Back to front
How the extreme conditions of the past five years will influence the next five

Prime markets: Future presentations
Rental sector: Generation rent
Development: Building momentum
This publication

This document was published in November 2012. It contains a review of all the key housing market indicators and news to the end of October 2012 and the Savills Research forecasts published November 8, 2012. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document.

Glossary of terms

- **Mainstream**: mainstream property refers to the bulk of the UK housing market with, for example, price movements monitored by reference to national and regional average values.
- **Prime**: the prime market consists of the most desirable and aspirational property by reference to location, standards of accommodation, aesthetics and value. Typically it comprises properties in the top five per cent of the market by house price.

The most commonly used abbreviations are:

- **DCLG**: Department for Communities and Local Government
- **FLS**: Funding to Lending scheme
- **IHT**: Inheritance Tax
- **LTV**: Loan To Value
- **Peak**: refers to the first half of 2007
- **PCL**: Prime Central London
The structure of the market has changed over the past five years, and house price forecasts will need to respond to an increasingly wide range of factors.

It is becoming clear that the current conditions in the UK housing market are unlikely to be a temporary phenomenon. The market conditions we called ‘normality’ ten years ago will not be resumed anytime soon. The structure of the housing market has changed, if not permanently then at least for the foreseeable future.

Across the market, rent levels are a good sign that occupier demand is as strong as ever. The biggest question in the current UK market is therefore ‘what value does this rental income have?’ and ‘what does that mean for mainstream house prices?’

Purchasing decisions, whether investor or owner occupier, are all based on perceptions of risk and return and this varies geographically and between different people acting in different capacities.

As a result, headline house price movements, particularly quoted at a national level, increasingly obscure highly localised and market sector specific variations.

Huge divergence
In the past five years, we have seen huge divergence in the performance of different property types and locations. This is represented at the extreme by the performance of large central London houses and small flats in the urban areas in the North of England.

Central London, largely unshackled by a lack of mortgage debt and until now the beneficiary of overseas wealth, has come under the HM Treasury spotlight. Increases in stamp duty and anti avoidance measures have subdued the market in the past six months, and though the threat of a ‘mansion tax’ seems history, the spectre of further wealth tax continues to make buyers cautious.

At the other end of the market, the inaccessibility of mortgage finance and a weak economic recovery have shifted the tenure of younger generations away from owner occupation towards renting. For those with equity looking to buy into this end of the market, the focus is firmly on the sector’s investment credentials and the income it can generate.

Inherent strength
Between these extremes, the extent of recovery in the core of the owner-occupied market will reflect the pace and distribution of economic recovery and the impact this has on sentiment going forwards. The inherent strength of local markets, reflected in measures such as transaction and repossessions, will also be important.

Our prognosis last year that inflation would continue to strip value from the mainstream housing market has proved to be correct in 2012. We anticipate this trend continuing over our next five year forecast period, during which we expect continued low interest rates, falling inflation and low house price growth. Prime markets are forecast to continue to outperform over the mid term, with London maintaining the edge.

It is also clear that house price forecasts will be impacted by an increasingly wide range of factors that impact differently on individual sub markets. There are still huge opportunities for developers, investors and even owner-occupiers in this changed environment – provided they understand its causes and effects.

Executive summary
The key findings in this issue

- Our five year house price forecasts reflect the realities of a market which favours equity rich households and excludes those with a high borrowing requirement, reinforcing the divergence in the purchasing power of buyers at different life stages. See pages 4/5
- In the mainstream market there are no significant drivers either for house price falls or price growth in the short term. See pages 6/7
- Over the next five years we expect to see a more widespread prime market recovery as London-generated equity flows into the prime regional markets. See pages 8/9
- While the capital value of residential real estate remains static, the behaviour of the rental sector is clear evidence of robust underlying occupier demand. See pages 12/13
- Overall levels of house building activity remain low, with starts at less than 55% of pre-downturn levels in England, Scotland and Wales. The land market is ticking along, with value growth during the third quarter of 2012 of 0.7% for greenfield and 0.4% for urban land. See page 14

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Market dynamics

LIFE STAGES INFLUENCE MARKET

The way equity is divided across the different generations of householders in the UK continues to influence transaction levels, which will be slower to recover in the lower tiers of the market.

Words by Lucian Cook

Our house price forecasts for the next five years reflect the realities of a market which favours equity rich households and excludes those with a high borrowing requirement. This means that the distinction between the purchasing power of households through the various life stages will persist, with implications for transaction levels in different tiers of the market and different locations.

The under 35s

Our analysis shows that the under 35s own less than 4% of the total equity held in the UK’s owner occupied housing stock. In the past five years the number of first time buyer purchases has averaged just 200,000 per annum, down from 390,000 in the previous five. As a direct consequence, the rate of growth in renting among this cohort has increased sharply since 2007. Recent census results show that the under 35s have become increasingly concentrated in urban centres. In the 20% of locations where they are most dominant, they now account for 36% of the adult population, having grown in number by 19% in the past decade.

As a result, the price of smaller properties in such locations will be increasingly driven by their underlying investment value, and the growth of rental will be a key factor. Transactions within this part of the market, and ultimately values, will be a function both of the extent to which the investment market grows and the extent to which housing wealth is preserved and passed down the generations.

Younger households aspiring

TABLE 1.1

Housing Market Transaction Forecasts (000s)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Up to £150k</strong></td>
<td>651</td>
<td>385 59%</td>
<td>397 408 427 467 492</td>
<td>128%</td>
</tr>
<tr>
<td><strong>£150k - £250k</strong></td>
<td>599</td>
<td>302 50%</td>
<td>312 322 343 375 400</td>
<td>132%</td>
</tr>
<tr>
<td><strong>£250k - £500k</strong></td>
<td>289</td>
<td>149 51%</td>
<td>154 158 169 189 205</td>
<td>137%</td>
</tr>
<tr>
<td><strong>£500k - £1m</strong></td>
<td>58</td>
<td>35 60%</td>
<td>36 39 42 48 53</td>
<td>152%</td>
</tr>
<tr>
<td><strong>£1m+</strong></td>
<td>16</td>
<td>11 70%</td>
<td>12 13 14 17 19</td>
<td>174%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,613</td>
<td>882 55%</td>
<td>911 939 995 1,096 1,169</td>
<td>133%</td>
</tr>
<tr>
<td><strong>Mortgage Completions</strong></td>
<td>1,197</td>
<td>587 49%</td>
<td>607 626 667 731 779</td>
<td>133%</td>
</tr>
<tr>
<td><strong>Cash Transactions</strong></td>
<td>416</td>
<td>295 71%</td>
<td>303 313 334 365 389</td>
<td>132%</td>
</tr>
<tr>
<td><strong>Total Value £bn</strong></td>
<td>£361bn</td>
<td>£219bn 61%</td>
<td>£228bn  £236bn  £252bn  £281bn  £304bn</td>
<td>139%</td>
</tr>
</tbody>
</table>

Table source: Savills Research, HMRC, CML
to home ownership have become increasingly reliant on the benevolence of baby boomers and downsizing relatives – the over 55s who control 66% of the equity tied up in owner occupied housing.

A significant rise in the proportion of first time buyers receiving help to buy, combined with a sharp increase in the deposit which they have to raise, means the assistance provided by the so-called ‘Bank of Mum & Dad’ has risen dramatically since the beginning of the credit crunch.

Our calculations suggest that, in the past five years, the financial help given to first time buyers has rocketed to between £15 and £18 billion, up from £6 to £8 billion in the five years pre crunch.

Aspiring Upsizers
Aspiring upsizers, or ‘second steppers’, looking to move up the lower and middle rungs of the housing ladder, face similar issues. A lack of house price growth is limiting their ability to build equity to carry over to their next purchase. At the same time a lack of first time buyers is limiting their ability to sell.

Mature Families
In the search for larger homes second steppers are at a disadvantage to more mature families, who are not only spread more broadly across suburban commuter and rural locations, but also hold 75% more housing equity than those in the younger age brackets. They are therefore able to raise the required deposit (or more), and borrow more cheaply as a consequence.

The over 55s
Those with the greatest equity and the fewest barriers to moving are the over 55s, the baby boomer and downsizing generation. But these potential buyers are currently held back by consumer sentiment and a desire to wait for better market conditions to maximise the equity they release.

The distinctions between these different groups are reflected in transaction levels in the different housing sub markets. And it is the relative buying power of the different life stage groups that will determine the pace of recovery over the next few years.
Mainstream markets
LOOKING BACK TO LOOK FORWARD

Our new house price forecasts project forward to 2017. But how do the five years post credit crunch inform us about the five years ahead?

Words by Neal Hudson

UK MAINSTREAM HOUSE PRICE GROWTH
Five-year forecast values

<table>
<thead>
<tr>
<th>Forecasts</th>
<th>Actual</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007-2012</td>
<td>2013</td>
</tr>
<tr>
<td>Market conditions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal Price growth</td>
<td>-11%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Real price growth</td>
<td>-24%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Transactions (000s)</td>
<td>4,410</td>
<td>911</td>
</tr>
</tbody>
</table>

Data source: Savills Research / Oxford Economics

11% below its peak level in September 2007, equivalent to a fall of 24% in real, inflation-adjusted terms.
Over that five year period we have had to adjust to a new set of market drivers – a weak economy, a lack of mortgage finance, low bank base rates and high lenders’ margins.
We have also moved to a low transaction market where the main source of funding has shifted from debt to equity. Gaps have widened between mature owner occupier households and would-be first time buyers, equity rich locations in the South and low value mortgage-constrained markets in the North.
Though there is significant variation across the capital, average prices in London are now above their previous peak according to Land Registry figures. But even in London, average mainstream values are effectively 9% below 2007 levels after adjustment for inflation. By contrast, in the North East of England nominal prices are 21% below their level five years ago, equivalent to a 32% discount in real terms.

Lessons for the future
What are the prospects of this changing significantly over the next five years?
Our house price forecasts are set against the backdrop of a low transaction market. This means that house price indices are being calculated by reference only to the part of the market that is trading, the relatively more affluent, equity-rich owner-occupier markets that now dominate activity.

Graph source: Savills Research using Nationwide House Price Index
This is likely to continue. Despite central government efforts to stimulate mortgage lending it remains heavily subdued, and the number of outstanding mortgages has reduced by more than 400,000 net over the past five years.

Low interest rates have prevented the market being flooded by repossessed or forced sale stock. This in turn limits the potential for price falls across the UK, except for example if there were to be a full blown double dip recession fuelled by a disorderly eurozone breakup.

The experience of London over the past five years is telling. Six boroughs – Westminster, Kensington & Chelsea, Hammersmith & Fulham, Hackney, Islington and Camden have seen positive inflation-adjusted price growth, but in Barking & Dagenham, Newham, Croydon and Havering prices have fallen by more than 20% in real terms.

Beyond London, only in two areas – Surrey and Windsor & Maidenhead – are average values back above their previous peak. But even in these equity-rich markets real house prices have been reduced by inflation. This correction that seems to have been enough to allow turnover to recover to within one third of pre-crunch market capacity. Healthier turnover should mean that they are now able to grow at least in line with the general rate of inflation, as the national economy recovers slowly in a low interest rate environment.

By contrast, in less affluent areas of the South East, such as Slough, Portsmouth or the Medway, price fluctuations are more in line with the national average, at 20% below their pre 2007 levels on an inflation-adjusted basis.

The question for these less affluent markets over the next five years will be how far prices have to adjust in real terms, and the extent to which this leads to further nominal house price falls. We believe that underlying rental levels may provide a clue here as income yields if not the prospects for capital growth, eventually encourage transactions.

See page 11 for our mainstream forecasts.
Prime markets

PRIME TIME’S FUTURE PRESENTATIONS

Understanding the reasons for the vastly different rates of post credit crunch recovery across the prime markets is key when predicting the market over the next five years.

In the 18 months between September 2007 and March 2009, all sectors of the prime residential market – whether prime or ultra prime, London or country – experienced sharp price falls of between 20% and 25%. Since that date, there has been a significant divergence in performance.

Prime London

Central London has seen the strongest recovery. Prices are averaging 22% above their third quarter 2007 levels. The ultra prime market, which has become increasingly international, has risen even further.

One of the key catalysts for the recovery was an exchange rate play as the weakness of sterling made London look inexpensive in a global context despite correspondingly strong investment prospects. This advantage has now largely been extinguished by the resulting price growth and a stronger pound.

The second key driver of international demand has been the ‘safe haven’ play. Economic uncertainty in the eurozone and...
political uncertainty in other world regions, such as the former Soviet Union and the Middle East, mean ultra wealthy individuals have looked to invest in an accessible market with a strong, long term track record for capital growth. Many well-rehearsed factors have combined to put London in this enviable position.

There is little doubt that the UK tax environment has historically been one factor conducive to such investment, but in the past two years this competitive advantage has been put under pressure.

Property specific taxes, such as stamp duty, have increased as has the exposure of UK property to other taxes following the recent introduction of anti avoidance measures. Though not fundamentally undermining London’s wider appeal, the market will take time to absorb these additional costs.

The third and most significant driver of underlying demand has been global wealth generation. This will continue to be a function of economic growth at a regional level globally, evidenced by the increasing profile of buyers from Asia in the prime new homes market in particular.

Though expected to continue over the medium term, short term pressures on the global economy may lead to a weakening of emerging market demand, particularly at lower price levels.

“The key question is what will trigger the flow of equity through the market to take advantage of current value differentials”

Sophie Chick, Savills Research

Outer Prime London

Such new world wealth has been less evident in London’s other prime markets where domestic demand is still dominant, and where prices have risen to a lesser degree. This said, in prime South West London, for example, they are on average 11.7% above their level five years ago. Without any significant injection of City bonus money in the past five years, price growth here has been driven by a recycling of domestic wealth and a displacement of wealth out of central London.

In an environment where banking profits are reduced and City pay is increasingly scrutinised, these markets will become more dependent on the outflow effect from central London, particularly when greater amounts of existing housing wealth begins to be exported out of the prime domestic markets of London, as owners start to look again at moving out of London into the commuter zone and beyond.

Prime Regional

Generally, the prime regional markets have had neither a substantial injection of equity from overseas buyers nor a consistent flow of equity from London to spark a sustained recovery in prices. These markets have been much more exposed to weak consumer sentiment among largely domestic buyers.

There have been exceptions. The market for mansion houses on private estates, such as St George’s Hill and Wentworth, has parallels with central London, both in terms of buyer profile and the nature of product offered. This sub market has substantially outperformed the rest of prime regional and is likely to continue to do so over the medium term.

In areas that benefit from a flow of housing wealth generated in London, the market has been stronger, but this equity flow has not reached far beyond the prime uber-towns of the South East, such as Beaconsfield and Sevenoaks.

This has created divisions between inner commuter zones, outer commuter zones and the rest of the UK, creating an urban-rural price gap within the commuter zone.

The next five years

Over the next five years, we expect to see a more widespread recovery as London-generated equity flows out. During this phase, we expect the ripple effect to follow the geographical distinctions already in evidence.

The uber towns are expected to be the greatest beneficiary of this ripple. We expect improved market conditions to feed first into the prime markets of the South East and other core prime markets beyond.

This improvement will filter across Britain, a process that is likely to be quicker in prime than in the mainstream market, given a lesser reliance on mortgage finance. As a result, prime markets will respond more quickly to economic improvements.

The key questions are what will trigger the flow of equity through the market and when. The current value differentials across the market suggest the platform is there; it is an improvement in sentiment that is now needed.
Market forecasts

HOUSE PRICES, 2013-2017

PRIME MARKETS
Five-year forecast values

<table>
<thead>
<tr>
<th></th>
<th>Actual</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>Central London</td>
<td>4.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Outer Prime London</td>
<td>3.5%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Prime Suburbs</td>
<td>-0.5%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Inner Commute</td>
<td>0.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Outer Commute</td>
<td>-2.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Wider South of England</td>
<td>-2.5%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>Mids North &amp; Wales</td>
<td>-3.0%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Scotland</td>
<td>-4.0%</td>
<td>-2.0%</td>
</tr>
</tbody>
</table>

Source: Savills Research

Five year change to end 2017

Prime market outlook

The prime central London market faces a number of short term challenges. First, an increased tax burden needs to be absorbed. Second, economic forecasts, and therefore the potential for wealth generation, have been reduced not only in Eastern and Western Europe but also in areas of emerging demand through Asia. This is likely to result in a period of static prices (though records will doubtless continue to be set in the ultra prime sector) before a return to price growth as the fundamentals of demand are restored from mid 2014.

We expect this to trigger a ripple effect through the prime regional markets as domestic buyers exploit the price differential compared to London, at a time when underlying economic conditions have improved.

“The prime central London market faces a number of short-term challenges”

Yolande Barnes, Savills Research
### MAINSTREAM MARKETS

**Five-year forecast values**

<table>
<thead>
<tr>
<th>Region</th>
<th>Actual</th>
<th>Forecast</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>5yrs to end 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK</strong></td>
<td>-2.0%</td>
<td>0.5%</td>
<td>1.5%</td>
<td>2.0%</td>
<td>3.5%</td>
<td>3.5%</td>
<td>11.5%</td>
<td></td>
</tr>
<tr>
<td><strong>London</strong></td>
<td>-0.5%</td>
<td>1.5%</td>
<td>4.0%</td>
<td>4.5%</td>
<td>5.0%</td>
<td>4.5%</td>
<td>21.0%</td>
<td></td>
</tr>
<tr>
<td><strong>South East</strong></td>
<td>-1.0%</td>
<td>1.5%</td>
<td>3.5%</td>
<td>4.0%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>19.5%</td>
<td></td>
</tr>
<tr>
<td><strong>South West</strong></td>
<td>-1.5%</td>
<td>1.0%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>4.0%</td>
<td>4.0%</td>
<td>15.5%</td>
<td></td>
</tr>
<tr>
<td><strong>East</strong></td>
<td>-1.0%</td>
<td>1.0%</td>
<td>3.0%</td>
<td>3.5%</td>
<td>4.5%</td>
<td>4.0%</td>
<td>17.0%</td>
<td></td>
</tr>
<tr>
<td><strong>East Midlands</strong></td>
<td>-1.5%</td>
<td>0.5%</td>
<td>2.0%</td>
<td>2.5%</td>
<td>4.0%</td>
<td>3.5%</td>
<td>13.0%</td>
<td></td>
</tr>
<tr>
<td><strong>West Midlands</strong></td>
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<td>0.5%</td>
<td>1.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>7.5%</td>
<td></td>
</tr>
<tr>
<td><strong>North East</strong></td>
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<td>-0.5%</td>
<td>-0.5%</td>
<td>0.0%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>4.5%</td>
<td></td>
</tr>
<tr>
<td><strong>North West</strong></td>
<td>-3.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.5%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>6.0%</td>
<td></td>
</tr>
<tr>
<td><strong>Yorks &amp; Humber</strong></td>
<td>-3.0%</td>
<td>0.0%</td>
<td>-0.5%</td>
<td>0.5%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>5.5%</td>
<td></td>
</tr>
<tr>
<td><strong>Wales</strong></td>
<td>-2.0%</td>
<td>0.5%</td>
<td>1.5%</td>
<td>2.0%</td>
<td>3.5%</td>
<td>3.5%</td>
<td>11.5%</td>
<td></td>
</tr>
<tr>
<td><strong>Scotland</strong></td>
<td>-4.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.5%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>6.0%</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Savills Research forecasts based on Nationwide actuals*

### Five year change to end 2017

- **Scotland**: 6%
- **North East**: 6%
- **North West**: 4.5%
- **Yorkshire & Humber**: 5.5%
- **South West**: 15.5%
- **South East**: 19.5%
- **London**: 21%
- **West Midlands**: 7.5%
- **East Midlands**: 13%
- **East**: 17%
- **Wales**: 11.5%

### Mainstream view

Though it is five years since the onset of the credit crunch, its legacy will continue to shape the housing market in the next five years.

First, it sets the economic backdrop. The resulting weak economic recovery provides few drivers for national house price growth, and low interest rates (even accounting for high lenders’ margins) limit pressure for house price falls.

It also influences patterns of prospective house price movements, whether between different locations or tiers of the market. We have been left with a much lower transaction market in which the distribution of equity and economic growth will combine, widening the gap between the traditional market leaders and laggards.

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“The legacy of the credit crunch will continue to shape the market”

Lucian Cook, Savills Research

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Five year house price growth key:
- ⬤ 4% to 10%
- ⬤ 10% to 15%
- ⬤ 15% to 20%
- ⬤ 20% to 25%
The payment of rent rather than mortgage interest is now the focus for many ‘Generation Rent’ households unable to raise the capital needed for a mortgage down payment.

**Supply and demand**
Since the credit crunch, the laws of supply and demand have driven rental growth despite a weak economic recovery. Low levels of residential investment activity mean the supply of rental accommodation has not kept pace with rising demand, particularly in employment hotspots.

On the supply side, the high capital values set by owner-occupiers have kept yields low, deterring income-seeking investors. Low levels of housing development, and a focus on building for more mature owner-occupier households, have reduced flows of new lettable stock.

On the demand side, there is a long term growth trend in the numbers and concentration of 20-34 year olds living in major cities, while the inaccessibility of mortgage finance means the number of those trapped in renting has increased sharply over the past five years (for details on London see Graph 5.2).

Political and business will is now undoubtedly focused on boosting organised and large-scale investment in residential property, but it will take time for targeted build-to-let schemes to make a significant difference to stock levels.

**Words by Yolande Barnes**

### RENTAL GROWTH
Five-year forecast values

<table>
<thead>
<tr>
<th>Rental Growth</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>5 years to end 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Mainstream</td>
<td>2.5%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>18.2%</td>
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<td>Greater London</td>
<td>3.0%</td>
<td>4.0%</td>
<td>4.5%</td>
<td>6.0%</td>
<td>6.5%</td>
<td>26.4%</td>
</tr>
<tr>
<td>Prime Central London</td>
<td>3.0%</td>
<td>5.0%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>24.0%</td>
</tr>
</tbody>
</table>

Data source: Savills Research

**GRAPH 5.1**

**Growth in asking rents** September 2011-12

![Graph showing rental growth](source)

*London asking rents inflated by temporary effect of Olympic short term lets
Meanwhile, the activity of private individuals – the biggest landlord group in the western world – is restricted by a lack of debt funding, leaving the sector reliant on equity-rich individuals and, ultimately, income-seeking organisations to provide stock. Against this context, a slow recovery in mortgage lending will only serve to increase demand.

Rents and incomes
The demand/supply imbalance has inevitably pushed up rents. The key question now is the extent to which rent rises can continue without stretching affordability to breaking point.

Given our robust forecasts for rental growth, price falls will only occur if investors are no longer willing to accept current yields. Gross yields average 6.7% for one bedroom properties and 6.1% for two bedroom properties, looking increasingly attractive against savings rates. Such yields will put a floor under residential real estate values and confound the sceptics who believe that UK house prices will suffer a significant double dip in nominal terms.

What are best investment prospects?
Our forecasts suggest the best medium term investment prospects are in urban areas in London and the South East where there is a growing population in the 20-34 age bracket and an under supply of rental stock. These markets have seen the strongest levels of both rental growth and capital growth. Looking forward they offer the prospect of a balance between income yields and capital growth.

In London alone – the real pressure cooker of demand – the number of households in the private rented sector has risen by 90% over the past 10 years, while the population of 20-34 year olds has grown by 18%. At the same time, the average first time buyer deposit has risen from £12,000 to £58,000.

In other markets, income yields are typically higher, but capital growth prospects lower. These offer a different type of investment opportunity, one that is likely to be based on longer term income streams.

What are the challenges for policymakers?
One of the biggest challenges the government faces is how to meet the housing needs of Generation Rent. The DCLG, the government department responsible for housing policy, has recently opened a consultation on the regulatory requirements in the rental sector.

There is a real need to address the issues causing concern (such as tenant choice and rental affordability), rather than their symptoms. Realistically, this means more investment from institutions is needed to deliver substantially increased levels of supply. This will require incentives to encourage the provision of well-managed, affordable rental accommodation.

For more detailed analysis see our documents, Special Report: Rental Britain (March 2012), and Spotlight: Rental Britain as an Asset Class (September 2012)
Jim Ward assesses the prospects for housebuilding

What is happening in the residential development market?

Overall levels of housebuilding activity remain low, with starts at less than 55% of pre-downturn levels in England, Scotland and Wales. The market is ticking along, with value growth during the third quarter of 2012 of 0.7% for greenfield and 0.4% for urban land, excluding London where values are up 4.6% over six months.

So why are housebuilders reporting record increases in profit?

Housebuilder margins are recovering after the disastrous downturn of 2009. The major housebuilders have recapitalised and are building out sites acquired at or written down to lower values. Land acquisition and development is now structured to create early cash flow and margin on scarce capital.

Is the problem the planning system, or is it demand?

The primary problem is scarcity of finance, or is it demand? Is the problem the planning system, margin on scarce capital. structured to create early cash flow and acquisition and development is now

Will the government’s measures to boost housebuilding have any impact?

Some of the measures, targeted at getting first time buyers on the housing ladder and providing development funding, have a proven track record and will add to delivery.

The government’s Funding for Lending scheme (FLS) seems to be the one to watch. Although opinion is split on whether this will improve mortgage volumes, it appears to be pushing down the cost of mortgage lending through the government-backed NewBuy scheme.

Bank of England survey data indicates further improvements in the cost and availability of mortgages as a result of FLS, although wider opinion in the financial sector seems to be split on whether FLS will lead to an increase in mortgage volumes.

Moves by the Financial Services Authority to loosen capital ratio rules, as they apply to FLS lending, could be helpful.

With these measures in place, the prospects for an upturn in active demand for new homes in 2013 are significant. This is reinforced by the consensus view that economic growth will pick up in 2013, provided it is not blown off course by headwinds from the eurozone, China or the US.

If the prospects are positive, why renegotiate planning obligations?

The National Planning Policy Framework is clear that planning obligations should allow for a competitive return to both developer and landowner. Where existing Section 106 agreements suppress land value to below a viable level, renegotiation will unlock activity and growth.

How much growth will come from increased housebuilding?

Analysis completed by Oxford Economics in 2010 indicated that building an extra 100,000 homes per annum would add 1% to GDP after two years. This counts as a political imperative to increase levels of housebuilding, alongside the economic and social case to fix the country’s long running shortfall of new homes.

For more detailed analysis see our document, Spotlight: London’s Housing Supply (July 2012)
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