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Spotlight
Prime Rental Markets

January 2014

SUMMARY

Across the prime residential market, rents have shown little growth over the past two years

- Rental values across prime London saw a marginal increase of 0.5% over 2013, reflecting an increase in available stock rather than falling demand.
- The best performing prime location in terms of rental growth is the suburbs. This is driven by a high number of tenants moving out from London.
- Rental growth is forecast to return to the prime London market in 2014, albeit slowly.

TABLE 1

Prime rental movements to Q4 2013

	All Prime London	Prime Central London	Prime North West London	Prime South West London	Prime North London	Prime East of City	Prime Commuter Zone
Q on Q	-0.5%	-0.8%	-0.1%	-0.8%	1.3%	0.8%	-2.1%
Y on Y	0.5%	-1.8%	-1.3%	1.7%	-0.4%	1.8%	1.4%
Since Peak	-1.7%	-5.2%	-9.3%	1.3%	-4.1%	4.9%	-5.1%
£ per sq ft	£41	£61	£43	£29	£34	£33	£16

Source: Savills Research

Over the past two years, rents have shown little growth across the prime residential markets. Rental growth in prime commuter locations, although not dramatic, has been higher than in prime London over this period. Average rents have risen by 4.7% in the commuter zones despite rental values experiencing a seasonal fall of -2.1% in the past three months. In comparison, London rents are up 1.2% over the same two year period.

Over the longer term, rental values in prime commuter locations are on average still -5.3% below their 2008 peak. However, in prime London, rental values are closer to their peak at just -1.7% below, which is a result of the relatively strong recovery in 2010. This was underpinned by a lack of available rental stock which is no longer evident.

Prime London

Rental values across prime London saw a marginal increase of 0.5% over 2013, continuing a period of lacklustre rental growth. This reflects an increase in available stock rather than falling demand. Consequently, the market remains active without landlords being able to dictate rental values.

This increase in competing supply has been particularly evident in central London, reflecting an increasing level of overseas investment. In 2013, 30% of landlords bringing stock to the market in prime central London were from overseas, compared to 19% in 2012.

We expect overseas investors to remain a force in the market, despite the recent announcement that capital gains tax will apply to non-resident investors. Particularly given that the tax will apply on future gains from April 2015.

This means that there will be no mass sell-off as foreigners look to crystallise past gains. It also seems unlikely that it will deter future overseas investors for whom the benefits of investment in London property are manifold.

In fact, even with capital gains tax, London still looks competitive on the international stage as Table 2 details.

Against this context, relocation budgets have fallen over the past year with the average budget in 2013 for a 2 bed and a 4 bed now -4.9% and -12.1% lower than in 2012 respectively.

Consequently, the largest rental falls have been seen in the higher value areas of prime central and prime north west London which achieve an average rent per square foot of £61 and £43 respectively.

Locations beyond the core central areas have seen stronger growth as tenants are looking for value and are increasingly willing to expand their search to locations they had not previously considered. The strongest rental growth over 2013 was seen by prime flats in the south west and the east of City.

TABLE 2

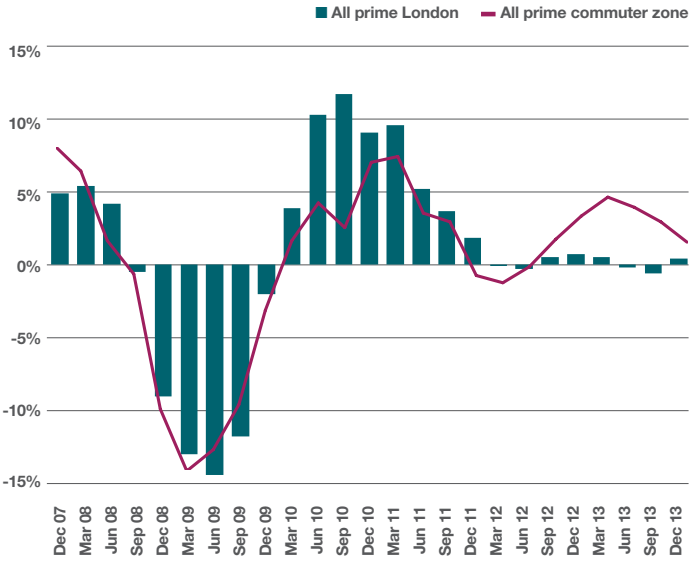
Cost of buying, occupying and selling £2m property
(% of total value, overseas buyer holding for five years)

	London	London (with CGT)	New York	Hong Kong	Singapore
To Buy	5.3%	5.3%	1.4%	24.7%	18.0%
To Occupy	0.5%	0.5%	9.3%	0.6%	0.8%
To Sell	1.5%	6.7%	7.4%	1.2%	1.0%
Total	7.4%	12.6%	18.1%	26.5%	19.8%

Source: Savills Research

GRAPH 1

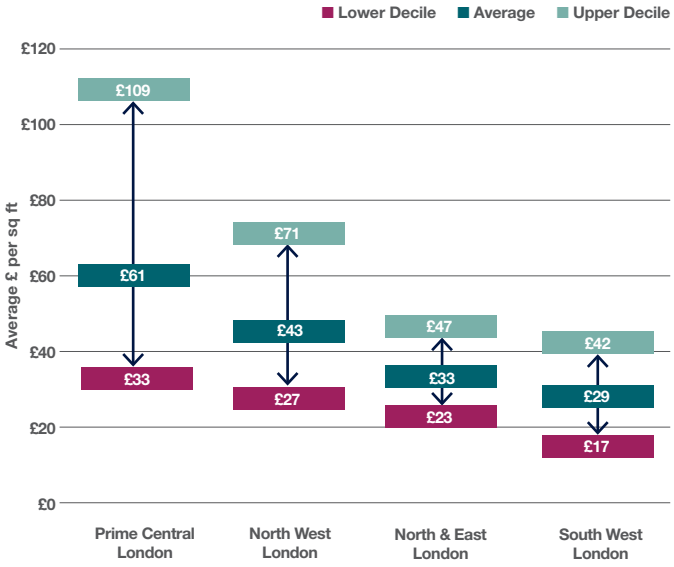
Annual prime rental movements



Source: Savills Research

GRAPH 2

Rent per square foot Prime London



Source: Savills Research

Renting in the prime commuter zone

The London suburbs prove to be the best performing prime location

The prime rental market

Beyond London, the prime rental market is largely confined to the high value suburban markets such as Elmbridge, Rickmansworth and Northwood, and areas within a 30 minute commute to London such as Sevenoaks, Guildford and Beaconsfield. Beyond that, the prime rental market only extends to specific high value urban markets such as Cambridge, Winchester and Oxford.

These markets are able to draw on a pool of demand from those relocating from London and/or commuting on a regular basis. They also attract international tenants in a way that other prime markets beyond those locations cannot.

This is reflected in the rental values commanded by these markets. Prime rental levels vary from an average of £18 per square foot in prime suburbs, to £14 per square foot in the outer commuter zone (around an hour from London). In locations such as Elmbridge, this figure can be as high at £20 per square foot with exceptional properties achieving £30 per square foot.

Recent rental growth

The best performing prime location in terms of rental growth is the suburbs, driven by a high number of tenants moving out from London. Over the past year, rental values have increased by an average of 4.5% and are now 1.3% above their 2008 peak.

The inner commute is a more varied picture. Annual rental value movements range from +8% to -8% depending on a number of local factors. Good schools play a significant role in rental values, as does proximity to public transport and the London station they connect to, which can impact different employment markets.

A higher proportion of tenants in these markets are moving from within the local area when compared to the suburbs. Nonetheless, tenants relocating from London still play an important role in this market, accounting for 23% of the total.

Further out in the commuter zone, the picture is more consistent, with rents increasing by 2.9% over the past 12 months and the highest growth seen in the urban locations. A similar trend of outperformance is seen in the sales market, indicating demand in these locations from potential buyers new to the area who want to 'try before they buy' and rent first.

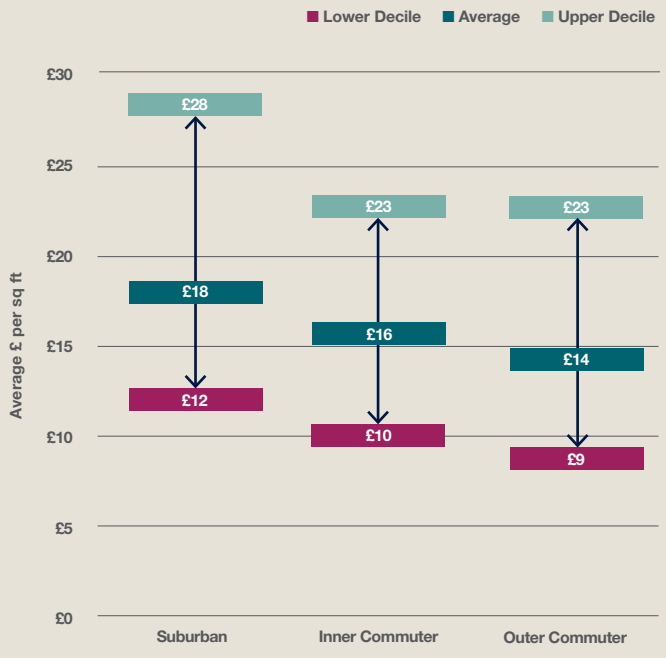
It is perhaps surprising in these prime locations that there is increasing demand from international tenants, who account for 28% of the market; this is up from 21% in 2012. North Americans are the largest international tenant group, accounting for 10% of the overall market and yet they rarely go on to buy in the UK, preferring to stick to the rental market.

Size matters

There is a clear correlation between size and rental growth. Since the peak of the prime rental market in 2008, 3 bed properties have seen the strongest growth with average rental values across the prime commuter zone now just -1.7% below their peak.

GRAPH 3

Rent per square foot Prime Commuter Zone



Source: Savills Research

TABLE 3

Profile of tenants

Prime Rental Location	International tenants	Tenants moving from London
Suburban	36%	32%
Inner Commuter	25%	23%
Outer Commuter	28%	17%

Source: Savills Research

TABLE 4

Prime rental movements by bedroom number

Rental Values in the Commuter Zone	Y on Y	Since 08 Peak
or	3.5%	-5.6%
	2.2%	-1.7%
	1.9%	-3.8%
	0.9%	-7.0%
+	0.5%	-5.4%

Source: Savills Research

TABLE 5

Five-year rental forecasts

Forecasts	2014	2015	2016	2017	2018	5 years to end 2018
UK Mainstream	2.0%	2.5%	4.0%	5.5%	5.5%	21.0%
London Mainstream	3.5%	3.5%	4.5%	6.0%	6.0%	25.8%
Prime London	2.5%	3.0%	4.5%	4.5%	4.5%	20.4%

Source: Savills Research

Forecasts

Across the UK, the private rented sector grew by some two million households in the decade to 2011. The largest growth was in the period since 2007 due to constrained mortgage availability.

Over the past few years, the government has introduced several initiatives to support home ownership, most notably the Help to Buy scheme. Yet, despite this, we expect the sector to grow by a further one million households in the next five years.

This increase in demand in the mainstream private rented sector has not been met with a similar increase in the supply of rental properties. This has resulted in rents being pushed up.

In the mainstream markets, supply is likely to remain constrained, but less so in the more valuable markets which is where new activity is concentrated and where overseas investors are particularly active.

Over 2013 we saw marginal rental growth in prime London but, given the recent increase in applicants and improved outlook and prospects for the economy, we expect this to pick up in 2014. From 2016 onwards we anticipate rental growth to be increasing by 4.5% per year.

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Lucian Cook, Savills Research

Residential Research

Lucian Cook
UK Residential
020 7016 3837
lcook@savills.com
Twitter: @LucianCook

Sophie Chick
Associate
020 7016 3786
schick@savills.com

Kirsty Lemond
Analyst
020 7016 3836
klemond@savills.com

Savills Lettings

Jane Ingram
Head of Lettings
020 7824 9048
jingram@savills.com