UK Residential – Autumn 2019

REPORT
Savills Research

Residential property forecasts

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Five-year forecasts ● UK mainstream and prime values ● Rents and transactions

13.11.2019

Arriving at our housing market forecasts has involved even more head scratching than normal this year. Amid Brexit uncertainty, fixing the assumptions on which to base them has been like nailing jelly to a wall. More recently, however, the jelly appears to have set firmly enough to get a fix on what the future may hold.

As we go to print, we know we face a general election on 12 December. Polls currently suggest there is a reasonable prospect that the Conservatives will regain enough of a majority to get the current Brexit deal over the line by 31 January.

This would suggest that the UK avoids an economic recession, providing the platform for house price growth once households have more certainty on the outlook for their household finances.

The flip side is the prospect of a long-anticipated, gradual increase in interest rates. This will progressively squeeze affordability at the point of getting a mortgage, especially in London and parts of the South East.

On these assumptions, we are forecasting the average price of a UK home will rise by **15%** over five years, with a Brexit-bounce only gaining a real foothold at the end of the transition period. We do so knowing that there will be substantial variation across different parts of the market. We also do so knowing that, jelly being jelly, the outlook could change quickly if circumstances dictate that we need to revisit these assumptions.

Lucian Cook
Head of
Residential Research
020 7016 3837
lcook@savills.com

15% growth over five years

Our forecast for growth in the average price of a UK home recognises there will be variation in different parts of the market and is based on a series of economic and political assumptions

2019

The current year

+0.5%

Key assumptions

GDP growth +1.3%

Income growth +2.8%

Bank base rate 0.75%

Despite surprisingly strong wage growth and levels of employment, not to mention an average mortgage interest rate of just 2.06%, uncertainty regarding the outcome of Brexit weighs down on buyer sentiment. That leaves annual house price growth across the UK at just 0.4% by the end of October. Modest price falls in the London mainstream market have filtered into its commuter zone, while markets further afield have slowed in the second half of the year. Given the deadlock in parliament, a general election in December reduces the prospect of any improvement in sentiment from agreeing a revised Brexit deal with the EU.

2020

House price forecasts

+1.0%

Key assumptions

GDP growth +1.1%

Income growth +2.6%

Bank base rate 1.00%

While the threat of a recession recedes, both GDP and wage growth remain suppressed, providing little impetus for a sustained Brexit bounce at this stage (though we do expect a burst of stronger market activity in the immediate aftermath of a Brexit deal). Ongoing uncertainty over the future of our trading relationship with the EU during the transition period and the impact of a slowing global economy means potential home movers remain relatively cautious about their household finances, particularly in the second half of the year. Lead indicators suggest demand will continue to be subdued in London as the focus shifts back towards gradually increasing interest rates over the medium term.

> "The outlook could change quickly if circumstances dictate that we need to revisit our underlying assumptions"

2021

House price forecasts

+4.5%

Key assumptions
GDP growth +2.0%
Income growth +3.0%
Bank base rate 1.25%

As the UK's future trading relationship with the EU and other major trading partners becomes clearer, confidence returns to the economy. This translates into improved wage growth, which acts as a stimulus for housing demand, while interest rates remain relatively low. London returns to modest growth, though this is constrained by how much buyers can borrow due to mortgage regulation. We expect the strongest price growth in the North West of England, reflecting the strength and diversity of the regional economy and the capacity for higher loan to income ratios.

2022

House price forecasts

+3.0%

Key assumptions
GDP growth +1.8%
Income growth +3.0%
Bank base rate 1.50%

Gradual increases in interest rates begin to constrain affordability more widely at the point of getting a mortgage. At a national level, that means house price growth relies on growth in household incomes among mortgaged owner-occupiers. Buy-to-let investors receive their first tax bill with the full restrictions on tax relief for mortgage interest. That will continue to curb demand from that buyer group, especially in higher-value, lower-yielding markets.

2023

House price forecasts

+3.0%

Key assumptions
GDP growth +1.8%
Income growth +3.0%
Bank base rate 1.75%

Annual house price growth continues at a relatively modest level, slightly above the rate of inflation. Help to Buy is scheduled to end in the early part of the year, which curtails demand from first-time buyers for new build housing and increases the focus on alternatives, such as shared ownership. Meanwhile, growth in values starts to unlock some of the mortgage prisoners who gradually build up enough equity to be able to trade up the housing ladder.

2024

House price forecasts

+3.0%

Key assumptions
GDP growth +1.7%
Income growth +3.0%
Bank base rate 2.00%

By the end of our forecast period, we expect mainstream house prices to have risen by 15% on average – varying from just +4.0% in London to +24.0% in the North West of England. On the basis of the economic assumptions stated, that brings mortgage affordability back in line with the average of the past 35 years and allows London prices to re-balance compared with the rest of the UK. Our forecasts remain sensitive to the economic assumptions used, particularly the cost of mortgage debt. If bank base rates continue to increase gradually towards 2.75% by 2027, as forecast, a period of low growth is likely to continue beyond this five-year period.

Note All forecasts apply to average prices in the second-hand market. New build values may not move at the same rate. Economic assumptions based on Oxford Economics forecasts as at October 2019 **Source** Savills Research

The distinction between mainstream and prime

How much elastic is there between the mainstream market primarily driven by mortgage affordability, and a prime market driven by flows of wealth?

Our forecasts for price movements in the mainstream housing market are typically driven by projections of affordability, primarily for mortgaged buyers. As we have set out on pages 6 and 7, these have regard to where previous price growth has left pricing in each region, as well as the effect of the economy on household incomes and, critically, the future cost of mortgage debt.

But not all markets are the same. Demand for prime housing is more affected by the creation and flows of wealth and has been more impacted by various tax changes over the past five years.

Consequently, there can be significant elasticity between the two. This is particularly apparent in London. Here, despite a significant recent slowing of the market, mainstream prices have risen by 15% during the past five years, while in the prime markets of central London, values have fallen by more than this figure.

This elasticity is likely to be a feature of the market over the next five years, although, this time, the prime market of central London (which makes up a small proportion of the London market as a whole) is expected to substantially outperform its mainstream counterparts.

> **“Elasticity is likely to be a feature of the market over the next five years”**

Regional price forecasts
Our 2020 and five-year mainstream forecasts

Scotland
2020: +2.0%
5-year: +19.9%

North East
2020: +1.5%
5-year: +19.9%

North West
2020: +2.5%
5-year: +24.0%

Yorks & Humber
2020: +2.0%
5-year: +21.6%

West Midlands
2020: +3.0%
5-year: +18.2%

East Midlands
2020: +3.0%
5-year: +18.2%

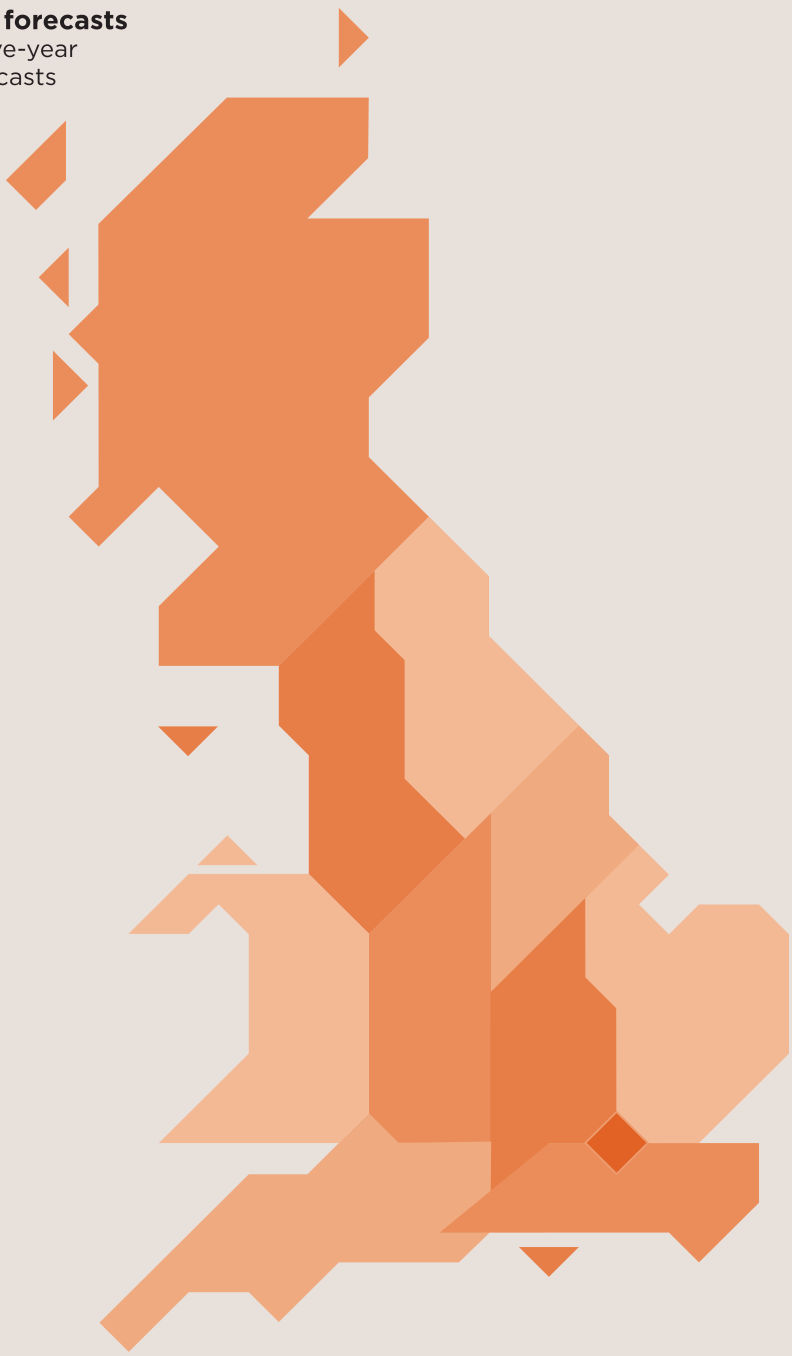
Wales
2020: +2.0%
5-year: +18.1%

East
2020: 0.0%
5-year: +10.9%

London
2020: -2.0%
5-year: +4.0%

South West
2020: +0.5%
5-year: +13.1%

South East
2020: 0.0%
5-year: +10.9%



Source Savills Research

Prime price forecasts
Our 2020 and five-year prime forecasts

Central London
2020: +3.0%
5-year: +20.5%

Other London
2020: +1.0%
5-year: +11.5%

London suburbs
2020: 0.0%
5-year: +13.1%

Inner commute
2020: 0.0%
5-year: +13.6%

Outer commute
2020: 0.0%
5-year: +14.2%

Rest of the South
2020: +1.0%
5-year: +16.5%

Midlands & North
2020: +2.0%
5-year: +20.5%

Scotland
2020: +2.0%
5-year: +18.7%

Definition of London markets: Suburbs: within the M25. Inner commute: within a 30-minute commute of London. Outer commute: within a 30-60-minute commute of London.

Definition of prime:
This market consists of the most desirable and aspirational property by location, aesthetics, standards of accommodation and value. Typically, it comprises properties in the top 5-10% of the market by house price.

PRIME CENTRAL LONDON

At the end of Q3 2019, prices in prime central London were 20.4% below their 2014 peak, the scale of falls having converged around this figure across all price bands. For a US dollar buyer, that left prices 42% below their peak, given the depreciation of sterling.

With central London looking relatively good value in both a global and historical context, this normally would have triggered a recovery. However, this has been delayed by political uncertainty, both in relation to Brexit and in Westminster.

The general election is likely to delay any recovery further, even though there would need to be a substantial change in the polls for the possibility of a majority hard left government to become a reality.

A Conservative government with a slim majority in parliament, combined with a bottoming out of sterling, would provide the platform for a recovery in this market.

We would expect that recovery to be weaker than in previous cycles due to the higher tax environment, prospect of gradually increasing cost of money and the fact that London has matured as a global city and financial centre.

Given the tax receipts that it would put at risk, we believe there is only a limited possibility of a significant stamp duty cut in the short term at least.

Prime central London forecast Price falls in the last five years should be followed by a recovery in the next five

	2020	2021	2022	2023	2024	5-year compound growth
Prime central London	+3.0%	+6.0%	+4.0%	+4.0%	+2.0%	**+20.5%**

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

> **"The improvement in deposit affordability in London is likely to widen the profile of first-time buyers"**

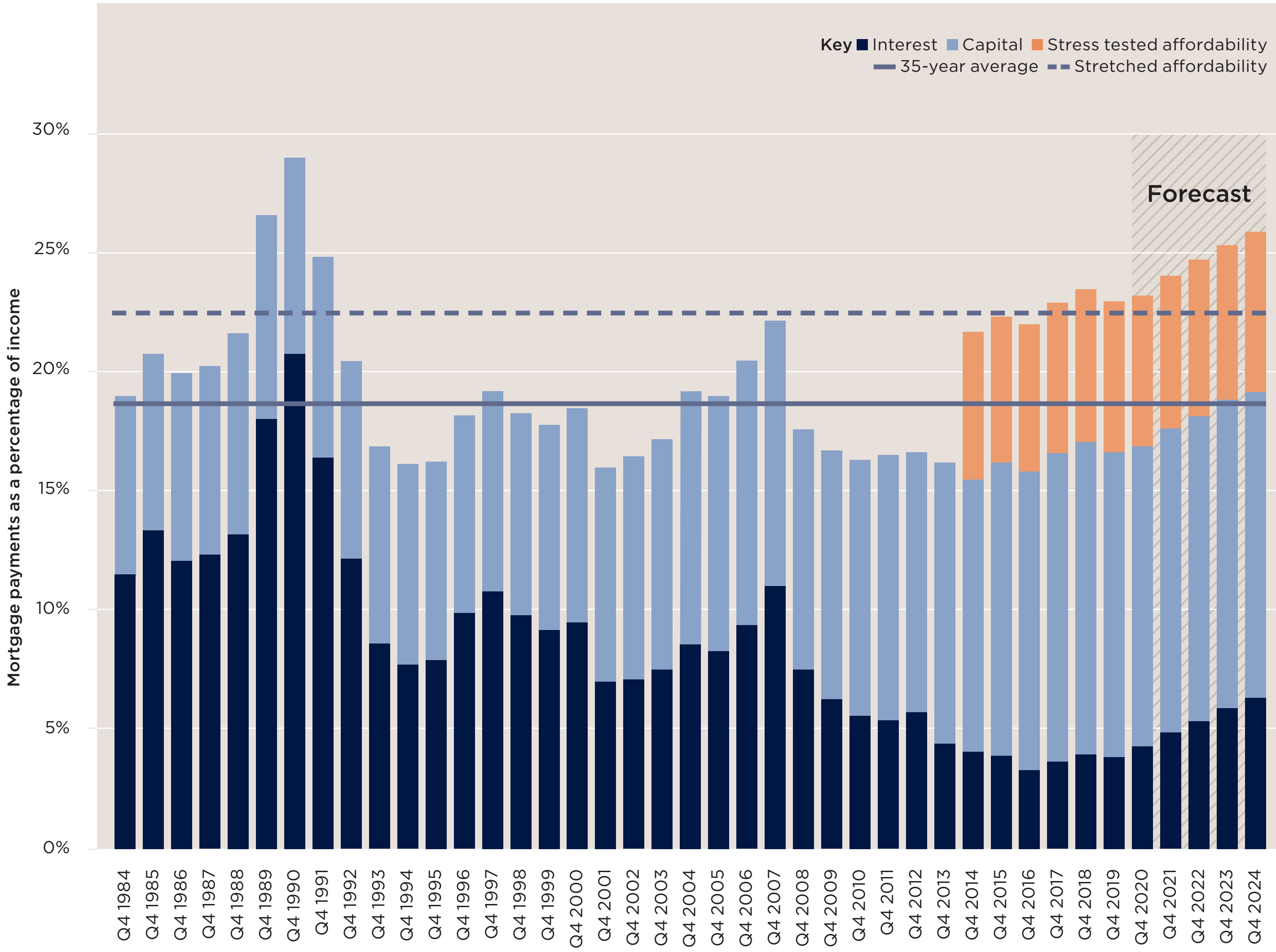
The stories behind our forecasts

Three key metrics in three charts. We examine the trends for affordability at a national level, regional house prices and pressures on first-time buyers in the capital

Our forecasts allow for mortgage affordability to return to the 35-year average, having been below that level since 2008, with progressive interest rate rises only supporting modest levels of house price growth.

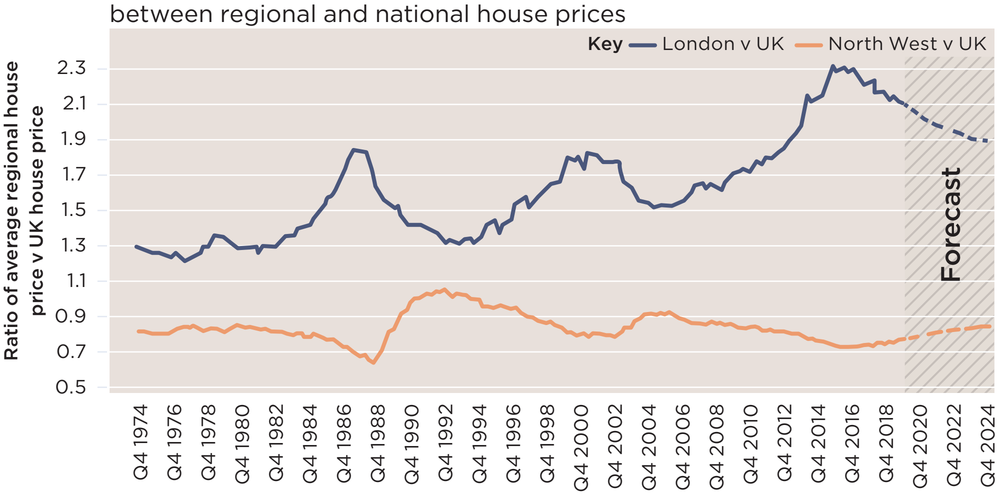
The ability to stretch affordability further will be limited by mortgage regulation, as the stress testing conducted by lenders limits the amount people can borrow; particularly in London and the more expensive markets of Southern England where loan to income multiples are higher than the UK average.

1. Affordability at a national level Our forecasts allow for mortgage affordability to return to the 35-year average



Source Savills Research, UK Finance

2. Regional re-balancing Restoring the ratio between regional and national house prices



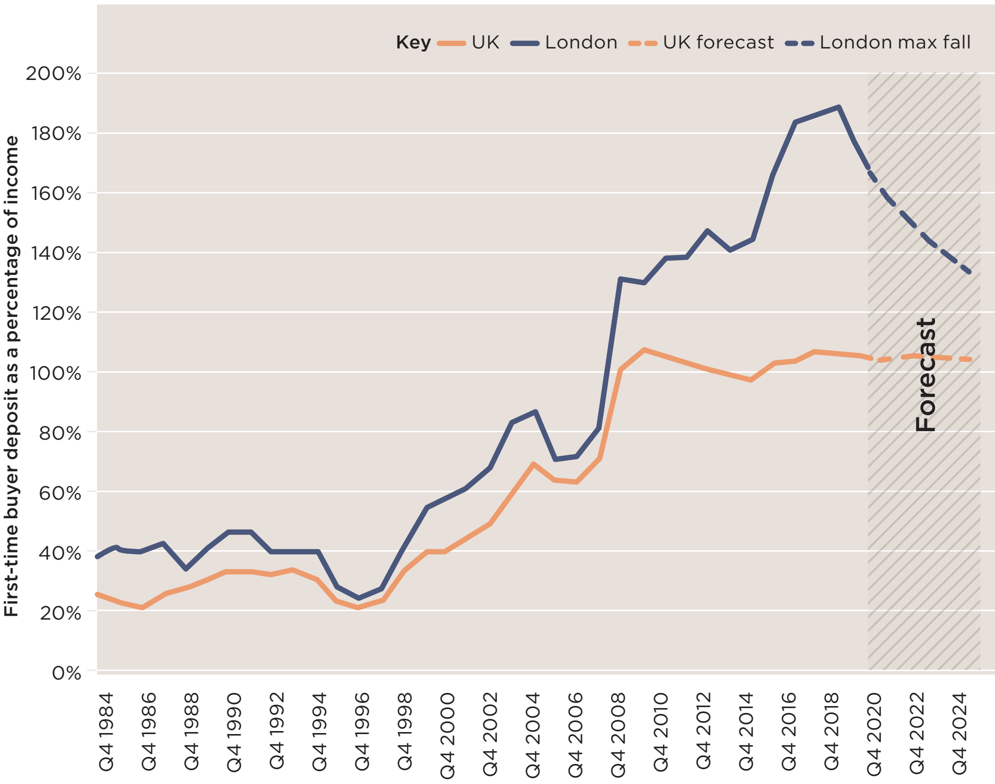
Source Savills Research, Nationwide

Over the next five years we expect to see a continuation of the trends historically witnessed in the second half of a housing market cycle, where London and the South underperform markets in the Midlands and the North of England.

This half of the cycle appears to have begun in 2016, coinciding with the Brexit referendum, at a time when London hit up against the limits of what people could borrow relative to their income.

By contrast, there remains more capacity for growth in house price-to-income ratios in the areas that typically perform more strongly at this stage of the cycle, even as interest rates rise gradually.

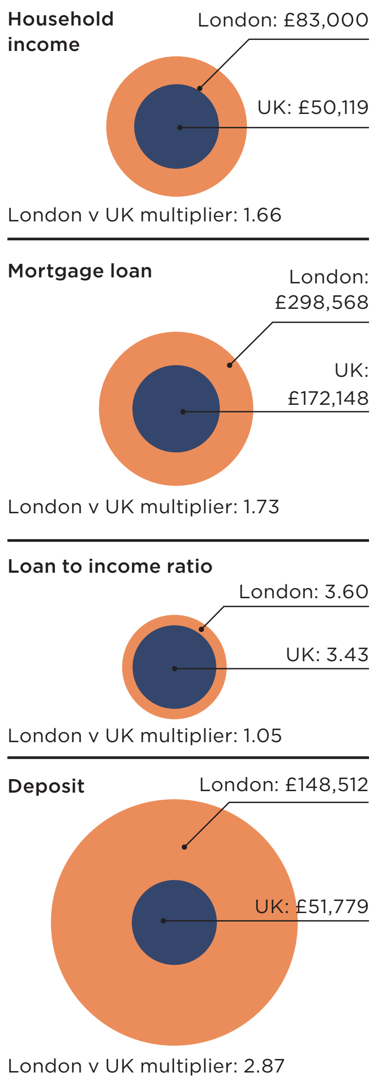
3. Bringing London back into line What our forecasts would mean for first-time buyers in the capital



Source Savills Research, UK Finance

Current average incomes of first-time buyers, the amount they are borrowing relative to that income and, most strikingly, their deposit, illustrate how far London remains dislocated from the rest of the UK housing market and why it has been more exposed to a market slowdown (see graphics, right). Our forecasts allow the level of first-time buyer deposits to converge with the UK average over the next five years (chart above). The improvement in deposit affordability in London is likely to gradually widen the profile of first-time buyers and result in an increase in transaction levels in this group, though the barriers to home ownership in the capital will remain high.

How far London is dislocated from the UK for first-time buyers



Beyond house prices

A summary of our outlook for transactions and rental values

MAINSTREAM RENTS

Pressure on private landlords will limit the supply of rental properties (especially in the higher-value, lower-yielding markets). But the proportion of household income that tenants can afford to pay as rent will be the overriding constraint on rental growth. The fundamentals supporting rental growth, incomes and employment, are strongest in London. While a glut of buy-to-let supply in 2016 has suppressed growth recently, we predict a return to London outperforming as tax changes push landlords out of the sector.

Rental forecasts Household income will be the main constraint on rental growth

Mainstream rents	2020	2021	2022	2023	2024	5-year compound growth
UK	2.0%	3.0%	3.5%	3.0%	3.0%	15.4%
London	2.0%	4.0%	4.0%	4.0%	3.5%	18.8%
UK (excluding London)	2.0%	2.5%	3.0%	2.5%	2.5%	13.1%
Income growth (UK)	2.6%	3.0%	3.0%	3.0%	3.0%	15.6%

Source Savills Research

TRANSACTIONS

We expect housing transactions to continue at around 1.2 million a year, with cash buyers continuing to account for around one-third of the market. By contrast, we expect mortgaged buy-to-let purchases to fall back further over the next five years, as tax restrictions combine with higher costs of debt to impinge on profitability. At a national level, first-time buyer numbers are expected to dip once Help to Buy ends, although we forecast mortgaged home mover numbers to increase slightly as some of those who have entered the housing market in the past five years begin to make their next step up the housing ladder.

Transaction levels Cash buyers will continue as the largest part of the market

Transactions	2020	2021	2022	2023	2024
Mortgaged first-time buyers	358,000	356,000	354,000	345,000	346,000
Mortgaged home movers	349,000	370,000	358,000	358,000	361,000
Mortgaged buy-to-let	60,000	55,000	50,000	50,000	50,000
Cash	440,000	420,000	430,000	430,000	430,000
Total	1,207,000	1,201,000	1,192,000	1,184,000	1,187,000

Note Numbers may not add up precisely to totals due to rounding **Source** Savills Research

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Savills Research

We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

Research

Lucian Cook
Head of
Residential Research
020 7016 3837
lcook@savills.com

Lawrence Bowles
Associate Director
Residential Research
020 7299 3024
lbowles@savills.com

Kirsty Bennison
Associate Director
Residential Research
020 7016 3836
kbennison@savills.com

Frances Clacy
Associate
Residential Research
020 7409 5905
fclacy@savills.com

Nicholas Gibson
Analyst
Residential Research
020 7409 8865
nicholas.gibson@savills.com