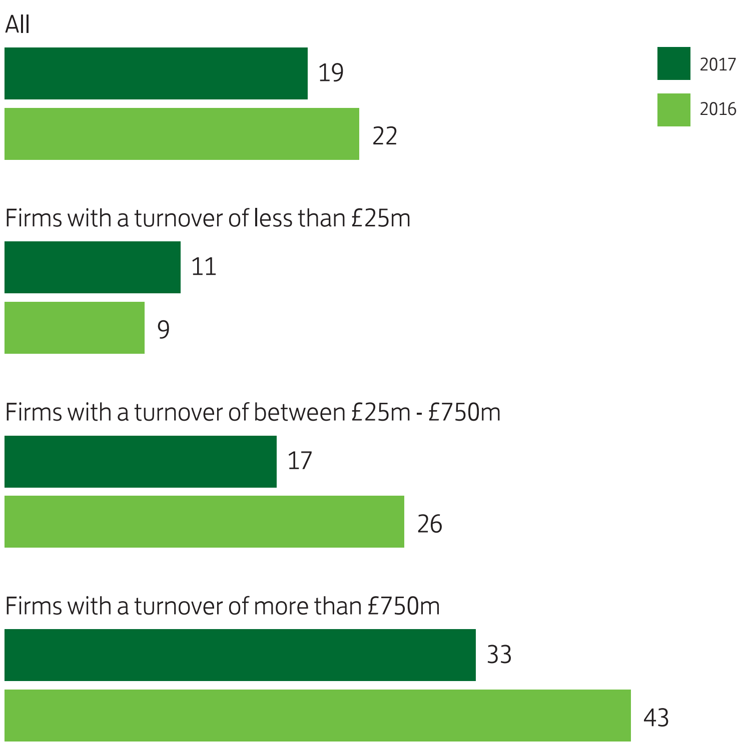
When we asked firms what they are doing to secure the future supply of permanent staff, more than two thirds (69%) said they were investing in staff development, just over half (51%) are setting up apprenticeship programmes and almost half (47%) are working with government bodies.

It does appear a slightly different position when working to secure the future labour supply of subcontractors, with 32% of firms working with industry bodies, 27% setting up apprenticeship programmes and 25% investing in staff development.

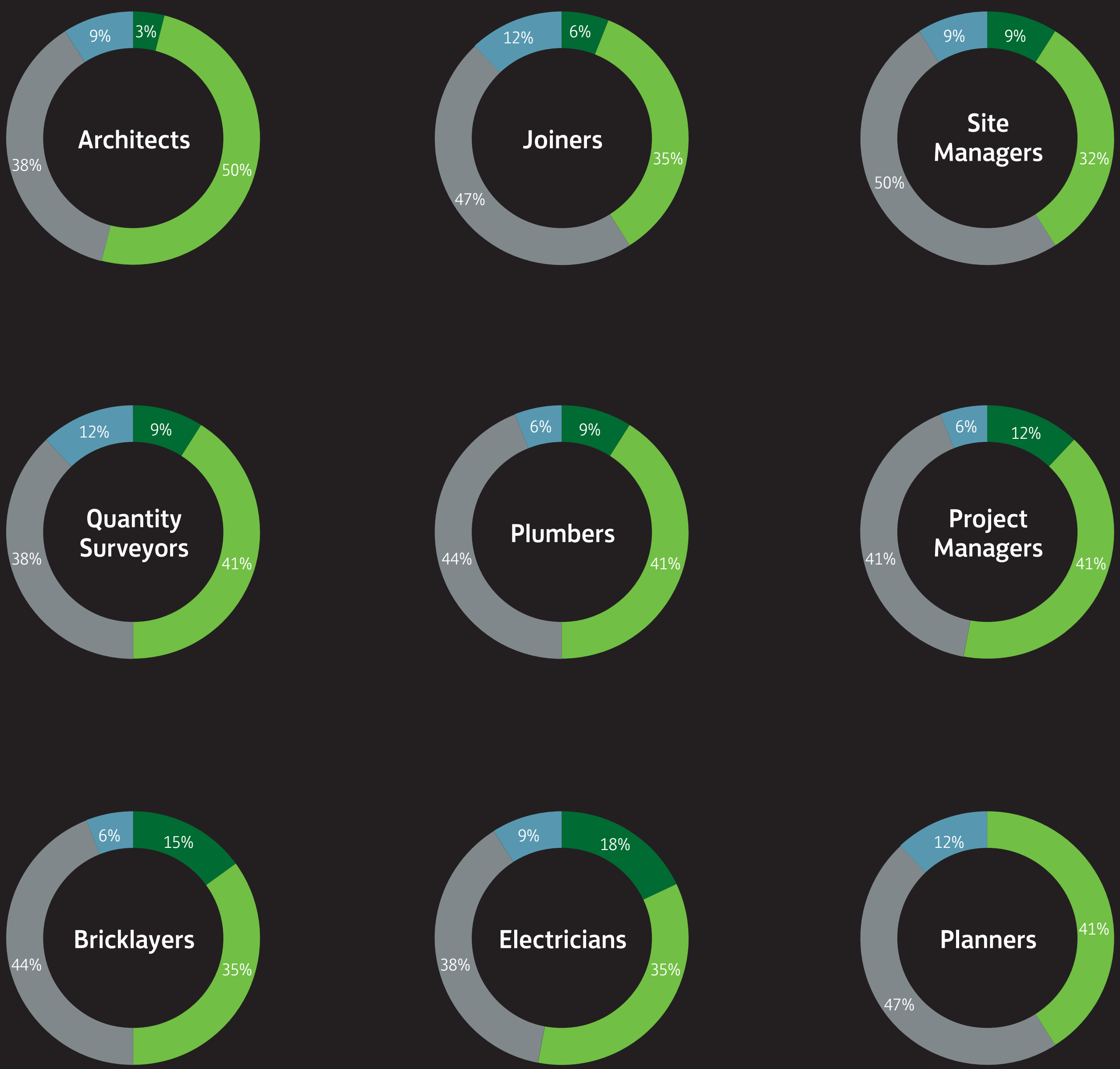
2 HBF Key facts and messages, 2016 http://www.hbf.co.uk/media-centre/facts-statistics/

3 Construction industry warns of Brexit 'cliff edge' over EU workers, Daily Telegraph, November 2017, http://www.telegraph.co.uk/business/2017/11/29/construction-industry-warns-brexit-cliff-edge-eu-workers/

How many new jobs do you plan to create in the next five years?



How have the ongoing EU exit negotiations affected the recruitment of these roles?



CHALLENGES

of firms said access to EU labour was a key challenge for their business

We have already seen in the previous section how the availability of skills and labour is a perennial pressure for the housebuilding sector, and that issue is being exacerbated by the UK's imminent exit from the EU.

At the time of writing, new research from the Home Builders Federation found that a sixth (17.7%) of the UK homebuilding workforce is from a European Union country, led by Romania, Poland, Lithuania and Ireland, which rises to 49.5% in London[4].

Overseas workers also tend to be younger than those from the UK and are more likely to be in their 20s and 30s[5].

The industry's reliance on EU workers could compromise its ability to deliver the Government's target of building 300,000 new homes every year, should this pipeline of skilled staff be closed.

So it was perhaps reassuring to find that two thirds (66%) of firms believe that there are currently enough skilled workers to fill roles in the sector, both nationally and regionally.

But when we asked housebuilders what the main challenges they face are, the EU exit dominated the agenda, with 44% flagging Brexit uncertainty, 32% the rising cost of materials and 26% access to EU labour.

Housebuilders said that Brexit was making it harder to recruit a diverse range of skills, from site managers (32%), to bricklayers, joiners and electricians (all 35%), quantity surveyors, plumbers, projects managers and planners (all 41%) and architects (50%).

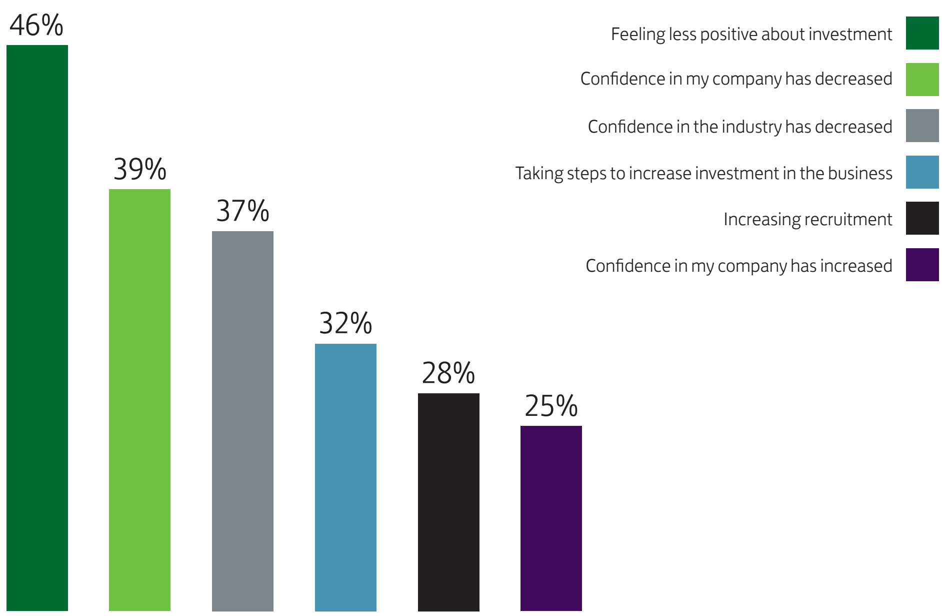
When it comes to filling permanent roles, firms believe the skills shortage is becoming more acute in almost every category.

Firms seeing a lack of quantity surveyors more than doubled from 21% to 50% year-on-year, joiners grew from 26% to 41% and project managers up from 25% to 38%, for example.

4 Home Building Workforce Census, 2017, HBF, http://www.hbf.co.uk/

5 Ibid

How has the negotiation around Britain's exit from the EU affected your business ?



GOVERNMENT POLICY

believe the sector has the resources to help meet the Government's housing targets

Housing has moved up the political agenda, with Prime Minister Theresa May pledging to dedicate her premiership to fixing Britain's housing crisis, including a target of building 300,000 new homes every year by mid-2020 in England alone.

Housing policy announcements were a key feature of the 2017 Budget, which took place just after this research and contained a number of new and increasingly supply-led solutions.

They included £8bn in financial guarantees to support private sector developments, £1.5bn in loans to SME housebuilders and £630m in grants to build the infrastructure that will make smaller sites viable.

There was a mixed reaction from housebuilders, who are already making plans to mitigate against the end of the Help to Buy scheme, which has helped more than 320,000 people buy a home, but which comes to an end in 2021.

The scheme has proved incredibly popular with developers, with 83% of firms describing it as fairly or very important to the industry, up from 76% last year.

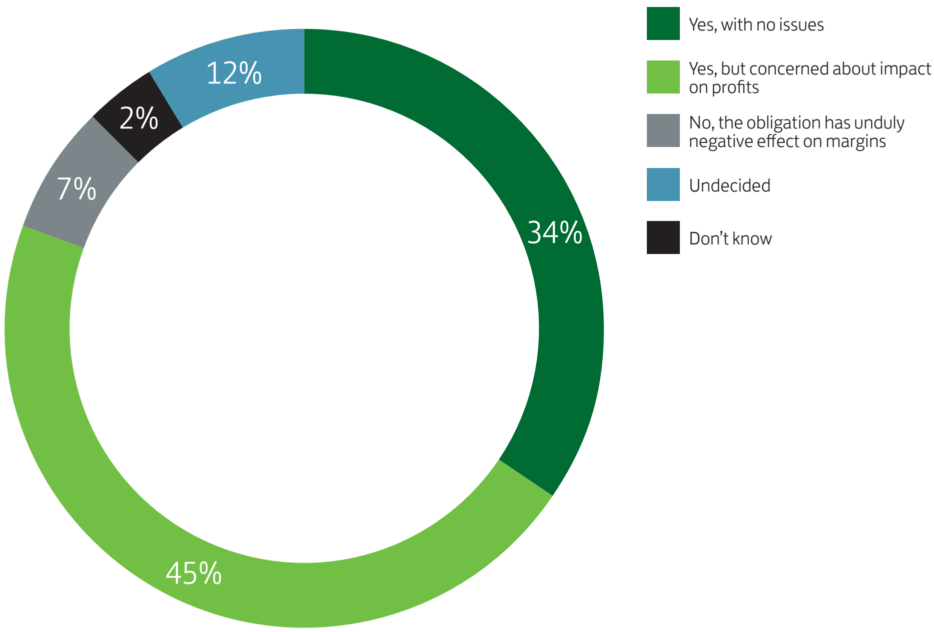
In February 2017, the Government also published a White Paper laying out its plans to boost housing supply and create a more efficient housing market.

Almost three quarters (72%) said the sector has the resources it needs to help the Government achieve the ambitions laid out in the Paper. These ambitions include more affordable housing, protection of the greenbelt and avoiding low density housing where land availability is short.

Meanwhile 42% flagged the availability of Government support in influencing that view.

But there were concerns over the legal obligation on local authorities in England to deliver self-build plots, dubbed the "Right to Build", which firms predicted would increase competition for local authority land (43%) and reduce the viability of specific sites (35%), though 34% said the number of design and build opportunities would increase.

Are you able to continue meeting your obligations to build affordable housing?



FOCUS – INDUSTRY INNOVATION

The housebuilding sector is proving eager to adopt innovative new building techniques, which hold the potential to address challenges around the supply, quality and affordability of new homes, as well as boosting productivity and profitability.

Modern techniques are centered on building ever bigger components, and even entire homes, off-site for delivery and assembly, but there are even more futuristic solutions on the horizon, from robot bricklayers[6] to 3D printed homes[7].

In this period of rapid innovation, it seems that UK firms are currently testing the waters by trying a wide range of new methods.

They reported that they are already investing in numerous new building techniques, led by modular housing (68%).

Site-based modern methods of construction (MMC), where components are brought together to be assembled on site, are being employed by 61% of respondents, along with panelised systems (56%), sub-assemblies and components (54%), 3D volumetric construction (39%) and pods (38%).

Companies of all sizes are investing in new building techniques, though, perhaps unsurprisingly, take-up has been slower among SMEs (firms with a turnover of less than £25m a year), which is likely down to the initial cost of investing proving a higher barrier to adoption. That said, firms of all sizes appear convinced that utilising this technology will support innovation.

In contrast with firms' general investment plans, which are forecast to decline slightly over the next five years, investment in new building techniques is set to increase in the same period, growing from 20% of current annual turnover to 24%.

There are a broad range of motivations behind firms' adoption of various new techniques, with respondents making a case for each method's impact on improving efficiency, growing margins, ease of build, better construction standards, better energy performance, elimination of waste and customer affordability.

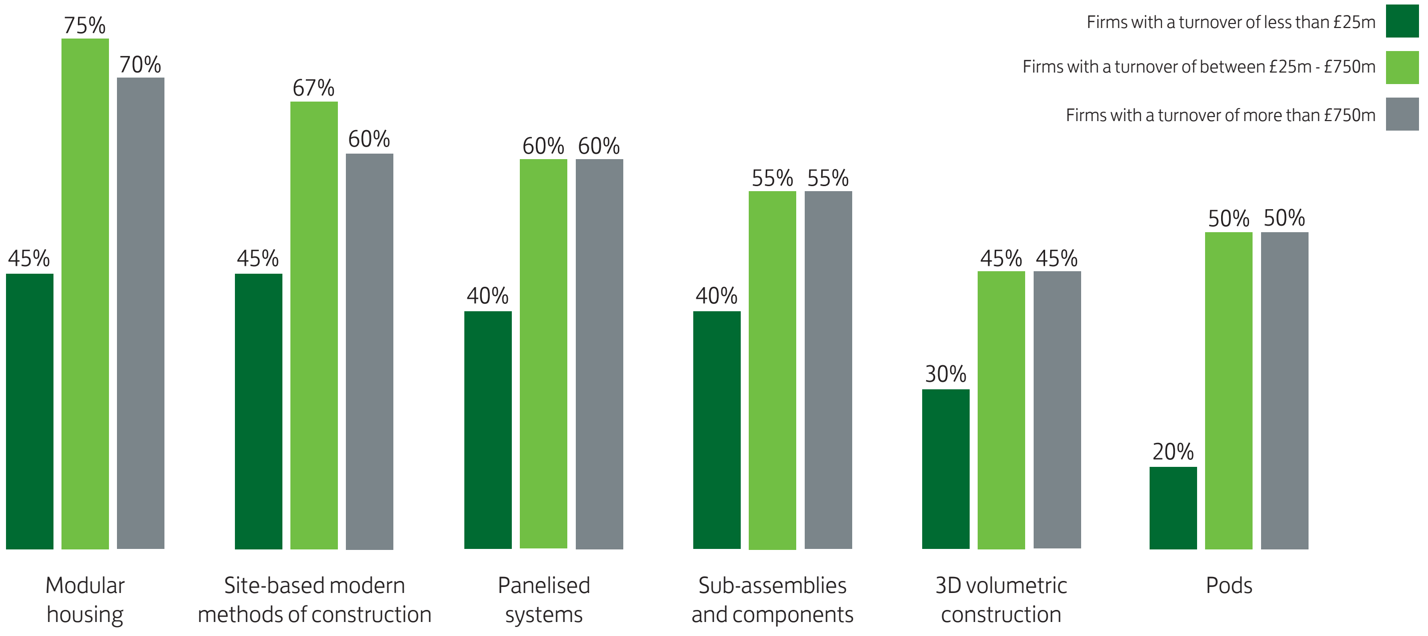
Sustainability is also likely to be an influencing factor, with 82% of firms saying that they're more focused on the issue now than they were five years ago, and only 2% saying it had fallen down the agenda.

In densely populated and high cost areas, micro units built using modern methods of construction reflect an industry innovating and prepared to change to deliver growth.

6 Fast brick robotics, 2017, https://www.fbr.com.au/

7 Tomorrow's buildings: construction industry goes robotic, BBC, May 2016, http://www.bbc.co.uk/news/technology-35746648

Which of the following new build techniques do you currently invest in?



CLOSING STATEMENTS

Stewart Baseley
Chairman,
Home Builders Federation

It has been yet another eventful 12 months for our industry.

Housing has risen even further up the list of political priorities with the Prime Minister herself dedicating her premiership to tackling the housing crisis and we've seen another steady stream of announcements designed to further boost housing supply, punctuated with another general election and a far-reaching Housing White Paper.

Amongst all this activity, house builders have been quietly getting on with the job, delivering another impressive increase in output in the year to March 2017. Net supply of 217,000 – up 74% in just four years – does not just represent rapid progress in closing the gap between demand and supply, it is also historically significant. Whilst still being some way short of the Chancellor's new target to increase delivery to 300,000 by the middle of the next decade, last year's output was the second highest annual figure this century; the third highest since the 1970s and more than the annual average during the 1950s. The future outlook looks encouraging too, as house builders buoyed by improvements to the planning system and the ever popular Help to Buy scheme, continue to invest in future residential sites. The 328,000 planning permissions recorded in the year to September 2017 is evidence of builders' ambitions to continue this positive trajectory. However, there is still more to do to streamline the planning process and address the obstacles to SME expansion and the growth of specialist builders, such as retirement developers. There are undoubtedly challenges ahead, some evolving and some new.

I very much welcome this third consecutive year of excellent research from Lloyds Banking Group which not only reflects the current position for house builders of all sizes, but also gives a good indication of the ambitious growth strategies in place across the industry to build on recent progress and deliver even more high quality new homes. The report highlights the careful thought and planning that companies are already engaged in as they take forward their strategies. From exploring new methods of construction, prioritising investment in skills or diversifying their products, with the recession now well and truly in the rear view mirror, house builders are readily planning for the future.

With output growing, the availability of skilled labour is increasingly a concern for companies, especially in light of uncertainty around future access to EU workers, a consideration borne out by the findings of this report. The Home Builders Federation's own research on this subject has shown that in London and much of Southern England, EU nationals make up a sizeable proportion of the workforce so in addition to the secured status of existing workers, the future migration prospects of others will also be a focus over the coming period as the UK adopts a new immigration system post-Brexit.

Even with challenges on the horizon, the outlook remains positive. Ambitious growth plans build on several years of rapid expansion in the industry and with a Government committed to an unprecedented housing delivery target, we look forward to further reforms to boost supply from existing housing providers and, crucially broadening that supplier base to promote a greater role for smaller private developers, housing associations and specialist developers. With few signs that the next 12 months will be any quieter than the last, we most certainly live in interesting times.

Nicola Barclay
Chief Executive
Homes for Scotland

Whilst home builders north of the border operate in a significantly different policy context given the devolved nature of housing, the same key challenges generally apply across the UK.

Compounded by uncertainty over Brexit, these unfortunately seem to be worsening, with growing skill shortages, optimism levels falling back from the previous report and around half of respondents less positive in relation to investment plans. The research highlights the continued importance of Help to Buy and a welcome improvement in the position for SMEs in accessing business finance, two specific areas of policy that remain key to increasing housing delivery.

Other particular areas of importance in the year ahead in Scotland relate to the outcomes of the current planning review and debate around land reform, with the continuing focus for Homes for Scotland being to work collaboratively with stakeholders and engaging positively with politicians to ensure our industry can deliver the many thousands of homes of all types our country needs for its growing population.

Lloyds Banking Group is focused on Helping Britain Prosper and this includes supporting the provision of new homes in both the public and private sectors. Our teams have the financial and industry experience to help make your growth and investment plans a reality.

For more information, get in touch with us

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Methodology:
Field research for this report was undertaken in October and November 2017 by Coleman Parkes Research. To gather representative data from this diverse industry, a broad cross section of 100 UK housebuilders and firms in the supply chain were interviewed, with companies ranging in size from less than £25m to £25-£750m and more than £750m annual turnover. The research targeted business owners, managers, directors, department heads and senior managers. Our survey questions focused on growth plans, job creation and skills, capacity and investment, legislation, the housing shortage and challenges.

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