

UK Residential - Autumn 2018



REPORT

Savills Research

Residential property forecasts

savills

Pulling in different directions

Our five-year forecasts examine the divergence in future house price performance between London and the regions

Where science meets art

If I were to bet my life savings on the piece of Savills research that will get more reaction than any other, I would stake it on this – our annual *Residential Property Forecasts*.

To arrive at our final figures, we use large sets of data and economic modelling to unlock future trends. But this work involves a degree of conjecture, too.

Our short-term forecasts rely on us accurately predicting what will happen to sentiment. We have some lead indicators of supply and demand to help with this. But 2018 has not been a normal year, and these indicators are arguably more fickle than ever.

Extreme scenarios

Take, for example, the reporting of the Bank of England's extreme, almost apocalyptic, scenario of 35% house price falls in the event of a hard Brexit and spiralling interest rates. We believe this is highly unlikely. A correction of this nature is without precedent and the economic conditions required are at the margin of a wide range of potential outcomes, as Mark Carney pointed out after the headline writers had made mischief.

That said, sentiment *is* exposed to how Brexit negotiations proceed and, specifically, the perception of what the outcome will mean for household finances.

While this all remains unclear, do not expect any great movement in house prices or market activity at a national level.

Our longer-term outlook for the housing market is more dependent on what will *actually* happen to household finances. Assumptions about earnings growth and interest rates are critical to this, especially

in an age of mortgage regulation. Our assumption, which is aligned with the central scenario of the Bank of England, is that these will increase gradually to support total house price growth of 14.8% at a national level over the next five years. As we argue on p4, that would put a squeeze on the level of mortgage that borrowers are offered relative to their salary, as mandatory stress tests become more difficult to meet.

We expect this to act as a drag on house price growth, especially in London and the commuter belt where the growth in house prices from 2005 to 2016 has left less room for movement.

More than just house prices

However, this report is not just about house prices. It is also about trends in buyer types and where they are buying. We also examine housing delivery, and just how the government sets about fixing our 'broken' housing market – a key plank of domestic policy.

This report may not come with a cover-mounted comfort blanket of absolute certainty. And you will have your own views about our conclusions. But forecasting is as much of an art as it is a science – and looking into the future remains a vital part of what we do.



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Contents

Five-year forecasts and market analysis

4-7 UK forecasts

We highlight the main drivers behind UK mainstream price movements. Plus, our five-year forecasts for the UK and its regions.

8-9 Region by region

As prices struggle in London, higher income yields and fewer constraints on mortgage affordability are driving performance in the Midlands as well as in the North.

10-11 Transactions

Transactions may have hit a plateau, but the trends in buyer types, and what they're buying, is far from static.

12-13 Build to rent

Demand for privately rented homes is set to rise. Is build to rent the answer to the mismatch in supply and demand?

14-15 Development

To reach government targets, housebuilders must diversify their products, tenures and delivery models.

16-18 Prime markets

We look at the factors shaping the UK's prime markets, as well as the prospects for growth.

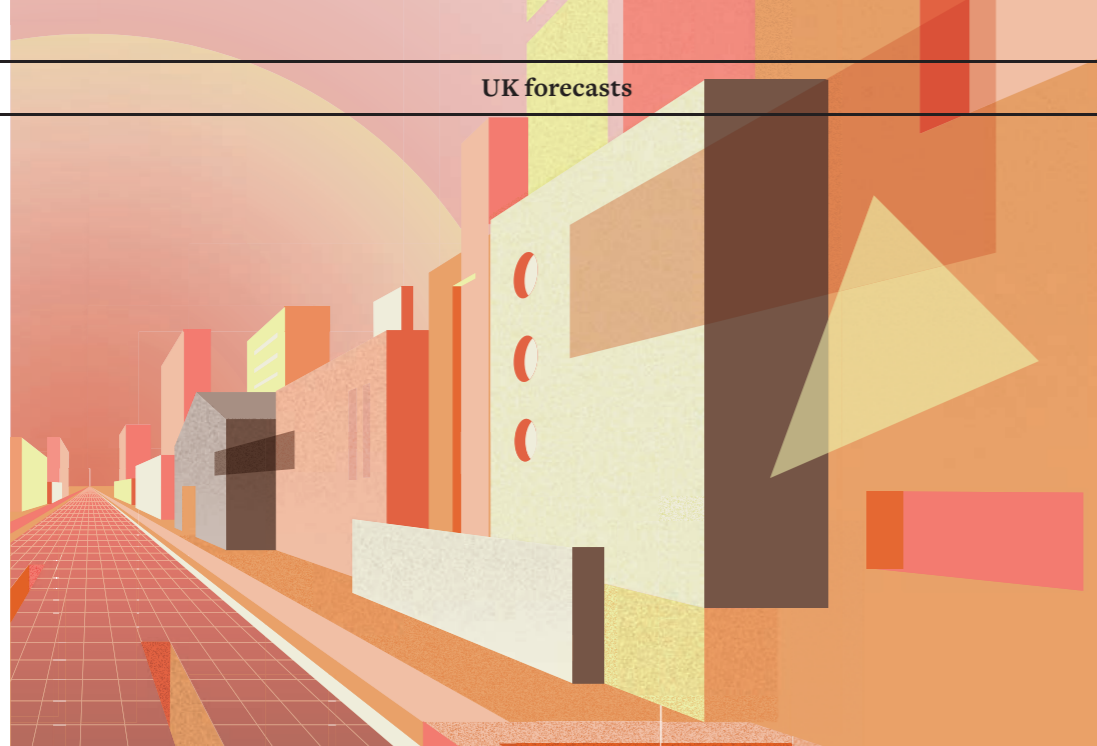
19 Contacts

Unfamiliar territory

At this point in the property cycle, growth in London typically slows as price rises ripple out to the regions. This time, the divergence appears even more marked. With Brexit uncertainty in the short term, a general election on the horizon and rising interest rates, stretched affordability will limit growth in London and the South. Conversely, we expect growth in the North West and Yorkshire to be over 20% by 2023 >

Words Lawrence Bowles

UK forecasts



UK forecasts



14.8%
Five-year compound growth forecast for UK residential market

to be a problem for those households already paying their mortgage. But, assuming it remains unchanged, a 3% affordability stress test for new buyers will start to impinge on the amount people can borrow relative to their earnings.

In turn, the rate of house price growth will be constrained. This is likely to have a much greater impact in London and the South East,

where buyers are already operating on higher loan-to-income ratios than elsewhere in the UK.

In combination with restricted tax relief, this will also continue to hit mortgaged buy to let investors. Already, these investors have become much less active in the market, especially where high house prices and low yields make it more difficult for them to make the sums add up.

That adds to the regional dimension of our property forecasts. So, in revisiting them, we have looked again at where we are in the cycle and concluded that the divergence in performance across the country is likely to be greater than we have previously predicted.

You can see how that divergence works region by region below, and read more over the page.

What's behind the 14.8%? UK house price forecast and key assumptions

	2019	2020	2021	2022	2023	5-year compound growth
UK house price forecast	☁️ 1.5%	☀️ 4.0%	☀️ 3.0%	☀️ 2.5%	☀️ 3.0%	14.8%
Household income growth	2.0%	2.9%	3.4%	3.5%	3.5%	16.1%
Base rate	1.0%	1.5%	1.8%	2.3%	2.8%	n/a

Source Savills Research, Oxford Economics

Two new housing ministers. Two Bank of England base rate hikes. Continued disagreement on what flavour of Brexit the public voted for back in 2016. A lot has changed since our property forecasts from a year ago.

Although we have become accustomed to a merry-go-round of ministers responsible for housing, the likely trajectory of interest rates and underlying Brexit uncertainty have been at the heart of a slowing in levels of UK annual house price growth. At the end of September, Nationwide put it at 2%.

The main impact of these factors has been to weaken confidence. Indeed, the RICS housing market survey has given a positive reading for new buyer enquiries in only two of the past 18 months.

Sentiment running low

In the short term, sentiment will remain the primary driver of house price movements. The economic implications of Brexit, and what this might mean for household finances, lies at the heart of this.

Last year, we based our forecasts on the assumption that the UK would begin a transition agreement with the EU in March 2019, followed by a free-trade agreement.

The progress that is made in Brexit negotiations, both in the run up to March next year and what happens afterwards, will be key to sentiment among buyers.

The sooner a deal is struck, the more certainty it will bring to the market. The more prolonged this period of uncertainty, the greater the chance that current market malaise will spread beyond London and the South East. This would slow house price growth more widely, at least until we get a clearer picture on the economic implications of leaving the EU.

More particularly, a lot depends on what Brexit means for interest rates and income growth.

There is some interplay between the two. Assuming that – as most economic forecasters are suggesting – we avoid a full-blown recession, then interest rates are probably the bigger of the two variables.

Affordability issues

For now, affordability, measured by mortgage payments as a percentage of income, remains pretty benign. The base rate is still only 0.75% – far lower than at any point in the 20 years before the global financial crisis. According to the Bank of England, the average interest rate for a two-year fixed mortgage in September was still only 1.7%.

The base rate hike in August was more about putting buyers on notice of what may occur in the future. The expectation is that base rates will rise gradually. This will put a squeeze on the amount people can borrow, particularly as mortgaged buyers factor in the additional cost of the capital repayments that have now become the norm. This is likely to amplify the effects of the stricter 2014 mortgage regulations over the second half of our five-year forecasting period.

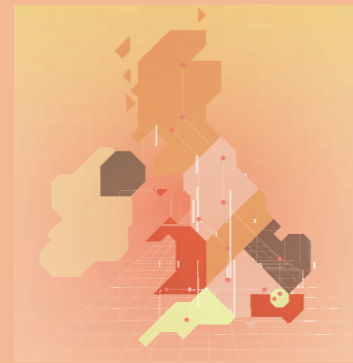
From 2021, we expect the Bank of England base rate to rise from 1.5% to 2.75% by the end of our forecast period. This is unlikely

Mainstream five-year forecast There is a significant divergence in performance across the country

	2019	2020	2021	2022	2023	5-year compound growth
North West	☀️ 3.0%	☀️ 6.0%	☀️ 4.0%	☀️ 3.0%	☀️ 4.0%	21.6%
Yorkshire & Humberside	☁️ 2.5%	☀️ 5.5%	☀️ 4.0%	☀️ 3.0%	☀️ 4.0%	20.5%
Wales	☁️ 2.0%	☀️ 5.5%	☀️ 4.0%	☀️ 3.0%	☀️ 3.5%	19.3%
East Midlands	☀️ 3.0%	☀️ 5.0%	☀️ 3.5%	☀️ 3.0%	☀️ 3.5%	19.3%
West Midlands	☀️ 3.0%	☀️ 5.0%	☀️ 3.5%	☀️ 3.0%	☀️ 3.5%	19.3%
Scotland	☁️ 2.5%	☀️ 5.0%	☀️ 3.5%	☁️ 2.5%	☀️ 3.5%	18.2%
North East	☀️ 2.0%	☀️ 5.0%	☀️ 3.5%	☁️ 2.5%	☀️ 3.5%	17.6%
South West	☁️ 0.5%	☀️ 3.5%	☁️ 2.5%	☁️ 2.5%	☀️ 3.0%	12.6%
South East	☁️ 0.0%	☁️ 2.0%	☁️ 2.5%	☁️ 2.0%	☁️ 2.5%	9.3%
East of England	☁️ 0.0%	☁️ 2.0%	☁️ 2.5%	☁️ 2.0%	☁️ 2.5%	9.3%
London	☁️ -2.0%	☁️ 0.0%	☀️ 2.5%	☀️ 1.5%	☀️ 2.5%	4.5%

Source Savills Research Note These forecasts apply to average prices in the secondhand market. New build values may not move at the same rate

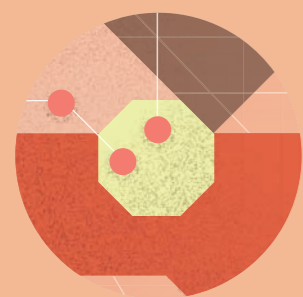
Parting of the ways



At this point in the cycle, we would expect to see house price inflation in London underperforming the UK average, as growth ripples away to the Midlands and North. Historically, when this happens, London

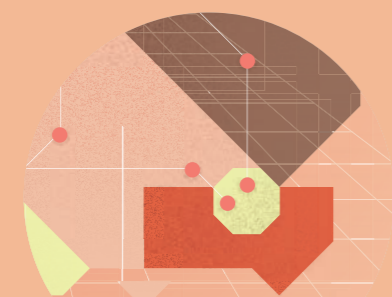
prices keep on growing, albeit at a slower pace. Over the next five years we expect growth in London to be much lower than at equivalent points in previous cycles as interest rates rise and the market rebalances.

Just as importantly, the experience of the past year tells us that those markets that traditionally perform best in the second half of a housing cycle can continue to grow, even if the London market is muted.



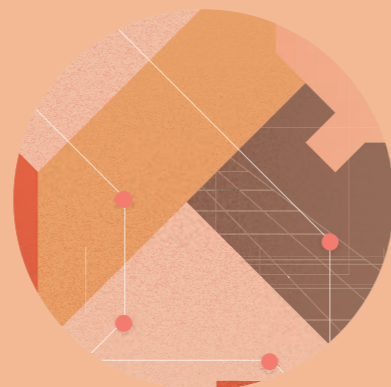
London

In the short term, London's global city status leaves it more exposed to Brexit uncertainty, holding back confidence in the market. On top of that, house price-to-income ratios in London's mainstream housing market are stretched to such an extent that even the small rises in interest rates we expect by 2021 will have a constraining impact on prospective buyers' budgets. Increasingly, price growth in the capital will be dependent on an area unlocking its latent potential, either through regeneration or infrastructure improvements.



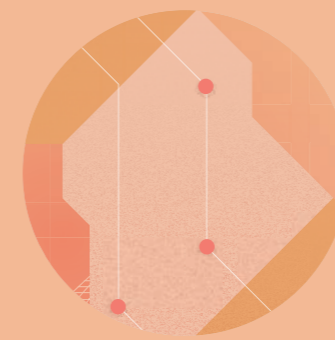
The South

Though markets across the rest of the South of England remain less constrained by affordability than in the capital, they are likely to be held back by less housing wealth flowing into the commuter zone, and mortgage constraints in higher-value areas. Price growth across much of the South is therefore likely to be dependent on earnings growth in the face of increasing interest rates. Lower-value markets may benefit from demand from budget-conscious buyers looking to stretch their buying power further.



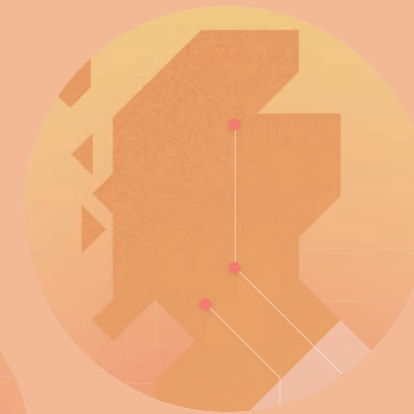
The Midlands

In 2018, the Midlands has been the UK's strongest-performing housing region. With fewer constraints on mortgage affordability than in areas further south, these markets have been able to better weather Brexit uncertainty. Sitting beyond the commuter zone, they have also been less exposed to the slowdown in London. Despite the prospect of higher interest rates, there is capacity for growth in the loan-to-income ratios offered to mortgaged buyers in the Midlands. Together with earnings growth, this has the potential to drive further house-price growth over the next five years.



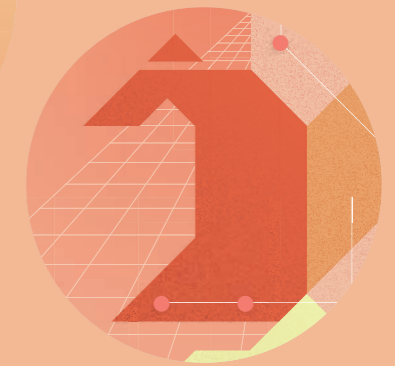
The North

With house prices in the North only recently returning to pre-credit crunch levels, there is more capacity for both household finances and mortgage lenders to support more growth over the next five years than in other regions across the UK. This would fit the pattern of previous cycles. Smaller deposits for first-time buyers and lower home-mover loan-to-income ratios compared with most of the rest of the UK are expected to underpin demand in the owner-occupier market. Meanwhile, we expect the ability to achieve higher income yields in the northern cities to underpin investment demand from both institutional and private investors.



Scotland

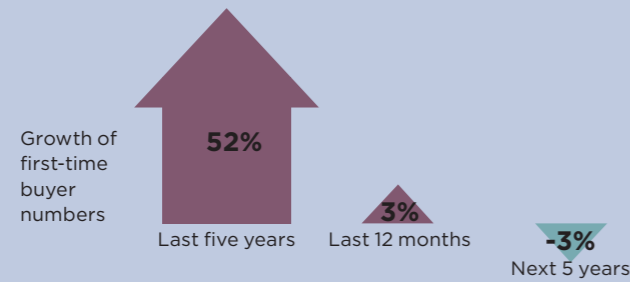
We expect Scotland to perform ahead of the UK average, growing 18.2% over the next five years. Much like the rest of the UK, growth will be tempered by political uncertainty with Brexit negotiations in 2019, a UK general election in 2022, and the additional factor of Scottish elections in 2021. Yet, Scotland still has room for growth, particularly in popular, well-connected neighbourhoods. In many of these markets, supply falls well short of demand, so competition will drive up values.



Wales

Wales is a hugely diverse housing market, ranging from the higher-value urban markets around Cardiff and Swansea to rural and coastal communities across Pembrokeshire and Gwynedd. Historically, house price growth in Wales has been stronger at this point in the cycle, so we expect it to perform in line with the Midlands. However, there may be room for some local markets to perform better. Most notably, there may be increased housing demand from Bristol spilling over the Severn, once the bridge tolls are removed.

“ We expect the ability to achieve higher income yields in the northern cities to underpin investment demand ”



Five key changes in buyer trends

Housing transactions have hit a plateau, with little prospect of recovering to anything close to 2007 levels. However, these headline figures mask shifting trends about buyer types and where they're buying

Words Ed Hampson

1 The regional picture

London and, to a lesser degree, the rest of the South, have continued to push up against mortgaged constraints at a time of fragile buyer sentiment. Across London, transaction numbers in the year to June 2018 were 6.2% lower than the year before and stood at only half of 2007 levels.

Growth has continued elsewhere in the country, especially in areas where affordability is less constrained and buyer confidence is higher.

2 A first time for everything

Shifting patterns of different buyer types also reveal more about how the market is now operating. Contrary to what we are sometimes asked to believe, the number of first-time buyer transactions has rocketed in the past five years.

In the year to July 2018, they stood at 364,800 – some 52% higher than five years ago and up by 3% in just one year.

Though take-up of Help to Buy has grown by an average of 22% per annum over the past three years, that's not the only contributing factor to this trend.

The 'bank of Mum and Dad' has had a much greater impact. That's not going to change any time soon, either, as any expansion of Help to Buy beyond 2021 is currently expected to be for a limited period and in a more targeted form.

Looking into the future, loan-to-income limits are also likely to act as a barrier to expansion. The average currently stands at a ratio of 1:3.69, having grown steadily since 2009, with more joint-income households taking mortgages at higher loan-to-income ratios. As banks become less willing to lend at ratios over four, there is only limited room for first-time buyers to stretch themselves as interest rates rise.

This is especially true in London, where first-time buyer transactions have already declined. After peaking

in Q3 2014, they have fallen by 15%. In the capital, loan-to-income ratios simply haven't been able to keep pace with price growth, leaving barriers to home ownership undiminished.

By contrast, in the South East, transaction levels have risen by 15% in the same period, fuelled, in part, by a migration of buyers into areas of greater affordability.

3 Existing owners staying put for longer

The number of home movers has been largely flat since 2014. Owners now trade up the housing ladder far less often. Our research earlier this year found the average period between moves grew from nine years in 2007 to 13.5 years in 2017.

With tighter mortgage regulation, homeowners in lower-growth parts of the UK have struggled to accumulate enough equity to trade up the ladder. And where house prices have grown fastest, households struggle to raise



The retirement housing sector offers vast potential to attract discretionary cash buyers in the future

sufficient mortgage debt to finance their move.

We see no reason for these trends to change significantly in light of our house-price forecasts. Therefore, we expect the number of homemovers to be largely static over the course of the five-year forecast period.

In the longer term, as with first-time buyers, homeowners' ability to trade up will increasingly depend on either a change in their personal finances or an injection of equity from older generations.

4 Mortgaged buy to let under pressure

The mortgaged buy to let market faces significant challenges. These purchases have fallen by 43% in the past two years, with evidence that highly geared investors are rationalising their portfolios and refocusing on lower-value, higher-yielding locations.

The stamp duty hit of 2016 continues to depress appetite in the market, while restrictions

on mortgage-interest tax relief are likely to result in even greater pressure on this part of the market. We expect these transactions to fall to around 50,000 by 2022, as those who remain in the market are required to supplement mortgage debt with more equity of their own.

5 Cash remains king

Cash buyers currently account for about 31% of the market. Though that figure has fallen a little since 2014, these buyers still represent a much bigger proportion of the market than was the case before the credit crunch.

Given evidence of the number of purchasers who are bearing the 3% stamp duty surcharge, these buyers are now a particularly important

component of investment demand, with a strong competitive advantage over those needing a mortgage.

With downsizers also adding to their number, these purchasers are often discretionary buyers. Some will wait until the political uncertainty of the next few years is resolved before they commit to buying.

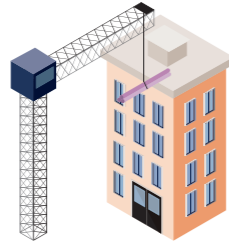
So, we expect their levels to dip before bouncing after the general election. In the longer term, their activity will be influenced by the development of the retirement housing sector – which remains one of the biggest opportunities still untapped in UK housing.

Highly geared buy to let investors are rationalising their portfolios and refocusing on lower-value, higher-yielding locations

Transactions per buyer type The mortgaged buy to let sector faces significant challenges

	2007	2018	2019	2020	2021	2022	2023	Change five years to 2023
Mortgaged first-time buyer	359,000	370,000	380,000	380,000	370,000	360,000	360,000	-3%
Mortgaged home mover	653,000	370,000	370,000	370,000	370,000	370,000	370,000	0%
Mortgaged buy to let	183,280	65,000	65,000	60,000	55,000	50,000	50,000	-23%
Cash buyers	422,000	370,000	360,000	350,000	380,000	360,000	380,000	3%
Total	1,618,880	1,175,000	1,175,000	1,160,000	1,175,000	1,140,000	1,160,000	-1%

Source Savills Research



We forecast the build to rent pipeline will more than double to 300,000 homes by 2021



Merano, Albert Embankment, London

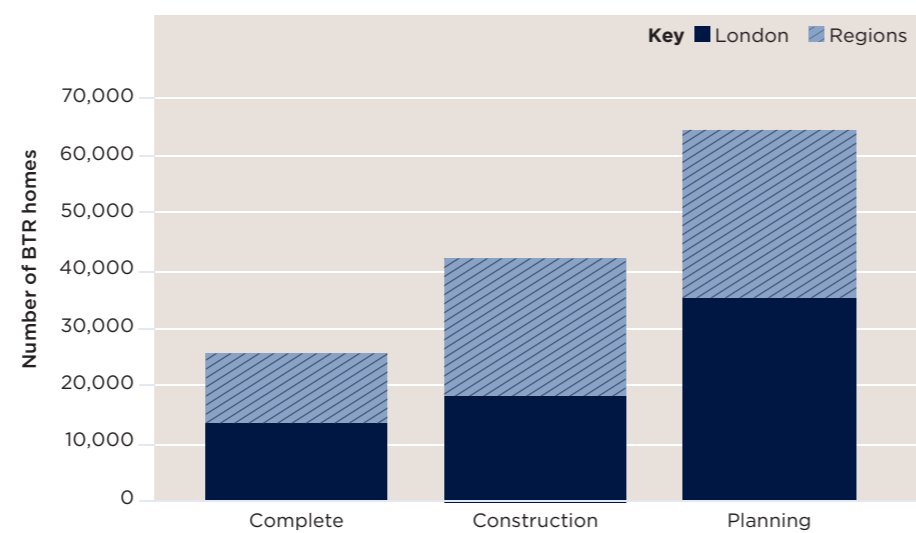
Things can only get BTR

With signs of a recovery in the rental market and stronger demand for rented homes, could build to rent (BTR) fill the gap left by buy to let?

Words Nicholas Gibson

Historically, rents have moved in line with household earnings. After all, landlords can only charge what tenants are able to pay. So, with weak earnings growth since the end of 2016, the sluggish rental growth of the last two years should come as no surprise. Earnings fell in real terms in 2017 and 2018, as inflation ran above the Bank of England's target of 2%. In the past, rental growth in London has been able to outperform earnings, as renters formed larger households with friends to split their rental bill. This trend seems to have reached its limit. London rents are now seeing a slowdown, with rents falling by 0.3% in the year to August 2018. With rental affordability in

Build to rent New properties as of September 2018



Source Savills Research, BPF



72,000
The number of buy to let mortgages redeemed since the start of 2017

London stretched, weaker growth is likely in the short term.

However, tightening access to mortgage finance, changing lifestyles and demographics is driving demand for privately rented homes at all price points. That mismatch in supply and demand has attracted a new kind of investor to the market.

Boom time for BTR?

Changes to tax relief on buy to let mortgage interest payments have made many private investors take a second look at their portfolios. With less tax relief and rising interest rates, many have chosen to consolidate or leave the sector. Depending on how policy evolves on longer-term tenancies and rent regulations, the pace of flight may accelerate further.

While putting pressure on buy to let, the Government has shown growing support for the institutional build to rent sector (BTR). Purpose-built rental blocks that are managed by professional landlords could help raise standards across

the rental market and increase the supply of rented properties in areas of high demand.

BTR is already gaining momentum, making up 8.7% of new housing starts in 2016/17. However, while BTR is gathering pace, it isn't yet delivering enough homes to counter the flight of buy to let investors. From Q1 2017 to Q2 2018, there were just under 10,000 build to rent completions. In the same period, 72,000 buy to let landlords redeemed their mortgages.

Until the supply of BTR properties increases dramatically, we will remain reliant on cash investors to bring more stock into the rental market. As a result, we're likely to see demand grow faster than supply over the next five years, driving rental value growth.

YIELDS: REGIONAL TRENDS REVERSE

Yields, annual gross rent as a proportion of the house price, have historically been lowest in London and the South. Since 2013, yields have decreased across the country, but have fallen fastest in London, where the mismatch between rental and house price growth was greatest. By contrast, yields in the Midlands and the North have fallen much less.

Our forecasts show these yields converging. We predict that as rents grow faster than house prices in the affordability-constrained South, yields will rise. In the Midlands and North, where house price growth will outpace rental values, we expect to see yields sharpen and move closer to those in the South.

👉 Tightening access to mortgage finance and changing demographics is driving demand for privately rented homes at all price points 👈

	Five-year forecast Rental growth is set to bounce back most strongly in London						5-year compound growth
	2018	2019	2020	2021	2022	2023	
UK	☁️ 0.5%	☁️ 1.0%	☀️ 2.0%	☀️ 3.0%	☀️ 3.5%	☀️ 3.5%	13.7%
UK exc. London	☁️ 1.5%	☁️ 1.5%	☀️ 2.0%	☀️ 2.5%	☀️ 2.5%	☀️ 2.5%	11.5%
London	☁️ -0.5%	☁️ 0.5%	☀️ 1.5%	☀️ 4.0%	☀️ 4.5%	☀️ 4.5%	15.9%
Earnings	☁️ 1.7%	☀️ 2.0%	☀️ 2.9%	☀️ 3.4%	☀️ 3.5%	☀️ 3.5%	16.1%
CPI	☀️ 2.5%	☀️ 2.0%	☁️ 1.6%	☁️ 1.7%	☁️ 1.9%	☁️ 1.9%	9.1%

Source Savills Research, Oxford Economics

New balance

With Help to Buy unlikely to last forever, housebuilding must diversify to meet demand. We examine how wider choice can be met, and who has the capacity to deliver

Words Emily Williams

1. The legacy of Help to Buy

Despite a 74% increase in delivery in the past five years, the development industry remains under pressure to build more homes. Currently, annual delivery is 217,000 homes, yet in the 2017 autumn budget, the Government stated its ambition for housebuilding to reach 300,000 homes per year. To achieve this, the development industry has to go beyond existing delivery models.

Help to Buy is underpinning current delivery. During 2017, new build sales represented 13.5% of all transactions. In the decade before the scheme launched, new build sales averaged 11% of all transactions, but Help to Buy has pushed and maintained new homes sales in a slowing sales market.

It is questionable just how much further this relationship can be pushed, particularly with doubts over the scheme's future after 2021. In a market characterised by a lower level of transactions, it will also be hard to increase output if the focus remains on homes for open-market sale.

As affordability becomes stretched and fewer households can buy or trade up, there is limited capacity for new housing stock to be absorbed by the for-sale market. Instead, development needs to reflect the market's increasingly diverse needs.

The future for Help to Buy

The main unresolved question for the development industry will be the form Help to Buy takes after its

current end date in 2021. The equity loan has helped fund more than 160,000 purchases in England since its launch in 2013. Nationally, Help to Buy has supported 44% of new build transactions in 2017/18, but its use has varied across locations, so the impact of a change or withdrawal of the scheme will be mixed.

Whether the scheme stops after 2021, or continues in a more targeted form, the key for developers is to have clarity as soon as possible, so they can develop appropriate strategies for sites that are coming through the planning pipeline.

The ability to deliver a diverse product including multiple tenures is likely to be the best way to soften the impact of any policy changes.

2. Diversifying to meet need

Over the past year, the Letwin Review has been investigating ways to increase build-out rates. It also concluded that diversity of housing is a barrier to high build-out rates, in terms of size and specification. Pricing also needs to compete with the local secondhand market.

Sir Oliver Letwin has suggested that to increase build-out rates, there needs to be more diversity of tenure to tap into demand in other parts of the market. He has concluded that the demand for affordable housing – particularly social rent – is 'virtually unlimited'.

Similarly, Sir Oliver has identified that the demand for private rented accommodation is a different market from open-market sale. Therefore,

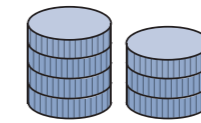
the delivery of private rented homes alongside those for market sale could accelerate absorption rates and – with them – build-out rates.

We estimate that additional build to rent completions will total 7,000 this year, with the potential to rise to 15,000 a year by 2021. This expansion includes more sites in suburban areas with access to employment and those demographic groups who look to rent.

The final recommendations of the Letwin Review are now imminent. A key question will be just how an expansion of affordable housing can be funded. The Government's new National Planning Policy Framework is designed to encourage realistically ambitious setting of policy in this

respect and, if it is done properly, it should be able to deliver more affordable housing.

But the Review does acknowledge that – under the current models of delivery – the rate of completion of affordable housing is limited by the need for cross subsidy from open-market sales on the rest of the site. We have previously estimated sub-market housing need in England at 100,000 homes per year, which would require at least £7 billion of grant funding per year. This is well above the £9 billion total allocated for the whole of 2016-2021.



£7 billion
Grant funding required to meet sub-market housing need in England of 100,000 homes per year

3. Identifying the capacity to expand

The expansion in housebuilding over the past five years has been driven mainly by the major housebuilders. Output by housebuilders has risen 74% since 2013, and developers who deliver more than 500 homes a year now account for 77% of all new home starts in England registered with the National House Building Council. However, we anticipate the strongest rate of growth in output over the next five years is likely to come from smaller housebuilders, housing associations and local authorities.

Small and medium housebuilders have struggled since the global financial crisis, but with increasing government support, particularly via the Home Building Fund, they should find access to finance to be less of an obstacle. The Letwin Review has also called for more opportunities for smaller developers to partner with large housebuilders on sites, to deliver more diverse product.

Currently, housing associations build 17% of new homes, and have ambitions to increase output. The

50 largest housing associations plan to build 43% more homes in 2020/21 than they did in 2016/17, reaching 50,000 completions. The increased scale of funding available to these organisations via partnerships with Homes England will also help the sector meet demand for alternative tenures, such as sub-market housing.

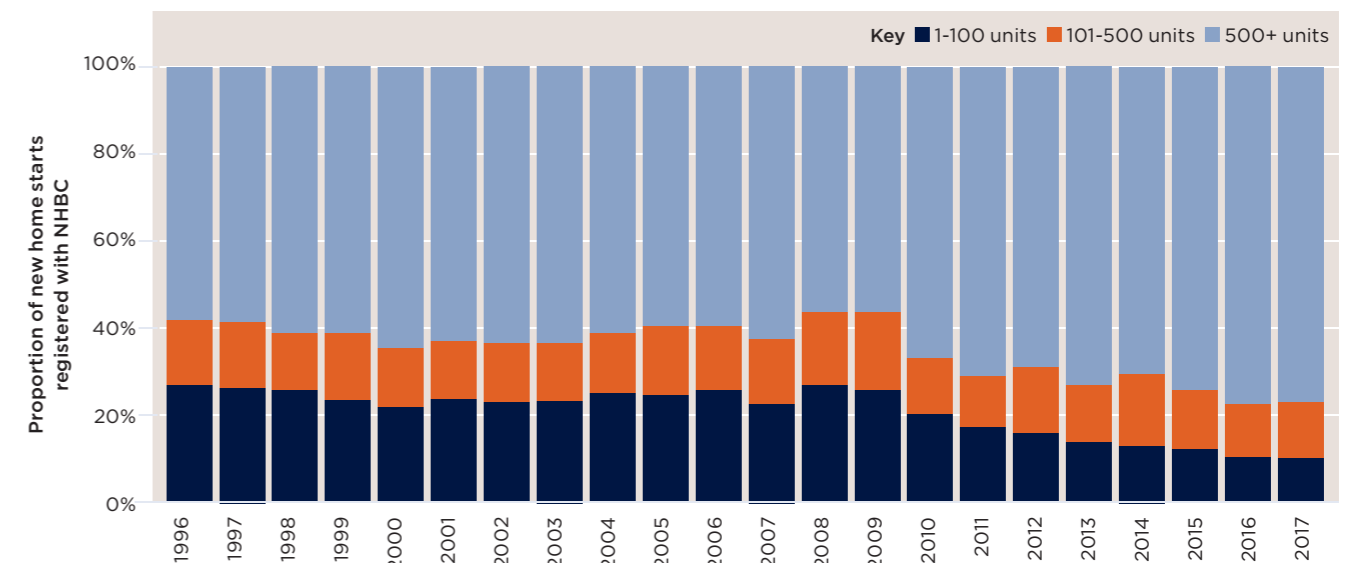
The recent removal of the HRA cap on borrowing will also allow local authorities to expand their development programmes. Local

authority completions currently stand at just 2,000 per year. But the relaxation of borrowing rules provides an extra £10-£15 billion of funding that will create capacity for an extra 15,000 homes across England each year.

For many local authorities, the main obstacle will be building up their construction capacity. Collaboration with the private sector will be essential to fully unlock this potential.

🗨️ **The strongest growth in output over the next five years is likely to come from smaller housebuilders, housing associations and local authorities** 🗨️

New homes starts More than 70% are by developers with output of 500+ homes per annum



Source NHBC



Holden Road, Tunbridge Wells, Kent

Prime: the roadmap to recovery

Despite pockets of modest growth in the regions, expect Britain's prime markets to remain price sensitive and driven by needs-based purchases until Brexit negotiations are complete, say Lucian Cook and Frances Clacy

What have been the key drivers in the prime housing market over the past four years?

Much like the mainstream market, the uncertain political and economic outlook has made buyers more cautious and price sensitive. The outlook for jobs and earnings in the City has been a particular concern for prime purchasers in London and the South East, though the risk of wholesale relocation of jobs in the banking industry has receded.

This has coincided with higher stamp duty costs and greater exposure to inheritance and capital gains tax for overseas buyers. The impact of this has been most noticeable in prime central London.

Although the prime markets tend to be much more equity-driven than the mainstream, mortgage regulation has also played a part in limiting the amount some buyers can borrow as they look to trade up – both in London's established wealth corridors and beyond.

What has this done to property prices in the prime London markets?

Even before the stamp duty overhaul in 2014, price growth had started to slow in prime central London as it started to look fully priced. That left it exposed to those stamp duty changes and marked a turning point in the market.

Subsequent political events and changes to the tax regime have led to values falling more gradually than in other downturns, but over a much longer period. At the end of September 2018, prices in this market had fallen by 18.4% since 2014 – a comparable level to other significant downturns in the early 1990s and after the credit crunch.

Other prime London markets, such as South West London, reached their peak a little later, in September 2015. The price adjustment there has been less severe than in central London, down 7.6% since 2014. However, annual price movements stand at -3.1%, similar to the most exclusive London neighbourhoods.

Prime five-year forecast The value offered in regional prime markets will underpin growth

	2019	2020	2021	2022	2023	5-year
Prime central London	-1.0%	0.0%	6.0%	2.0%	5.0%	12.4%
Other London	-1.0%	0.0%	3.5%	1.0%	3.5%	7.1%
Suburban	-1.0%	0.0%	3.5%	1.5%	4.0%	8.2%
Inner commute	0.0%	0.0%	3.0%	2.0%	4.0%	9.3%
Outer commute	0.0%	0.0%	3.0%	3.0%	4.5%	10.9%
Wider South	1.0%	2.0%	3.0%	3.5%	4.5%	14.8%
Midlands/North	2.0%	2.0%	3.0%	3.5%	4.0%	15.3%
Scotland	2.0%	2.0%	3.0%	3.0%	3.5%	14.2%

Source Savills Research Note These forecasts apply to average prices in the secondhand market. New build values may not move at the same rate



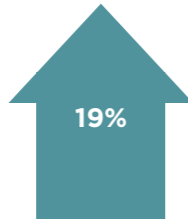
Hermitage Gardens, Morningside, Edinburgh

And the markets beyond London?

With less impetus from the capital, annual price movements have gradually moved into modest negative territory across the high-value suburbs in the home counties, prime properties in the uber-towns of southern England and their village and rural counterparts. In these markets, there was noticeably weaker price growth in the run up to the slowdown.

Further north and into Scotland, markets have been more robust. Lower values and slower price growth in the past 10 years have meant less exposure to stamp duty and left them less sensitive to weakened sentiment. Here, modest annual price growth remains, with Edinburgh city the strongest market during the past year. >

🗨️ Political events and changes to the tax regime have led to values falling more gradually than in other downturns 🗨️



Rise in stamp duty take in central London in the past four years, despite a fall in transaction levels

What are the prospects of a cut in stamp duty at the top end of the market?

The latest comprehensive data we have on stamp duty receipts relates to the 2017/18 tax year. It suggests that transaction levels in London's two central boroughs of Kensington and Chelsea and Westminster have fallen by 35% in the past four years, but that the stamp duty take is still 19% higher than in 2013/14.

Furthermore, sales of properties of more than £1 million across the country as a whole were 25% higher in 2017/18 than four years previously. With a relatively high proportion of purchases bearing the 3% stamp duty surcharge as well as a higher underlying rate of tax, they raised an additional £1 billion in tax revenues over the same period.

In April, the Treasury calculated that cutting each of the marginal 10% and 12% rates of stamp duty by 1% would result in a loss in tax revenues of more than £100 million which made a cut look unlikely. Instead, we have seen proposals for an additional surcharge on non-UK resident buyers of between 1% and 3% that is expected to increase tax revenues by up to £120 million.

What does history tell us about the prospects for a recovery in the prime housing markets?

Historically, any recovery in the prime markets has been sparked in central London, with a strong bounce in values. Often, the catalyst has been a currency advantage, though it requires this property to look identifiably good value and for some of the uncertainty afflicting the market to clear.

As a result, until Brexit negotiations are complete, we expect the market to remain price sensitive and driven by needs-based purchases.

The experience of the past underpins our central London forecasts from 2021 onwards. However, the prospect of increasing interest rates, higher investment returns on competing assets and a general election in 2022 suggest a less exuberant recovery than in previous cycles, especially given the higher tax environment.

We expect the other, more domestic, prime markets of London to benefit from a flow of wealth out of central



Cyril Mansions, Chelsea, London

Historically, any recovery in the prime markets has been sparked in central London, with a strong bounce in values

London during that recovery phase. But they are more likely to be held back by weak sentiment feeding up from the mainstream housing market. The impact of rising interest rates will also be felt more strongly, given the much greater use of mortgage debt in these markets.

That is likely to weaken any ripple effect into the commuter zone. It is more likely that the relative value afforded by other prime regional housing markets will be a greater driver, meaning higher expected price growth across the prime housing stock across the rest of the UK.

Prime variation Price growth in the past year and since 2014 (to September 2018)

	Prime central London	Other London	Suburban	Commuter zone	Wider South	Midlands/ North	Scotland
Annual growth	-3.8%	-3.1%	-2.8%	-1.6%	-1.2%	2.5%	2.0%
Four-year growth	-18.3%	-7.6%	-3.2%	3.8%	6.9%	6.1%	4.0%

Source Savills Research



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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