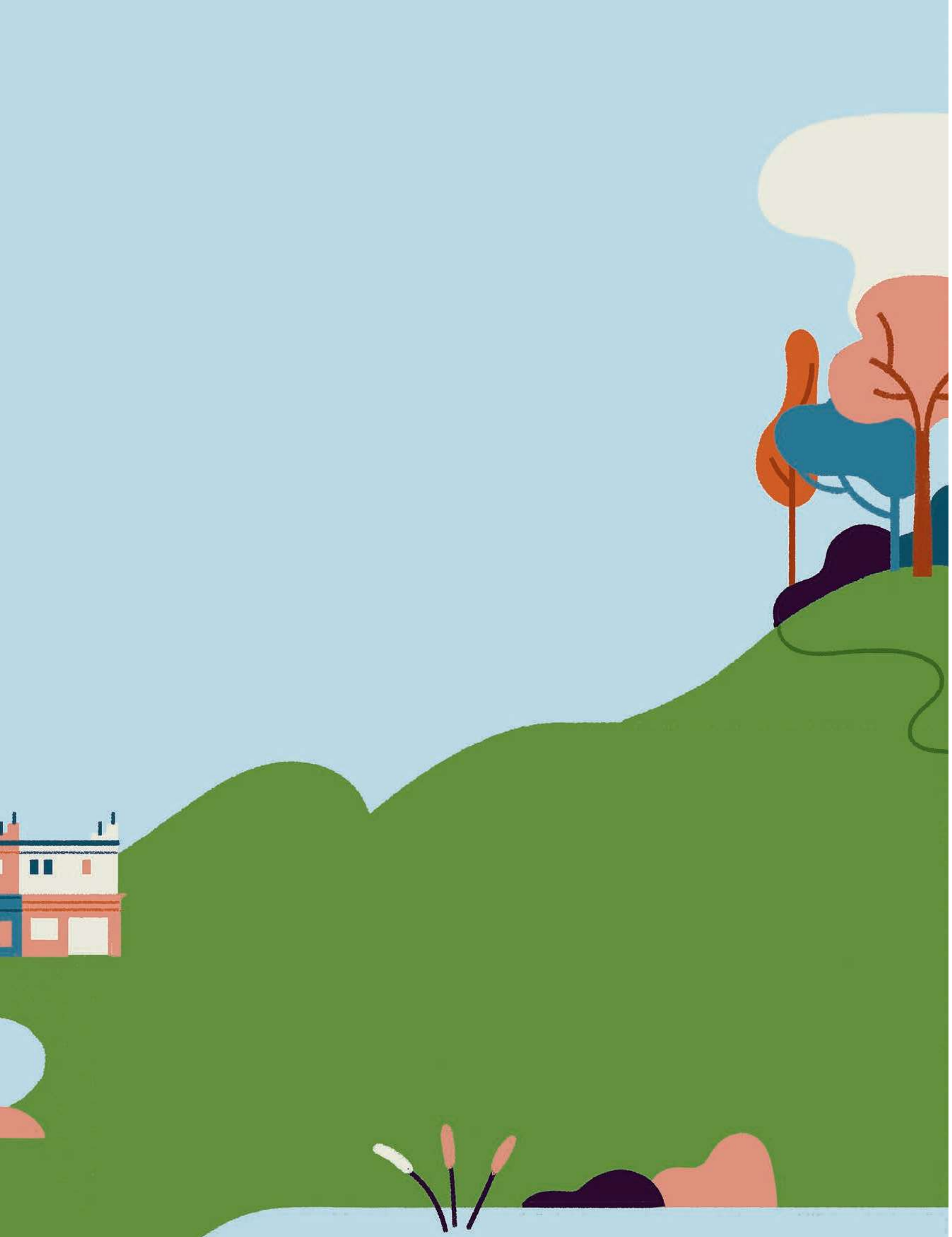
REPORT

*Savills Research*

# RESIDENTIAL PROPERTY FORECASTS

WINTER 2021

savills





# A year like no other

We opened one of our publications earlier this year by saying "2021 will be a complex year". Little did we know just how true this prediction would prove to be.

Record low mortgage rates and the demand for more space supported house price growth, particularly for larger properties. A range of stamp duty holidays across the UK simply added more heat to the market. Early data from after the holidays' end suggests the housing market has cooled back from a rolling boil to a gentle simmer.

Those rapid price rises across the country this year have eroded housing affordability, as Frances Clacy explores on page 8. In the North and Midlands, where affordability is less constrained, we can expect price growth to outperform. But in regions such as London and the South East, where affordability was already stretched, this will limit the pace of price growth over the next five years. The prime markets will prove the exception to this rule, bouncing back as international travellers return to central London.

On page 10, Guy Whittaker sets out our revised rental forecasts, predicting a resurgence in London as the lustre of city centre life returns. Emily Williams predicts housing delivery on page 12, weighing up greater government support for affordable housing against the withdrawal of Help to Buy. And on page 14, Lawrence Bowles answers the fiendishly difficult question of what happens to transaction numbers.

With a bit of luck, 2022 will be a less complex year than 2021. Regardless, our research will be here to help guide you through even the most challenging of market conditions.

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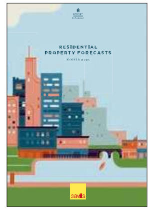
## 6 key takeaways from our report

1. Mainstream UK house prices will **rise 13.1%** by 2026
2. Growth will be **fastest in the North** of England and slowest in London
3. Rents in cities will **bounce back** as we see urban life regain its lustre
4. Transactions will slow after next year as the Government withdraws support, but working from home will **drive upsizer demand**
5. Even with a £12 billion Affordable Homes Programme, **we won't get back to 2019 levels of housing delivery until 2026**
6. **Prime central London will outperform** as international travel resumes



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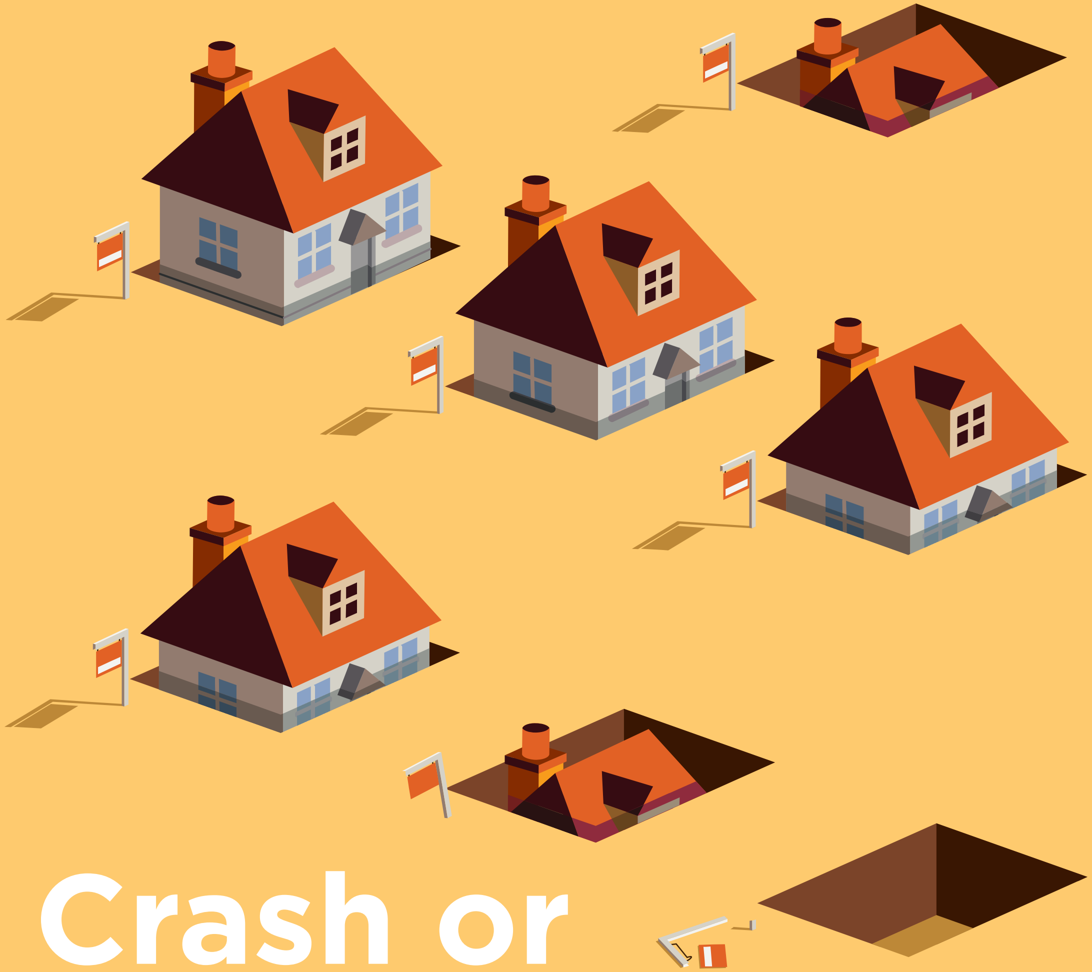

# Crash or cushioned?

The average UK house price has continued to rise strongly during 2021. Will economic factors lead to a dramatic correction of values or can we expect a more moderate response?

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Back in March 2020, all of the speculation was about how far house prices and transaction levels would fall as a result of the economic impact of Covid-19. Then, few could have predicted the scale of government intervention to support jobs and the housing market more directly.

### Hoodwinked

But still the market contrived to confound most housing experts, selling us the most outrageous dummy. The average UK house price rose by 12.3% over 18 months. And annual transaction levels hit 1.55 million in the year to September 2021, 30% more than the 2017-19 average. That begs the question as to what happens next, especially given the stamp duty holiday is over and many of the factors that encouraged homeowners to reconsider what they wanted from a home are fading.

### Looking like a soft landing

Together, this almost certainly means there will be less urgency in the market from 2022. We have already seen three-month on three-month house price growth fall from 3.9% at the end of June to 1.7% at the end of September.

We expect price growth next year to be much more muted than we have seen of late, with the prospect of the current burst of inflation persisting into next year and bringing forward the first anticipated interest rate rise.

But in the short term, there are a number of economic factors that support decelerating price growth as opposed to something more dramatic.

Firstly, interest rates are incredibly low. The average rate for a five-year fixed rate mortgage at a 75% loan-to-value (LTV) ratio was 1.29% at the end of September, according to the Bank of England. For buyers with more equity, lenders have fallen over each other to offer five-year rates well below 1%.

Secondly, the vast majority of mortgaged homeowners are insulated from rates rising earlier than expected, even if inflation continues to rise over the short term. This insulation has been provided by the 93% of mortgage borrowers who have locked into low, fixed rates and by the proportion of those who fixed for five years or more.

Thirdly, unemployment looks to have been contained, limiting the risk of forced sales. Indeed, mortgages in arrears currently represent just 1.2% of the outstanding loan book. That's lower than at any point in the past decade.

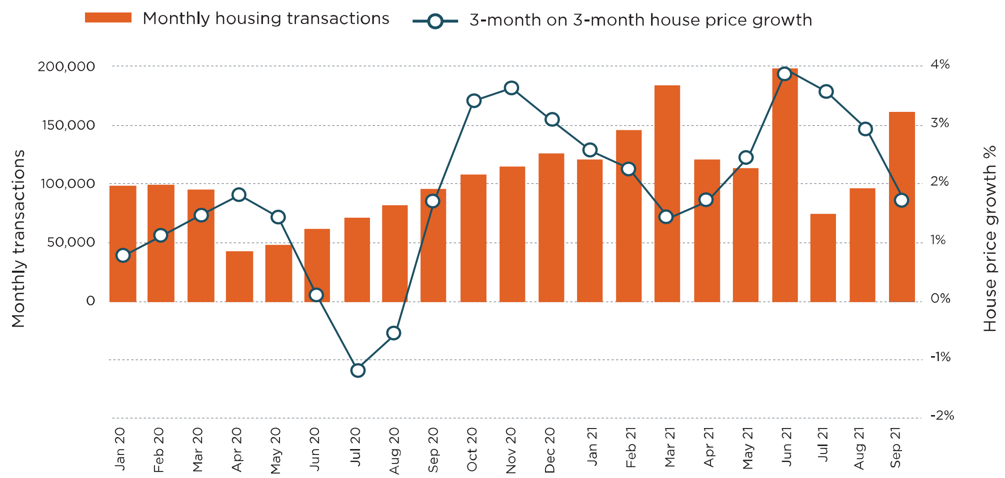
### Lead indicators

Such a moderation is further supported by lead indicators which are specific to the housing market.

First, the RICS housing market survey suggests that, though demand has softened, supply coming to the market has been more constrained. That means undersupply will continue to characterise the market going into 2022.

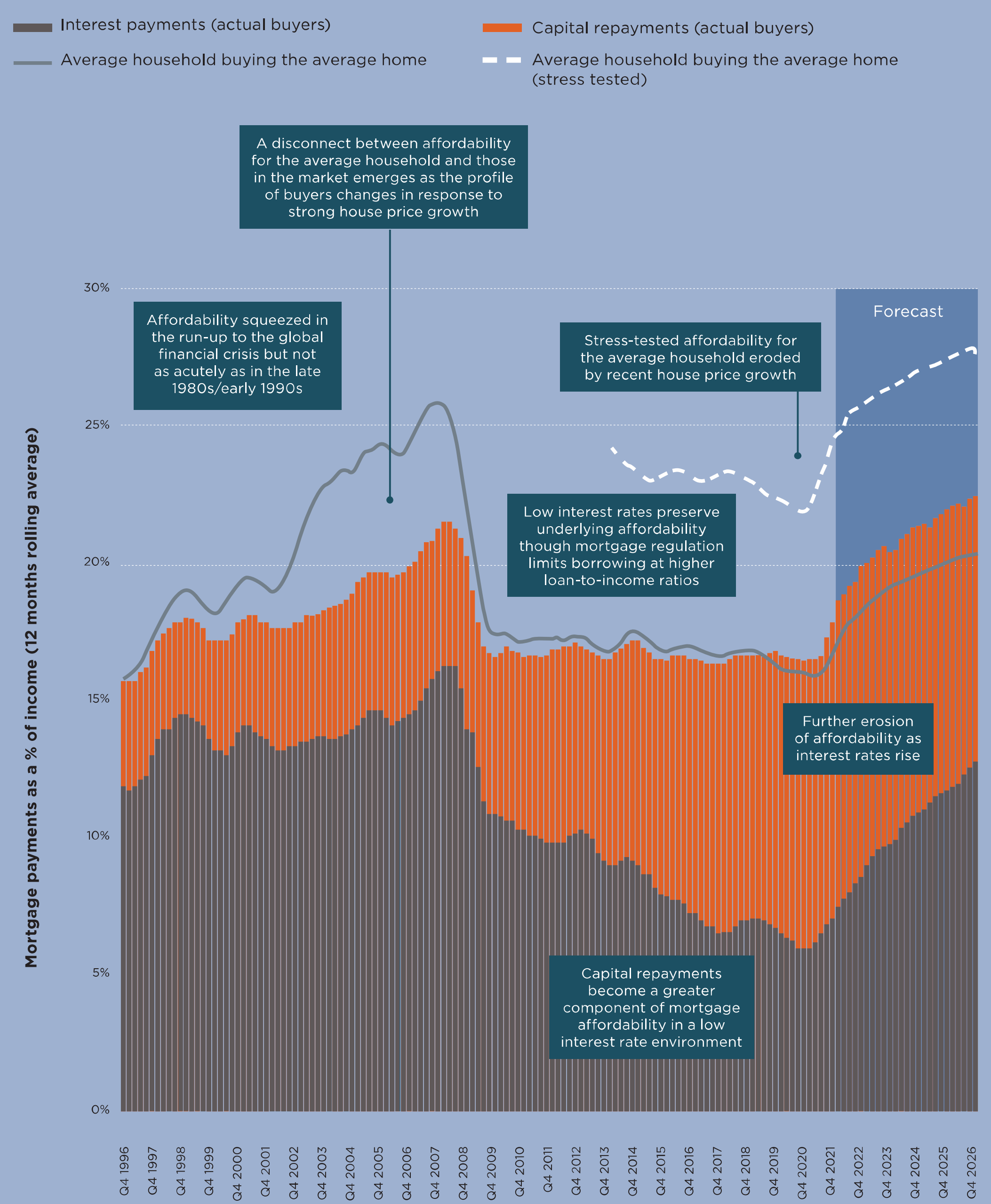
Data from TwentyCi supports this. In the three months to September 2021, the level of new stock coming to the market was 12% below that seen in the more normal market conditions of 2017-19. Meanwhile, the number of agreed sales was 26% higher than this benchmark, though much lower than earlier in the year.

**Transactions and growth in the mainstream housing market**




**Source** Savills Research using HMRC, Nationwide

## Affordability at point of purchase
(assuming 25-year repayment mortgage)




**Source** Savills Research using UK Finance, Oxford Economics





### Affordability constraints

Hoodwinkings and soft landings aside, you cannot escape the fact that the market has less capacity for price growth in the next five years because of what has happened in the past year and a half.

So while it looks as though the low cost of debt will protect the market from a downturn in the short term, gradually increasing rates are likely to constrain future price growth.

One of the oddities of the housing market recently is that while prices have risen during the pandemic, the average loan-to-income ratio among people actually buying has barely moved. That is because the market has been more weighted to more affluent households. As the market normalises, we expect to see that change; something unlikely to escape either the eagle eye of the lenders or the Bank of England.

That is likely to bring underlying affordability more sharply back into focus and, perhaps more pertinently, act as a drag on what households are able to borrow when rates start to rise. The affordability stress testing introduced in 2014 will add to that drag, particularly as rates trend upward.

### Interest rates and sensitivities

Accordingly, the capacity for price growth is sensitive to the speed and scale of those rate rises.

Our forecasts assume that the Bank raises rates twice in 2022, bringing them to 1.5% at the end of our forecast period before plateauing at 1.75% at the end of 2027 (beyond the end of our forecasting period). For consumers, this could result in a double whammy: an increase in variable rates and a higher premium to secure a fixed rate, though in part this will depend on the appetite of lenders.

In these circumstances, we expect the average UK house price to rise by 13.1% over the next five years. Growth beyond that would limit the profile of people able to buy with a consequential impact on longer-term transaction volumes.

> "We expect the average UK house price to rise by 13.1% over the next five years. Growth beyond that would limit the profile of people able to buy"

### Mainstream residential forecasts and economic assumptions

| | Type | 2022 | 2023 | 2024 | 2025 | 2026 | 5 years to 2026 |
|---|---|---|---|---|---|---|---|
| UK house price growth | Annual growth | 3.5% | 3.0% | 2.5% | 2.0% | 1.5% | 13.1% |
| Transactions (millions) | Annual total | 1.24 | 1.14 | 1.09 | 1.09 | 1.09 | |
| Real GDP growth* | Annual growth | 5.8% | 2.4% | 1.7% | 1.7% | 1.6% | 13.9% |
| Unemployment rate* | Year-end figure | 4.4% | 4.2% | 4.0% | 3.8% | 3.8% | |
| Bank base rate* | Year-end figure | 0.5% | 0.75% | 1.0% | 1.25% | 1.5% | |

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

# Residential forecasts

We expect the mainstream markets of Wales, Scotland and the North of England to show the strongest price growth, as has occurred historically at this point in the housing cycle. Price growth looks more constrained in London except in the capital's prime markets

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PRIME MARKETS

The rarefied prime housing market of central London continues to look good value in a historical context and is expected to benefit from an increase in overseas demand as international travel picks up. That presents the prospect of a strong burst of house price growth next year, though a general election in 2024 could interrupt a more sustained recovery.

More generally, the equity-rich prime housing markets are less dependent on mortgage affordability and interest rates. But the prospect of an increased tax burden for wealthier households tempers our view on the levels of growth in the more domestic part of the market.

Across all markets we expect to see the change in working patterns underpin demand in suburban and more rural areas further away from major employment centres, albeit to a lesser degree than we have seen in the past year and a half.

*You can read more about the prospects for the prime housing market in Prime Residential Property Forecasts.*

**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 residential forecasts

Five-year house price forecasts

| | 2022 | 2023 | 2024 | 2025 | 2026 | 5-year |
|---|---|---|---|---|---|---|
| Prime central London | 8.0% | 4.0% | 2.0% | 4.0% | 4.0% | 23.9% |
| Prime outer London | 4.0% | 3.0% | 2.0% | 2.0% | 2.0% | 13.7% |
| Prime regional | 4.0% | 3.5% | 3.0% | 3.5% | 4.0% | 19.3% |

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

MAINSTREAM MARKETS

While all regions have seen upward pressure on prices since the market reopened in June 2020, it has been strongest across the markets of Wales, Scotland and the North of England. That was to be expected at this point in the housing market cycle, even if the extraordinary levels of growth seen in some parts of the country were not.

And if historical trends are anything to go by, the north-south divide in house prices looks set to close further over the next five years. The Government's levelling-up agenda has the potential to play to this, though it is much less clear whether it will have a material effect on prices during our forecast period.

The potential for price growth looks particularly constrained in the London mainstream market, which has become increasingly confined to more affluent households. That reflects the extent to which London prices became dislocated from the rest of the UK housing market from 2005 to 2016, something that continues to have a bearing on our price expectations. However, housing supply in London remains far below need. New developments, particularly those in areas connected to both employment centres and green space, will continue to perform well.

## Mainstream residential forecasts

Five-year house price forecasts

| | 2022 | 2023 | 2024 | 2025 | 2026 | 5-year |
|---|---|---|---|---|---|---|
| North West | 4.5% | 4.0% | 3.5% | 3.0% | 2.5% | 18.8% |
| Yorkshire/ Humber | 4.5% | 4.0% | 3.5% | 3.0% | 2.5% | 18.8% |
| Wales | 4.0% | 4.0% | 3.5% | 3.0% | 2.5% | 18.2% |
| North East | 4.0% | 3.5% | 3.5% | 3.0% | 2.5% | 17.6% |
| East Midlands | 4.0% | 3.5% | 3.0% | 2.5% | 2.0% | 15.9% |
| West Midlands | 4.0% | 3.5% | 3.0% | 2.5% | 2.0% | 15.9% |
| Scotland | 4.0% | 3.5% | 3.0% | 2.5% | 2.0% | 15.9% |
| South West | 3.5% | 3.0% | 2.5% | 2.0% | 1.5% | 13.1% |
| South East | 3.0% | 2.5% | 2.0% | 1.5% | 1.0% | 10.4% |
| East of England | 3.0% | 2.5% | 2.0% | 1.5% | 1.0% | 10.4% |
| London | 2.0% | 1.5% | 1.0% | 0.5% | 0.5% | 5.6% |
| UK | 3.5% | 3.0% | 2.5% | 2.0% | 1.5% | 13.1% |

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

# Rental revival

As people return to the cities, we expect a strong recovery in rental values. Plus, we see encouraging signs that a fast-growing Build to Rent sector will provide wider choice

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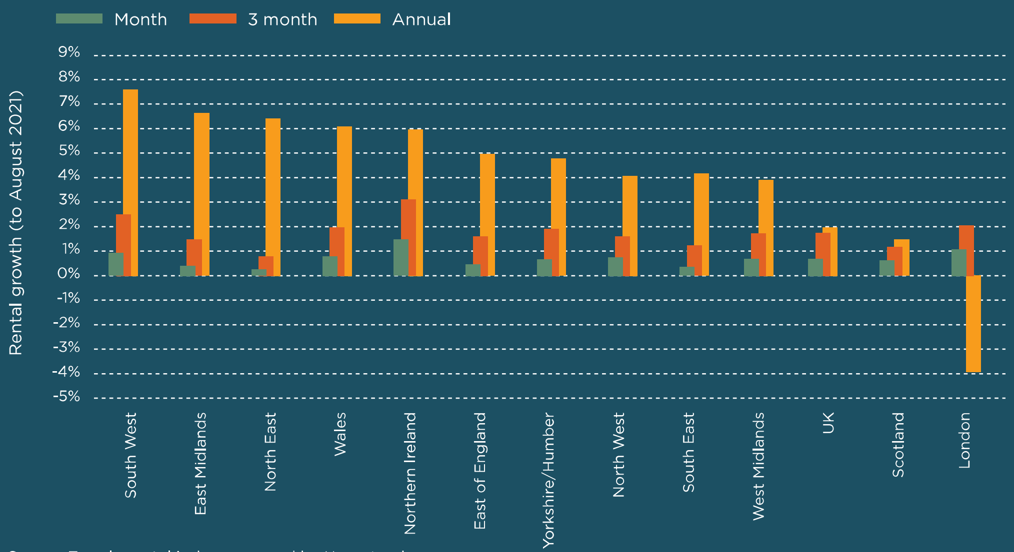
## 1

The first eight months of 2021 saw the divergence of last year's rental market start to unwind. Rents began to recover in cities, with a return to annual growth in markets such as Manchester, Birmingham and Edinburgh. And while London rents were lower in August 2021 than in 2020, the capital saw the second-fastest monthly rental growth after Northern Ireland (see below).

### Regional rental growth




**Source** Zoopla rental index, powered by Hometrack

## 2

Students and young workers are returning to cities, pushing up tenant demand, while rental supply is falling. UK Finance data suggests landlords redeemed 56,500 buy-to-let mortgages in the year to July 2021. And analysis of Zoopla listings shows 8% of properties listed for sale in Q3 2021 had been rented out in the past three years, more than double the proportion in 2019. The RICS September survey recorded the largest-ever gap between tenant demand and rental supply.

## 3

Mortgage data shows the stock of buy-to-let properties is growing far slower than before. As interest rates rise over the next five years, we'll see further pressure on mortgaged landlords, many of whom face a far less generous tax environment than when they first bought. This creates a gap in the market, which we expect Build to Rent (BtR) will grow to fill.

BtR homes make up a tiny proportion of the broader rental market – under 2% of all homes for rent. But this subsector is growing quickly. There are just under 64,000 BtR homes complete and let, with a further 42,000 homes under construction and 99,500 homes in planning. The total pipeline has grown elevenfold in the past decade.

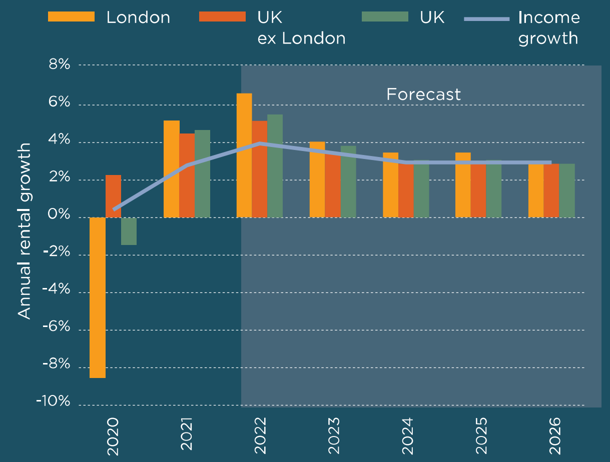
With a diverse list of entrants spanning Goldman Sachs, Transport for London, and John Lewis & Partners, there is no shortfall of ambition. Citra, Lloyds Bank's new BtR arm, has announced it wants to build a portfolio of 50,000 homes, more than three quarters the size of the current total BtR stock.

Recently, we have seen investors turn their attention to building suburban houses for rent, diversifying a sector dominated by urban apartments: 90% of operational BtR homes are flats. As the sector continues to grow, diversify and mature, we can expect investor partnerships with housebuilders to support a rising share of housing delivery across the UK.

## 4

Beyond a rent rebound in 2022, we expect rents to resume their long-term correlation with income growth. That means we expect UK rents to rise by **19.9%** over the next five years, in line with expectations for incomes. In London we expect rental growth in 2022 will regain much of the ground lost in 2020, boosting the five-year outlook. There, we expect rents to be **22.2%** higher at the end of 2026 than where they are today.

### Annual rental growth 2020-2026




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

## 5

We predict that rents in London and other cities will continue to recover through 2022. More than half of Savills lettings agents said proximity to transport links was one of tenants' top three priorities when choosing their next rental property, according to our Q3 2021 agent survey.

# The future of housebuilding

Although it will take years for housing delivery to return to pre-pandemic levels, affordable housing and Build to Rent are expected to make up a greater share of housing delivery over the next five years, says Emily Williams

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**£12 billion**
Funding from the 2021-26 Affordable Homes Programme to deliver 180,000 homes over the next five years

**60,000**
The average number of new affordable homes we expect to complete each year until 2026

**7,000 to 14,000**
The increase in homes built specifically for the private rental sector between 2016/17 and 2019/20

**-25%**
The fall in annual housebuilding starts in England in 2020/21

**2025/26**
The earliest time frame we expect housing delivery to return to pre-pandemic levels





In the year to March 2021, England's housing delivery fell by 15%. The new Affordable Homes Programme and rising Build to Rent (BtR) investment will help fuel the recovery, but we predict housing delivery will fall again in 2021/22 and only return to pre-pandemic levels in 2025/26.

### You can only finish what you've started

The fall in housing supply through 2021 and 2022 is largely down to construction timings. While housing completions fell by 15% in 2020/21, starts were down 25% year on year. That smaller pipeline of homes under construction means we'll see fewer homes completed in the coming year.

This adds to a trend that emerged long before Covid-19. The number of homes under construction had been falling since the beginning of 2019, as completion numbers overtook starts. Housing delivery must naturally fall as a result. But why are housebuilders starting work on fewer homes?

### Bye-bye, Help to Buy

One reason could be that housebuilders were preparing for a drop in demand as the Government introduced tighter restrictions on the Help to Buy (HtB) scheme in April 2021. Through 2019, Savills land agency colleagues reported growing demand for smaller sites that could be completed before the HtB restrictions came into place. With the scheme due to end entirely in 2023, housebuilders may be more hesitant to commit to larger sites.

Another reason for falling starts may be that we don't have enough land with planning permission in the right places. Our analysis shows the average planning permission is getting bigger, which means sites gaining consent now will take longer to deliver. It also shows permissions are skewed to areas with lower housing demand, with land availability stubbornly low in the markets where affordability pressures are greatest.

The withdrawal of government support and the challenge of building out homes on larger sites mean we expect affordable housing and BtR to make up a greater share of housing delivery over the next five years.

### Diversity of tenure

The 2021-26 Affordable Homes Programme commits £12 billion in funding to deliver 180,000 homes over the next five years. We also have growing demand from investors through for-profit social housing providers, greater development capacity from local authorities, and commitment from housing associations to keep investing in new homes.

While we expect fewer affordable homes from developer contributions over the next five years, we still expect an average of 60,000 new affordable homes to complete each year until 2026.

We also expect large institutional investors to back the delivery of more homes for private rent. The number of homes built specifically for the private rental market doubled between 2016/17 and 2019/20, from around 7,000 to 14,000 completions. With rising investor demand for homes in suburban and town locations, we believe delivery could more than double again to 30,000 annual BtR completions by 2025/26.

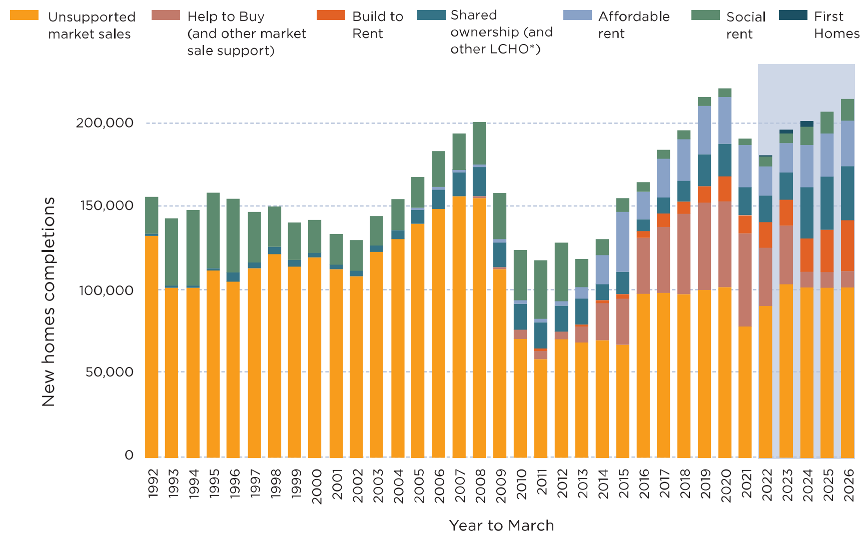
### Reaching new heights?

Developers are also facing the possibility of significant shifts in housebuilding policy. In recent years, the Government has given the housebuilding industry a clear target of building 300,000 homes a year, and focused interventions on ensuring that the planning system is responding to the market to deliver into high-demand areas. Housing affordability has been used as a key indicator for places that need higher volumes of new homes.

However, the appointment of Michael Gove as Secretary of State for Levelling Up, Housing and Communities appears to be signalling a shift in government thinking. At the Conservative Party Conference, Gove mentioned that "focus [for housebuilding] shouldn't necessarily be geographically where it's been before", instead focusing on the Midlands and North of England as part of the wider levelling-up agenda.

While the Government so far remains committed to the 300,000 homes target, it is unclear how this level of development can be achieved if planning policy is not aligned with market signals.

## Annual new homes completions by tenure




**Source** Savills Research using data from the Department for Levelling Up, Housing and Communities (DfLUHC)

* Low Cost Home Ownership schemes

# TRANSACTIONS Q&A

## Which buyers have been most active in the market? And has that now peaked? Lawrence Bowles provides some much-needed clarity

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**How much has the "race for space" boosted transaction levels?**
**LB** Overall transactions averaged 1,196,000 a year between 2017 and 2019. They rose to 1,552,000 in the year to September 2021, fuelled by three significant monthly spikes as buyers sought to complete purchases prior to various stamp duty holiday deadlines. As has been well documented, upsizers drove much of that boost in activity, as they looked for more space inside and outside the home.

However, we have seen an increase in activity across all buyer types. That includes first-time buyers, despite the growing challenge of raising a deposit to let them access competitive mortgage finance. It also includes buy-to-let investors who face an ever-increasing regulatory burden.

**What has been the increase in transactions by buyer type in the year to June 2021 (v 2017-2019)?**
- Mortgaged first-time buyers +13%
- Mortgaged home movers +31%
- Buy-to-let investors +31%
- Cash buyers +22%

**What has happened since the stamp duty holiday ended in September and what does that tell us about what happens next?**
**LB** Data from TwentyCi shows the number of agreed sales is still higher than in a normal market, while this number has eased back since the end of May. This is particularly true for higher price bands. That suggests the reprioritisation of housing needs will continue to support higher than normal housing transactions into next year. In certain parts of the market, this will be tempered by a lack of stock.

**How is the make-up of transactions expected to change over the next five years?**
**LB** Even as transaction levels return to their pre-pandemic norm, we expect their composition to change. Some of the increased propensity to trade up the housing ladder is likely to stick as people work from home more often. There is also the prospect that flat owners who have been unable to move because of cladding issues will return to the market over our forecast period.

The outlook for first-time buyer numbers is less certain. In England, Help to Buy has supported 12% of mortgaged first-time buyer purchases in the past five years. But it is due to come to an end in April 2023. And despite various efforts to increase the availability of higher loan-to-value mortgages (to reduce first-time buyer deposit requirements), nothing has been proposed anywhere near the scale of Help to Buy. This will increase reliance on the Bank of Mum and Dad, which we expect to fund more than 40% of first-time buyer purchases over the next three years.

That is likely to place further pressure on the private rented sector and support demand for the growing institutional investment in that area.

By contrast, as interest rates rise, we expect to see further pressure on mortgaged buy-to-let landlords. This will compound as those landlords face the cost of renovating their properties to meet rising energy efficiency standards.

**And what about cash buyers?**
**LB** Since the financial crisis, cash buyers have played an important role in the market, both as investors and owner-occupiers. The buoyant market conditions since June 2020 have presented an opportunity for downsizers to unlock some of the equity tied up in their existing homes. For many, however, the lack of a suitable home to downsize to is the main barrier to moving. This said, we have seen a significant increase in interest in developing housing for older people, which is likely to open up more activity among this group.

### Transaction levels by buyer type

| | Average 2017-2019 actual | 2020 actual | 2021 expected | 2022 forecast | 2023 forecast | 2024 forecast | 2025 forecast | 2026 forecast |
|---|---|---|---|---|---|---|---|---|
| Mortgaged first-time buyers | 350,000 | 304,000 | 400,000 | 340,000 | 300,000 | 290,000 | 290,000 | 290,000 |
| Mortgaged home movers | 351,000 | 310,000 | 460,000 | 380,000 | 350,000 | 330,000 | 330,000 | 330,000 |
| Mortgaged buy-to-let investors | 75,000 | 65,000 | 110,000 | 80,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| Cash buyers | 420,000 | 366,000 | 520,000 | 450,000 | 420,000 | 400,000 | 400,000 | 400,000 |
| Total | 1,196,000 | 1,044,000 | 1,490,000 | 1,240,000 | 1,140,000 | 1,090,000 | 1,090,000 | 1,090,000 |

**Note** Figures may not sum exactly due to rounding **Source** Savills Research, UK Finance, HMRC



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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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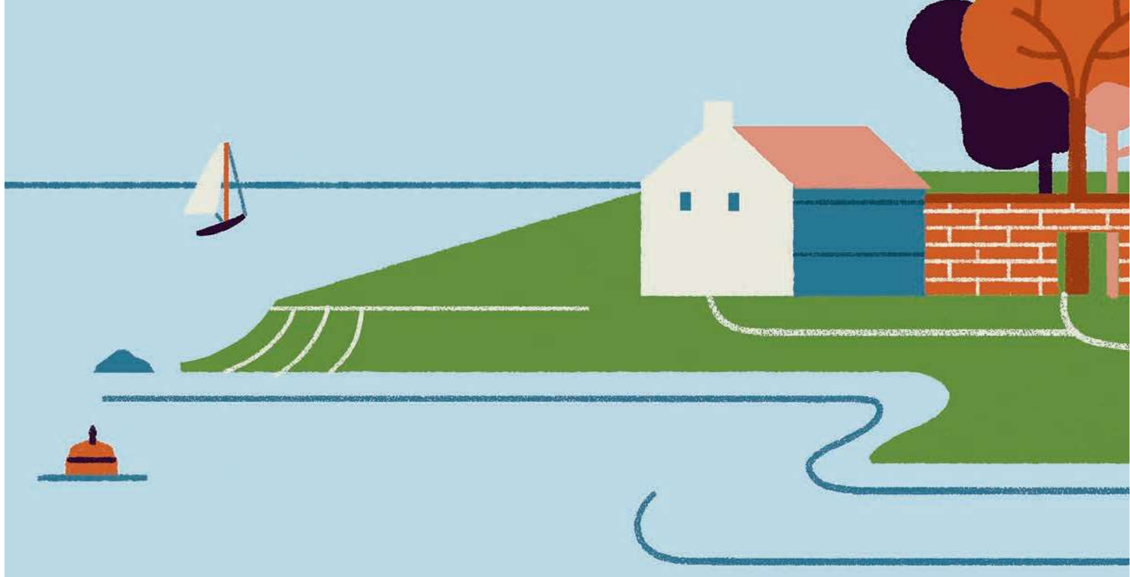

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