UK Residential – Q4 2020

SPOTLIGHT

Savills Research

Prime Residential Rents

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Recent prime rental movements • Landlord and tenant survey • Future supply and demand

> As many tenants placed more emphasis on lifestyle drivers, so rental demand has been displaced from London into the commuter zone

The rental markets of prime London and the prime commuter belt performed very differently during the final three months of 2020, as tenants continued to reassess their needs.

The results of our December landlord and tenant survey show that many of the trends shaping the sales market have carried over into the rental market: a desire for more space, stronger demand for houses over flats in London, and an increase in the appeal of properties across the wider commuter belt and beyond.

Meanwhile, economic pressures and international travel restrictions have put a strain on the rental receipts of some landlords, while there has also been speculation about a possible increase in rates of capital gains tax. That has made some landlords consider exiting the sector, even though the maths are not as clear cut as might be expected.

While the current lockdown is likely to mean these trends continue over the bulk of 2021, the big question is whether they will shape the longer term. This remains difficult to predict and depends on the extent to which working from home is achievable once the vaccine is rolled out.

Landlords will need to continue to be responsive to shifting demands as they emerge, proving successful property investment requires active management.

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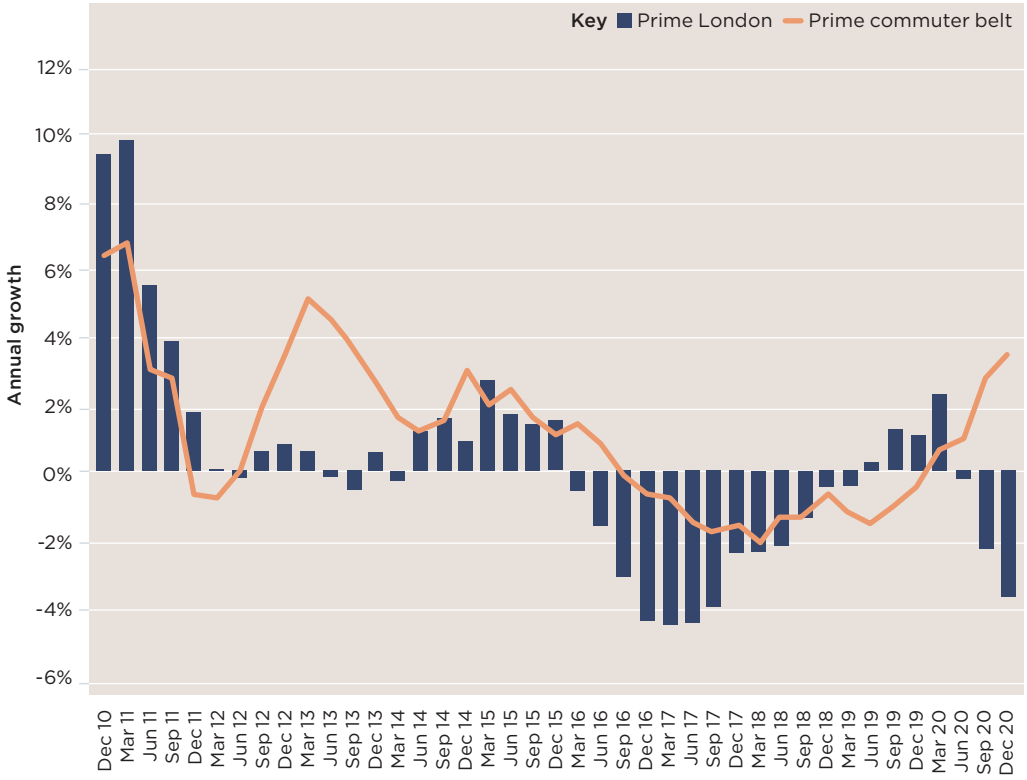
Rental growth Prime commuter belt rents continue on an upward trend



Source Savills Research

Lifestyle influences demand

Growth across the commuter belt reflects changing priorities

Across the prime housing markets of the commuter belt, rents increased by 0.7% in the fourth quarter of 2020, leaving them 3.4% higher year on year. This marks the strongest annual growth in rents across the commuter belt for more than seven years.

Meanwhile, prime London rents fell by 1.5% in the three months to December 2020, leaving them down 3.7% over 2020. That has been driven by a 6.2% annual fall in the rental value of flats, which have been at the sharp end of an increase in stock coming from the short-term lettings market and a reduction in demand from international students, young professionals and sharers.

Beyond London, the key driving factors have been strong demand paired with low levels of stock. Our offices outside of London saw a 36% increase in new applicants registering in 2020 compared with 2019. Because of this high demand, 82% of our agents in the commuter belt reported available stock levels continued to be put under pressure over the final quarter of 2020.

More specifically, as many tenants placed more emphasis on lifestyle drivers, so rental demand has been displaced from London into the commuter zone. For this reason, the likes of Sunningdale, Farnham and Sevenoaks have seen the greatest uptick in rents over the past 12 months. The rental gap between properties in urban and surrounding areas also narrowed in 2020, given the increased emphasis on access to the countryside. Rural and village locations saw annual rental growth over the past year of 4.4% and 3.8% respectively, slightly above the average 3.1% annual growth seen in urban commuter locations.

Across the capital, tenants have continued to emphasise the need for more space and the availability of a private garden. As a result, the rental value of prime houses proved relatively robust (seeing rental falls of just -0.2% over the course of the year).

That meant areas with strong family housing stock such as Wimbledon, Wandsworth and Clapham were the top performers of 2020. Bucking the trend for the rest of the capital, prime South West London saw marginal growth of 0.2% over the fourth quarter and 1.9% across the year as a whole.

By contrast, the regions of North and East London and prime central London continued to see the largest rental falls over the past quarter, with values decreasing by -3.1% and -1.9% respectively. In these areas, a surfeit of stock and a lack of international travel – both factors specific to the experience of lockdown – combined to suppress rental values during 2020.

What our tenants and landlords say

During December, we asked our tenants and landlords how they think the market has been impacted by Covid-19. Here are our findings.

Drivers of demand

Perhaps unsurprisingly, our survey reported that the biggest reason for renting (37%) was that tenants are not yet ready or able to buy. However, beyond London a larger proportion of tenants said they were renting to try a new location or because of relocation for work, both key drivers for the rental markets in the commuter belt.

Given the increased emphasis on achieving a good work-life balance, seven out of 10 tenants asked said they would be more inclined to work from home in the future as a result of Covid-19, with half of them reporting they were significantly more inclined to do so. Of those who were more inclined, three-quarters thought this would be for three days or more per week, indicating that some of the changing patterns of demand will have a lasting impact.

We also asked tenants what their priorities would be when looking for their next rental property. Location was ranked the most important factor, followed by property attributes and the condition of the property. Value was fourth, with services available least important to tenants; a reflection of how the pandemic has changed tenants' short-term priorities.

Price expectations

The survey results point to a disconnect between the rental expectations of London landlords and tenants over the short term. While almost 40% of landlords anticipate rents will stay the same over the next 12 months, many tenants think rents will continue to fall. By contrast, in the markets outside of London, tenants and landlords look to be slightly more aligned, with the majority expecting rents will either stay the same or increase slightly over the next year.

Over the next five years, the price expectations of landlords and tenants are broadly aligned in both markets, pointing to a gradual normalisation as the effect of Covid-19 recedes.

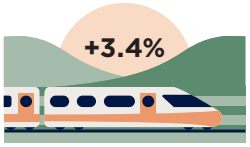
71%
are more inclined to work from home more in the future

51%
are significantly more inclined

78%
of those more inclined to work from home think it will be for three days or more per week

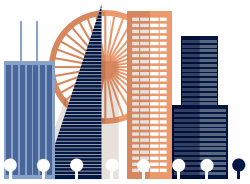
Market monitor

Key statistics for the prime rental market



Annual rental growth across the prime commuter belt

-0.2%
Annual rental falls across prime London houses



-6.2%
Annual rental falls across prime London flats

36%
Increase in the number of new applicants registering with Savills offices outside of London 2019 vs 2020

Source Savills Research

Prime rental movements	Central London	North West London	South West London	West London	North and East London	London suburbs*	Inner commuter belt**	Outer commuter belt†
Quarterly growth	-1.9%	-1.6%	0.2%	-0.7%	-3.1%	1.2%	0.5%	0.5%
Annual growth	-6.6%	-3.8%	1.9%	-0.3%	-7.5%	2.0%	4.4%	3.5%
5-year growth	-21.2%	-8.4%	-4.1%	-4.1%	-5.2%	-3.4%	1.2%	0.8%

Note *Within the M25 **Within a 30-minute commute †Within a one-hour commute. Rental movements to December 2020 **Source** Savills Research

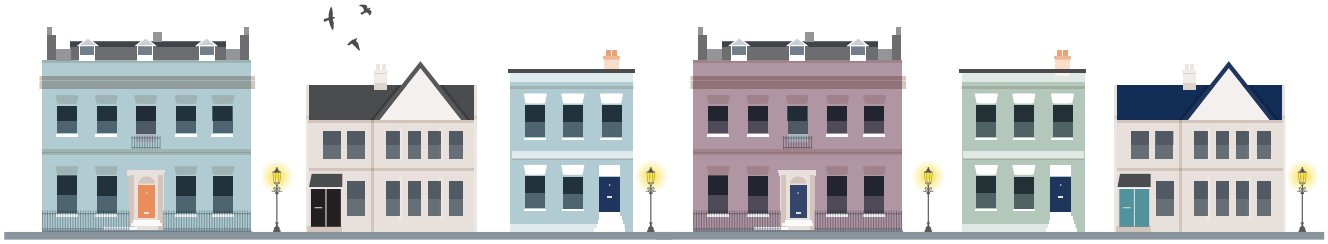
The future of supply and demand

As we have detailed previously, in 2020 the pandemic distorted the relationship between supply and demand in different sectors of the prime rental market. It is likely to have a longer-term impact on this dynamic in other ways. First, interest rates are now expected to stay lower for longer, as the Bank of England looks to support a longer term economic recovery. This will provide some breathing room for private landlords who now only get a 20% tax credit on their mortgage interest.

However, those re-evaluating their portfolios are likely to have a keen eye on other possible tax changes as the government seeks to recover the costs of supporting the economy through lockdown. Specifically, there has been much speculation about an increase in personal rates of capital gains tax, to align them with rates of income tax. Indeed, a report by the Office of Tax Simplification (OTS), commissioned by the Chancellor, was published on this issue in November 2020.

On the face of it, the prospect of an increase in tax rates provides an incentive for landlords sitting on a capital gain to sell their property or, at least, change their ownership structure before such changes are introduced. That would potentially reduce the supply of stock available to rent. However, the OTS report recommended the government also consider reintroducing indexation, such that only inflation-adjusted gains would be taxed. While far from guaranteed, if this were the case, our analysis suggests if this were to happen it would be much less clear cut, leaving many landlords with an uncomfortable dilemma.

Read more in Lucian Cook's blog here: http://sav.li/lh8



OUTLOOK

In the short term, we expect the trends that we have seen over the past year to continue. This will be particularly evident in the prime central London market, which has been restrained by travel restrictions.

The return of international travel should see an uptick in demand from both corporate relocations and international students and, in due course, the return of some stock to the short-term rental market. That is likely to restore the balance between supply and demand in a market which looked set for rental growth at the beginning of last year.

The issue for many is that, given the unpredictability of Covid-19, the timing of this rebalancing is uncertain, with much dependent on the speed and success of the vaccination programme.

In the meantime, we expect to continue to see demand from tenants wishing to relocate for lifestyle reasons over the short term, particularly if they are unable to secure a property to purchase. Once the vaccine rollout gains further momentum, this will become less of a driver, though there are signs that it will continue to have some bearing on the balance of demand between different parts of the prime market.

Longer term, as the effects of the pandemic subside, there will be more capacity for normal rental growth to return.

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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.

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