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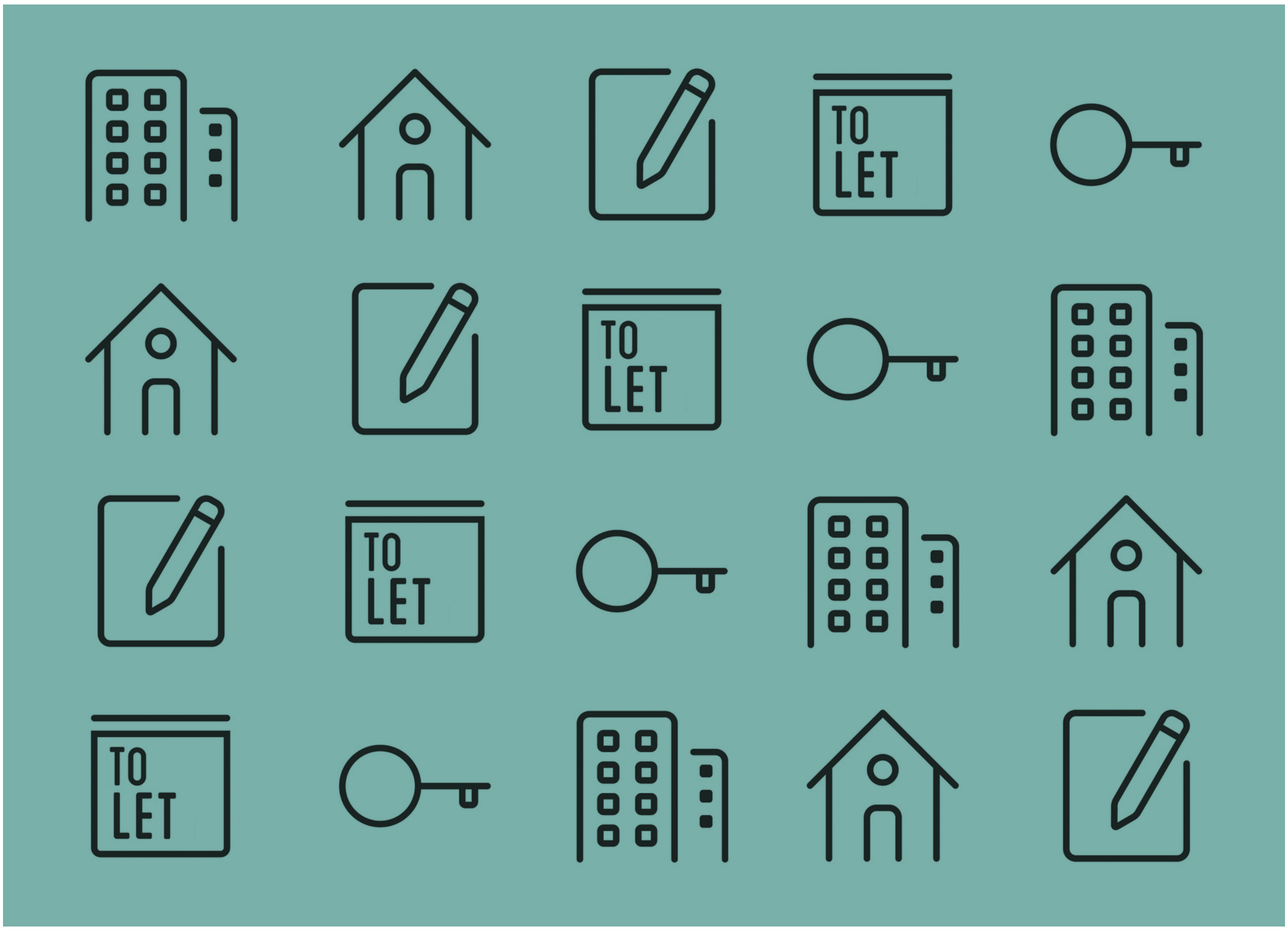
Spotlight | July 2017

Prime residential rents



Summary Headline rents continue to slide across prime London and the commuter belt in the face of uncertainty. But pockets of the market are bucking the trend – some as a direct result of the Brexit vote

- **Over the past year, prime rents across London fell by 5.4%, the most pronounced falls being in the highest value, core prime central London locations.** Here, landlords have absorbed an average decrease of 9.5% in rents since the credit crunch, although this has been offset by strong capital growth over this period

- **Despite falling rents, the average corporate relocation budget has risen by 13% year on year.** This has been largely driven by banks and financial institutions relocating higher-level staff, often moving with their families to live close to top schools

- **The prime markets within an hour of London saw marginally positive rental growth over the past three months, although annual growth remains negative.** Demand continues to remain more robust for smaller properties from needs based renters relocating for work or lifestyle reasons

- **Landlords have had to contend with regulation and legislation changes that have curtailed investment into the residential sector.** While this is likely to limit supply coming to the market, cash buyers who are not affected by mortgage regulation will underpin investment

- **In the mid-term, increased supply from new build and accidental landlords unable to sell is likely to suppress rental growth in London.** However, London's global city status will ultimately underpin demand. We expect to see an uptick in the number of renters moving out to the commuter zone

Market overview

Despite an overall fall in rents across prime London, the market reveals some interesting micro trends

Prime London rents have continued to fall slowly during the past year, marking a seventh consecutive quarter of marginal falls. Rents were softening ahead of the EU referendum, but the Brexit vote has changed the shape of the market, creating a series of interesting micro trends that are concealed by average figures.

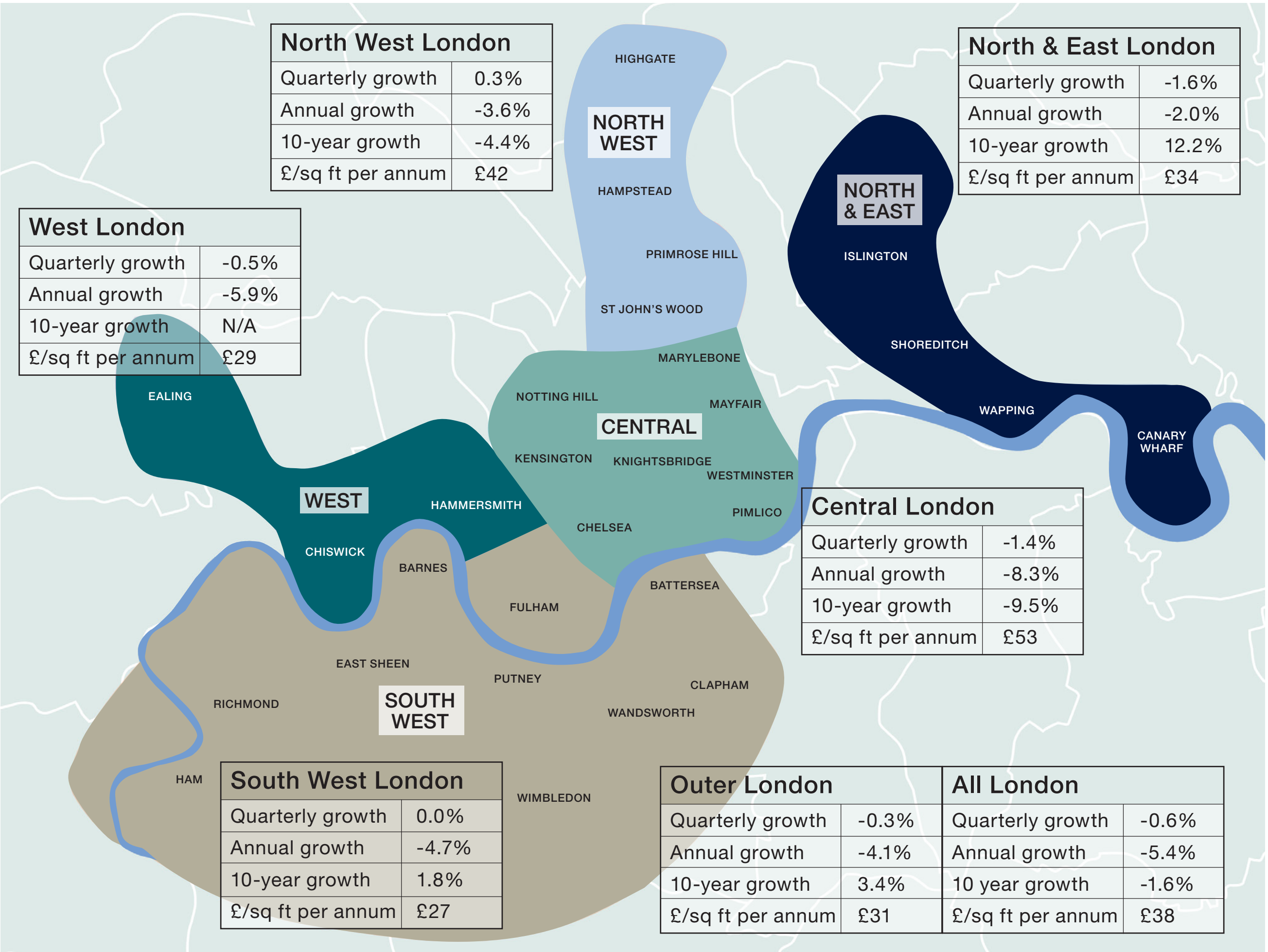
Average prime London rents fell by 0.6% in the second quarter of 2017, with an annual decrease of 5.4%. This leaves rents an average of 1.6% down on their pre-credit crunch level.

The most pronounced falls have been in the highest value, core prime central London locations, where rents are down 8.3% year on year, having fallen by 1.4% over the past three months.

Landlords in these markets have absorbed an average decrease of 9.5% since the credit crunch. This has been offset by the 20% capital growth over this period, a figure that would have been much higher were it not for the 14.4% fall in capital values since September 2014.

Across the outer prime London market, falls are smaller, averaging 0.3% over the quarter and 4.1% annually. Despite these figures, rental growth remains positive, with an average rise of 3.4% over the 10 years post credit crunch.

Prime London by region Rental growth remains subdued in prime residential markets, although new businesses in the belt from Canary Wharf up to Islington have supported growth here in the past 10 years



North West London	
Quarterly growth	0.3%
Annual growth	-3.6%
10-year growth	-4.4%
£/sq ft per annum	£42

North & East London	
Quarterly growth	-1.6%
Annual growth	-2.0%
10-year growth	12.2%
£/sq ft per annum	£34

West London	
Quarterly growth	-0.5%
Annual growth	-5.9%
10-year growth	N/A
£/sq ft per annum	£29

Central London	
Quarterly growth	-1.4%
Annual growth	-8.3%
10-year growth	-9.5%
£/sq ft per annum	£53

South West London	
Quarterly growth	0.0%
Annual growth	-4.7%
10-year growth	1.8%
£/sq ft per annum	£27

Outer London	
Quarterly growth	-0.3%
Annual growth	-4.1%
10-year growth	3.4%
£/sq ft per annum	£31

All London	
Quarterly growth	-0.6%
Annual growth	-5.4%
10 year growth	-1.6%
£/sq ft per annum	£38

Source Savills Research

Corporate demand

As financial institutions and the diplomatic community relocate senior personnel to London, the market is seeing greater demand for family homes close to top schools in some locations

Despite falling rents, the Savills Corporate Services team reports that the average corporate relocation budget has risen by 13% year on year. This is largely driven by higher financial-sector budgets. In the first half of 2017, these were 59% higher than the same period last year, adding more than £2,000 to the average monthly budget.

This time last year, companies were relocating fewer senior executives to London, focusing more on mid-ranking staff moving alone or as a couple.

By contrast, banks and financial institutions are now relocating higher level staff, some accompanied by their families, to steer decision making through the Brexit period.

According to Savills data, the same is also happening in the diplomatic community. Demand would not normally be registered until the third quarter, but embassies are already signalling their intentions. This means greater demand for family homes close to top schools, such as the German school in Ham and the American school in St John's Wood.

At the same time, existing tenants are downsizing, concerned about job security and political and economic uncertainty. This is particularly the case in prime south west and west London where the typical five-bedroom house costs between £5,000 and £10,000 per month. An average three or four-bedroom house would represent a saving of between 15 and 25%.

Best in class Tenants now prefer high-spec properties in immaculate condition over the prestige of a well-known address. New build properties are setting the bar, with the quality of place an important factor, favouring locations such as Marylebone and Westminster.

Investors entering the market need to consider what they buy and where. Existing owners, particularly the great London estates, need to continue their programmes of stock upgrades and public realm improvement to retain a rental premium and prevent voids.

Lifestyle influences growth

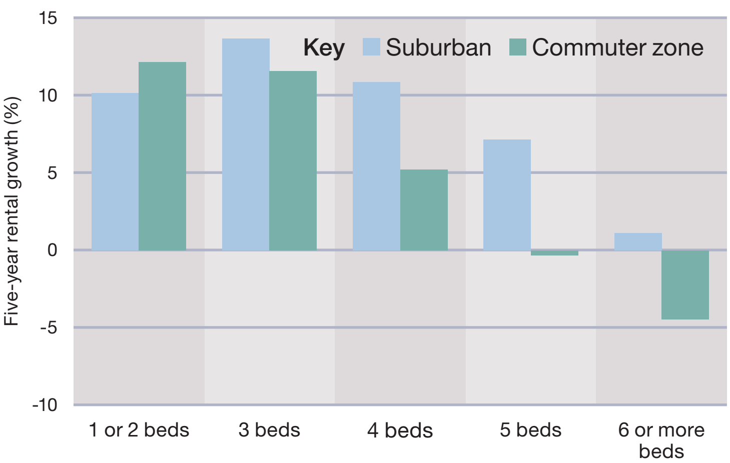
Over the past five years, prime rental markets in London's suburbs have performed better than the capital. Even here, though, lifestyle choices can have a significant impact on demand

In prime rental markets within an hour of London there was marginal rental growth of 0.2% during the second quarter of 2017. Although annual growth remains negative, over the past five years rents have increased 6.5% on average across the commuter belt, outperforming prime London. The strongest markets are in affluent suburbs such as Esher, Northwood and Cobham where rents have increased by more than 8%.

However, these figures mask a variation of performance between the sizes of property, as demand has remained more robust for smaller properties. This reflects a wider division in the market between needs-based renters looking for small or medium sized housing in an urban environment and 'big-budget tenants' looking for trophy properties.

Across all properties, the market is dominated by people relocating for work or lifestyle reasons and those who are working on a 'try before they buy' basis. Properties in a city or town with good schools, easy access to amenities and transport remain popular. By contrast, demand continues to be weaker for both village and rural locations.

Small is strong Demand from needs-based renters looking for small or medium sized housing remains robust



Source Savills Research

Outlook

As a global city, rental demand in London remains strong. However, increased choice means that tenants are focused on finding value and best-in-class properties

Prime rental markets continue to face challenges. The current supply imbalance is likely to suppress rental growth in the mid-term. As such, we are forecasting small rental falls with marginal price growth in the coming years.

While we expect strong continued demand from young, affluent households facing a significant deposit hurdle to buy their first home, the strength of rental demand from other tenant groups will be more dependent on London retaining its position as a global financial centre.

With this in mind, landlords will need to be realistic and flexible in their price expectations while offering stock of the best quality to ensure the property meets prospective tenants' requirements.

In the commuter zone, we expect the preference for prime family housing in the suburbs and key commuter towns to continue, particularly as we see more meaningful increases in those following the traditional relocation routes out of London.

Buy-to-let sector review

Landlords have had to contend with regulation and legislation changes that have curtailed investment into the residential sector. The restriction of income tax relief on mortgage interest payments and the introduction of greater mortgage regulation by the Bank of England has had a big impact on the buy-to-let sector. While this is likely to limit supply coming on to the market at a national level, investment will be underpinned by low mortgage interest rates supporting borrowing alongside the dominance of investors who are buying with cash.

£35 billion — Forecasted buy-to-let lending for 2017 (down from £38 billion previously predicted)

-60% — Mortgaged buy-to-let numbers have fallen from 2006/07 levels (though distorted by the spike in March 2016)

2/3 — Buy-to-let activity was driven by remortgage lending, accounting for more than two thirds of total lending in April

Prime rental forecast The current supply imbalance is likely to suppress rental growth in the mid-term. As such, we are forcasting small rental falls with marginal price growth in the following years

	Historical annual			Forecast annual					5-year compound growth
	2014	2015	2016	2017	2018	2019	2020	2021	
Prime London	0.8%	1.2%	-5.1%	-3.0%	0.0%	1.0%	3.0%	3.0%	4.0%
Prime commuter zone	2.9%	1.0%	-0.7%	-1.0%	0.0%	1.5%	2.5%	2.5%	6.0%

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

Savills team

Please contact us for further information

Lucian Cook
Head of UK
Residential Research
020 7016 3837
lcook@savills.com

Jane Cronwright-Brown
Head of Lettings
020 7578 9980
jcronwrightbrown@savills.com

Kirsty Bennison
Associate, UK
Residential Research
020 7016 3836
kbennison@savills.com