savills

Market in Minutes
Prime London Rental Markets

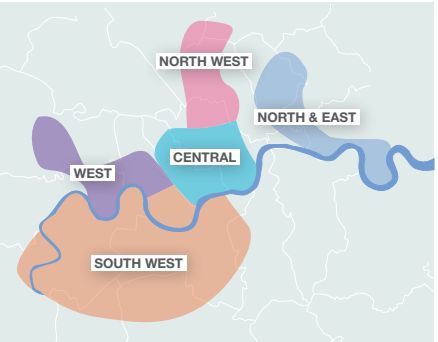
Q1 2016

SUMMARY

Negative annual rental growth figures are masked by some important variances

FIGURE 1

Price movements in prime London rental markets to Q1 2016



	Prime Central	Prime North West	Prime South West	Prime West	Prime North and East	All Prime London
Quarterly	-0.7%	1.1%	-0.1%	-0.1%	0.0%	-0.1%
Annual	-2.0%	1.4%	-1.4%	-1.3%	2.1%	-0.8%
Past 5 Years	3.0%	-5.5%	3.9%	N/A	8.9%	2.0%

Source: Savills Research

In the prime residential markets of London annual rental growth slipped into negative territory for the first time in two years at the end of the first quarter of 2016.

This means prime rental values in London have risen by a meagre 2% in total over the past five years.

Rental growth

However, this overall average hides some important variances. Smaller less expensive properties have generally performed much more strongly, with one and two bedroom properties showing total five year rental growth of 8.2% and 5.0% respectively. Consequently, while the market for properties between £500 and £750 per week has shown five year rental growth of 6.8%, those over £1,500 per week have seen rents fall back by -5.2% over the same period.

In part, this reflects differences in demand profiles, with needs based domestic tenants more prevalent in the lower price bands. Furthermore, those tenants tend to have a wider employment base being less dependent on the financial and business services sector.

More generally, the modest rental growth seen reflects the amount of competing supply across the prime London market, given the level of investment buying activity seen across both the second hand and new build sectors.

Investment stampede?

There has been much media attention on the surge in investor buying activity prior to the introduction of the 3% additional stamp duty surcharge that came into effect on 1st April. Indeed, across the UK as a whole, figures from the Council for Mortgage Lenders suggest that the number of mortgages completed for the purchase of buy to let properties in the first two months of this year were 26% and 28% higher than in the same two months of 2015 and 2014, respectively.

In the prime London market, investors and those buying property to redevelop accounted for 19% of the market in the first quarter of 2016 up from 13% in Q1 2015. However, this should be set against the context of a relatively subdued market, given the underlying caution regarding Brexit and the already high levels of stamp duty on the most expensive property.

Such buying activity was most heavily concentrated in the market between £500k and £1m, where investors and developers accounted for one in three purchasers of prime property. This reflects not just the better rental performance of these properties but also the higher income yield returns available and the lower tax costs on acquisition.

> "Smaller less expensive properties have performed much more strongly, with one bed properties showing five year rental growth of 8.2%"
> Savills Research

2%
Rise in prime rental values in London over the past five years

6.8%
Five-year rental growth of properties between £500 and £750 per week

19%
Percentage of buyers purchasing for investment purposes in Q1 2016

Policy implications

The imposition of the additional 3% stamp duty is just one of a series of measures introduced by the current government to temper investment in the residential sector. In our last Prime Rental Spotlight (Q4 2015) we looked at the potential impact of the progressive reduction in the tax relief available on mortgage payments, noting that while this would limit the ability of those with recourse to debt to expand their portfolios, it would not affect the high proportion of cash investors in the prime London market.

In the March 2016 budget, residential investments were specifically excluded from the cut in the rate of capital gains tax from 28% to 20%. A measure that, like the stamp duty surcharge, was intended to have an impact across a wider range of investors.

Such tax measures have been introduced in the absence of mortgage regulation akin to that introduced for home buyers in April 2014. However, with the Bank of England keeping a close eye on the buy to let sector, it was always envisaged that such regulation would come in due course.

The first concrete proposal for that regulation was announced in a consultation paper published in March. It makes provision for all mortgage lenders to adopt an affordability test when assessing prospective buy to let lending – accounting for all income and outgoings relating to the property and the other net income of the prospective borrower – that is stress tested having regard to interest expectations over a minimum five year period.

FIGURE 2

Prime rental markets: Five-year forecast values

	2016	2017	2018	2019	2020	5-year
Prime London	2.0%	2.0%	2.5%	3.0%	3.0%	13.1%

Source: Savills Research

OUTLOOK

New policy will affect private investors with a mortgage

Although we expect these measures to have greater impact in the more debt-driven mainstream residential investment markets, they are expected to temper future investment in the prime residential markets most notably among those private investors with a mortgage. Nonetheless, we expect continued demand from those cash investors attracted to the long term security offered by prime London residential assets.

Against this context, while we expect strong continued rental demand from young affluent households facing a significant deposit hurdle to buy their first home, the strength of rental demand from other tenant groups will be more dependent on London's performance as a global centre of commerce.

In the March 2016 budget, residential investments were excluded from the cut in the rate of capital gains tax

It is proposed that all mortgage lenders adopt an affordability test when assessing prospective buy to let lending

Savills Research team

Please contact us for further information

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

Sophie Chick
UK Residential
020 7016 3786
schick@savills.com

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