UK Residential – Q2 2022

SPOTLIGHT

Savills Research

Prime Residential Rents

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Prime rents in London and the commuter belt ● Rental reforms explained ● Market outlook

> “Growth in London has now more than compensated for the falls seen across much of the capital during the pandemic”

Prime rents continue to rise at a rapid rate. A lack of available stock and enduring tenant demand have continued to put upward pressure on rental values during the first half of 2022.

In London, the recovery is roaring ahead, with the strongest annual growth since 1998 – higher than the levels seen following the Global Financial Crisis in 2008. This record growth has now more than compensated for the losses seen during the pandemic.

And although rents continue to increase across London's commuter belt – following two years of rapid growth – it looks as though they are beginning to level out.

While a lack of stock appears to remain a key issue over the short term at least, we expect wider economic drivers and regulatory changes to become more of a consideration for landlords in the longer term.

Inflation and the cost of living crisis will undoubtedly begin to bite in the coming months. And when it comes to regulatory changes, the devil will very much be in the detail. With many factors at play over the coming months and years, the real question is: what does all this mean for the prime rental markets?

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London: record rental growth

The capital's recovery remains in full swing. Over the three months to June, prime London rental values increased by a further 3.3%. This left annual growth at 13.5% – the highest annual increase in over 20 years.

This growth has now more than compensated for the falls seen across much of the capital during the pandemic. From March 2020 to March 2021, prime rents in London were down by 5.5%. However, since March 2021, they have increased by a significant 14.7% on average, emphasising the strength of the recovery.

North and East London continues to be the strongest performing region during the past year. Here, rents were severely impacted at the beginning of the pandemic because of the high proportion of flats, a time when many were looking for larger properties, and young professionals (who are a key seam of demand) chose to leave the city. However, as the return-to-work movement took hold at the end of 2021, this part of London saw a significant bounce back over the fourth quarter, which has been sustained into 2022.

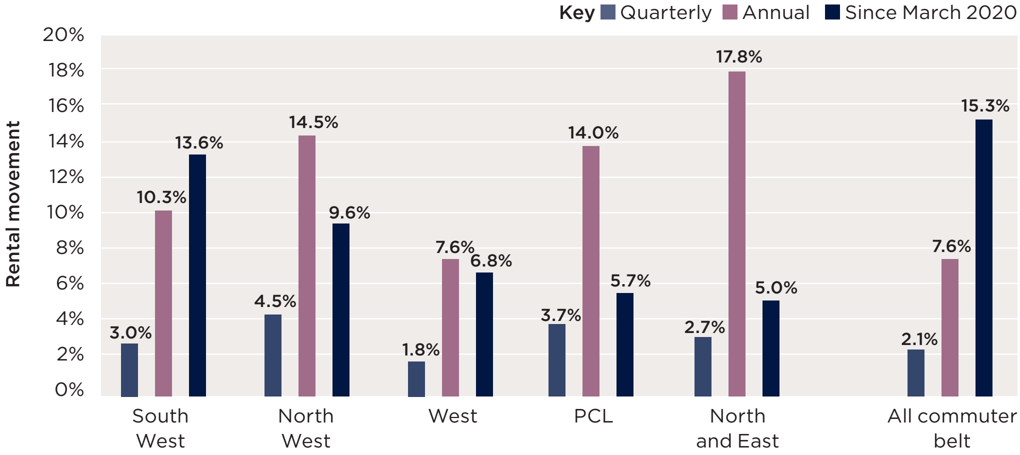
Growth over the second quarter of 2022 has been primarily driven by the other regions that were most affected by the pandemic, including prime central London and North West London. As the capital regains its buzz, these areas are now recovering. Key international tenant groups have started to return, along with students and corporate relocations.

Elsewhere, South West London continues to be the top performer over the pandemic as a whole, despite a recent slowing in the rate of growth. This region benefitted during the various lockdown periods as many tenants looked here in the 'race for space'. Although this trend has slowed slightly from the height of lockdown, it continues to be a key driver of demand in the region.

London's flat market also continues to recover, with rents up by 14.9% over the past year; higher than the 11.7% growth seen for houses. And for the first time, all geographical submarkets in London have seen rents for flats return to pre-pandemic levels. But, despite this recent outperformance, rents for houses are 12.4% above their pre-pandemic (March 2020) level compared with just 5.5% for flats, as larger properties have tended to perform more strongly throughout the pandemic.

Rental value recovery

The varying pace of recovery across London's regions and commuter belt



Source Savills prime lettings index, Q2 2022

Commuter belt: market starts to slow

Prime rents across London's commuter belt increased by 2.1% over the second quarter of the year, leaving annual growth at 7.6%. This is slightly down from the peak of 8.0% at the end of 2021 but follows two years of rapid growth. Rents are now a significant 15.3% higher than in March 2020.

Although rental growth looks to be levelling out after a sustained period of increases, some hotspots are still outperforming. Areas with the strongest quarterly growth include Cobham (+8.2%), Farnham (+4.6%) and Guildford (+4.5%), all of which attract multiple strands of demand – from young professionals and corporate relocators to families.

Over the past year, growth has continued to be led by towns (+8.9%) as connectivity and commutability remain key. Rents in surrounding village and rural locations have increased by a more modest 5.4%.

The commuter belt has seen significant tenant demand throughout the pandemic. This, coupled with an enduring lack of stock across sales and lettings, has maintained upward pressure on rents. When asked where demand was coming from over the last quarter, 88% of our agents ranked families in the top two, with a third ranking 'those who were unable to buy' in their top two. This beat 'try before you buy' which is typically a more common reason in this market.

Section 21 and rental reform

Almost half of our agents report that the abolition of section 21 is the most significant concern for landlords. We unpack what new reforms may mean for the rental markets

Goodbye section 21, hello periodic tenancies

Amid recent political shenanigans, the government published its proposals for reform of the private rented sector. On 16 June, the Department for Levelling Up, Housing and Communities (DLUHC) published the long-awaited white paper for the reform of the private rented sector across England, Wales and Northern Ireland.

Just 21 days later, Boris Johnson announced his resignation as prime minister. But not before the resignation of housing minister Stuart Andrew and the sacking of Michael Gove, the secretary of state with the responsibility for bringing forward the legislation to enact the reforms.

While a new housing minister has since been appointed in the latest cabinet reshuffle, it is, as yet, unclear what this means for the future of the Renters Reform Bill. This is only likely to become fully clear once the new prime minister and their chosen ministerial team are in place.

But, if and when the new proposals do reach the statute book, they would convert all current Assured and Assured Shorthold Tenancies (ASTs) to periodic tenancies. It is worth noting that this would largely replicate measures undertaken in Scotland six years ago which retains a vibrant private rental market.

In the case of ASTs, this would remove the right for a landlord to serve an incontestable two-month notice to quit at the end of a fixed tenancy term (the demise of section 21). While that would give most tenants increased security of tenure and would mean that most landlords would have to rely on specific statutory grounds to recover possession of their property, those grounds would be extended in scope.

Exclusions and omissions

This would not apply to all residential lettings. Residential tenancies where the rent exceeds £100,000 per annum and lettings to corporate tenants both sit outside of the Assured and Assured Shorthold Tenancy system. In these cases, a landlord's right to possession will continue to be primarily governed by the term of the tenancy agreement.

In most other cases, the white paper indicates that the new code would be implemented in two stages: starting with new tenancies before bringing existing lettings into its ambit. That would provide landlords with a window to ensure they have in place an up-to-date tenancy agreement, reflecting a new age of landlord-tenant relations.

Protecting liquidity

Importantly from a landlord's perspective, new grounds would also be introduced to allow them to recover possession of their property if they wish to sell it, occupy it themselves, or allow it to be occupied by close family members. Exercisable six months after the commencement of the tenancy and on two months' notice, this would protect the liquidity of their investment and their ultimate ability to gain vacant possession.

Landlords should also take comfort from a new mandatory ground for possession for repeated serious rental arrears, defined as two months' worth of rental arrears occurring three times within three years, which will sit alongside a four-week notice period where a tenant has rental arrears of at least two months. However, practically, much will depend on how effective a 'wide ranging' package of court reforms are in accelerating possession proceedings to give effect to this (something we know is being looked at closely by government).

Other key features of the white paper include the creation of a new ombudsman for the private rented sector – who would have the power to fine landlords up to £25,000 – and a requirement for privately rented homes to meet the decent homes standard.

Re-imagining rent reviews

Yet, for the majority of prime landlords already demonstrating good practice, the provisions for rent review will be of greater relevance. Here the white paper provides for once-a-year rent reviews, again on two months' notice, based on changes to market prices rather than any other measure – for example, preventing rents from being moved in line with inflation.

Interestingly, the white paper appears to assume that rents will be reviewed exclusively by landlords proposing rent increases, with no mention of the prospect of rental values falling and tenants seeking a rent reduction. This said, proposals do include a right for tenants to refer the matter to First Tier Tribunal to challenge 'unfair rent increases'. In extreme cases, they will also be able to fall back on the right to bring the tenancy to an end on two months' notice in negotiations.

All of this means that we expect landlords will have to provide more hard evidence for proposed rental increases in the future, something which is likely to mean greater reliance on established rental indices such as our own. In the meantime, all eyes will be on how wholeheartedly the next political incumbents embrace these proposals.

Market monitor

Key statistics for the prime rental market

+13.5%

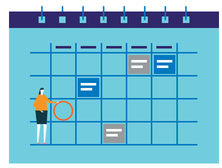
Record annual growth across prime London

+15.3%

Rental increase in the prime commuter belt since the start of the pandemic (March 2020)

47%

of Savills agents say abolition of section 21 is the biggest concern for landlords



16 June

The Department for Levelling Up, Housing and Communities published its white paper on rental reforms

Source Savills Research

Outlook for the prime rental markets

Assessing future rental value movements in London and the commuter belt

Supply and demand imbalance likely to continue over the short-term

Following strong levels of rental growth over the first half of 2022, we predict the acute lack of stock and continued strong demand will maintain pressure on prime rents across both London and the commuter belt, at least in the short term. In June, stock levels in the capital remained 35% below those of June 2019 and 44% lower in the commuter belt. By comparison, new applicants registering in London are up 71% on June 2019 levels and are 45% higher in the commuter belt. As such, we expect continued rental growth over the third quarter of this year, driven by the significant imbalance between supply and demand.

But inflation and the cost of living will bite

However, over the final quarter of 2022 and into 2023, we expect the cost of living and inflationary pressures to bite. A second energy price cap rise in October 2022 will likely put more pressure on tenants' – somewhat already limited – spending power. Although the prime markets may be more insulated against some of these pressures than the mainstream market, we do anticipate a significant slowdown in the rate of rental growth from the end of 2022 onwards.

As a result, although we anticipate rental growth will continue over 2022, it will be slightly tempered over the second half of the year given ongoing economic pressures. In London, we are forecasting prime rental growth of 12.0% over 2022, with growth of 7.0% expected in the commuter belt.

In 2023, we anticipate rental growth to slow significantly to 1.0% across both London and the commuter belt as a result of cost of living increases, inflation, and other economic pressures. In addition, the significant levels of rental increases since the pandemic do limit the capacity for future growth over 2023 and beyond. This follows a similar trend to how the prime rental markets performed after the Global Financial Crisis, where the rate of growth slowed in the years following an initial bounce back.

Longer-term factors at play

Over the medium term, as inflationary pressures begin to normalise, we expect to return to more historic levels of rental growth. Wage growth may allow some additional rental growth as some of the spending power of tenants returns. And regulatory changes may result in some private landlords exiting the market and, as such, limiting stock levels in some areas. But over the longer term, the capacity for further sustained growth will be limited given the rate of growth experienced over 2022 and, indeed, since the pandemic. Over the five years to 2026, we are forecasting total rental growth of 18.3% for prime London and 11.9% for the prime commuter belt.

Prime rental forecasts

	2022	2023	2024	2025	2026	5-year compound growth to 2026
Prime London	12.0%	1.0%	2.0%	1.5%	1.0%	18.3%
Prime commuter zone	7.0%	1.0%	1.5%	1.0%	1.0%	11.9%

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

Savills Research
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