SPOTLIGHT

Savills Research

PRIME RESIDENTIAL RENTS

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The fourth quarter of 2022 finally brought a slowdown in the rate of rental growth across the prime markets. Seasonality factors were much more at play than over recent years, with the impact more in line with a typical pre-pandemic year.

Despite this, prime London recorded the second strongest growth in the final quarter of a year (apart from December 2021) for over 10 years.

And despite low levels of supply activity has remained strong, with deals in the capital higher than pre-pandemic levels.

Average gross yields in 2022 have increased for London's prime housing stock, as rental growth outpaced capital value growth in the first three quarters of the year and capital values softened in the final three months of the year.

Looking forward, we expect the shortage of stock which has been a key factor over the past few years to keep upward pressure on rents over the short-term. However, we expect these pressures to stabilise and stock to gradually increase over the coming years.

The sheer scale of growth over the past two and half years limits the capacity for further significant increases in rental values and over the longer-term we expect growth to return to more historic levels.

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> "Prime London's rental annual growth stands at 10.9% over 2022, as tenant demand continues to outweigh supply"

Rents slow across the prime market

Seasonality factors at play as prime rental growth slows in the last quarter of 2022

After an exceptional couple of years, rental growth slowed over the final three months of 2022. This is in line with typical seasonal changes and comes off the back of a period of particularly strong growth.

In prime London, rents increased by 0.7% over the final quarter, down from the 3.1% recorded in Q3. Despite this slowdown, the performance over the last three months still remains well above a typical fourth quarter. Indeed, Q4 2022 marks the second strongest quarterly growth seen in December for over 10 years, only surpassed by growth seen in December 2021.

Prime rental annual growth stands at 10.9% over 2022, as tenant demand continues to outweigh supply. Although below the levels experienced over the early parts of 2022 this still represents significant growth, especially in the context of the economic slowdown and short-term pressures on household incomes. It brings total rental growth since the start of the pandemic to 12.5%.

Across the prime commuter belt quarterly growth also slowed to 0.4%, leaving rents 5.6% higher than at the end of 2021. This suggests the commuter belt rental market is returning to more normal levels of growth after a period of stellar performance. Rents have increased by 17.0% since March 2020.

As stock still remains low in a historical context, pressure on rents is expected to remain over the short-term, but not at the levels of the recent past.

Smaller properties more robust against wider market pressures

Smaller properties at lower price bands generally outperformed larger, more expensive rental homes over the final quarter of the year. The top end of the rental market is driven mainly by discretionary spending and given that the market is less frantic than over the summer of 2022, pressure on pricing has eased slightly at the top end of the market.

By contrast, demand for smaller properties and lower price bands is often domestic and more 'need-based'. Savills agents reported young professionals and corporate tenants continued to be a key seam of demand across London, alongside demand from families in the commuter belt. These 'needs-based' tenants are expected to continue to drive up competition in the early part of 2023, particularly given supply constraints.

Which hotspots are still outperforming?

Prime central London and North & East London were the top-performing regions over the last quarter of 2022. More specifically, Marylebone (3.4%), Earls Court (2.6%) and Islington (2.2%) topped the performance tables. These areas have seen lower total levels of growth over the past few years and so have the greatest remaining capacity for growth moving forward.

Elsewhere, properties in West and North West London recorded more subdued levels of quarterly growth, after a particularly strong third quarter. The domestic family house markets across South West London which had seen some of the greatest levels of rental growth over the preceding two years had a mixed performance, with many locations remaining flat whilst others continued to outperform.

In the commuter belt, locations furthest from London have performed the most strongly over the past three-months. Locations such as Winchester (2.8%), Oxford (2.7%) Farnham and Henley (1.5%) have led the way. This suggests post-pandemic lifestyle choices continue to be important to many tenants.

Supply and demand balance continues to drive the market

The pronounced imbalance between demand and supply has been at the heart of the strong rental growth of 2021 and 2022 across the prime rental markets. Consistent high levels of letting activity have meant new stock coming to the market has let quickly, meaning available stock levels have remained low. While this relationship between lettings activity and stock levels has remained broadly consistent over the past two years in the commuter belt, it became more pronounced in London in 2022. A gradual and progressive easing in this dynamic lies behind our outlook for rents over 2023.

Prime rental movements by location

Q4 2022	Central London	North West London	South West London	West London	North and East London	Suburbs*	Inner commute**	Outer commute†
Quarterly growth	0.8%	0.3%	0.7%	-0.1%	0.9%	0.0%	-0.3%	1.9%
Annual growth	11.6%	13.5%	8.9%	9.6%	11.6%	5.3%	5.6%	5.9%
Growth since Mar-20	10.2%	13.4%	16.5%	10.3%	10.5%	15.7%	18.1%	16.6%

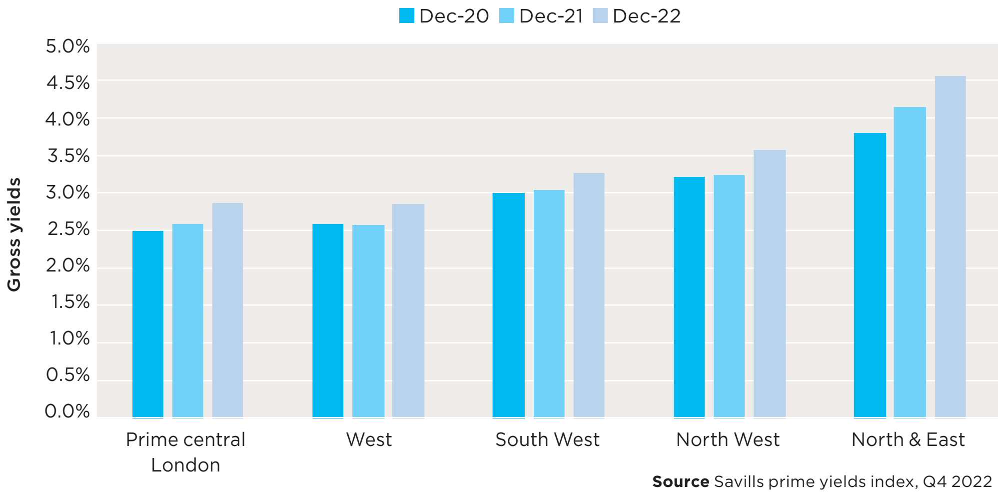
*Within the M25 **Within a 30-minute commute †Within a one-hour commute

Source Savills prime lettings index, Q4 2022

Yields continue to increase

While regulatory and financial pressures are likely to limit activity from mortgaged investors, the increase in yields are expected to continue to underpin demand from cash investors

How have gross prime London yields changed over recent years?



Source Savills prime yields index, Q4 2022

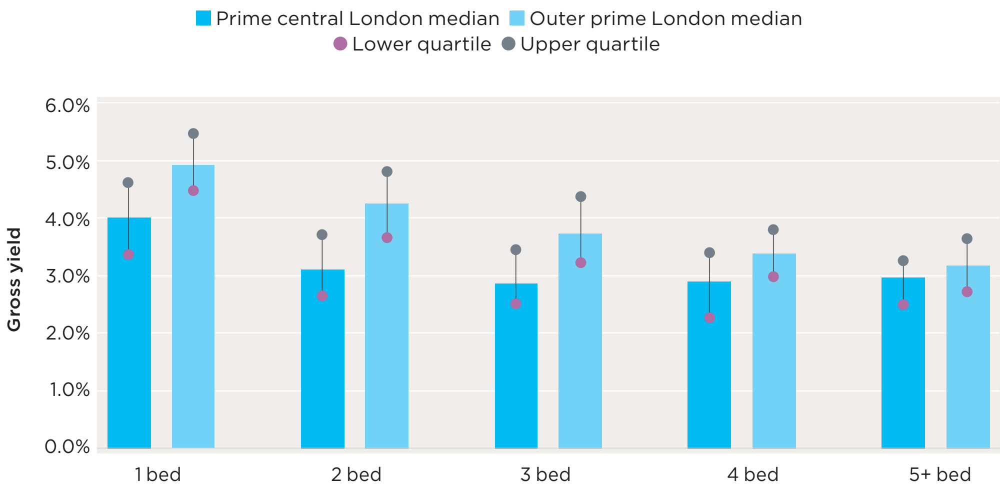
Average gross yields in London rose across all regions over 2022

Not only do they sit above both 2021 and 2020 but also pre-pandemic levels. This is a result of significant levels of rental growth coupled with more modest capital value growth over the last two and a half years. And as the sales market looks to cool over the coming year, gross yields could increase further over the short-term.

While regulatory and financial pressures on leveraged investors are likely to limit activity from mortgaged investors, the increase in yields on offer are expected to continue to underpin demand from cash investors. We expect their activity to focus on smaller properties where income returns are highest; with an increased emphasis on stock selection, given the variation in yields available in different locations and at an individual property level.

Meanwhile, the increase in returns may also encourage frustrated sellers to make their property available in the rental market until conditions in the sales market pick up.

Variation in prime yields across locations and property size



Source Savills prime yields index, Q4 2022

Market monitor

Key statistics for the prime rental market

+0.7%

Quarterly growth across prime London, higher than a typical fourth quarter

+5.6%

Annual growth across prime commuter belt, despite a slowing over the second half of 2022

+5.0%

Prime London growth forecast for 2023 as competition is expected to remain high in the short-term

+3.0%

Growth forecast in the prime commuter belt in 2023, as the imbalance between supply and demand gradually normalises

Source Savills Research

Is the prime rental market calming down?

In prime London the slowdown in growth seen over the final quarter is typical of seasonal changes and comes off the back of an incredibly strong year

As detailed overleaf the unprecedented growth in rental values of prime housing over the past two years has primarily been created by an imbalance between supply and demand. We expect this to continue to drive more modest rental growth in the short-term, in part given increased pressures on household incomes and corporate budgets.

Additionally, we expect supply constraints to ease with additional stock coming to the market from accidental landlords as a result of a weaker sales market and continued activity from cash investors looking to take advantage of lower capital values and higher rents. But limited activity from mortgaged investors and those deterred by increased levels of regulation, is likely to mean those increases in stock occur gradually.

Meanwhile, from a demand perspective the mainstream market is more likely than the prime market to see a spike in demand from frustrated buyers due to rising interest rates.

There are signs that the rate of rental increases are starting to slow already in parts of the market. The evidence of the second half of 2022 suggests the growth in rents of prime properties in the commuter belt is beginning to normalise.

As such, we are forecasting average rental increases across the prime commuter belt of 3.0% over 2023 and then 2.0% by the end of 2024.

In prime London the slowdown in growth seen over the final quarter is typical of seasonal changes, and comes off the back of an incredibly strong year. And, we are predicting competition will remain high this year. We therefore expect rents to continue growing over 2023, although at a slower rate. We are still forecasting an increase of 5.0% over 2023 and a further 3.0% by the end of 2024.

The sheer scale of growth over the past two and half years does limit the capacity for further significant increases. Over the longer-term we expect growth to return to more historic averages, as the balance between supply and demand is gradually restored.

Prime rental forecasts

	2023	2024	2025	2026	2027	5-year compound growth to 2027
Prime London	5.0%	3.0%	2.0%	1.5%	1.5%	13.6%
Prime commuter zone	3.0%	2.0%	1.5%	1.0%	1.0%	8.8%

Note These forecasts apply to average rents in the second-hand market. New build rental values may not move at the same rate. **Source** Savills Research

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Savills Research
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