



Uncertainty clouds the future for UK housebuilders

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Neil Hume ON LONDON

Housebuilders do not have a lot going for them at the moment. Public-sector job losses, fiscal tightening, problems getting mortgages and deteriorating consumer confidence are just some of the headwinds.

Hardly a day goes by without more bearish data. If it's not a housebuilder or a trade federation warning that the crucial autumn selling period has not delivered the expected pick-up in homes sales, it's news that mortgage lending remains in the doldrums.

Indeed, the Bank of England revealed on Friday that mortgage approvals had fallen to a seven-month low of 47,474 in September. To put that figure in perspective, economists consider an approval level of 70,000-80,000 as consistent with stable home prices.

But what does all that mean for quoted housebuilders such as Bovis Homes and Persimmon? Obviously, it is not good news that the market is slowing (or, as some analysts claim, has ground to halt). However, this should not come as a surprise to anyone given the media fixation with house prices. Moreover, given recent share price weakness, isn't a lot of the bad news in the price? The UK housebuilding sector has fallen about 14 per cent in the past month, underperforming the wider market by 17 percentage points. Shares in Taylor Wimpey and Barratt Developments are trading close to 12-month lows, having lost a fifth of their market value in the past month.

Deutsche Bank reckons the housebuilding sector now trades on a little under 0.5 times its forecast of tangible net asset value for 2011. This is the lowest point this

year and according to Deutsche shows that share prices are already discounting a double dip in home prices - or another fall of greater than 15 per cent year-on-year.

As such, the bank thinks the sector is cheap and has advised clients to take advantage of recent share price weakness to build positions. Deutsche also believes that industry data could turn positive at the start of next year thanks to easy comparatives and a less nervous consumer.

That view is echoed by Simon Brown of Matrix. He thinks data could pick up during the spring selling season and reckons increasing rental costs and the realisation that government spending cuts are to be phased in should tempt buyers back in the market.

But let's take a more pessimistic view for a moment and see how valuations stack up.

Alastair Stewart, analyst at Investec Securities, believes there is a serious risk of a double dip in house prices and land values. As such he has slashed his target prices for housebuilding stocks to reflect that risk.

Given the dismal backdrop, Mr Stewart thinks housebuilders should trade at a 30 per cent discount to his estimate of their net asset value. This involves substituting companies' audited land values, which he says are based on flawed accounting assumptions, and replacing them with what he thinks are the real average theoretical cost of land. In every case this is lower than the reported level.

One can take comfort from the fact that there remains a fundamental undersupply of houses in the UK. What's interesting from this exercise is that only Taylor Wimpey and Bellway are trading below Mr Stewart's target prices. The rest are above and some, such as Persimmon, considerably so. Under this scenario housebuilders are not cheap, although one can perhaps take comfort from the fact that share prices are heading towards these more bearish targets.

Equally one can take comfort from the fact that there remains a fundamental undersupply of houses in the UK. Mr Brown expects a new build rate of 125,000 units, at best, over the next three years, which he notes is below the annual household formation rate of 220,000.

But, unless there is some focus on these longer-term structural issues, the housebuilding sector seems very unlikely to reverse its performance against the wider market. As long as the outlook remains uncertain, investor focus will remain on mortgage availability data, house price surveys and how well the economy holds up

as the government's austerity programme kicks in. As long as it does, housebuilders will struggle.

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