UK Residential – February 2020

SPOTLIGHT
Savills Research

Prime Residential Rents

Five-year forecasts • Regulation and supply • The shape of future demand

> "Lack of stock has particularly benefitted the market for flats in London, where rents increased by 1.2% over 2019 compared to growth of 0.5% for houses"

The second half of 2019 marked a turning point for the prime London rental market, as growth began to return after a three-year period of rental falls.

Since early 2016, and the introduction of the 3% stamp duty surcharge for additional homes, prime rents have fallen by 7.7% across London and by 14.9% in the more expensive central London market. But the additional supply that came into the market as a result of that surcharge has now mostly been absorbed.

In London's commuter belt, the prime market is also showing signs of recovery, though at a more gradual rate compared with the capital. Rents across markets from Cambridge to Surrey fell by 0.5% during 2019 – but this was the smallest annual adjustment for three years.

So, what will be the driving factors for rents over the coming five years?

The result of the general election reduces the risk of rent controls proposed by the Labour Party. But with a swathe of other regulation either introduced during 2019 or under consultation, challenges remain for the buy-to-let market. The question will be the extent to which this has a serious impact on supply in the market, and whether any shift is significant enough to trigger strong rental growth going forward.

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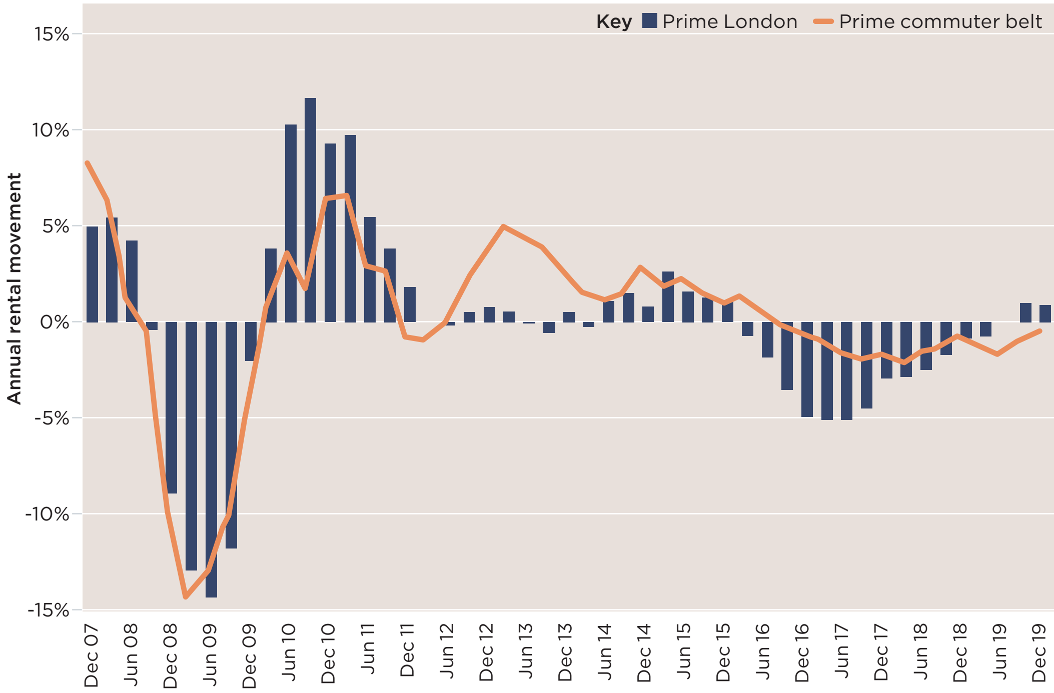
Positive trends Signs of recovery across London and commuter markets



Source Savills Research

Lower stock, higher rents

Most London regions are now recording an increase in growth

Rents across prime London increased by 0.9% during 2019, marking a second successive quarter of annual growth. The regions of prime West London, from Hammersmith to Ealing, and prime South West London, stretching from Clapham to Richmond, saw the strongest growth over 2019 of 2.9% and 1.6% respectively.

This growth was primarily driven by low levels of stock, while demand has remained steady. Indeed, 68% of our agents across London reported a lack of stock as their biggest challenge over the previous three months.

This lack of stock has particularly benefitted the market for flats in London, where rents increased by 1.2% over 2019 compared to growth of 0.5% for houses. Tenant demand remains strongest at the lower end of the prime market, fuelling growth for smaller, less expensive property. But some markets have seen record prices for family houses, such as Barnes, which is very much driven by best-in-class properties.

While most London regions are now recording rental growth, the prime central London market has continued to see small price reductions, with rents falling by 0.9% during 2019. Value and condition remain the major driving factors in this market, with many tenants searching for the right property at the right price while being flexible on location.

A slow sales market last year saw an increase in accidental tenants choosing to rent rather than buy, and also prevented accidental landlords from selling.

Almost three-quarters of our agents in markets in London's commuter belt saw an increase in 'try before you buy' tenants over the last three months of 2019. These were made up both of tenants trying a new area before they committed to a purchase, and those who had already sold their property but had not yet found one to buy.

Rents for smaller properties remain strong in the commuter zone. Again, this is being driven by a lack of stock. Prime housing remains price sensitive in these markets, while lower-value stock continues to sell well – proving an incentive for landlords looking to exit the market.

On track Prime London saw a second successive quarter of annual growth

	All prime London	All prime commuter belt
Quarterly growth	-0.2%	0.0%
Annual growth	0.9%	-0.5%
5-year growth	-6.6%	-2.6%

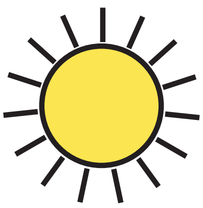
Note Values to Q4 2019 **Source** Savills Research

Price monitor
Key statistics for the prime rental markets

40%
Proportion of Savills tenants across London who work in finance and insurance

20,000
The number of completed build to rent homes across London

Rents fell across the prime commuter belt in 2019, the smallest annual adjustment for three years



10.9%
Five-year growth forecast for prime London rents

Source Savills Research

Addressing the supply issue

The impact of policies, regulation and new build on the market

Sloane Gardens
London SW1,
£2,650 per week

The buy-to-let landlord continues to have their finances squeezed, for example through the cut to mortgage interest tax relief – the full effects of which will be felt from April this year.

Since 2016, 132,000 buy-to-let mortgages have been redeemed across the UK. The lack of supply this is causing is starting to have an impact on some parts of the prime rental market. With more regulation to come, how far will supply be further reduced?

Regulation

The consultation of Section 21 of the Housing Act to abolish no-fault evictions looks to provide further support to tenants, alongside other suggestions such as lifetime deposits. But there could be unintended consequences of the abolition of Section 21 that may be counter-productive. Some landlords may choose to sell, causing further supply issues in the market and creating upwards pressure on rents. And for committed landlords, rent review provisions will become much more of a focus.

Over the past four years, we have seen the nationality of landlords across prime London continue to diversify. International landlords have increased their share of the market from 27% in 2016 to 35% in 2019. However, the proposed additional 3% stamp duty surcharge for non-resident international buyers may prove to be a limiting factor for new supply coming from international landlords.

New build stock

While the development of new prime schemes over £1,000 per sq ft across London have slowed amid Brexit-related uncertainty, there is stock still under construction that will soon be completing. Some of this will come to the market as rental stock. Currently, the completion of this supply is expected to peak in 2021. This will likely provide competition to existing stock of similar price, and may suppress strong rental growth in the short term.

Beyond the individual private landlord, the market for institutionally owned purpose built rental stock continues to grow. There are 20,000 build to rent homes now complete across London, with many schemes due to complete soon, such as Wood Wharf at Canary Wharf. Though this type of stock has increased, it is unlikely to replace the stock sold by those individual landlords exiting the market.

Factors influencing demand

Activity from prime tenants remains surprisingly robust across both London and its commuter belt. Despite the uncertainty of Brexit throughout 2019, the corporate relocation market continued to see strong demand for placements across a range of industries. The initial expectation that many in the finance and insurance sector would be relocated elsewhere in Europe as a result of Brexit does not appear to have materialised. The proportion of Savills tenants working in this sector in London has risen since 2016 to account for 40% of the market in 2019.

But Brexit has not yet been fully resolved, with a trade agreement still to negotiate. So, the implications for tenant demand across the prime markets may yet to be realised.

Another factor may be the impact the proposed additional 3% stamp duty surcharge has on demand from those who only spend part of the year in the UK. Non-resident would-be buyers may opt to rent instead if the cost of buying with that additional tax outweighs the cost of renting.

Prime rental forecasts Prime rental markets are projected to recover in the longer term

	2020	2021	2022	2023	2024	5-year compound growth
London	1.0%	1.5%	2.5%	2.5%	3.0%	10.9%
Commuter zone	0.0%	1.0%	1.5%	2.0%	2.0%	6.7%

Note These forecasts apply to average rents in the second-hand market. New build values may not move at the same rate **Source** Savills Research

RENTAL RECOVERY

Tenant demand looks to remain steady going forward, although this will be determined by how the UK economy reacts to leaving the EU and the impact this may have on job creation, income growth and, therefore, corporate budgets.

However, further regulation in the buy-to-let sector may mean we see an increase in landlords choosing to exit the market and sell their property. This may include accidental landlords who see a stronger market in which to sell.

In London, new build supply, including purpose built rental stock, may increase in the short term and limit rental recovery over the next two years. But with the number of new schemes starting construction having dramatically slowed, this is unlikely to be a limiting factor over the longer term.

Therefore, we expect prime rents to continue to strengthen across the London market, particularly after 2021 as that new build stock moves through the market and growth returns to trend level thereafter.

The commuter belt market is also expected to recover, although at a slower rate. Here, it's unlikely to be new build supply that limits rental growth, but affordability and how far some tenants can stretch their income, particularly for young professionals and families.

Capital growth is likely to be stronger than rental growth over the next five years, which will underpin the returns for committed landlords.

For this group, the key to achieving a rental premium and preventing long voids will be providing stock of the highest condition, even if that means investing in refurbishment, and timing the launch correctly – particularly for the family house market in early spring.

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Savills Research
We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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