Mind The Funding Gap

The financial challenges facing small and medium-sized housebuilders

delph property group

collaborative partnerships in residential

Summary

Small and medium-sized (SME) housebuilders play an important role in delivering new housing but the future of this industry and its contribution to the housing crisis is under threat.

Access to finance has become a lot harder across the economy for small and medium-sized enterprises ever since the onset of the recession and, as a consequence, the proportion of homes built by small housebuilders has halved in recent years.

With a far from certain economic outlook, escalating costs and ongoing delays at planning, the smaller housebuilders' difficulties have been compounded by the continuing post-downturn nervousness of lenders.

Partnerships with small and medium-sized housebuilders deliver a range of benefits that are often not provided when doing businesses with larger operators, such as achieving a bespoke approach to quality. A study by the Local Government Information Unit found that small developers had a better track record of delivering the numbers than larger volume builders. Working with SMEs is also a way to invest in local jobs and skills.

Financial constraints are the most significant obstacle to growth according to 69% of constructions firms

Source: Q4 2016 RICS Construction Market Survey

The slow, steady decline of house building

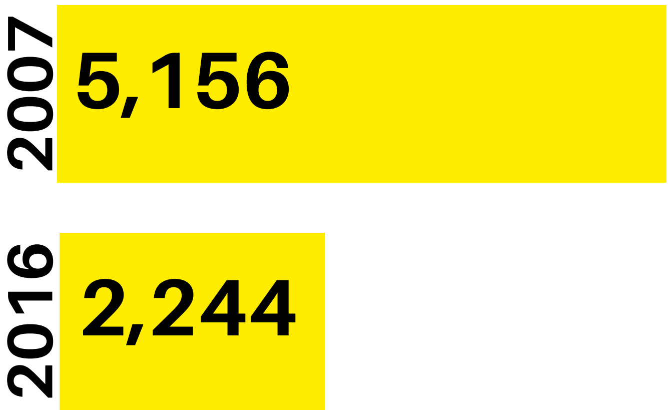
In the late 1980s, small and medium-sized firms were responsible for most of the house building that took place in the UK. This fell to less than 50% by 2008.

Although each individual company delivered fewer than 500 properties on average per year, collectively the sector was responsible for 70% of all new homes.

Over the past three decades, the percentage of new homes delivered by SMEs has been progressively eroded – falling to less than 50% in 2008. The financial crisis was a major turning point and many SME housebuilders found they simply could not weather the storm.

A National House Building Council (NHBC) breakdown of completions by company size reveals a polarisation of the market since it peaked in 2007. Since the crash, the number of housebuilders delivering 30 or fewer homes more than halved from 5,156 in 2007 to 2,244. By contrast the number of volume builders, those that registered 500 or more completed homes, stayed relatively constant, dropping by just one from 37 in 2007.

Small and medium housebuilders



Since 2007, the number of housebuilders delivering 30 or fewer homes has more than halved in 2016

Source: Q4 2016 RICS Construction Market Survey

Losing market share to the major housebuilders

Competition for land is an issue that is often cited to explain why SMEs have struggled and continue to lose.

A survey from the Federation of Master Builders in 2016 found that 67% of SME housebuilders in England consider a "lack of available land" to be their biggest problem, while large housebuilders are sitting on over 600,000 plots of land – enough to build up to one million new homes in the UK.

Market share of the largest five housebuilders has increased significantly since the period of austerity, which followed the start of the 2008 recession. The downturn accelerated a process of consolidation which began much earlier. In 1960 the top ten housebuilders accounted for approximately nine per cent of all new housing production. By 2004 this had increased to 46 per cent.

The constraints on development land in the UK has created a unique dynamic. Unlike many other European countries, the restricted supply of land in the UK creates incentives for firms to combine both land development and housing construction functions. The larger sized firms that are created can therefore employ strategies to influence local land markets through their land banks.

This is particularly the case for larger housebuilders. The issue of landbanking is complicated and contested – including persistent claims that developers are hoarding land with planning permission and thereby restricting new housing supply. This has been countered with strong rebuttals and evidence that the landbanks of the large housebuilders are actually decreasing in size.

67 %

of SME housebuilders in England consider a "lack of available land" to be their biggest problem

Source: Federation of Master Builders House Builders Survery September 2016

Why access to finance is problematic

The financial challenges that threaten SME housebuilders come from several directions.

Banks are reluctant to lend and capital requirements continue to rise. Meanwhile, there is a perceived lack of government support for SMEs, while large housebuilders insist that they cannot meet demand for new housing.

A major problem that SME housebuilders face is securing finances to forward fund construction. Although bank lending has not completely ceased, the terms at which they are awarding loans have tightened to such an extent that it simply is not tenable for the majority of SMEs to front the collateral, or manage the excessive interest rates.

Since the recession, banks are less willing to lend to small housebuilders unless they are certain that there is no risk involved. Research from the Forum of Private Businesses has found that the average overdraft lending rate for SMEs is 6.6% (far above the 0.5 base rate set by the Bank of England). The conditions of bank loans mean that developers face the impossible choice between looking for funding from other sources, or accepting a loan on terms they are uncertain they will be able to fulfil – either action could potentially result in their business grinding to a halt.

In 2016, development finance, typically available on a project-by-project basis was at 60-65% loan to value. Prior to 2008, SME builders could obtain 70-90% loan to value.

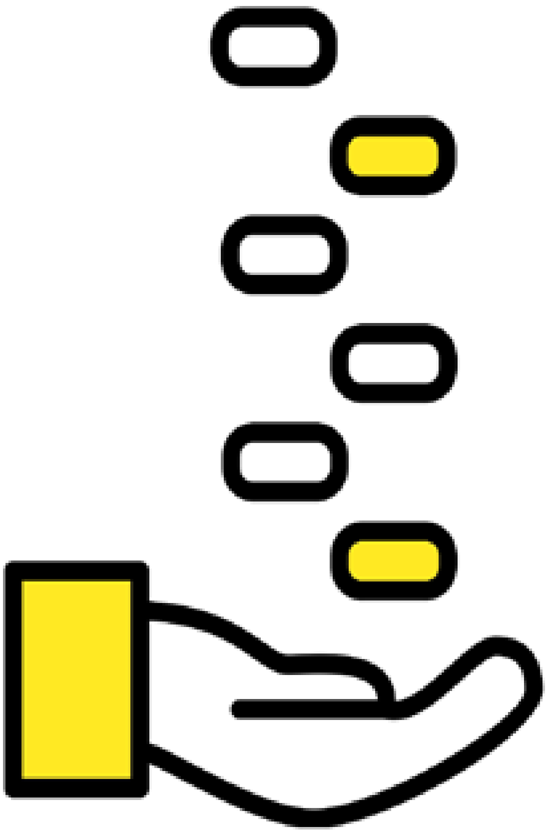
Source: Reversing the decline of small housebuilders: Reinvigorating entrepreneurism and building homes January 2017

Late payment and the impact on SMEs

Late or non-payment, which can occur due to insolvency, default or dispute, is a major problem in the construction industry, where labour and materials are generally paid upfront.

Findings from the SME Confidence Tracker report for Q2 of 2016 show that in the year between August 2015 and August 2016, the construction sector was one of the worst hit for having to write off debt due to late payment.

Construction SMEs counted for a third of all SMEs that had to write off debt, cancelling £15,000 on average over the past year.



£15,000

average amount of debt written off in 2015 by construction SMEs

Source: SME Confidence Tracker Q2 2016 http://www.bibbyfinancialservicesblog.com/tag/sme-confidence-tracker/

Alternative Funding Models

The issue of SMEs having to take on bank loans with unreasonable fees and interest rates can be eliminated or severely reduced by working with partners that can provide alternative models of funding.

Delph has helped SME builders and developers by offering the following alternative funding models:

Off Plan

With an off plan deal, SME housebuilders can secure a significant deposit plus staged payments on construction milestones. This helps cash flow and can also enable them to secure better funding terms with banks and funders. It also cuts out sales risk and future marketing costs.

Pre-Purchase Partnership

This arrangement gives the opportunity for a housebuilder to bid on a scheme knowing it has a guaranteed sale price agreed with an investor or partner prior to their offering a submission. This can give confidence throughout the construction process and removes any risk of late payment so that once everything is completed, the housebuilder can proceed quickly on to their next project.

Forward Funding

Under this model, an investor is able to buy the land and fund construction on stage payments or interim valuations. This approach allows an SME builder to clear the balance sheet, eliminate risks, and make large savings on marketing, sales and finance charges. When housebuilders and developers partner with property investors, they can secure better financial terms through reducing interest rate charges, increasing loan to value gearings and giving access to a wider choice of lenders.

Are we turning a corner?

The slow decline of the SME housebuilder has been bad news for Britain. The net result, fewer homes built and people priced out of the housing market in increased numbers.

Although the sector has seen better days, there are encouraging signs that things are about to turn a corner. There is now widespread acceptance that the sector has an important role to play in helping the country meet the housing challenge. In response, the government has signalled its intention to support the industry and the recently published housing white paper "Fixing our broken housing market" outlines a number of significant measures to support the SME construction industry.

Delph has long believed that SMEs are an engine for growth. While we happily work with many of the biggest names in the construction industry, over the years some of our best projects have been delivered by small, independent builders. That's why in 2016 we announced a £500 million fund to provide development finance for housebuilding projects outside of London over a five year timeframe. We made the money available in response to the news that banks and other financial institutions are pulling away from investing in property. Our intimate knowledge of the housing industry, and the support of an expert in-house construction team, means we can often finance projects when the banks can't.

Nicholas Belkin

Head of Acquisitions, Delph Property Group

About Delph Property Group.

We buy off plan or completed apartment blocks from 50 - 400 units in city centre locations across the UK. We also offer forward funding and large deposits to reduce risk for builders and developers.

Since it was founded in 1948, Delph has been solely focused on residential property either through investing or developing, giving us unparalleled experience that sets us apart from other companies.

For land and acquisitions contact:
Nicholas Belkin
Tel: +44(0) 20 7907 5565
Email: nbelkin@delphgroup.com

For general enquiries contact:
44-45 Great Marlborough St, London, W1F 7JL
Tel: +44(0) 20 7907 5555
Fax: +44(0) 20 7907 5556
Email: info@delphgroup.com

Website:
www.delphgroup.com

Twitter:
www.twitter.com/delphgroup

LinkedIn:
www.linkedin.com/company/delph-property-