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## The evolving New Build market and how this will affect lenders and valuers

In this paper we take a closer look at Government-led initiatives targeted at procuring new homes, with a focus on Modern Methods of Construction, Office to Residential and social housing.

*"I want to fix this broken market so that housing is more affordable and people have the security they need to plan for the future. The starting point is to build more homes. This will slow the rise in housing costs so that more ordinary working families can afford to buy a home and it will also bring the cost of renting down. We need to build many more houses, of the type people want to live in, in the places they want to live. To do so requires a comprehensive approach that tackles failure at every point in the system." Prime Minister Theresa May*

The Government's strategy for a sustainable housing programme was outlined in the White Paper – 'Fixing our broken housing market' which was published in February 2017 by the Ministry of Housing. The paper provided their vision, focusing on the need to increase the availability, quality and production of housing in both the private and public sectors. The overarching aim is to increase the production of housing to provide an additional 225,000 to 250,000 new homes each year, which is an optimistic aspiration.

Several solutions have been proposed and schemes have been adopted to meet this challenge but it's unclear as to whether the targets and vision can be realised. The proposal includes the conversion of office accommodation (and possibly light industrial units) into residential development solutions, the



manufacture of off-site/innovative housing, mixed tenure developments, easing of local authority approvals for new development, release of land and the continued support of the Help to Buy scheme.

These areas of Government policy will be a focus for residential valuers, and will provide both new challenges and opportunities for all interested parties.

### The Farmer Report

Prior to the White Paper, Mark Farmer (an independent consultant) concluded a hard-hitting review of the construction industry titled 'Modernise

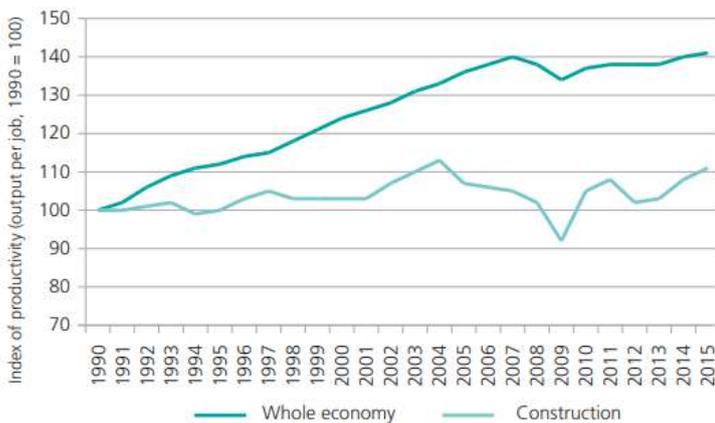
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or Die', a report commissioned by the Government to look at various issues concerning the construction industry so that policies can be reviewed and key matters addressed.

In the report, Andrew Wolsenholme, CEO, Co-Chair of the Construction Leadership Council, stated: "Put simply, much of the industry does not make enough money, or, where money is being made, feel enough confidence it will stay profitable into the future. The consequence is underinvestment in training and development, in innovation, in raising productivity. The challenge the report sets us is to do things differently – to reduce the reliance on building in the same way that we have for decades if not centuries, with its heavy demand for on-site labour."

If the status quo is maintained, crucial matters need to be considered; can the UK meet the housing need using traditional methods with a limited labour force? In a word – 'no', concluded the report. The country needs to look for alternatives and a new direction in procuring houses, from small infill developments to inner city multi-use high rise structures and new town developments.

*Productivity indices: whole economy v construction*



Source: ONS 2016, Labour productivity statistics

## Modern Methods of Construction, innovative construction and off-site construction

In the last 12 months the full or part use of alternative buildings, components and materials have been seen, but they are not of a sufficient scale to fill the void required to meet with the Government's own target of nearly 300,000 new homes every year.

The universal term for this is Modern Methods of Construction (MMC) or 'off-site' but it is still very much an emerging industry, with many new types. The graph below illustrates the need for increased productivity in the residential sector.

New building systems in the market are various and use a range of materials, from concrete, to timber and light gauge steel and can be in panel form, hybrid systems or full modular units. When fully constructed they can also be virtually impossible to identify in some instances, without a higher level of knowledge to look at constructional details.

Memories of the past, and the failures of factory-built houses, along with the misconception that these dwellings are 'pre-fabs' still exist and haunt the industry. As they are generally untested in Britain should lenders support them and will purchasers buy them?

In addition, the construction industry is still a fragmented one with several players in the market, but overarching regulation/assurance is required, and quickly, to provide lenders and valuers the assurance and confidence they need.

In the aftermath of the tragedy of Grenfell Tower, individual components of any building and the associated Building Regulations requirement have been in question. This has led to concerns as to whether new technologies will provide suitable life spans, will be safe, are installed correctly and will be

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suitable to mortgage lenders. Dame Judith Hackitt's independent review of 'Building Regulations and Fire Safety' is still being digested by the Government and industry experts.

Upon reflection, would we prefer a house to be built like a car? Can one imagine Mercedes building a car in your garden with many operatives using thousands of components in extreme weather conditions over a period of many weeks? Or would you like it made in a purpose-built factory using precision machinery and adopting exacting tolerances? The answer seems an obvious one; internationally in North America purchasers will pay more for an 'off-site' new home than they will for a unit built 'in-situ'.

## Valuer expertise

To assist the use of alternative methods the Buildoffsite Property Assurance Scheme (BOPAS) was created in partnership with the Royal Institute of Chartered Surveyors (RICS), Lloyds Register and BLP insurance.

BOPAS states: "BOPAS was developed to address these concerns and perceived risks associated with innovative construction. BOPAS is recognised by the principal mortgage lenders as providing the necessary assurance underpinned by a warranty provision, that the property will be readily mortgageable for at least 60 years."

However, the above passage is not strictly true. The valuation/survey industry has seen examples of new builds using an MMC superstructure, such as Structurally Insulated Panels (SIPs), that are fully accredited by BOPAS, being used in combination with inferior exterior cladding systems that are deemed to be unacceptable to lenders. This highlights the challenges to valuers and the mortgage industry.

The process still needs a far more joined-up approach from the proposed scheme to completion of the site. If only one element fails then questions will be raised in terms of who is accountable for the issue and most importantly who will remediate the works – the main contractor, the sub-contractor, the material supplier or the freeholder? Adverse press coverage of Barratt timber framed houses in the early 1980s, which failed, highlighted this matter and any future high-profile failure will be detrimental to the industry.

Highlighting the need for change, The Guardian newspaper reported in January 2016, "The last time Britain managed to build over 200,000 homes in a year, which was in 2008, it required stocks of 1.1bn and production of 1.9bn bricks to fulfil orders and keep prices stable enough to facilitate construction.

"Britain's brick stocks fell to a low of 323m in October 2014, but rose slowly to 535m at the end of October 2015. In 2004, stocks were at 617m and brick production reached 2.87bn, while ten years later in 2014 just 1.8bn bricks were produced.

"The massive drop in production is due to a number of brick factories being mothballed immediately after the 2008 financial crisis."



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## What can the industry do?

It can be difficult for a valuer to identify a house which has been constructed off-site, after it has been built. Valuers should use the resources available to them. Since 1<sup>st</sup> August 2018 the UK Finance disclosure form references key issues, such as ground rent terms and the construction type of the building. Resources are also available within the BOPAS website providing lists of approved contactors, though this database is incomplete.

In a data-driven world, the more information that can be provided, the better for all parties concerned. Ongoing training of valuers will also help them to be better placed to assess these schemes and trends.

## Office to Residential (OTR)



Prior to the White Paper, the Government relaxed planning conditions in May 2013 to provide ability for developers to convert office accommodation without the need for planning permission to provide residential accommodation.

This policy of deregulation was proven to be successful in regeneration of redundant office blocks and has boosted the number of available units. These permitted development (PD) schemes have

proven to be popular in many cities throughout England (Scottish planning laws vary). From April, 2013 to March/April 2017 568 schemes were proposed (RICS research).

## Challenges to the industry

Although schemes are proposed and undertaken within planning framework this doesn't automatically ensure that the completed schemes will be acceptable to lender clients. These schemes have provided various questions for valuers and lenders to consider – for example:

- **Location** – Is the position suitable for on-going demand? For example, is the block surrounded by industrial or commercial units and is access poor?
- **Layout** – Are units suitable for residential occupation, although building regulations still apply is the layout practical? Are window positions suitable, are the units large enough or the right mix of studios, one and two-bedroom units?
- **Quality** – Many developers are new to the market and may not adopt a mainstream warranty provider, and quality of the completed units are sometimes questionable.
- **Structure** – Is the original structure fit for purpose and likely to be mortgageable – is it of non-traditional construction and will it have a reasonable lifespan?
- **Cladding** – Has retrospective cladding been provided – is this fire retardant?
- **Aesthetics** – Does the finished block still resemble the proposal, and does it still have the appearance of its existing use?
- **Parking** – Is the parking mix suitable for the location?
- **Commercial activity** – Are the units over unknown or unsuitable commercial activity on the ground floor(s)?

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- **Investor sales** – Are the blocks only likely to interest investors? Some OTR schemes have been sold to Private Rental Sector (PRS) investors to provide initial capital but this dynamic can change the feel of the block. Some marketing agents are also providing projected rental yields.
- **Warranty provision** – Does the warranty provider provide a staged inspection of the block and does the cover extend to the original structure as well as the additions/alterations or conversion?
- **Other** – the same challenges to ‘normal flats’ relating to ground rent, ground rent escalations, event fees, service charges, owner restrictions still exist.

## Case study

A recent property development scheme relating to an office conversion has been partially completed, with the block being situated in a reasonable location with good transportation links, with parking, a reasonable lease and to a good specification.

The main issue relating to this block relates to the units having many bedrooms with inward facing windows into a central atrium, this has created light and privacy issues, given the corridor is outside the bedrooms, therefore high-level openings (for privacy) but the natural daylight is limited and has created a rather dull environment within the subject units in many of the apartments. The block complies with all regulations, but does it form on-going and sustainable mortgageability? An image of one of the affected rooms is included on this page.

These questions are posed to lenders and valuers on a weekly basis and decisions made on such blocks will determine the future of such developments. It’s not an easy task.

Also, the site pictured on Page 4, provides an example of an inappropriate conversion in terms of

external appearance, ground floor use and future management considerations. Is this suitable for prime mortgage security?



## Increase in the social housing sector

A reversion to increased social housing provision is also part of the greater Government strategy and along with Housing Associations more land is being made available for new or regeneration schemes. Some councils have even created new housing development companies to create new developments and have also promoted off-site/innovative and sustainable developments.

One example is Wolverhampton Homes who have been created as the housing/development arm of the local authority and they have mainly adopted modular homes that will be made available for sale, shared ownership or rental. The schemes are available for Help to Buy and are supported by most mainstream lenders, subject to usual considerations relating to the locality.

"This project is yet another example of how the council is using innovative ways to accelerate house building in the City of Wolverhampton," stated City of

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Wolverhampton Council Director for Housing, Kate Martin, when discussing an initial scheme in April.

## Summary

The challenge to provide more 'new build' homes is one for the whole residential sector to work in collaboration on to achieve sustainable developments. The role of valuers is to protect the lender and learn from lessons of the past. To achieve this valuers require a higher level of knowledge than was previously deemed necessary to inspect and appraise new build sites and to appreciate the possible future challenges ahead.

As demonstrated, offsite/MMC and property development schemes are helping to fill a void, but they are still new to the market and are still to be rigorously tested and proven. Lenders need to be provided with the required assurance to accept these innovations, and surveying companies need to assist this by creating pragmatic and robust guidance and feedback.

One of the key conclusions from the RICS Research Paper 'Assessing the impacts of extending permitted development rights to office-to-residential change of use in England', was stated as 'The original impact assessment from DCLG in 2013 was flawed. The policy of office-to-residential change of use being permitted development should be properly reviewed, and it should be returned to full planning control'. The task of valuing 'new builds' certainly isn't an easy task.

e.surv Chartered Surveyors now has a dedicated New Build team to support lenders with these issues. For any enquiries, please contact:

David Harbour, Chief Surveyor:  
[david.harbour@esurv.co.uk](mailto:david.harbour@esurv.co.uk)

## Feedback

**This paper was produced by the Risk & Governance department of e.surv Chartered Surveyors. We aim to address the issues that matter to our corporate clients and therefore invite your feedback on this paper.**

**In addition, we are keen to hear about any other subject areas that are of interest to you so that we may consider covering these in future.**

**Please send your feedback to David Ward at [david.ward@esurv.co.uk](mailto:david.ward@esurv.co.uk) or ring 01536 535527.**