savills

Market in Minutes
Prime Rental Markets in the Commuter Belt

Q1 2016

SUMMARY

Smaller properties continue to see the strongest rental growth

- Strong demand for smaller properties continues as tenants are faced with the issue of raising the deposit for their first mortgage.
- Landlords have been hit with a number of measures introduced by the current government in an attempt to limit future investment in the residential sector.
- We expect these measures to limit the amount of stock which comes onto the rental market, underpinning the growth in rents for existing investors.

FIGURE 1

Prime Rental Movements to Q1 2016

No. of bedrooms	Average Annual Rent	Annual Rental Growth	5 Year Rental Growth
1 or 2	£17,600	2.5%	12.3%
3	£24,300	2.8%	12.3%
4	£38,300	1.6%	9.0%
5	£54,100	0.9%	5.5%
6+	£78,700	0.5%	4.0%

Source: Savills Research

Rental values of prime property in the commuter zone increased by an average of 1.4% over the year to March 2016 to bring five year rental growth up to 7.6%, reflecting the continuation of modest but consistent rental growth in the period since mid June 2012.

Small is beautiful

Smaller properties of three or fewer bedrooms continue to see the strongest rental growth, with the average rent having risen by 2.7% in the past year and 12.3% over the past five years.

The strength in demand for one and two bedroom accommodation reflects the age profile of the tenants in this sector – with one third of tenants being in their 20s and a further 35% in their 30s – and their personal and financial circumstances. Such tenants face well documented issues in raising the deposit for their first mortgage but are also increasingly attracted by the flexibility of renting given an increasing propensity to move jobs in the first half of their working life.

With such tenants renting for longer life stages, this has fed into more demand for small family accommodation for tenants in their thirties and early forties.

Markets for these smaller properties are generally serviced by Landlords with a strong investment motive for the purchase and ownership of their rental property. By contrast, Landlords of larger prime rental properties are more likely to be letting out a dwelling which has previously been their main residence.

Our research shows that 39% of Landlords of properties of five bedrooms or more are letting their property out because either they are relocating for employment purposes or are unable to sell their main home. Landlords of such properties have only seen rents rise by a net figure of 4.0% over the past five years, and a meagre 0.5% in the past 12 months.

Regulation & Legislation

Going forward all Landlords will have to contend with a series of government measures to limit future investment in the residential sector and by the Bank of England to ensure lending in the sector does not leave mortgage providers unduly exposed.

Recent headlines have focused on the short term effects of the increase in stamp duty for those buying additional homes. 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, as investors have sought to beat the 1st April tax deadline.

Higher transactional costs post 1st April are likely to temper future investor activity, particularly given that residential investments were specifically excluded from the cut in the rate of capital gains tax from 28% to 20% in the March 2016 budget. They are also likely to deter accidental Landlords, (despite some provisions in the stamp duty proposals and existing capital gains tax legislation to protect their position).

Investors reliant on mortgage debt will be further impacted by the progressive reduction in the tax relief available on mortgage payments. This will take on added significance for those looking to expand their portfolios given recent proposals for the Bank of England to introduce greater mortgage regulation to the buy to let sector.

These regulatory proposals make provision for all mortgage lenders to adopt an affordability test when assessing prospective buy to let lending to account for all income and outgoings relating to the property (including tax) together with the other net income of the prospective borrower. Echoing the regulatory measures put in place for owner occupiers, that affordability will then be stress tested against the prospect of interest rate rises over the following five years.

LOOKING FORWARD

We expect these measures to limit the amount of new rental stock which comes to the market, underpinning rental growth for existing investors.

We expect the demand to continue to be stronger for smaller prime rental properties in the suburbs and key commuter locations of the capital, driven by professional couples and young families who aren't yet ready to buy or who are working on a 'try before you buy' basis.

Despite early indications of renewed relocation activity, a true indication of the strength of demand for larger properties will only be given in the summer months, as families look to rent larger properties in preparation for the start of the school year in September.

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