The ripple effect

How London’s affordability pressure is changing the pattern of price growth

The rise of the regions
As London price growth slows, the North will begin to outperform the capital

Five-year forecasts
Our latest look at the future of the mainstream and prime property markets

Making moves
Transaction levels are changing. What does this mean for different buyer groups?
The six factors that underpin our housing forecasts

The housing market is shaped by many moving parts. Lucian Cook outlines six key factors that enable Savills to deliver the best predictions for the future of the market.

Forecasting house prices is not for the faint hearted. Getting it right presupposes you have made the right economic assumptions, can predict the direction of government and Bank of England policy and have the ability to foresee the fickle nature of buyer sentiment. And yet there is plenty we do know, or can predict with confidence, that allows us to best estimate the future of the housing market. In particular, there are six key factors (right) that influence our forecasts. They show how the UK housing market has many moving parts.

How we occupy our property changes over time and between generations. That means house prices, which we consider at a regional and national level on page 4, are just part of the picture. Transaction levels can be as much of a variable, whether across the market or among different groups of buyers, as we explore on page 12.

Our thoughts on what these six factors mean for the market are laid bare throughout this edition of Residential Property Forecasts.

1. In the short term, there will be uncertainty over what Brexit means for the UK economy and, just as importantly, for individual households’ wealth and financial security. While it will take time for the precise impact to become clear, this uncertainty will make buyers more cautious in the short term at least.

2. Mortgage interest rates in the UK are likely to rise over the next five years. That is likely to put a squeeze on the amount people can borrow in an age of mortgage regulation. Dramatic increases in the cost of borrowing, that would create undue financial stress on households, are unlikely.

3. Buy-to-let investors are now beginning to feel the effect of the mortgage regulations that owner-occupiers have lived with since 2014. They also now bear greater stamp duty costs and, unless there is a change of political heart, will increasingly be affected by restrictions on income tax relief.

4. London has shown much greater house price growth than the rest of the country for the majority of the past decade. So, it is likely to be more constrained than the rest of the country by the factors above.

5. In previous cycles, we have always reached a point where house price growth in the north of the country exceeds that in the south. In the past, it was facilitated by a strong economy or relatively unrestricted access to mortgages.

6. We are not building enough homes of the right type in the right places to meet demand. However, there seems to be an increased political desire to address this.

Lucian Cook
UK Residential
Lucian looks after a team of 27 researchers and is one of the country’s leading market commentators. 020 7016 3837 lcook@savills.com
"We expect the market to return to growth in 2019-20, as employment, wage and GDP growth swing back towards trend levels. But, in the longer term, we will face the impact of interest rate rises."

Lawrence Bowles assesses growth prospects for the UK housing market against a backdrop of economic and political pressures.
Mainstream house prices  Our five-year forecast

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Source: Savills Research  Note: These forecasts apply to average prices in the secondhand market. New build values may not move at the same rate.
Has London’s market run out of steam?

A decade of strong growth in the capital’s housing market has seen it become dislocated from the rest of the UK – and left the market pushing against the limits of mortgage regulation and affordability.

PRICE GROWTH SLOWS

With a home purchase representing such a major financial commitment in London, buyer sentiment has become very sensitive to the current political and economic uncertainty. Over the course of 12 months, the slowdown in annual rates of price growth has been dramatic; from 7.1% to -0.6% according to Nationwide. Despite a continuing low interest rate environment, further modest sentiment-driven price falls over the next 12 months are a distinct possibility.

HITTING MORTGAGE LIMITS

Perhaps more importantly, buyers have become increasingly confined to more affluent households, who have stretched themselves to the limits of how much they borrow relative to their income. Numbers of housing transactions in London have fallen as a consequence, most significantly among those taking on a larger mortgage to trade up the housing ladder. There were 29,000 in the 12 months to the end of June this year, just 36% of the levels of 10 years ago. Stamp duty has also become a bigger cost, eating into a buyer’s equity. The area that is within the reach of both aspiring first-time buyers and the mythical ‘ordinary middle-class, 2.4 children’ household has also shrunk. Buyers have progressively had to widen their search across the 33 boroughs over the past 10 years, initially pushing up house prices in the wealth corridors, then at their fringes, then into new hotspots to the east and more recently the extremes of outer London. In most cases, the up and coming areas have now up and come. Of the 600 wards or neighbourhoods of London for which we have reliable house-price data, only 28 now have an average house price of less than £300,000. An MP on a salary of £75,000 would only be able to buy the average-priced property in 34% of London if they had a 20% deposit and borrowing 4.5 times their income.

FUTURE OUTLOOK

The capacity for further house price growth in London is limited, with mortgage regulation doing exactly what it was intended to do. It is holding back borrowers from taking on excessive levels of debt in an attempt to chase the market. This has slowed the market to prevent it from overheating. Mortgage regulation is likely to continue to act as a drag on the capital’s house price growth over the next five years, especially as interest rates creep up and the mandatory stress testing of affordability becomes more of a constraint.

That could change if interest rates rise more than is currently anticipated. But it is more likely that modest price growth will be reliant on London-wide household earnings growth, the ability to attract international wealth in the most valuable markets, and infrastructure and regeneration unlocking the latent capacity for growth at a local level. Increasingly, the gains made in London’s housing market are being exported into the commuter zone where buyers can get more space for their money.

Katy Warrick, Head of London Research
Katy specialises in London residential development

Capacity for further house price growth in London is limited, with mortgage regulation doing exactly what it was intended to do.
Northern exposure

While London is forecast to lag behind the rest of the UK over the next five years, which region will see the biggest growth? Here are six reasons why we believe it will be the North West.

WORDS LAWRENCE BOWLES

MARKET CYCLES

Historically, whenever London has been the slowest-growing region, the growth profile has flipped to put the North West and North East as the fastest-growing areas. We predict this happening over the next five years; though perhaps not to the same degree as the past, given the economic and lending environment.

MICRO-MARKETS

Manchester is an ambitious and growing hub, and will attract more investment. As yields tighten there, investment is likely to spill into other northern cities such as Leeds and Liverpool. Cheshire offers large, prime properties at a steep discount to the home counties, so could attract uppers who would otherwise have moved there.

HOUSE PRICE AFFORDABILITY

Affordability is far less stretched in the North West than in London. In the North West, the average ratio of house price to income was 3.7 for mortgaged first-time buyers; in London, the ratio was 5.5. The greater prospects of getting on the housing ladder is likely to make the region attractive to aspiring homeowners.

DEPOSIT REQUIRED

The average first-time buyer in the North West pays a deposit of £19,000, 54% of their annual income. In London, it’s £99,753, or 149% of average income. That means people in the North West can afford to buy sooner and are less constrained by the need to accumulate stacks of wealth.

STAMP DUTY

The cost of moving properties is much lower in the North West than in London. In 2016, the average SDLT rate paid in the North West was 2%, compared with 5% in London. Taking the difference in house prices into account, the average bill was £3,000 in the North West compared with £25,700 in the capital.

RENTAL AFFORDABILITY

Rent on a median two-bedroom property makes up 23% of gross income in the North West, compared with 47% of gross income in London. This means that renters in the North West have more money left over to save towards a deposit. That is likely to mean the region retains more of its graduates.
Mulch is made of the plight of first-time buyers. Receiving significant support from the Bank of Mum and Dad and, to a lesser but still important degree, the Help to Buy scheme, they ended the 12 months to the end of June within 5% of their pre-crunch level. The potential for further significant growth in this number, however, is limited in an age of mortgage regulation where deposits are likely to remain high. But the constraints which this imposes vary across the country, the extremes seen in London are unrepresentative of the majority of the rest of the UK. In the South East, the constraints are less acute, but still significant. In this region, the average household income of first-time buyers exceeds £50,000, and the average mortgage stands at more than four times that figure. Meanwhile, the average deposit is a considerable £48,000. Who is able to buy is restricted by their ability to raise that kind of sum for a deposit, along with the need to have a substantial household income. There seems little capacity to stretch loan-to-income multiples much further than they already stand and, as a result, that is likely to limit growth in first-time buyers in this part of the country.

By contrast, in the North West, the average income of a first-time buyer is just over £35,000, and the average mortgage is 3.34 times that sum. The average deposit – though certainly not to be sniffed at – is considerably less, at £19,000. And, while there are still undoubted constraints to be found in this area of the UK, they are not nearly as great as those experienced by their South East counterparts.

The number of mortgaged home movers is only marginally higher than first-time buyers. Transactions have risen by less than 10% in the past five years, far less than the 29% across the housing market as whole. In part, this activity reflects falling levels of home ownership. It also reflects a lack of earnings growth and rising levels of consumer credit that impinge on the ability to obtain a larger mortgage. But, perhaps more crucially, it points to households moving up the housing ladder less often. This reflects the longer time it takes to build up equity to make the next move – not just with house price growth, but paying down existing mortgage debt. A period of low house price growth will do little to help people build up sufficient housing wealth to be confident of moving up the ladder, although this should ease over the five years of our forecast period.

In London, the cost of buying a house with an extra bedroom – and the ability to get a mortgage to do so – is likely to drive demand into the commuter zone, where up-sizers get more for their money. In part, this activity reflects falling levels of home ownership. It also reflects a lack of earnings growth and rising levels of consumer credit that impinge on the ability to obtain a larger mortgage. By contrast, in the North West, the average income of a first-time buyer is just over £35,000, and the average mortgage is 3.34 times that sum. The average deposit – though certainly not to be sniffed at – is considerably less, at £19,000. And, while there are still undoubted constraints to be found in this area of the UK, they are not nearly as great as those experienced by their South East counterparts.

The stamp duty surcharge has raised far more revenue for the Treasury than was envisaged, largely through the volume of cash investors. Changes seem unlikely. Meanwhile, the effect of restricted tax relief is probably yet to show its hand, given the benign interest rate environment and its staggered introduction. Mortgage regulation has had a more immediate impact since its introduction for small private landlords in January 2017 and was applied to portfolio landlords in October.

It seems likely we’ll see mortgaged buy-to-let numbers fall further, with investors looking to cheaper, higher-yielding properties to make the sums add up – often outside London and the South. >
TransactiOns
Cash buyers have become more dominant, and now account for 34% of all house purchases – but they’re likelier to be cost cautious

The number of cash buyers has become much more dominant in the market – they now account for some 34% of all house purchases, and 45% of all sums spent on house purchase. Amongst this group, investors, second-home buyers and those buying a home for other family members, now have to contend with the 3% stamp duty surcharge. All are likely to be more cautious, particularly as returns from mainstream market investments become much more targeted.

Currently, the average person using the scheme is buying a property worth £270,000, and has a yearly household income of £53,000. First-time buyers make up 81% of Help to Buy loans; 36% are putting down a deposit of more than 5%.

Across the board, it remains to be seen exactly what will happen when Help to Buy comes to an end in 2021. The scheme is currently supporting 40,000 new house purchases a year across England, which has been underpinned by the announcement of another £10 billion of funding. Being of such importance to the housebuilding industry, we expect that it will be extended in some form. But, concerns over the extent to which it is funding housebuilder profits, and its effectiveness at getting people on the housing ladder, means it may be reduced in scope. One possibility may be that it becomes more targeted.

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Pushed to the limit?

There are two major factors helping to put the brakes on rental growth in the near term. First: supply. When the former Chancellor announced a 3% stamp duty surcharge on additional homes in 2016, buy-to-let investors scrambled to buy properties before the 31 March deadline. As a result, we saw a glut of properties marketed for rent in the second half of 2016 and early 2017, which has helped to keep rental value growth low. Asking rents across England and Wales grew just 1.9% in the year to June 2017, and fell by 3.2% in London.

Since June, the London market seems to have accommodated this new supply and rental values have stabilised. And, with government removing tax relief on buy-to-let mortgage payments, we expect to see new rental supply slow down over the next few years – unless build to rent developers can step in to fill the gap.

The second major factor affecting rental values over the longer term is affordability. Historically, rents have grown largely in line with wages. However, recent wage growth in the UK has been stagnant as Brexit-wary employers try to limit their costs. With rising levels of employment, this is forecast to change, with incomes set to head back to real growth by 2019. Given how tightly affordability is stretched in London, and the levels of supply we have seen over the last two years, we see no pressure for rents to rise in excess of wage growth.

As wages return to growth, rents for the mainstream market look set to grow faster in London – although there is still potential outside the capital, with high-yielding employment hubs leading the way

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“Realism is helping to keep the prime markets moving”

Prime central London values now sit 15.2% below their 2014 peak, but recent falls have been slowing. Has the market found its level? We look at the prospects for the prime London and country markets

What has happened since 2014?

The prime London markets have had political, economic and tax headwinds to contend with over the last three years – some of which have fundamentally changed the face of the market. The most significant has undoubtedly been the changes to stamp duty. For buyers in this market, it has become a lot more expensive to move, and those discretionary buyers adding to a national or global portfolio face a bigger financial decision. The aftermath of these reforms has meant vendors have had to adjust their price expectations as this tax is absorbed into the market. But it is not just stamp duty that has caused these price falls. A typical £2 million house in prime central London has seen price falls of almost double the stamp duty bill.

There has also been uncertainty in the market following the Brexit result and the snap general election. And international buyers have also had to deal with a less hospitable tax environment, following changes to inheritance tax and capital gains tax. The result is a market that has become sensitive to sentiment and price.

What about markets outside London?

While the number of £1 million+ properties actually sold in London is down, it is a different story for the country. Since the introduction of the first stamp duty reform in December 2014, values across the prime country market are up 4.5% as these markets have been more resilient to the factors that have subdued London.

However, the sentiment felt in London is beginning to ripple outwards. London’s prime outlying suburbs (such as Esher, Rickmansworth and Weybridge) saw price falls of 1.1% over the last year. These markets are feeling the effects of stamp duty, as well as mortgage regulation.

How have buyers changed since 2014?

Buyers are likely to be much more savvy about pricing – evident in the number of price cuts we’ve seen. Across the country, there has been a 90% increase in the number of £1 million+ properties that have had a price cut in the first half of this year compared to last. But where vendors are realistic, transactions have held up. In addition, we have seen a reduction in investor buyers. In London, they have gone from accounting for 21% of Savills buyers in 2014 to 16% this year.

Prime country markets have been more resilient to the factors that have subdued London

The uncertainty in the market has also made sales and purchases more needs based. Across London and the country, the number of £1 million+ properties that have been brought to the market in the first half of this year against the first half of last year is down by 16%.

Where does it leave us going forward?

Historically, we have seen an average of 5.7% real growth per annum in prime central London, boosted by London’s transformation into a global city. Yet the changes that have occurred since 2014 suggest a departure from this trend. With tax changes and uncertain sentiment, it is difficult to see what would support the growth to get us back to the same level. Instead, we are expecting to see two more years of subdued growth – both across the prime London and country markets. Once a degree of uncertainty starts to clear we should see growth, when London will appear comparatively good value. Yet this bounce-back and growth is likely to be less than we’ve seen in previous cycles. London has already matured into a world city, and the effects of mortgage regulation in the more domestic ports of the market will limit huge amounts of growth.

In the country markets, the price gap remains, and growth will be reliant on wealth moving out of the capital into the commuter zone. Beyond here, it will be local economic drivers supporting prices.

Gaby Day, Analyst
Gaby specialises in prime London and country markets

Prime house prices Our five-year forecast

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

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Spring Terrace, Richmond, Greater London
To have any impact on affordability, we need to build more homes. We look at the catalysts that could shape meaningful progress: government pressure on developers, new housebuilders, and increasing land supply.

**GOVERNMENT PRESSURE**

The white paper explicitly identifies slow delivery as one of the major difficulties facing the housing market. It proposes a more streamlined approach to planning, giving local authorities increased powers to deliver community infrastructure, and applying a standardised method to calculating housing need that could result in increased land supply in high-demand areas. It also suggests that local planning authorities could have powers to turn down applications from developers who have not shown a strong track record of delivering previously consented sites.

The Government wants to hold developers to account for new home delivery and ensure sites with planning permission are built. Although it’s unclear how this will take effect, it is evident that this pressure, combined with the new housing delivery test for local authorities, means that the development industry can’t turn down applications from developers who have not shown a strong track record of delivering previously consented sites.

The Government wants to hold developers to account for new home delivery and ensure sites with planning permission are built.

**LAND AVAILABILITY**

The potential to deliver homes will always be limited by the supply of land, especially in high-demand areas. The planning system could do more to respond to market signals to release land where affordability is most stretched. While the number of homes gaining permission each year has increased 56% since the 2012 introduction of the National Planning Policy Framework, this has been spread across England, and where new homes are needed the most.

For housing delivery to reach 300,000 homes per year, we need to make full use of the untapped market capacity in higher-demand areas. There is a shortfall of almost 90,000 planning consents each year in the least affordable areas in the country. More land availability in these areas would allow new entrants in the market without pushing up land values. This can then support higher output from smaller developers and mixed tenure delivery programmes from housing associations, which would move us towards being able to deliver the housing needed to support continued economic growth.

A step change in delivery is most likely to come from new entrants to the market. Over the past 18 months, we’ve seen small and medium housebuilders, much reduced during the GFC, re-enter the land market. But their resurgence relies on government support and continued housing market strength.

Institutional investors are also starting to fund build-to-rent schemes. In the UK, 17,000 build-to-rent homes have been completed, but this is an emerging sector. We expect delivery to increase as confidence grows; 79,000 build-to-rent units are in the development pipeline.

The greatest untapped potential comes from housing associations. The Savills Housing Sector Survey 2017 revealed that 66% of housing associations plan to deliver market-sale homes over the next five years, and more than 80% want to build homes for shared ownership or affordable rent. Delivering affordable housing increases the potential for absorption of new homes and allows for continued housebuilding in the event of a market downturn.

If housing associations are to achieve these ambitions, they need to have access to land and construction capacity, either their own or through partnerships. In our survey, 82% of housing associations said they plan to or are considering partnering with a private developer in the next five years. As many traditional builders are at capacity, the new development ambitions of housing associations could start to bring modern methods of construction (MMC) into the mainstream. We estimate that there could be capacity to build over 60,000 homes per year through MMC by 2022.

To have any impact on affordability, we need to build more homes. We look at the catalysts that could shape meaningful progress: government pressure on developers, new housebuilders, and increasing land supply.