RESIDENTIAL PROPERTY FOCUS Q1 2013

Family values
What the genealogy of the housing market means for different buyer types

Inside
The true worth of UK housing

Downsizing: Identifying hotspots
Upsizing: Commuting assessed
Investment: Making a return

savills.co.uk/research
Foreword

KEEPING IT IN THE FAMILY

Housing wealth in the UK is in the hands of older generations, but releasing equity to the younger generations can be tricky

This year should be one of celebration for the few of us who believed, back in the 1980s, that residential property could and should be invested in as a commercial asset class.

Now, all these years on, significant deals have been done involving corporate, institutional and private wealth with more expected this year. This will start to increase the number of purpose-built, professionally managed homes for rent and tenants will have increasing choice. As supply rises, rents should also rise at more sustainable and affordable rates.

But the structural change in UK housing markets has already been profound. The number and value of market lets has already increased very dramatically since the rental nadir of 1989 and is still increasing. ‘Privately rented stock’ has risen in numbers and value – from £354 billion to £893 billion since 2002.

Rising rental demand has been met by small-scale individual landlords who, in common with most western countries, provide the bulk of market rented accommodation. Since the credit crunch, new private landlords have been those with equity and not the highly geared buy to let investors of the early Noughties. Among them are the ‘accidental landlords’ who have found themselves unable or unwilling to sell at current values so have let their properties instead, sometimes renting the property they then live in.

The increasing demand for rental accommodation shows no signs of abating as generations who, in the past, would have swollen the ranks of owner-occupiers are now excluded by lack of deposits.

Housing wealth is now concentrated in the hands of older generations and the amount of equity held in housing is polarising between these ‘haves’ and the younger ‘have nots’.

Releasing equity from the generation that has it to the generation that needs it is tricky. Not only is the amount that can be easily released, through downsizing for example, limited (see page 6), it is most likely to be released through inheritance, or even trading, much later in life than the next generation of young families need it.

No wonder the average age of mothers at the birth of their first child is rising. Few twenty-somethings are able to become both homeowners and parents – and only a limited number of would-be grandparents are able to act as ‘Bank of Mum and Dad’.

Behaviours and barriers

It is ‘softer’ social issues like these that arise from housing market change, which are most likely to influence future policy direction. As time goes on, fewer politicians will be able to stomach the thought of the rental bill presented by a generation of pensioner-renters.

Nor will the dilution of wealth among the younger and more productive and entrepreneurial generations – who in times past would have funded new businesses by mortgaging the family home – prove so palatable. Home ownership is likely once again to creep up the political agenda.

Understanding the behaviours and barriers to the effective functioning of a trans-generational housing market and understanding the appropriate role of a functioning rental market within that will be key to appropriate policy response.

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Executive summary

The key findings in this issue

- The distribution of value amongst different types of property tells a story of an increasingly polarised housing market, with a growing proportion of value coming from the private rental sector. See pages 4/5
- The trend towards downsizing is likely to gain momentum as parents increasingly tap into their equity to help their children onto the housing ladder. See pages 6/7
- Traditionally, the UK’s retirees have been attracted to the South West and parts of Wales, and more generally to coastal areas, including East Anglia and the North East. See page 8
- For many households, the need for more space and a less frenetic pace of life provides a powerful impetus to move out of London and into commuter territory. But the trade-off is a complex one. See pages 10/11
- With increased demand for rental accommodation set against the context of low levels of housebuilding, a simple mismatch between demand and supply has driven rental growth, despite the underlying economic conditions. See page 12/13

Contents

- Polarisisation in the UK housing market
- Making use of housing wealth
- Where are the downsizer hotspots?
- Market forecasts
- Value in the commuter zone
- Making a return in the rental sector
- Prime numbers
Market dynamics

POLARISATION IN THE UK HOUSING MARKET

With wealth concentrated in fewer people’s hands, the distribution of value among different property types across UK housing tells the story of an increasingly polarised market.

Ten years ago the UK’s housing stock was worth an estimated £2.9 trillion. Within just five years, at the peak of the market, this figure had rocketed to £5.4 trillion. Today it stands at £5 trillion. The distribution of value amongst different types of property tells a story of an increasingly polarised housing market. A growing share of value comes from the private rented sector. Such property is now worth some £893 billion, equivalent to 18% of the total value of all UK housing.

And amongst owner occupiers, those who own their property outright hold an increasing share of the total pot. Some £1.7 trillion worth of owner occupied housing is now completely free of mortgage debt. This figure is just 7% below the total value of homes subject – to a greater or lesser degree – to a mortgage. The UK housing market is increasingly driven by investment at one end and substantial home owner equity at the other, symptoms of a market in which wealth is increasingly concentrated in fewer people’s hands.

Private renters

The UK’s housing stock is estimated to be worth around 6.5% less than at the peak of the market in 2007. By contrast, the private rented sector has grown to such an extent that its aggregate value has risen by 36% in the same five year period. Since 2002 the volume of private rental stock has grown by 61%, while its value has risen by an astonishing 153%. This has happened over a decade when the total value of all housing stock has risen by 72%.

In the five years pre-peak, from 2002-2007, the sharp rise in house prices both restricted accessibility to home ownership amongst would-be first time buyers and underpinned demand from buy to let investors.

GRAPH 1.1
The value of UK housing stock

Graph source: Savills Research
The dynamic has changed – for investors at least. With lower prevailing and forecast rates of capital growth, income yield has become increasingly important amongst investors looking for balanced mid-term returns.

**Downsizers**

A lack of mortgage debt and high deposit costs are also acting as a trigger for downsizing. At a time when the younger generations are struggling to access or move up the housing ladder, those older owners sitting on substantial pots of equity are often the only potential source of funds.

The biggest regional pool of unmortgaged owner occupied stock, worth £337 billion, is in the South East. But the retirement and pre-retirement hotspots further from London, such as East Dorset, East Devon, Christchurch, the New Forest and the Malvern Hills have the highest concentrations of unmortgaged homes. It is not clear which pot of equity has the greatest capacity to be unlocked.

**On the way up**

The unlocking of equity in the wealthy commuter belt around London is in part dependent on the activity of upsizers – those with family still at home who look to upsize and make the trade-off between space, cost and travel time to work.

Since the downturn, these upsizers have been reluctant to move from London to its hinterland, reducing the pool of buyers for downsizing sellers. There are signs that this is changing, but so far the trend has been for owners to stay in London and for housing wealth to be recycled in its more affluent boroughs.

This has concentrated wealth in the capital. London’s housing stock value has risen by some £140 billion (14%) in the past five years – equivalent to the value of the entire housing stock of the North East of England. London’s residential real estate value now totals £1.1 trillion.

**Rebalancing the equity**

It means that over 20% of total value of the UK’s housing stock is in London – the highest share since 2000. As the economic backdrop improves, home owners in the capital are expected to exploit their advantage and look beyond the M25 for real commuter value.

But, of course, London’s residential value is not all locked up in owner occupied stock. Some 37% of the total value of UK private rented housing and 19% of the stock sits within London. Within areas popular with younger generations, such as Hackney, private rental stock accounts for around 40% of the total housing value.

Above all there remains substantial equity in the UK’s housing market. In the past five years, the equity-rich market segments have shown the strongest performance. We now fully expect this equity to be applied increasingly to other parts of the housing market in the UK over the next five years.

More will find its way into the residential investment market, to helping younger generations get on or move up the housing ladder and out into predominantly owner occupied housing in the commuter belt.

The housing market may be increasingly polarised, but its different parts are far from completely disconnected.

"The UK housing market is increasingly driven by investment at one end and substantial home owner equity at the other"

Lucian Cook, Savills Research
Downsizing continues to gain momentum, as those approaching retirement seek to release wealth, and parents assist their children with the sizeable deposits required to get onto the housing ladder. Moving to a smaller home after the children have flown the nest probably sounds a very sensible idea for many people. Not only will they be living somewhere cheaper and more manageable to run, but they are also likely to be able to release wealth that could help to fund their later years or be passed to younger family members trying to get on the housing ladder.

Indeed, retirees and those approaching retirement (55 plus) have a great deal of equity tied up in their homes. Our analysis suggests that in total, two-thirds of all the wealth tied up in owner occupied homes is held by this age group.

Table 2.1

Average cash release from downsizing at a local authority level across the UK

<table>
<thead>
<tr>
<th>Downsize</th>
<th>Average Cash Release (£)</th>
<th>Proportion of Locations to Release £100k+</th>
<th>Proportion of Locations to Release £200k+</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 bed to 1 bed</td>
<td>55,049</td>
<td>7%</td>
<td>1%</td>
</tr>
<tr>
<td>3 bed to 2 bed</td>
<td>68,547</td>
<td>11%</td>
<td>1%</td>
</tr>
<tr>
<td>4 bed to 3 bed</td>
<td>145,666</td>
<td>78%</td>
<td>12%</td>
</tr>
<tr>
<td>5+ bed to 4 bed</td>
<td>306,070</td>
<td>94%</td>
<td>56%</td>
</tr>
<tr>
<td>3 bed to 1 bed</td>
<td>123,596</td>
<td>53%</td>
<td>8%</td>
</tr>
<tr>
<td>4 bed to 2 bed</td>
<td>214,213</td>
<td>100%</td>
<td>35%</td>
</tr>
<tr>
<td>5+ bed to 3 bed</td>
<td>451,736</td>
<td>100%</td>
<td>92%</td>
</tr>
</tbody>
</table>

Table source: Savills using Rightmove Asking Price Data

Words by Neal Hudson

“Our figures show that first time buyers have received two or three times as much parental help with their deposit as they did before the financial crisis”

Neal Hudson, Savills Research

Market constraints

According to the Survey of English Housing, there has historically been a surprising level of resistance to moving among older people, despite the fact that half of over-55s have a bigger home than they need. Those in their retirement years account for just 6.5% of all homemovers each year but just under 30% of non homemovers. Across the market as a whole, downsizing tends to be triggered by a life event that highlights the need for a smaller home. Until then, elderly people may be deeply resistant to leaving the family home or the neighbourhood, according to a 2009 report by the Centre for Housing Studies.

Potential financial benefits are not a key driver, the report found, partly because across much of the country there’s not a great deal to be gained in monetary terms, taking into account the costs and sheer hassle of moving. For instance, downsizing from a typical three-bed to a two-bed property would release more than £100,000 of equity in only one tenth of UK locations. So for most people in the mainstream housing market, downsizing is a matter of need rather than choice.

Typically they move from a three-bed to a one-bedroom home in order to maximise the amount of cash they can release. On average, such a move frees up around £123,000 (though it’s worth noting that still, in almost half of UK locations, the money released amounts to less than £100,000).

Affluent homeowners

However, it’s a rather different story for people who own larger properties and live in the more affluent parts of the country. For them, downsizing can unlock substantial sums. Thus, a move from a four- to a three-bedroom property would release £100,000+ of equity in almost 80% of UK locations.

Such homeowners are thinking about lifestyle and preferences when they decide to downsize; it’s often a question of convenience and a desire to be nearer the family and young grandchildren. Typically they’ll make the move in the run-up to retirement or immediately after, and they’ll keep a certain amount of space to accommodate family visitors.

A typical move might involve the sale of their four- or five-bedroom home and a move to a two- or three-bedroom home. Importantly, the bigger

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Such homeowners are thinking about lifestyle and preferences when they decide to downsize; it’s often a question of convenience and a desire to be nearer the family and young grandchildren. Typically they’ll make the move in the run-up to retirement or immediately after, and they’ll keep a certain amount of space to accommodate family visitors.

A typical move might involve the sale of their four- or five-bedroom home and a move to a two- or three-bedroom home. Importantly, the bigger
the family home, the more equity a typical two-bedroom downsize releases. Thus, a move from a four- to a two-bed home frees up over £200,000 on average, with such sums being achieved most regularly in the South East. A move from a five- to a three-bed home would release much more – on average, over £450,000.

With average sums of this size involved it’s hardly surprising that downizers are more commonplace in more affluent areas where owners stand to gain most.

Downizers now drive 22% of prime London sales and 38% of those in the prime regional market.

Looking forward

Looking ahead, the trend towards downsizing is likely to gain momentum, as parents increasingly tap into their equity to help their children onto the housing ladder. Already, over the past five years, our figures show that first time buyers have received two or three times as much parental help with their deposit as they did before the financial crisis.

This trend is likely to be concentrated among wealthier families moving out of four-bedroom plus family homes, especially in the South East, as activity in the residential market picks up.

How far will the drive to give the next generation a leg up onto the ladder extend down through the mainstream market?

It’s interesting to compare the amount of cash released by a mainstream move from a three- to a two-bedroom property with the average deposit needed by a first time buyer. Although there is some regional variation, this comparison indicates such a move would release equity worth two to three times the size of the deposit needed. Even away from the upper end of the housing market, downsizing by parents could be a godsend for first time buyers that helps to fuel sales in the lower echelons.

This is likely to underpin an increase in downsizing. Our calculations indicate that around 55,000 homeowners currently downsize each year, releasing equity of around £7 billion. Over five years we believe this will increase to 90,000 households, releasing equity of around £14.6 billion.

We expect this release of equity to result in a further increase in the amount of parental assistance to first time buyers that has averaged around £3.5 billion a year post-credit crunch.

TABLE 2.2

<table>
<thead>
<tr>
<th>Region</th>
<th>Average Equity released by moving from a 3 bed to a 2 bed (£)</th>
<th>Average FTB Deposit (Council of Mortgage Lenders) (£)</th>
<th>Multiplier</th>
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<tbody>
<tr>
<td>London</td>
<td>189,174</td>
<td>61,294</td>
<td>3.1</td>
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<tr>
<td>South East</td>
<td>81,290</td>
<td>34,425</td>
<td>2.4</td>
</tr>
<tr>
<td>South West</td>
<td>72,245</td>
<td>31,062</td>
<td>2.3</td>
</tr>
<tr>
<td>East of England</td>
<td>66,157</td>
<td>30,837*</td>
<td>2.1</td>
</tr>
<tr>
<td>West Midlands</td>
<td>49,757</td>
<td>21,551</td>
<td>2.3</td>
</tr>
<tr>
<td>Scotland</td>
<td>52,751</td>
<td>20,825</td>
<td>2.5</td>
</tr>
<tr>
<td>North West</td>
<td>47,436</td>
<td>17,031</td>
<td>2.8</td>
</tr>
<tr>
<td>Yorkshire and The Humber</td>
<td>44,503</td>
<td>15,540</td>
<td>2.9</td>
</tr>
<tr>
<td>East Midlands</td>
<td>44,272</td>
<td>20,622</td>
<td>2.1</td>
</tr>
<tr>
<td>North East</td>
<td>42,627</td>
<td>14,726</td>
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</tr>
<tr>
<td>Wales</td>
<td>38,132</td>
<td>15,712</td>
<td>2.4</td>
</tr>
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</table>

Table source: Savills using Rightmove Asking Price Data and CML data on first time buyer lending

* Estimated
Downsizing

IDENTIFYING THE DOWNSZIZER HOTSPOTS

In areas with high concentrations of potential downsizers, moving from a four-bedroom to a two-bedroom home can free significant equity.

Although the greatest gains from downsizing are to be made on the whole in London and the South East, the concentration of older people tends to be lower in these areas as they move away in search of a more leisurely lifestyle. Traditionally, the UK’s retirees have been attracted to the South West and parts of Wales, and more generally to coastal areas including East Anglia and the North East. However, not all of these ‘pensioner honeypots’ have housing markets equally favourable to downsizing in financial terms.

We have looked at the amount of equity that can be released by moving from a four-bedroom to a two-bedroom home in the locations with the highest concentrations of residents aged 55 and 65 plus, and found that on average, it’s around £190,000 (just below the national average).

Releasing wealth

Regional market variations mean that in a third of the pensioner honeypot locations, more than £200,000 of equity typically becomes available through such a downsizing move, making them particularly attractive to older people looking to release housing wealth.

Indeed, on average, across these prime downsizing locations, it’s possible to make the less drastic move from a four- to a three-bedroom property (thereby retaining more accommodation) while still releasing over £150,000.

Top of the tables is the Mole Valley in Surrey, where more than £330,000 on average is freed up by downsizing from four to two bedrooms; Chichester, the Cotswolds, Christchurch and Castle Morpeth are also all in the £300,000 plus bracket.

More broadly, locations in the South West account for more than a third of the top 30 downsizer hotspots. At the other end of the scale are areas such as Thanet in Kent, Great Yarmouth in Norfolk and South Holland in Lincolnshire, which, although they boast a high concentration of retirees, have much lower-value local housing markets.

In these areas, it’s possible to release an average of £100,000 by moving from a four- to a two-bedroom home – but those only downsizing from four to three bedrooms won’t free so much equity.

MAP 3.1

Map source: Savills using 2011 Census and Rightmove asking price data

Equity released downsizing from 4 to 2 bedrooms

- £250,000 and above
- £200,000 to £250,000
- £175,000 to £200,000
- £150,000 to £175,000
- £125,000 to £150,000
- Under £125,000

Areas in coloured shades have high concentrations in the 55-65 or 65+ age group
### PRIME MARKETS

**Five-year forecast values**

<table>
<thead>
<tr>
<th></th>
<th>Actual</th>
<th>Forecast</th>
<th>5yrs to end 2017</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2013</td>
<td>2014</td>
</tr>
<tr>
<td>Central London</td>
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<td>0.0%</td>
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<tr>
<td>Outer Prime London</td>
<td>5.0%</td>
<td>0.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Prime Suburbs</td>
<td>0.4%</td>
<td>1.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Inner Commute</td>
<td>-0.1%</td>
<td>1.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Outer Commute</td>
<td>-1.6%</td>
<td>0.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Wider South of England</td>
<td>-2.3%</td>
<td>-1.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Mids North &amp; Wales</td>
<td>-2.6%</td>
<td>-2.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Scotland</td>
<td>-4.8%</td>
<td>-2.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Source: Savills Research forecasts based on Nationwide actuals

### MAINSTREAM MARKETS

**Five-year forecast values**

<table>
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<tr>
<th></th>
<th>Actual</th>
<th>Forecast</th>
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<tr>
<td></td>
<td>2012</td>
<td>2013</td>
<td>2014</td>
</tr>
<tr>
<td>UK</td>
<td>-1.1%</td>
<td>0.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>London</td>
<td>0.7%</td>
<td>1.5%</td>
<td>4.0%</td>
</tr>
<tr>
<td>South East</td>
<td>-0.2%</td>
<td>1.5%</td>
<td>3.5%</td>
</tr>
<tr>
<td>South West</td>
<td>0.2%</td>
<td>1.0%</td>
<td>2.5%</td>
</tr>
<tr>
<td>East</td>
<td>-1.9%</td>
<td>1.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>East Midlands</td>
<td>-0.8%</td>
<td>0.5%</td>
<td>2.0%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>-0.8%</td>
<td>0.0%</td>
<td>0.5%</td>
</tr>
<tr>
<td>North East</td>
<td>-1.3%</td>
<td>-0.5%</td>
<td>-0.5%</td>
</tr>
<tr>
<td>North West</td>
<td>-1.6%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Yorks &amp; Humber</td>
<td>-2.5%</td>
<td>0.0%</td>
<td>-0.5%</td>
</tr>
<tr>
<td>Wales</td>
<td>-2.7%</td>
<td>0.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Scotland</td>
<td>-3.3%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Source: Savills Research forecasts based on Nationwide actuals

Annual house price growth key: ▢ Below 0% ▢ 0% to 2% ▢ 2% to 4% ▢ 4% to 6% ▢ 6% to 8% ▢ 8% and over
Five year house price growth key: ▢ 4% to 10% ▢ 10% to 15% ▢ 15% to 20% ▢ 20% to 25%
For many households, the need for more space and a less frenetic pace of life provides a powerful impetus to move out of London and into commuter territory. But the trade-off is a complex one, involving a balance between travelling distances, commuting costs and hassle on one hand, and more affordable house prices and lifestyle benefits on the other.

Moreover, the financial incentive to move out may have been eroded by the combination of rail fare increases – up 18% over the past three years – and the continuing ultra-low interest rate environment (which enables even relatively large London mortgages to be serviced manageably).

Commuter journeys are typically between 20 and 90 minutes long (commuter presence drops off rapidly for stations involving longer travel times), so our analysis has looked at house prices near London underground stations in zones two and three, compared with those around a sample of 174 commuter belt stations.

**House price trade-offs**

Even using a simple house price average (in other words leaving out the different housing stock make-up in an area), it’s clear, unsurprisingly, that housing is much more expensive in London than beyond it. The average house price in zone two is over £486,000, compared with £333,000 in the 20-30 minute commuter belt – a difference of more than £150,000.

Average house prices continue to reduce as journey time lengthens, though more gradually and not consistently. Thus, for a train journey of 40-50 minutes you’ll find house prices averaging just over £260,000; but the location of expensive ‘honeypot’ towns such as Oxford and Winchester means the 50-60 minute average rises to £320,000. Accept an 80-90 minute commute and you’ll pay, on average, just £217,000 for a home.

**Size matters**

When the price differentials of different house sizes are taken into account, the picture becomes rather more nuanced. Most striking is the price gap between larger (four-bedroom) properties in London and those outside. A four-bedroom house averages £1.2 million in zone two; in the 20-30 minute commuting zone, in contrast, it’s just over £500,000, and that figure falls gradually to just over £360,000 in the 80-90 minute zone.

So the potential property cost reduction for a London-based family wanting a larger home and willing to accept a longer commute is considerable. Indeed, a move out to more distant commuter territory – often a decision based on lifestyle and education choices – could feasibly free up sufficient equity to fund major family commitments such as school fees, or a London bolthole that would make it easier to maintain links with the capital.

In contrast, for one-bedroom properties, the cost differential between London and the commuter belt is less dramatic (averaging £315,000 in zone two, falling to £145,000 in the 20-30 minute commuter zone). Moreover, there’s much less to be gained by a longer journey time.
daily journey: even extending from a 30-minute to a 90-minute commute knocks less than £30,000 off the cost of a one-bedroom property.

Commuters on the bottom rungs of the housing ladder are therefore more likely to move out of London to cheaper commuter destinations, specifically to try and maximise price differences between the two locations.

**Annual cost comparisons**

Any house price savings must be set against the costs of commuting. An annual rail and underground season ticket now costs between £3,600 and £6,000, depending on the length of the journey. But comparisons are easier to make if the trade-off between travel and housing costs in different locations can be assessed on a like-for-like basis. We have therefore standardised housing costs, first, by calculating the interest payable on a 75% loan to value mortgage (at a rate of 3.75%) for an average four-bedroom property in each zone and adding that to the cost of the season ticket.

This analysis confirms the cost savings of a move from London out to the commuter belt – but emphasises there’s currently little additional financial benefit in accepting a longer commute. This is because although season ticket costs rise as the journey becomes longer, low mortgage interest rates mean there is relatively little difference in the cost of servicing the housing debt.

Mortgage interest on a typical four-bedroom property is only around £4,200 a year less in the 80-90 minute zone than in the 20-30 minute zone, and when higher travel costs are factored in, the cost advantage shrinks to around £2,000.

However, London’s higher house price effect means mortgage capital repayments are progressively more expensive in the nearer zones; when we build these repayments in, costs skew more decisively back in favour of a longer commute. Thus, on an 80-90 minute commute, the annual savings equate to £98 per minute for a four bedroom house (see Table 4.1).

Of course, cost savings vary according to local variations in house prices. For those London commuters game for a relatively lengthy journey, places such as Ely and Stowmarket offer particularly good value.

**Zoning in or out?**

In practice, in the face of economic uncertainty, a relatively strong London property market compared with surrounding areas, significant fare rises and low interest rates, there has been little incentive for those living in zones two and three to contemplate a move to the commuter belt. However, when mortgage rates start to move upwards, minds will be focused on the cost of London property – and the relative attractions of more affordable commuter belt locations.
Investment

MACING A RETURN IN THE RENTAL SECTOR

As the number of households in the UK entering private renting continues apace, the appeal of residential investment in the sector looks set to widen.

Words by Jacqui Daly

Our analysis suggests that the value of housing in the private rented sector in the UK is now just short of £900 million. But what are the prospects for those looking to invest?

What is the scale and distribution of growth in the private rental sector?

Census figures show that the number of households renting privately increased from 2.6 million to 4.2 million between 2001 and 2011 across England and Wales. Across the UK, we estimate that some 4.8 million households were in the private rented sector in 2012.

Most tenancies are concentrated in urban areas, typically reflecting the demographic profile of these areas. In Birmingham, Leeds, Manchester, Liverpool and Bristol, the number of private rented sector households has risen by 77% in the last decade and now account for 23% of all households in these cities.

In London, however, where high property prices are an even greater barrier to home ownership, the size of the private rental sector is larger still. The highest concentration of tenancies is in the inner London boroughs, where some 40% of households occupy rented housing. This is expected to rise to 50% by 2017.

What has driven this shift towards renting?

Reduced accessibility to homeownership, the lack of new social housing and the increasing social acceptability of renting at all stages of life, have boosted the demand for privately rented homes.

Of these, the biggest driver has been the increased difficulty in accessing home ownership. As house prices rose relative to incomes through the late Nineties and early to mid Noughties so the cost of raising a mortgage deposit increased.

The shift to renting, which importantly began at the turn of the millennium, gathered pace post credit crunch as deposits required by banks rose.

Is this a permanent or temporary phenomenon?

There is evidence that accessibility to mortgage finance has improved but the improvement is not significant. The number of mortgage products available at loan to value ratios of in excess of 90% have increased. However those mortgage products carry a significant interest rate premium. At the end of December the average rate for a 90% fixed rate mortgage was 5.31%, compared to 3.35% for the equivalent 75% LTV loan.

Consequently, the increase in mortgage products is failing to have much of an impact on lending at the bottom of the housing chain. Whilst the number of first time buyer loans increased by 12% in the year to the end of November, they remained 42% lower than in the period from 2003 to 2007.

This continues to cause a split between buyers with access to equity, usually via the Bank of Mum and

“We estimate that by 2016 one in five households in England will be renting in the private sector. A total of 5.9 million households” Jacqui Daly, Savills
Dad, and those who would like to own their own homes but are forced to rent for longer.

So the indications are that recovery in the mortgage markets will be slow and gradual. Given the credit constraints, and the shortfall in social housing, we estimate that by 2016, one in five households in England, a total of 5.9 million households, will be renting in the private sector.

What does all this mean for rental growth?

With increased demand for rental accommodation set against the context of low levels of house building, a simple mismatch between demand and supply has driven rental growth, despite the underlying economic conditions.

Evidence from asking rents suggests that this rental growth has been highest in London and the South East, particularly in markets attractive to more affluent young households.

As we look forward, rents will continue to be pushed up where there is a mismatch between supply and demand. We forecast that average rents in the mainstream market will increase by 18.2% by 2017, though a weaker economy and fears of public sector cuts are likely to keep a lid on rent rises in the cities of the North and the Midlands. Rental growth in areas dominated by tenants on housing benefits is also likely to be limited.

What are the investment prospects?

In the medium-term, the prospect of capital growth in London and the South East will deliver highest overall returns. However, we expect income yield to become an increasingly important driver of investment demand, particularly amongst institutional investors who have become increasingly active in the market.

For those investors, the ability to drive additional income returns from the emerging build to rent model will widen the appeal of residential investment across the cities and towns of the UK.

### TABLE 5.1

<table>
<thead>
<tr>
<th>Region</th>
<th>Buy to Let Yield</th>
<th>5 year price forecast</th>
<th>Annualised 5 year return forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
<td>Net</td>
<td></td>
</tr>
<tr>
<td>London</td>
<td>5.4%</td>
<td>3.8%</td>
<td>21.0%</td>
</tr>
<tr>
<td>South East</td>
<td>5.7%</td>
<td>4.0%</td>
<td>19.5%</td>
</tr>
<tr>
<td>East</td>
<td>5.6%</td>
<td>3.9%</td>
<td>17.0%</td>
</tr>
<tr>
<td>South West</td>
<td>5.3%</td>
<td>3.7%</td>
<td>15.5%</td>
</tr>
<tr>
<td>East Midlands</td>
<td>5.7%</td>
<td>4.0%</td>
<td>13.0%</td>
</tr>
<tr>
<td>Wales</td>
<td>5.9%</td>
<td>4.1%</td>
<td>11.5%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>6.1%</td>
<td>4.3%</td>
<td>7.5%</td>
</tr>
<tr>
<td>North West</td>
<td>6.3%</td>
<td>4.4%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>6.0%</td>
<td>4.2%</td>
<td>5.5%</td>
</tr>
<tr>
<td>North East</td>
<td>6.2%</td>
<td>4.3%</td>
<td>4.5%</td>
</tr>
<tr>
<td>UK</td>
<td>5.8%</td>
<td>4.1%</td>
<td>11.5%</td>
</tr>
</tbody>
</table>

Table source: Savills Research
Market dynamics

PRIME NUMBERS

The prime residential property market... statistically speaking

£187bn The total value of housing stock in the boroughs of Westminster and Kensington & Chelsea, £11 billion more than the value of the entire housing stock of Wales

3,000 The total number of properties with a current value of over £2 million that have been put into offshore corporate structures in the past 10 years

£4.1bn The total value of sales over £5 million in the prime London markets in 2012 within 3% of the record set in 2011

5.1% The growth seen in the prime markets of London in 2012, of which 2.8% occurred in the first quarter of the year

23.9% The average increase in the value of prime central London property compared to the pre-downturn peak of 2007

-9.5% The average extent to which prices in the prime residential markets beyond London differ from those in the third quarter of 2007 (though falls vary from -4.8% in the inner commuter zone to -16.2% in the Midlands and North of England)

£31bn The total value of housing stock in Elmbridge, Surrey – part of the prime suburban markets where prime property prices edged 0.4% higher in 2012

£14bn The extent to which the value of housing stock in Edinburgh exceeds that of Glasgow

Savills research team

Please contact us for further information

“No wonder the average age of mothers at the birth of their first child is rising. Few twenty-somethings are able to become both homeowners and parents.”
Yolande Barnes

“As the economic backdrop improves, homeowners in the capital are expected to exploit their advantage and look beyond the M25 for real commuter value.”
Lucian Cook

“The ability to drive additional income returns, as the build to let model is embraced and develops, will widen the appeal of residential investment across the UK.”
Jacqui Daly

£187bn

The total value of housing stock
in the boroughs of Westminster and Kensington & Chelsea, £11 billion more than the value of the entire housing stock of Wales

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The total value of housing stock in Elmbridge, Surrey – part of the prime suburban markets where prime property prices edged 0.4% higher in 2012

£14bn

The extent to which the value of housing stock in Edinburgh exceeds that of Glasgow
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