SPOTLIGHT
Savills Research

Mainstream Rental Forecasts

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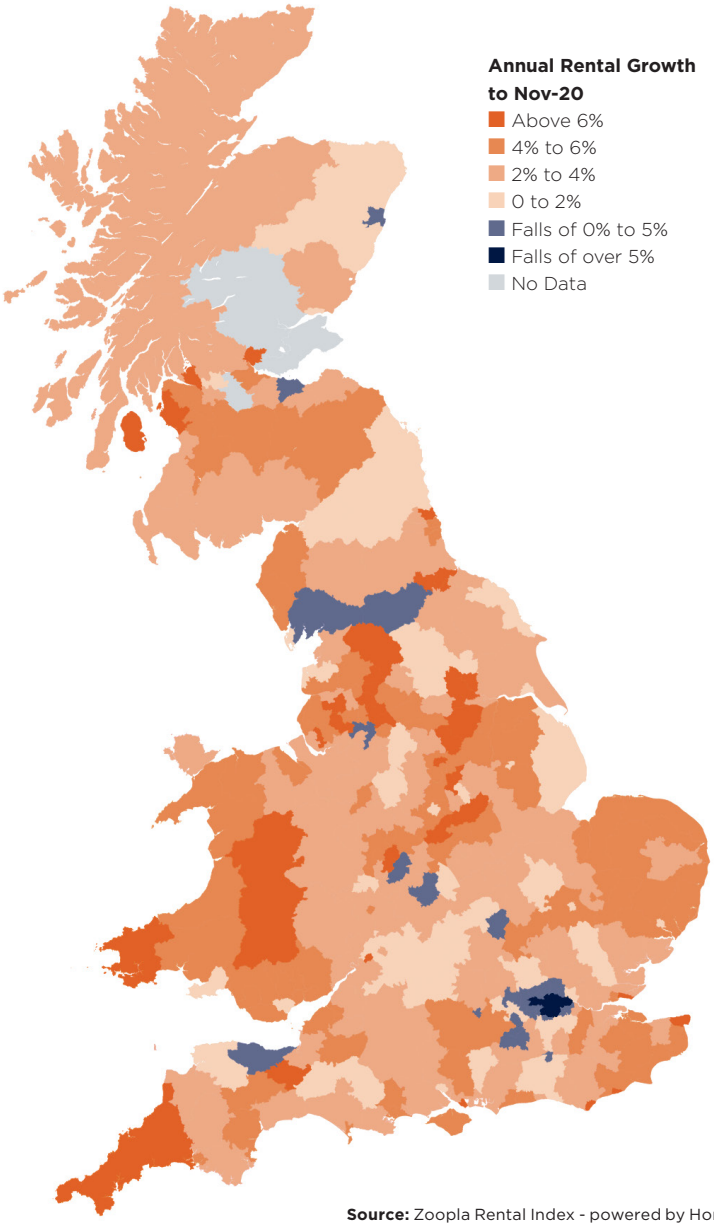
Figure 1 Annual rental growth across the UK (to November 2020)



Source: Zoopla Rental Index - powered by Hometrack

Market disruption

The rental market has always varied across the country, but the impact of Covid-19 has driven this variation to new heights. The pandemic, and related lockdowns, has meant a unique combination of factors have disrupted the relationship between supply and demand, causing rental falls in some city centre markets but supporting the market for larger properties in other locations.

As the vaccination programme is rolled out we expect the market to progressively normalise; reversing some of the Covid-specific trends seen in 2020. In time, we expect rental growth to become primarily dictated by growth in incomes, much as it has done in the past. But, given the prospects for the wider economy, we expect a period when the rental market remains price sensitive to be followed by a burst of stronger rental growth, which we have pencilled in for 2022.

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Table 1 Five-year forecasts for mainstream rents

Region	2021	2022	2023	2024	2025	5 years to 2025
UK rental growth	0.8%	4.5%	3.7%	3.5%	3.5%	**17.0%**
London rental growth	1.5%	5.5%	4.0%	3.5%	3.5%	**19.3%**
UK excluding London rental growth	0.5%	4.0%	3.5%	3.5%	3.5%	**15.9%**
UK income growth	0.4%	5.2%	3.8%	3.5%	3.3%	**17.3%**

Source: Savills Research, Oxford Economics

National Divergence

The impact of the pandemic on rental values has been most acute in city centre markets. As a result, a number of these markets have seen rental falls during the year, with London for example down -6.1% over the 12 months to November. In contrast, rents have increased by 2.8% on average across the rest of the country in the same period.

This average disguises the fact that some of the other major cities have also seen rental values fall. So while smaller cities, towns and suburban areas have seen continued rental growth, in Birmingham, Manchester and Edinburgh rental values are down -3.4, -1.4% and -2.0% respectively.

These falls may not come entirely as a surprise. The past few months have seen numerous headlines on households escaping city centres during lockdowns for large homes and green space in less urban areas. This behavioural shift goes some way to explaining why suburban and rural areas have seen growth at the expense of the major cities. This is only part of the picture however. We can also explain much of the trend by looking at the amount of rental supply.

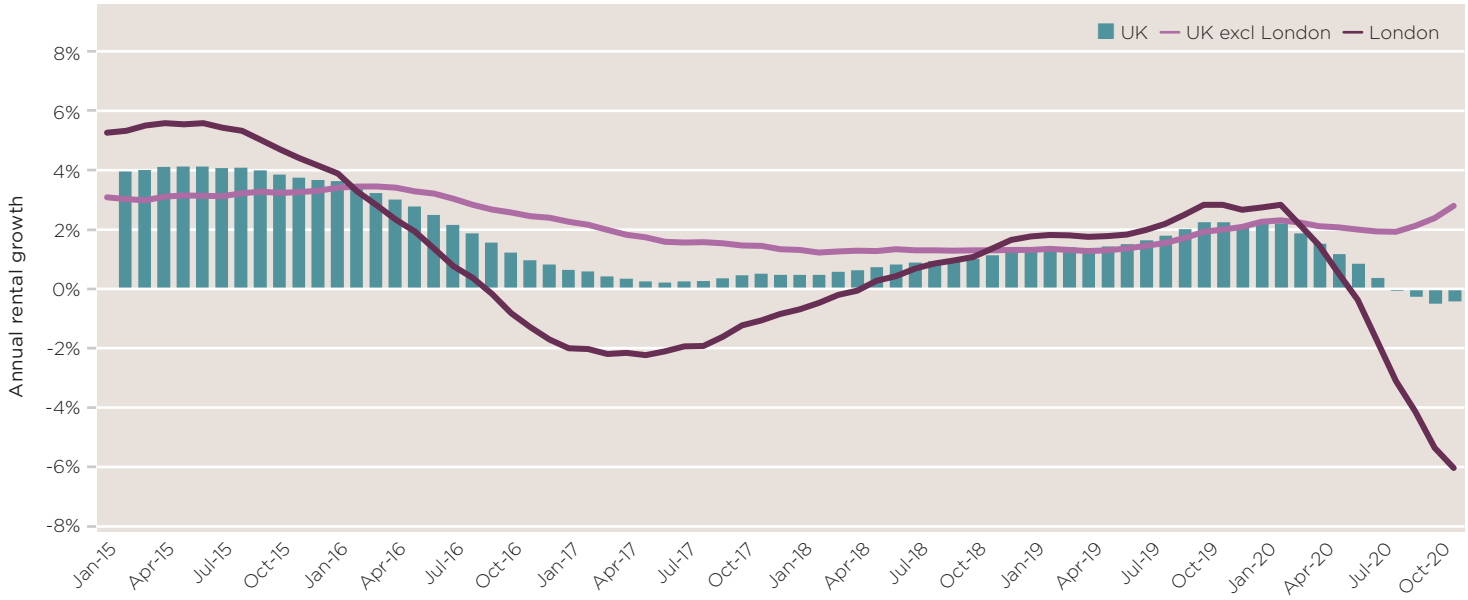
Rental Supply

In the run up to the pandemic, the number of new rental listings had been on a downward slope for several years, both nationally and in London. This reflected both a longer average length of residence among tenants and a lack of new stock coming through from the buy to let market, given the tax and regulatory pressures faced by private investors. The absorption rate of this stock was steady, with tenant demand trending gradually upwards. This helped drive rental growth both for London and the rest of the country prior to 2020.

Covid-19 only briefly disrupted the national trend, with absorption bouncing back almost instantly to prevent a build-up of unlet stock and allow continued rental growth.

However, London has seen a significant jump in the amount of new supply. This has meant over the course of the past 10 months rental affordability has been much less of a driver in London and some other city centres. Instead, it has been this build-up of excess supply which has been the primary cause of the fall in rents in these areas.

Figure 2 Rental growth varies significantly between London and the rest of the country



Source: Savills analysis using Zoopla Rental Index - powered by Hometrack

Where has rental supply come from?

So the key questions are where did all this new supply come from and will levels fall as day-to-day life resembles something closer to normality? There have been some sources of entirely new supply. For example, more short-let stock has entered the mainstream rental market given the lack of travel and tourism. In certain sub-markets completions of new developments partly pre-sold to investors have also added to the level of available rental stock.

Although applicant demand was strong overall after the first lockdown of 2020 eased, we have seen a build-up of unlet properties in specific areas, reflective of demand from certain groups of tenants who have been particularly affected by the events of 2020. This includes one and two bedroom flats in urban centres, such as London, with limited or no outdoor space. That stock is mostly in the hands of private landlords who have been keen to retain an income, even if lower than their pre-pandemic expectations

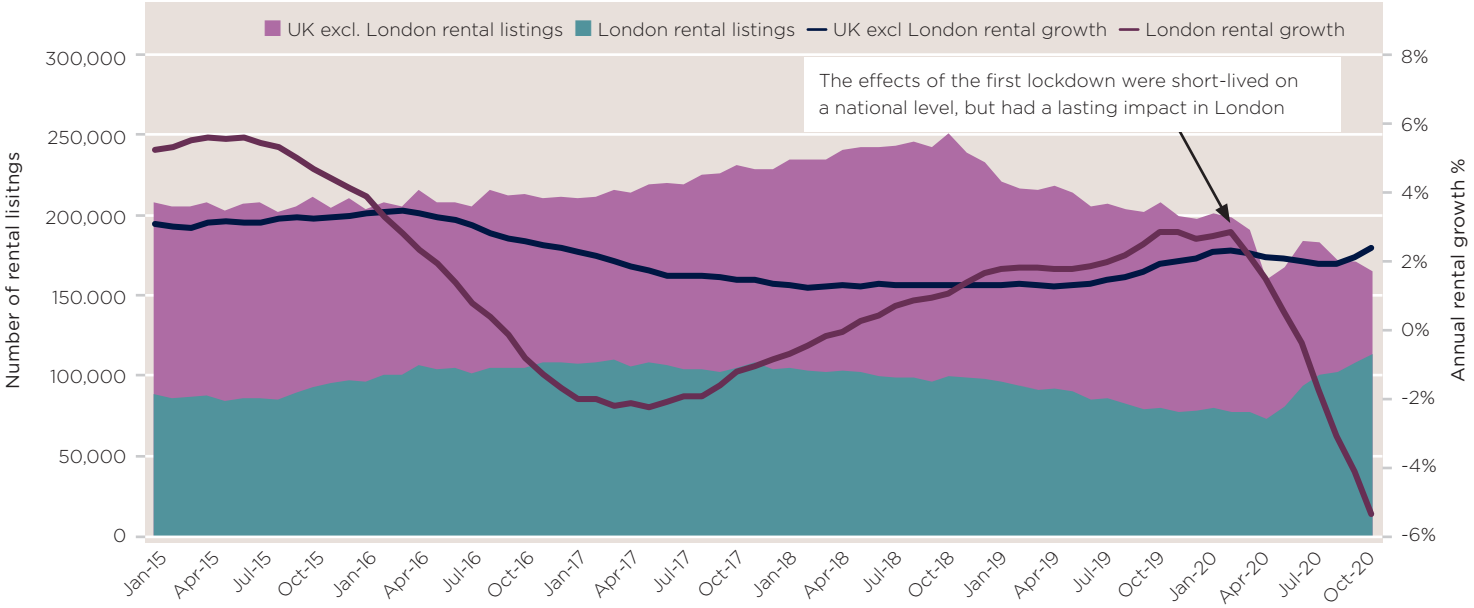
More specifically, we have seen younger home-sharers move back to the family home, at a time when they can work remotely and save money by handing back the keys at the end of their tenancy. We have also seen reduced corporate and student demand, with international demand particularly affected.

How has Build to Rent fared?

The Build to Rent (BtR) market has not been immune to the impacts of Covid-19. But there are signs that the institutional investors have been better placed than small-scale private investors to manage voids, protect their occupancy levels and therefore minimise the impact on overall rental receipts.

Certain BtR schemes also appear to be benefiting from a 'Flight to Quality' as tenants seek high quality homes that offer designated workspace and amenities, a priority for those expecting to continue working from home in the future. While not completely disconnected from the wider market, these factors have given the BtR sector a competitive advantage, helping to explain why an established operator such as Grainger has reported 1.8% like for like rental growth across its BtR portfolio across 2020.

Figure 3 The levels of supply can explain much of the current patterns of rental growth



Source: Savills using Rightmove, Zoopla Rental Index - powered by Hometrack

As restrictions relax, we expect demand to recover

What then of the future? 2021 is likely to be a year of two halves.

On the one hand, rising levels of unemployment in the first half of the year combined with weak income growth will constrain the market. Renters on lower incomes, who are more likely to work in sectors such as hospitality or retail, are more exposed to these economic risks.

On the other hand, as vaccine deployment gains momentum, we can expect a phasing out of social distancing, potentially from Q2 onwards. This will be critical to domestic demand returning to the major cities. Working from home, while likely to remain above pre-Covid levels, will reduce, and we expect to see a corresponding rise in demand for city centre living.

It will also be key to the return of international tenant demand. Though extra barriers faced by EU residents looking to work in the UK and the pace of vaccination in other countries may temper this, a return of tourists should allow some stock to return to the short-term let market.

This is expected to mean that London outperforms the rest of the country, reversing some of this year's rental falls. Although we're starting to see the recovery of supply levels to pre-Covid levels in some London markets, there's still an oversupply of unlet properties due to changing tenant preferences. As it will take time to erode that excess supply in 2021, we expect much stronger rental growth in 2022.

In later years we are likely to see a return to income growth acting as the main driver behind rents both nationally and in London.

This rental growth is likely to be underpinned by the continued divestment of buy-to-let landlords – especially among those most recently affected by non-payment of rent or extended void period. This will leave an opportunity for BtR to step in, make up the shortfall in supply and benefit from the longer term, less volatile, rental growth prospects.

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