Rental growth and rental affordability

July 2017

- Residential rental growth over the last decade has ranged from +45% to -7% across regions. The variance is largely explained by local economic factors.
- Rents have tracked earnings over the long run. Rental affordability is worst in London while it is the best for a decade in regions outside southern England.
- Rents are expected to fall by 1-2% in London over 2017 while outside London rents are set to increase by 3% with higher growth in the Midlands and Eastern regions.

Where next for private rents?

The stock of private rented homes has grown by 1.1m (31%) since the global financial crisis. Demand for rented housing has also grown but the impact on rents varies widely. This paper examines the long run trends in rental growth and affordability and considers the near term outlook.

Hometrack rental index reveals long run trends

Hometrack's regional rental indices track average asking rents from 2004 onwards across England and Wales. Figure 1 plots year on year growth in rents and average earnings over this period. The chart shows two rental series – one for London and the second for England and Wales (E&W) excluding London.

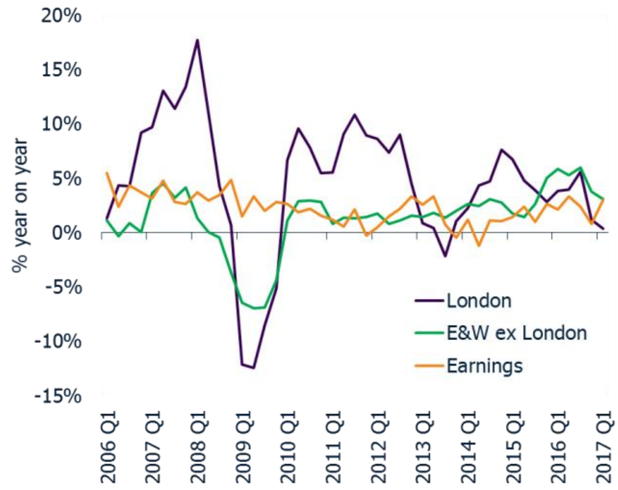
Rents fell between 2008 and 2010

Rents fell between 6 and 12% during the global financial crisis as accidental landlord's boosted supply while falling employment weakened demand. Since 2010 rental growth at a national level, outside London, has largely tracked the growth in average earnings with the growth in rents averaging 2.7% per annum.

Strong demand drives out-performance in London

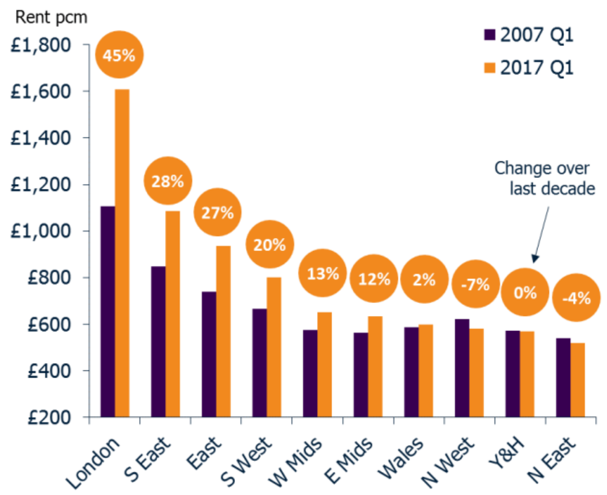
London has recorded higher levels of rental growth since 2010 averaging 4.5% per annum with periods of weaker inflation in 2013 and now in 2017. Strong employment growth in London over this time, 2-3x faster than other regions, has increased rental demand. In addition, high house prices and tighter mortgage regulation have made it harder for first time buyers to transition from renting to buying, further sustaining demand for rented housing.

Fig. 1 – Growth in rents and earnings



Source: Hometrack

Fig. 2 – Rents and rental growth over last decade

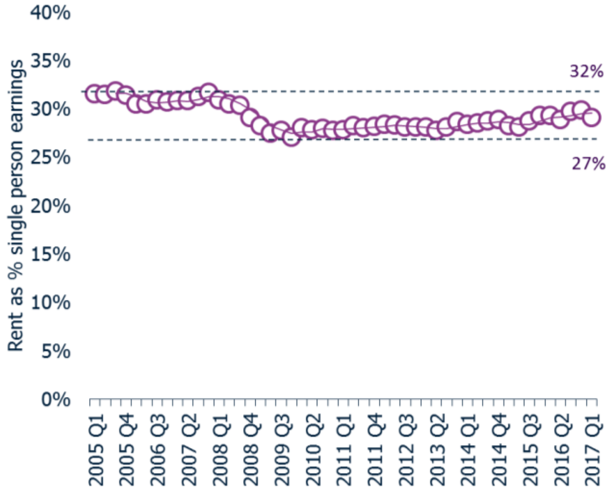


Source: Hometrack

Wide variation in rental growth over last decade

Figure 2 puts the change in rents over the last decade in context. While rents have increased by 45% in London, and over 20% in southern regions, rents elsewhere have been broadly flat in nominal terms with weaker growth in employment and earnings failing to offset the fall in rents recorded in 2008/9.

Fig.3 – Affordability - rent as % average earnings



Source: Hometrack/ONS

Rents track earnings over the long run

At the national level rental affordability has been broadly stable over the long run with rents accounting for between 27% and 32% of gross annual earnings over the last 12 years (figure 3). This is not surprising as tenants can only allocate a certain percentage of earnings towards housing costs. This feature of the market makes investing in housing attractive for those seeking an asset where the underlying performance is linked to earnings growth.

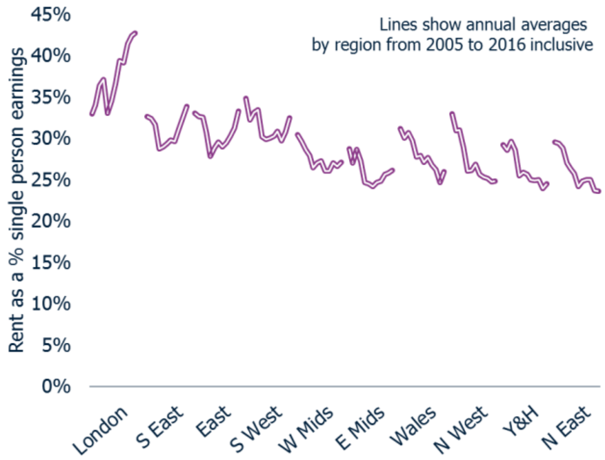
Affordability impacted by varying occupancy levels

Our analysis of affordability makes allowance for differing levels of occupancy for rented housing i.e. more than one earner per rented home. In markets with the greatest demand pressures levels of occupancy are higher. This is one reason why rental growth in London has run at close to 5% per annum in recent years. Census data shows that 60% of 2 bed private rented homes in London are 'fully occupied' compared to 32% for owner occupied property.

Diverse profile of rental affordability across regions

Figure 4 plots the annual trend in rental affordability by region between 2005 and 2016. The relative differences across the country are clear with Wales, the Midlands and Northern regions having the most attractive affordability in contrast to stretched affordability levels in London. It is not surprising that rental growth in London has slowed to 0.4%. Outside London rental growth is running at 3.1%.

Fig.4 – Regional affordability 2005-2016*



Source: Hometrack/ONS
**Modest occupancy adjustment made in London, S East*

Rents in London to post small falls in 2017

We expect average rents in London to fall over 2017 by 1-2% on stretched affordability and slower jobs growth. We expect a tightening in rental supply in the next 12 months to support rent levels, primarily in London. Higher levels of stamp duty and changes to tax relief for landlords have reduced new purchases, with buy to let borrowing down 30% on 2015 levels.

Rental growth to run at 2-3% pa outside London

In contrast, we expect rental growth outside London to continue to track earnings growth with rents rising at 2-3% per annum. Rental growth looks set to outperform in the Midlands and Eastern regions where rents are currently increasing at close to 5% per annum.

Hometrack
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