

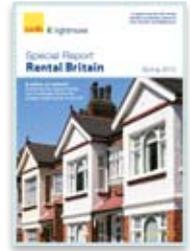
# Special Report **Rental Britain**

Spring 2012

## **A nation of renters?**

Examining the opportunities and challenges facing the private rented sector in the UK





# Special Report Rental Britain

The UK's private rented sector has witnessed a fundamental shift over the past five years. But what are the implications for future generations?

## Introduction

The private rented sector is an important sector and a major challenge for the UK's housing industry, but while house price information is available in abundance, information regarding rental demand, rents, their affordability, and investment returns across the UK is relatively limited.

This report seeks to fill this knowledge gap and combines research from Savills, a major real estate service provider for the rental property sector, and Rightmove, the UK's leading online destination for rental property.

Britons are rapidly returning to renting their homes in a phenomenon that has been dubbed 'generation rent'. But a more fundamental shift is happening that will have an impact beyond a single generation and change the nature of our nation of home owners.

By the end of 2011 the total value of private rented stock in the UK had reached £840 billion having risen by 42% in just five years, and the number of private rented households had reached an estimated 4.8 million up

from 3.4 million just five years ago. As such private renting now accounts for just under one fifth of the total value of the housing stock of the UK.

The shift to private renting has accelerated since the credit crunch, thanks to constrained mortgage finance and the significant deposit hurdle for would-be home buyers. By 2016 we estimate that one in five households – or 5.9 million households in England will be renting in the private sector.

But how will the private rented sector meet this demand? £200 billion of investment is needed over the next five years but only £50 billion is expected to come from buy to let finance.

This report gives an overview of the sector, the risks and opportunities, we have examined the 30 largest rental markets outside of London and, given the diversity of the market in the capital itself, studied London at an individual borough level. In addition, we have drawn on existing data sources to look at rental demand and supply. →

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## → Summary of findings

Our main findings can be summarised as follows:

### The Growth in Private Renting

■ We estimate that Britons paid a total £48 billion in rent to private individuals and institutions in 2011 and forecast that this will rise to £70 billion within five years as rents and the amount of renting rises.

■ More households will be renting for longer as the social and demographic profile of renters changes. As renting becomes a way of life it will need to lose its stigma.

### Supply Challenges

■ £200 billion of investment is needed over the next five years to meet demand for private renting. But constrained levels of buy to let lending and house building raise issues over the ability to meet this demand. We forecast that only £50 billion will come from buy to let mortgages.

■ Rental growth and modest improvements to income yields are beginning to change investor behaviour, though low income yields remain the biggest barrier to long term investment.

### Rents and Affordability

■ Rental levels vary dramatically across the UK. A two bedroom property in London varies from £9,980 a year (£830 pcm) in Bexley to £48,230 (£4,020 pcm) in Kensington and Chelsea. Analysis of the 30 largest rental markets outside of London reveals extremes – from £5,650 (£470 pcm) in Bradford to £15,800 (£1,315 pcm) in suburban Surrey (Elmbridge).

■ Affordability relative to income also varies dramatically. In London the average rent for a two bedroom

property averages 53% of the average single person's salary. In the North East it is 25%.

### The Need for Supply

■ Increased supply is critical to offering tenants more choice, raising the standard of private rented accommodation and addressing affordability issues affecting some markets. A comparison between Oxford and Milton Keynes illustrates this. In the former the average rent for a two bedroom property equates to 57% of the average salary, while in the latter it is 32%

■ Research from Rightmove indicates that 63% of current tenants expect rents to be higher in 12 months, illustrating that the shortage of supply is creating severe upwards rental pressure. This could lead to an overstretching of tenants' finances or a 'rental bubble' in some locations.

### Market Returns

■ Investment returns relative to other asset classes will dictate the pace of new investments into the market.

■ The average gross income yield across the UK is 5.8%, a figure that rises to 7.7% for investors able to secure discounts of bulk purchases.

■ Gross income yields are currently much higher for smaller properties where occupational demand is more heavily weighted to renting. The average gross income yield for a one bedroom property of 6.7% compares to 5.3% for a three bedroom property.

■ Headline yields for two bedroom property vary between 7.8% in the 10% of postcodes with the highest yields to 4.4% in the 10% of postcodes with the lowest yields.

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“In London the average rent for a two bedroom property averages 53% of the average single person's salary. In the North East it is 25%”

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■ Income yields do not vary significantly between regions although average yields in the South tend to be lower than North of the country. Yield variations are much more closely linked to localised differences between high and low value markets, particularly in London.

■ On the basis of Savills house price forecasts, we expect let residential property to deliver a total net return of just under 7% over the next 10 years (excluding costs of finance). Large scale investors should expect to receive higher returns.

■ Given relative capital growth prospects the best prospective returns over the next 10 years are expected in London (8.2%) and the South East (7.7%). Across the London boroughs forecasts for total net returns vary between 7.3% and 9.1%. Of the 30 largest rental markets outside of London we forecast that the best total returns over the next 10 years will be delivered by Reading, Woking, Milton Keynes and Elmbridge (Surrey).

### Looking Forward

■ Small private investors are likely to balance income yield and capital growth prospects, take a long term view on house prices and invest across the UK according to their means and time frames.

■ Larger institutional investment is critical to meeting the demand for private rented accommodation. In the short to medium term we expect it to be focused in London and the South East. This requires rental stock to be delivered by the new build market in volume at a discount to owner occupied values.

■ To facilitate this may require a change in the planning system, with private rented sector housing being increasingly interchangeable with affordable housing.



## A Market Mismatch

### Rising Demand & Trapped Renters

Over the course of 2011 the level of unmet demand for private renting continued to rise. Rightmove research shows that search activity has more than doubled over the past two years while available stock for rent is down by nearly 10%. Meanwhile the RICS reported letting activity outstripping new supply for 11 successive quarters to January 2012.

Demand for rental accommodation has been accelerated by the increasing inaccessibility of home ownership. Would-be first time buyers continue to find mortgage finance at high loan to value ratios all but non-existent and where available, lenders' margins are higher, meaning that it often remains cheaper for this group to rent.

In October 2011 Rightmove found that trapped renters, who state they would like to buy but cannot afford to, accounted for over half (55%) of the UK rental sector.

Despite the fact the English Housing survey suggests that over 50% of private renters are under the age of 35, over a quarter of these trapped renters were over the age of 40.

It seems inevitable that we will see a continuation of the structural shift towards renting over the next five years at least. It is equally inevitable that there will be more households renting and they will be renting for longer. Increased demand for private rented accommodation will include family housing.

In Rightmove's recent rental survey, 37% of tenants stated that they have been in their current property for five years or longer, while 22% expect to be renting for three years or longer.

"The profile of renters will change, with more affluent sections of society being forced or choosing to rent"

TABLE 1  
**Annual Growth in Asking rents to Q4 2011**

Region	%
London	7.2%
North East	5.9%
North West	4.5%
East Midlands	4.2%
East of England	3.9%
South East	3.3%
South West	2.6%
West Midlands	2.3%
Yorkshire and The Humber	1.2%
Scotland	0.5%
Wales	-3.6%
<b>UK</b>	<b>5.2%</b>

Table source: Rightmove/Savills

## Rental Demand Drivers

### Facts and figures

In the third quarter of 2007, gross mortgage lending at loan to values of more than 90% equalled £14.6 billion, in the third quarter of 2011 it was just one twentieth of that figure. (FSA)

The average deposit for a first time buyer in the UK currently stands at £26,000 up from £12,000 five years earlier. In London that average rises to some £58,000, with 71% of first time buyers requiring assistance from the bank of mum and dad to finance their purchase. (CML)

At the end of January 2012 the average discounted interest rate for a 90% LTV mortgage stood at 5.3%, compared to 3.2% for a 75% LTV product – an increased cost of some 65%. (Bank of England)

The profile of renters will change, with more affluent sections of society being forced or choosing to rent. Increased demand for private rented accommodation will include family housing.

Rental Britain needs to boost supply.

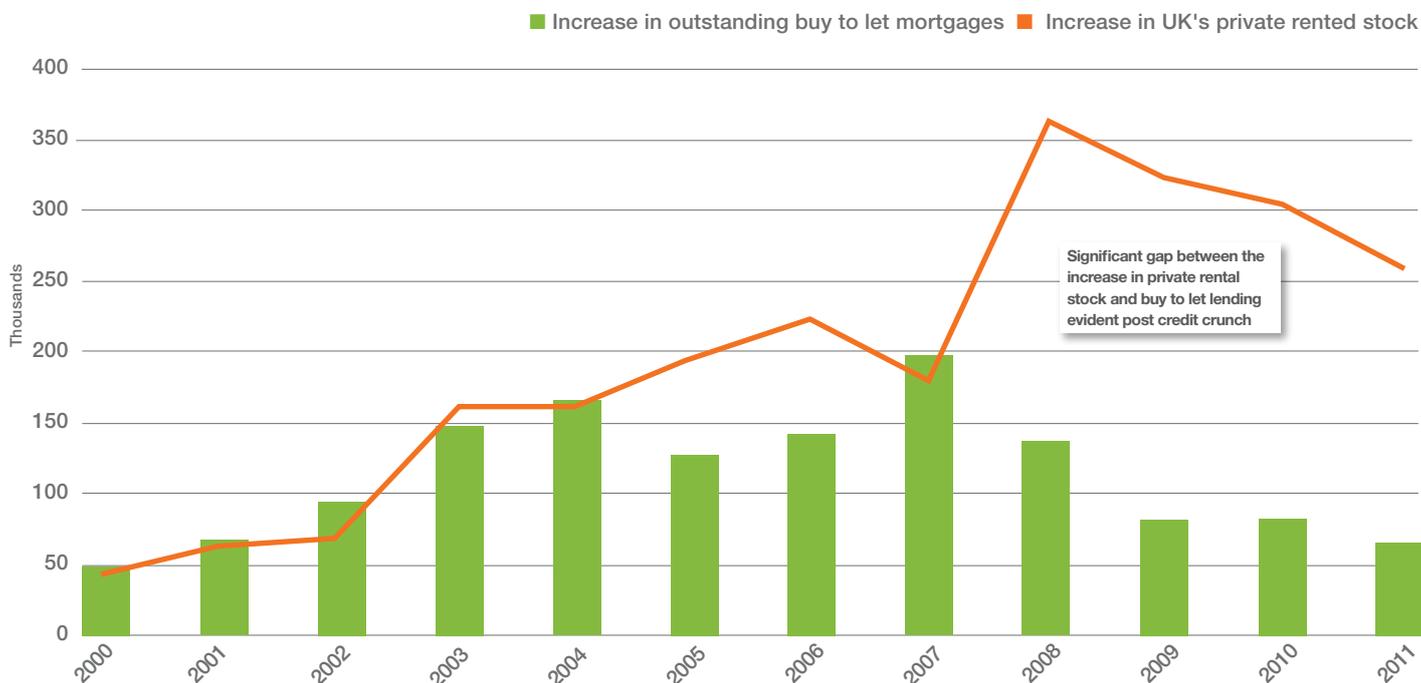
### Constrained Supply and Next Generation Landlords

Demand will undoubtedly continue to rise but the future supply of private rented sector accommodation is less secure. Until 2007 the rise in demand for private renting was broadly matched by debt-backed buy to let investment.

However, buy to let mortgage lending has fallen significantly post credit crunch and levels of private house building have fallen by 46% in England (source DCLG) bringing less new stock into the private rented sector.

Rightmove research illustrates that the gulf between rental demand, as measured by search activity, and supply, measured by available properties for rent, is at its highest level since April 2009.

GRAPH 1  
**Investors filling the gap left by the buy to let mortgage drought**



Graph source: Savills using CLG & CML data

So where will new rental stock come from and who will be the landlords of the future?

When the sales market faltered the accidental landlord brought supply to the market, but this is not a permanent solution. Attention has therefore turned to cash rich private investors, institutions and investment funds.

Whether private individuals or institutions, investors must understand the returns they can expect and the split between income and capital growth.

A slow recovery in the housing market, particularly in the lower tiers where owner occupier demand is weakest, suggests income will make a greater contribution to total returns in the medium term, although some investors remain motivated by capital growth.

**The importance of yields**

Despite strong total returns fuelled by historic house price growth, low income returns have been the Achilles heel in the residential investment proposition, but lower capital growth forecasts are now focusing attention on yields.

The mismatch between demand and supply in the rental sector has triggered sharp rent rises (5.2% nationally in

2011, 7.2% in London) and pushed out income yields, albeit slowly.

There is evidence that improved rental returns, combined with low returns on cash investments, is beginning to shift the perception of residential property as an investment class. In October 2011 a Rightmove survey found that 41% of existing residential investors saw attractive yields as their main reason for investing in property.

The Bank of England Credit Conditions Survey published in January 2012 reported increased demand for mortgage credit from buy to let investors, the only area of growth in the mortgage market.

Still we expect rental demand to continue to outstrip new rental supply and for rental growth to exceed capital growth over the next five years at a national level.

This is good news for investors but could place increased pressure on rental affordability. In some markets, particularly those dominated by tenants receiving housing benefit, this will temper rental growth prospects.

Against this context existing landlords, new investors and today's tenants critically need an understanding of rental levels, their affordability and their relationship with capital values.



## → Rental Levels & Affordability

### Rental Values

Average asking rents, like underlying house prices, vary significantly across Great Britain.

The variation in rental levels across London is particularly extreme, ranging from an average annual asking rent of £9,980 (£830 pcm) for a two bed property in Bexley to £48,230 (£4,020 pcm) in Kensington and Chelsea.

Beyond the capital there are a range of factors that dictate rentals at a local level, though proximity to London tends to equate to higher rents. In the South East, the average annual asking rent for a two bedroom property is over £10,300 (£860 pcm), while it is below £6,170 (£515 pcm) in North East.

### Regional rental markets

Across the 30 largest rental markets outside of London, two bedroom annual rents vary from £15,800 (£1,320 pcm) in Elmbridge to £5,670 (£470 pcm) in Bradford.

The five markets with the highest rental value (Elmbridge, Oxford, Brighton and Hove, Woking and Reading) are all located in the South East where the average two bedroom rental value exceeds £10,000 per annum in each. The five markets with the lowest rental value (Bradford, Kirklees, Warrington, Sheffield, Coventry) are all located in the Midlands and the North.

However, there are markets that do not follow the orthodoxy of a north-south divide. For example, the average rent for a two bedroom property in Manchester (£8,600 pa / £720 pcm), being 15% higher than in Leeds (£7,450 pa / £620 pcm), exceeds that of Medway and Colchester.

### Affordability issues

It is clear these disparities in rental values are not merely a function of different income levels. In October 2011 Shelter looked at affordability

## Rental Values at a Local Level

### Two bedroom property values show regional variances

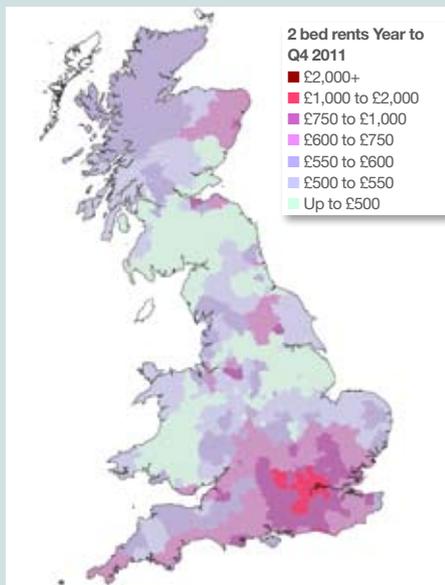
The highest and lowest value rental markets follow a familiar pattern. In the South East region the highest value rental market is Windsor and Maidenhead where the average rental value for a two bedroom property in 2011 of £16,170 per annum. This compares to an equivalent rent of £6,660 per annum in the cheapest local authority of Hastings.

As might be expected affluent locations beyond London including Brighton (£12,720 pa/£1,060 pcm), Bath (£10,190 pa/£850 pcm), St Albans

(£12,200 pa/£1,020 pcm), Poole (£9,600 pa/£800 pcm), York (£9,360 pa/£780pcm) and Chester (£8,090/pa/£675pcm) all have high rental values relative to those of their region. In Scotland, oil wealth means that two bedroom rents in Aberdeen are 6.8% higher than in Edinburgh.

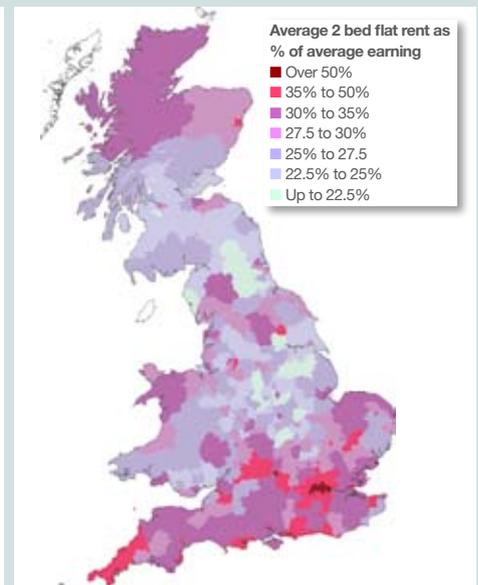
At the bottom of the scale Blaenau Gwent in South Wales is the cheapest rental market with the average rent for a two bedroom property just £4,560 per annum (£380 pcm) in 2011.

MAP 1



Map source: Rightmove/Savills

MAP 2



by comparing the median rent for a two bedroom property to median salary.

As the profile of the rental demand is shifting to increasingly affluent groups excluded from home ownership, so we expect rental affordability to be driven by mean rather than median incomes.

Accordingly, our preferred measure is to look at relative levels of rental

affordability by comparing mean average rents for two bedroom properties and mean average incomes.

As an average across the local authorities of Great Britain the average annual rent for such a property equates to 31% of the average local salary. In London the average rises 53% and across the South East it is 35%. By contrast, in the East Midlands and the North East the average is 25%, albeit actual disposable income levels are lower.

This demonstrates the extent to which demand for housing is met by existing supply within the private and social rented sectors is at least as important as affordability in setting rental levels.

"The five markets with the highest rental value are all located in the South East where the average two bedroom rental value exceeds £10,000 pa"

# Prime Rental Markets

## A different set of factors

Prime family rental markets are largely confined to London and the South East and in just 14% of all local authorities rents for properties with four or more bedrooms average more than £24,000 per annum (£2,000 per calendar month).

All are located in London or its immediate commuting hinterland with the exception of Poole, Castle Morpeth and the high value Cheshire markets (within the local authority of Macclesfield).

Prime markets for family housing are not driven by the same factors as the rest of the market. Savills research shows that an inability to buy is rarely a reason behind renting, accounting for just 8% of tenant demand in 2011. The main driver is relocation through employment (51%), supplemented by demand (25% of tenants) from those who have made a conscious decision not to buy.

Prime central London rental levels reflect the dominance of tenants employed in the financial and business services sector and demand from international tenants (some 45% of demand is from North American and Western Europe tenants) and are of a different order compared to the rest of the market.

Average asking rents for properties of four or more bedrooms in the central London boroughs of Kensington and Chelsea and Westminster average £130,200 (£10,850

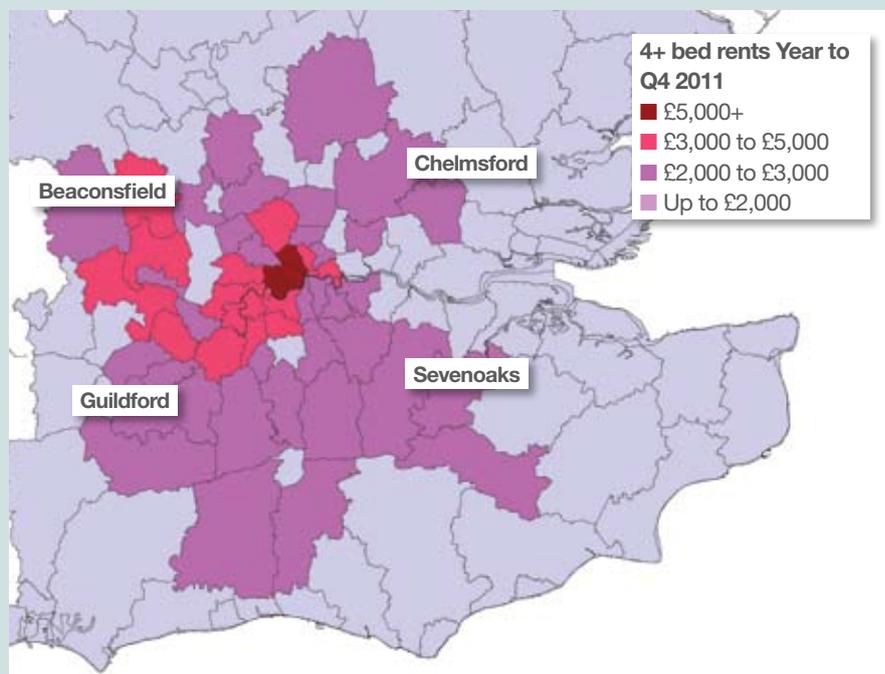
pcm) and £118,500 (£9,875 pcm) per annum respectively.

In Camden and Hammersmith and Fulham equivalent figures would be £73,000 (£6,080 pcm) and £64,300 per annum (£5,360 pcm).

Outside of the capital, the highest value prime rental market is that of Elmbridge, in suburban Surrey, where the average annual rent for a property of four or more bedrooms is £58,300 (£4,850 pcm). ■

MAP 3

### Average asking rents for properties of 4 or more bedrooms



Map source: Rightmove/Savills

→ It is clear there are affordability issues for those confined to the private rented sector in certain markets. These are not just restricted to the more expensive London boroughs. Oxford and Brighton & Hove are two classic examples. In these two markets, where demand clearly outstrips supply, the average rent

"Tenants will move to lower cost locations within a town or city and shared renting will become more common"

for a two bedroom property equates to 57% and 47% of average salary.

**With six out of ten tenants Rightmove surveyed forecasting that their rents will be higher in 12 months' time, the majority of landlords may be expecting the upwards spiral of rental returns to continue. However, in areas where rents are close to their affordability ceiling, landlords pushing for higher returns could end up with arrears and voids rather than a secure long-term income. Wise investment and realistic pricing, however, could deliver a win-win scenario of acceptable rental yields for landlords and a secure stream of tenants paying a sustainable rent.**

### Practical implications

Within these markets landlords face a trade off between maximising rents and maintaining a secure income stream. In some cases the pragmatic solution will be to rein back rental expectations to limit the risk of a default on rent and avoid the subsequent costs of recovering unpaid rent.

Some tenants will move to lower cost locations within a town or city and we believe shared renting, already common in London, will become more common as the most economical way for single people to rent. Across Britain average monthly rents per bedroom fall from £533 per bed for one bedroom properties to £349 per bed for two bedroom properties to £293 per bed for three bedroom properties. →

TABLE 2 **Average Rent for a 2 bed property as a % of Earnings ( Local Authority Level)**

Region	%
London	53%
South East	35%
South West	33%
East of England	32%
West Midlands	27%
Yorkshire and The Humber	27%
Wales	27%
North West	27%
Scotland	26%
East Midlands	25%
North East	25%

Table source: Rightmove/Savills/Oxford Economics

→ **Supply requirements**

Issues of rental affordability will only really be improved with a significant injection of new housing stock, particularly private rented housing, into the market. And what is clear is that so-called ‘accidental landlords’ and cash rich private investors will not supply new private rented stock in anything like the volumes needed.

There are examples of well supplied markets in the South East where rents, both prime and mainstream, are much more in line with the UK average in comparison to average salary. In Elmbridge in Surrey, the most expensive of our 30 markets outside of London, the average two bedroom rent is 35% of average salary.

Milton Keynes provides a very good example of a mainstream market where there is a healthy supply of new stock delivering greater rental affordability and here the average rent for a two bedroom property is 32% of average salary.

More supply, across all tenures, can ease rental pressure and will help to improve the quality of the private rented housing stock. According to the English Housing Survey over 37% of private rented dwellings failed to meet the decent homes standard in England in 2010.

Ultimately though, delivering that supply comes down to the investment credentials of residential rental markets. →

Of all purchasers intending to buy a property in the next 12 months, only 14% state they are a buy to let investor. This level has remained virtually unchanged from the 13% a year ago. This indicates that the private rented sector needs further encouragement if it is to deliver significantly more stock to the market.

"Milton Keynes provides a very good example of a mainstream market where there is a healthy supply of new stock delivering greater rental affordability"



## → Investment Returns

### Income yields

The UK average gross yield for let residential property is 5.8%. After costs and voids we would expect a typical private landlord to see net yields in the order of 4.1%.

Income yield is not just important to investors it can also inform those making the decision as to whether to rent or buy. It gives an indication as to the relative costs of servicing a mortgage against the cost of paying rent. A low yield typically indicates that, subject to an individual's precise mortgage requirement, renting will typically be the cheaper option.

The headline net yield has historically been a constraint on investment into the residential sector though against current bank deposit rates of 1.6%, even these yields look a relatively attractive proposition.

There are clear opportunities to improve on this headline return. Our analysis shows that there is substantial variation in gross income yields between property types and

“Income yield is not just important to investors it can also inform those making the decision as to whether to rent or buy”

between high and low value markets within individual locations.

Smaller units in the lower tiers of market, where tenant demand from singles and couples in earlier life stages is strongest, deliver much higher yields. The average gross yield for one bedroom properties stand at 6.7%.

Higher income yields can also be achieved by buying in lower value markets. To demonstrate this we have divided the country's postcode sectors into 10 equal sized groups by reference to the income yield delivered by a two bed property.

The highest yielding 10% postcode districts generate an average gross yield of 7.8%. In this group the average asking price of a two bed investment property is under £100,000.

By contrast in the lowest yielding postcode districts, where the average value of a two bedroom investment property is £326,000, the average gross yield is just 4.4%.

Yet, it is vital to understand local variations. A key finding of our research is that average income yields do not vary dramatically at a regional level or even local authority level, but are much more linked to localised differences between high and low value markets.

Across the UK as a whole, average gross income yields are in the range between 4.8% and 6.2% in three quarters of all local authorities.

Whilst the regions of the north offer marginally higher income yields, within each region there is a wide variation in income yield around the average. →

TABLE 3

### Average Yield by Bedroom Number (UK 2011)

Property Type	% all stock	% advertised stock	Gross Yields
	17%	22%	6.7%
	40%	41%	6.1%
	31%	22%	5.3%
	11%	15%	4.3%

Table source: Rightmove/Savills

→ The extremes are especially marked across inner London where the top 25% postcode districts provide an average yield of 7.0%, while the bottom 25% yield 3.9%. Here the distinction between high and low value markets is particularly marked.

In London postcodes where the average price for a two bedroom property is below £200,000 the average gross income yield is 6.2%. In areas where prices average £300,000 to £500,000 that yield falls to 4.7%. In the super prime areas where the average two bedroom property price exceeds £1.5 million that yield falls further to 3.3%.

In the North West, where the average gross income yield is higher at 6.3% for a two bedroom investment property, the top 25% postcode districts provide an average yield of 7.0%, whilst the bottom 25% yield 3.9%.

### Enhanced income returns

Large scale investors typically improve upon average income yields by acquiring bulk portfolios at a discount to vacant possession rates. A 25% discount would lift the average gross income yield from 5.8% to 7.7% across the UK as a whole and take gross income returns in the top 10% yielding post code districts to over 10% for two bedroom property.

TABLE 4

### Distribution of Gross Income Yields by Postcode District (2 bed property Q4 2011) Inverse relationship between house prices and yields

	Gross Income Yield	Average Capital Value
Top 10%	7.8%	94,044
2nd decile	6.9%	112,305
3rd decile	6.4%	118,796
4th decile	6.1%	125,004
5th decile	5.9%	144,885
6th decile	5.6%	151,385
7th decile	5.4%	176,564
8th decile	5.2%	184,642
9th decile	4.9%	197,224
Bottom 10%	4.4%	326,827

Table source: Rightmove/Savills

"At a national level, house price growth has historically significantly enhanced total returns in the residential investment sector"

### Total returns

Both investors and renters undoubtedly need to be mindful of the extent to which income yields vary across different segments of the market and the relationship this has with capital growth prospects.

This enables investors to look at total prospective investment returns. It enables would-be buyers to understand how much delaying the decision to buy will cost them both in terms of rent versus the cost of funding a mortgage and potential lost capital growth opportunity.

TABLE 5

### Indicative bulk investor gross income yields

All investment property	Gross Income Yield	
	Normal	Bulk Investor
UK average	5.8%	7.7%
Inner London	5.4%	7.2%
North West	6.3%	8.5%
2 bed properties	Normal	Bulk Investor
Top 10%	7.8%	10.3%
Bottom 10%	4.4%	5.8%

Table source: Rightmove/Savills

At a national level, house price growth has historically significantly enhanced total returns in the residential investment sector. Average house price growth equates to 6.7% per annum over the past 30 years, exceeding inflation by 2.8%.

Based on the Savills house price forecasts and assuming that landlords' costs account for 30% of gross rental income, we believe that the average annual total return for residential property across the UK will be around 6.9% over the next 10 years. This rises to 8.2% in London and 7.7% in the South East. Large scale investors should be able to achieve higher double digit returns in these locations.

Identifying markets that offer the best investment prospects is complex. It is not as simple as comparing gross →

→ average income yields of, say, less than 5.5% in Bristol and Brighton to yields of over 6.5% in Liverpool and Nottingham. As we have seen, each area will provide opportunities to deliver yields some way over the average. Equally there will be a trade off between income yields and capital growth prospects that will vary significantly between locations and, to a degree, property types.

Investors with a significant borrowing requirement are going to be attracted to higher income yielding markets to allow them to service debt. This may mean investors concentrate on one and two bedroom housing where yields are highest and the growth in demand for renting will be the most concentrated.

However there will be a place for larger housing within balanced portfolio not least to accommodate forecast rising demand for family accommodation. As people delay entry into the housing market, so there will be an increase in demand for rented family accommodation of three beds or more, that is expected to offer better capital growth prospects to offset lower income yields.



TABLE 6 **Historic Additional Returns from Capital Growth – UK Residential**

	Nominal	Real
10 years	5.9%	2.6%
20 years	5.8%	2.8%
30 years	6.7%	2.8%

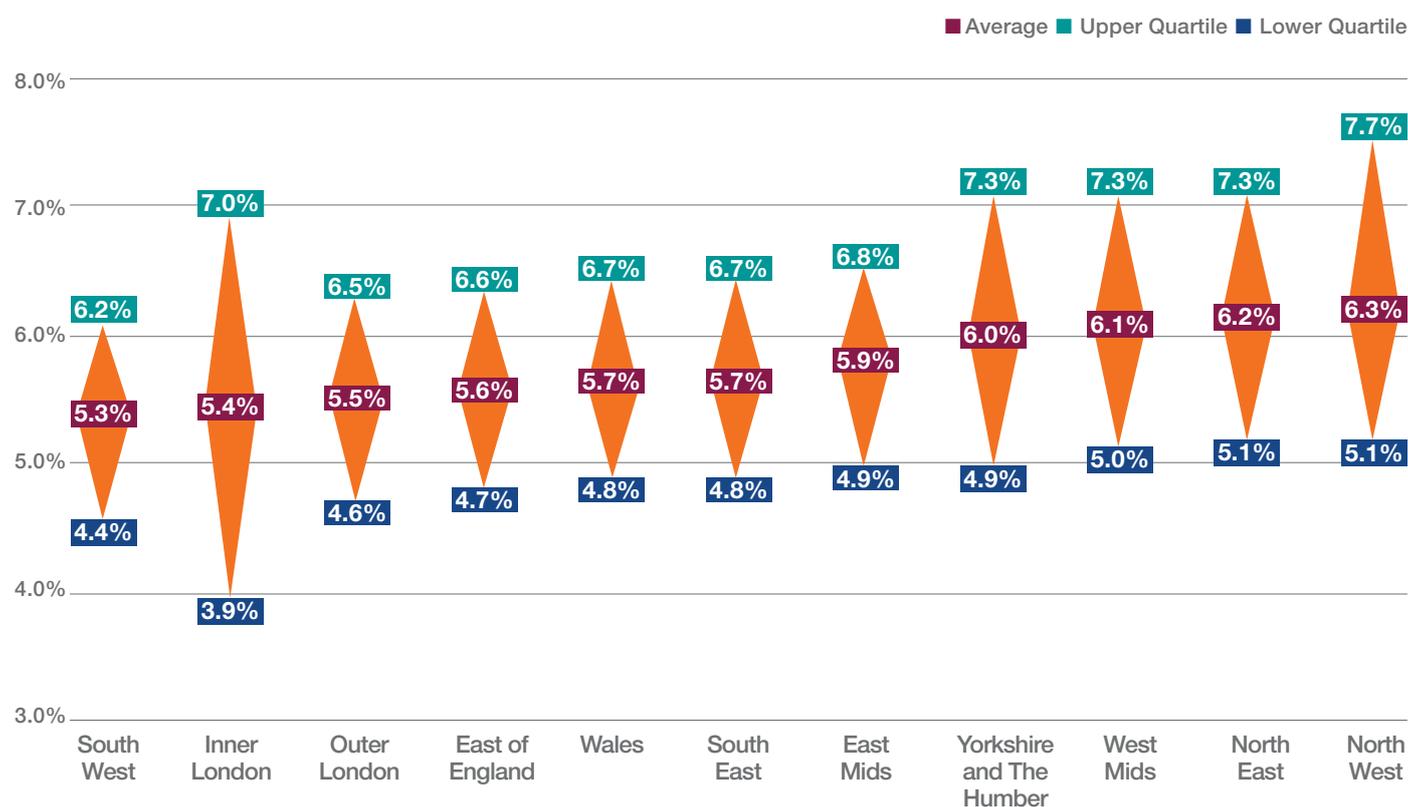
Table source: Rightmove/Savills

TABLE 7 **Gross Income Yields for 2 Bedroom Properties in London 2011**

Average Price Band	Gross Income Yield
Up to 200,000	6.2%
200,000 - 300,000	5.4%
300,000 - 500,000	5.1%
500,000 - 1,000,000	4.7%
1,000,000 - 1,500,000	3.9%
Over 1,500,000	3.3%

Table source: Rightmove/Savills

GRAPH 2 **Gross Income Yields for 2 bedroom properties by region (2011)**



Graph source: Rightmove/Savills



## → Where to invest across the UK

Notwithstanding the fact that there is significant localised variation in income yield, we have looked at prospective total 10-year investment returns at a local authority level both across the boroughs of London and the 30 largest rental markets outside of London.

### London

London's lower yielding boroughs tend to have higher capital growth prospects and vice versa. This means that forecast total returns are relatively tightly grouped, varying between 7.3% and 9.1% per annum on average over the next 10 years.

Consequently there is no clear pattern in the distribution of returns. For example, Newham, a low value, high income yield market delivers returns of just over 9.0% marginally higher than Islington which is a much higher value lower yielding market with superior capital growth prospects.

Across London total returns compare favourably with the rest of the UK. Decisions as to precisely where to invest will be dependent on investors'

“The markets outside of London that show the highest potential returns are all located in the South East, where capital growth prospects are strongest”

preferences for income yield or capital growth, exit plans, level of investment and risk. In the case of private investors, decisions (particularly regarding location) will be shaped by whether they plan ultimately to live in the property or view it purely as an investment.

**In Rightmove's recent Consumer Confidence Survey, South West London, East London, South East London and West London all featured in our Top 10 'landlord markets' at position 1, 3, 6 and 9 respectively. These post-towns were ranked by the proportion of tenants believing the current market to favour the landlord.**

### Beyond London

The markets outside of London that show the highest potential returns are all located in the South East, where capital growth prospects are the strongest.

Areas with weaker capital growth prospects such as Milton Keynes and Medway deliver sufficiently high income yields to deliver competitive forecasts for competitive returns. By contrast, despite higher income yields in northern markets reduced capital growth prospects will continue to suppress total returns.

To identify investment opportunities in the northern cities, it will be necessary to look for higher yielding lower value stock or to look beyond a 10 year investment horizon to secure competitive returns.

### → The Investment Matrix

The tables below show average annual total returns for the next 10 years and the extent to which those returns are made up by net income yields. For example, annualised total returns of over 8.0% are expected in Elmbridge with

net income yield making up less than half of this return. Net income yields are calculated at 70% of gross income yield. Savills house price forecasts have been adopted to arrive at capital growth.

TABLE 8

### Investing in London

		Forecast Total Returns 2011-2012				
		7.0% to 7.5%	7.5% to 8.0%	8.0% to 8.5%	8.5% to 9.0%	Over 9.0%
Proportion of Total Return from Rent	Less than 40%			Kensington & Chelsea, Westminster		
	40% to 45%	Hounslow	Barnet, Kingston, Harrow, Camden, Hammersmith & Fulham	Wandsworth Richmond	Islington, City of London, Southwark Hackney	
	45% to 50%		Croydon, Bexley, Havering, Sutton, Brent, Enfield, Redbridge, Haringey, Hillingdon, Bromley	Lewisham Ealing Lambeth Merton		
	50% to 55%		Waltham Forest			Greenwich Tower Hamlets
	55% to 60%			Barking and Dagenham		Newham
	Over 60%					

Table source: Rightmove/Savills

TABLE 9

### Investing outside of London

		Forecast Total Returns 2011-2012					
		Less than 6.0%	6.0% to 6.5%	6.5% to 7.0%	7.0% to 7.5%	7.5% to 8.0%	Over 8.0%
Proportion of Total Return from Rent	Less than 50%					Brighton & Hove	Elmbridge
	50% to 55%			Southend	Bournemouth Bristol, Colchester	Oxford Southampton	Reading Woking
	55% to 60%				Northampton	Portsmouth Medway	Milton Keynes
	60% to 65%		Edinburgh Stockport Warrington	Cardiff	Leicester Nottingham		
	65% to 70%	Bradford	Newcastle, Leeds Manchester Sheffield	Coventry Birmingham			
	Over 70%	Kirklees	Glasgow Liverpool				
	Over 80%						

Table source: Rightmove/Savills

# Looking Forward

## The prospects for Rental Britain

The shift towards Rental Britain shows little sign of slowing in the near future. Britons paid in excess of £48 billion in rent to private and institutional landlords. This figure is forecast to rise to exceed £70 billion by 2016.

Whilst there is little doubt that rental demand will increase, the pipeline of new rental supply is likely to be the main constraint on the expansion of the sector. Over the past 10 years we estimate that over £380 billion has been invested in the private rental sector of which over £140 billion was in the form of buy to let mortgage finance. Rental Britain needs a further £200 billion to be invested in private rented sector housing to meet tenant demand over the next five years.

We believe that in the order of 75% of this will have to be financed otherwise than by way of buy to let mortgages. This will require a combination of private and institutional investment.

Smaller private investors are likely to look beyond the short to medium

term, banking on a return to house price growth of inflation plus 2.5% to 3.0%. They are likely to balance income yield and capital growth prospects and invest across the UK.

By contrast, larger institutions are expected to chase income yield more aggressively, particularly given relatively low house price growth prospects over the next five years.

In the short term financially distressed stock will offer some opportunities and facilitate targeted investment in higher income yielding sectors, particularly those in the Midlands and North of England.

However, our estimates of total return suggest that institutional investment demand will be focused in London and the South East,

where repossession rates are lower. To meet investor demands here rental stock will to be delivered by the new build market, in volume and at a discount.

To achieve this without impinging on the viability of development will require the planning system to formally recognise the need for private rented accommodation as interchangeable, to a greater or lesser degree, with affordable housing provision.

This may go against political aspirations for a nation of private sector home owners and development industry funded social housing. But if we are to cater for Rental Britain it would appear to be a necessity. ■

“Rental Britain needs a further £200 billion to be invested in private rented sector housing to meet tenant demand over the next five years”

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