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THE NEW PRIME

The impact of equity-rich owners on rural, coastal and scenic markets

Market Insights

2023 Vol. I

WELCOME

In the latest of our Market Insights series, real estate guru Yolande Barnes has delivered another in-depth look at current forces and trends in the UK's prime sectors.

The research and commentary contains some fascinating findings: the surprising amount of equity held in UK property and the geographical distribution of that equity; the dominance of rural, coastal and scenic locations by equity-rich owners, and how this differentiates these sectors.

We expect 2023 to be a challenging time to find 'best in class' property. This research will help us to navigate those headwinds and ensure that our advice to clients is based on robust intelligence to back up our instincts and experience.

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EXECUTIVE SUMMARY

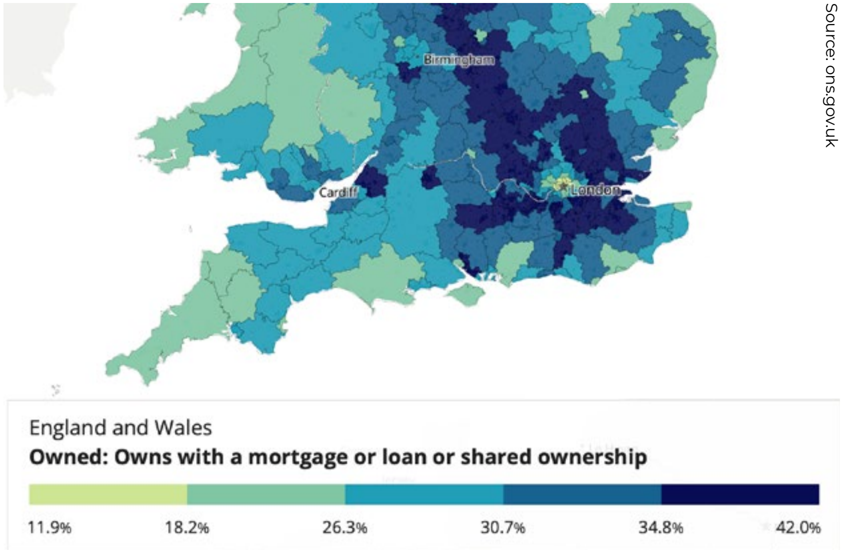
- Prime housing markets have behaved very differently from mainstream, mortgaged housing over recent decades.
- Prime markets, particularly in London, have tended to lead recovery after recession and have out-performed average UK price rises since the 1980s.
- The factors driving price growth in prime central London were very powerful until 2014 when prices seem to have hit a high plateau and stopped growing above the rate of mainstream markets.
- Before 2014, a perfect storm of urban renaissance, the rising power and significance of London on the global stage, the success of business, stock markets and other investment markets, wealth creation, falling yields and rising asset prices made 'very prime London' residential property one of the highest performing asset classes in the world.
- In 5 out of 8 distinct market phases since the millennium, prime central London property has performed in a diametrically opposite way to the mass markets monitored by the building societies and transaction-based indices in the rest of the UK.
- But it is important to learn from the behaviour of prime markets in the past because there are now parts of the mainstream housing market which are behaving more like prime markets used to.
- This is because significant proportions of the housing market have escaped the confines of mortgage lenders and indebtedness, having very little or no reliance on borrowing. This is through both debt repayment and the creation of new wealth and equity which has been invested in real estate.
- Over half of all owner occupiers own outright, without a mortgage. This is a complete turnaround from just 20 years ago when nearly 60% of homeowners were mortgagors.
- As a result, the relationship between house prices, mortgage interest rates and household incomes has broken down for the 55% of all households who own outright, without borrowing.
- The geographical distribution of equity-rich households is very different to that of households reliant on jobs, incomes, interest rates and lending policies. Housing equity is concentrated in coastal and countryside areas which offer quality of life without the ties of regular contact or commuting to employment centres.
- Mortgage lending is heavily linked to workplaces and commuting patterns. Even after Covid, mortgagors still seem to be tied to the workplace and their source of income. It is therefore local wages and national interest rates that will continue to hold sway over those, now minority, markets.
- For equity-rich households, the opportunity cost of money, the alternative uses and value of their housing wealth is more important. In this way, the driving factors of house price growth have become much more like those which have governed prime housing markets over the past few decades.

■ The factors and considerations which dominate the prime markets are of increasing relevance to other UK markets. Understanding the drivers of, and limits to growth in prime markets will now be key to understanding the future of many more mainstream markets.

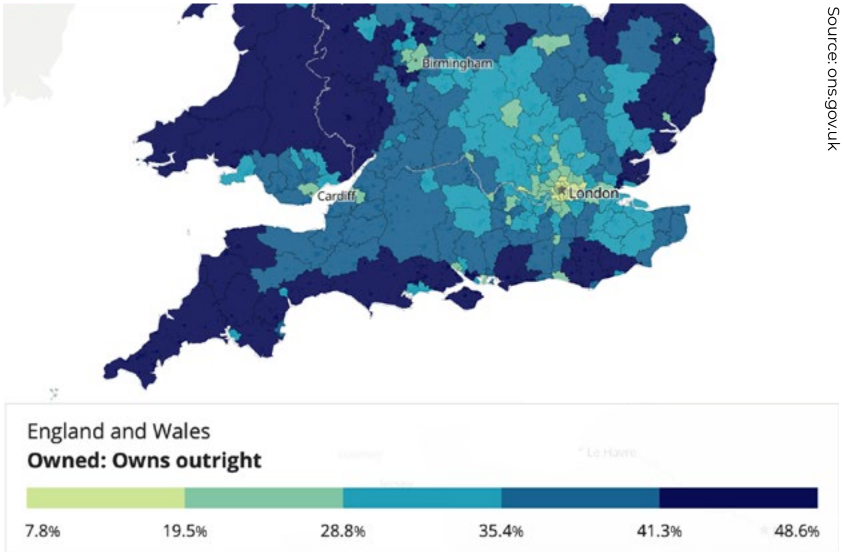
■ The very prime central London residential market has barely recovered following seven years of falling prices. Demand has shifted away from central London toward alternative towns and cities and toward country houses. This started before the pandemic.

■ Equity-rich owners are like prime owners in having much more discretion in buying and selling behaviour. In the event of recession, these markets are less likely to be supplied by forced sales due to debt. Supply may be much more restricted as a result and sellers more likely to withdraw from weak markets. This means that recession is less likely to produce price falls on the same scale as mortgage-reliant, mainstream markets but more likely to result in significantly lower levels of turnover.

■ An understanding of the recent history of prime markets and trends in housing demand and market behaviour are outlined in this report to help buyers and sellers to understand how their assets may behave in future and why.



Source: ons.gov.uk



Source: ons.gov.uk

SCAN HERE TO VIEW INTERACTIVE MAPS ONLINE

THE NEW PRIME

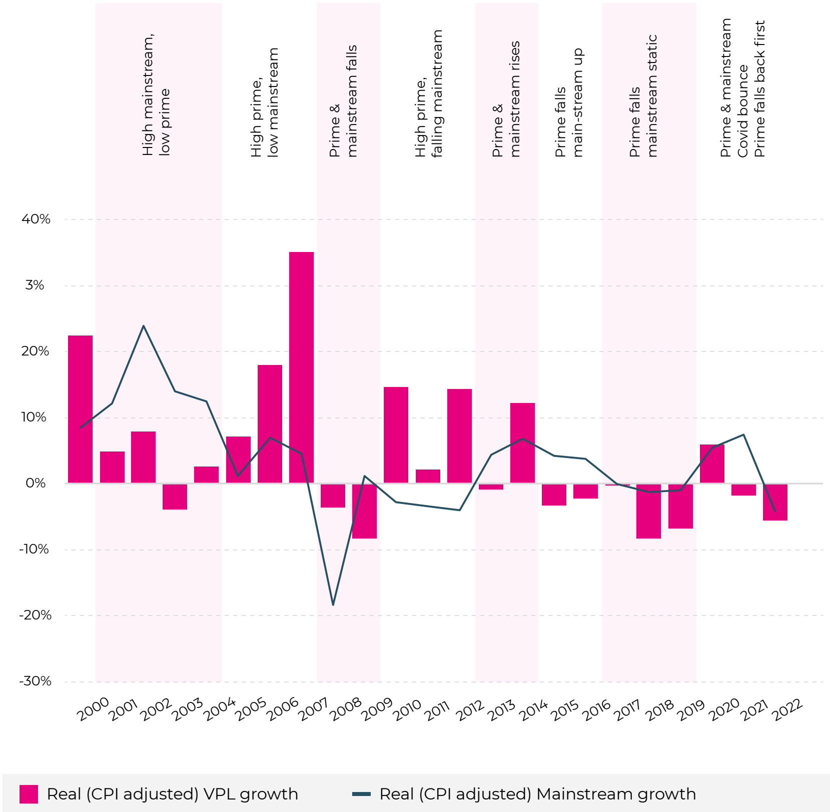
UP OR DOWN? WHAT'S HAPPENED TO HOUSING MARKETS SO FAR THIS MILLENNIUM

The new year always brings a flurry of statistics and forecasts which claim to report on 'the UK housing market'. There are not many homeowners who will be able to relate these averaged, national figures to what has happened in local and niche markets because there are significant variations around these norms. This is particularly the case if the property in question is in the most expensive parts of central London.

Neither are single figures covering just the past 12 months particularly useful in markets where the average holding period is in the region of 20 years – and rising.

Owners in the very prime areas of central London (Holland Park, Notting Hill, Kensington, South Kensington, Chelsea, Knightsbridge, Belgravia, Mayfair and St James) spent 5 years from September 2014 watching the value of their properties slump by about -12%. Only the extraordinary post Covid markets have now (nearly) restored values back to those 8 years ago. Prime London prices are growing in nominal terms. As with all markets, it is now inflation and currency shifts which threatens devaluation.

GRAPH 1: VERY PRIME LONDON & UK MAINSTREAM GROWTH COMPARED



Source: Nationwide BS, YBC, LonRes

Meanwhile, the mainstream housing market, reported by the mortgage lenders and those monitoring transactions, shows a very different pattern of growth. According to the Nationwide Building society, for example, 'average' UK house prices continued to grow while prime markets in London fell. The Covid era bounce has also been more profound in mainstream markets and prime country markets than in prime London ones, partly because demand seems to have shifted away from major urban conurbations to other types of traditional prime properties and new types of prime property in regional markets.

These profound differences in behaviour between prime markets and mainstream is not new. There have been eight market phases since the start of the millennium and in only 3 of them have prime and mainstream markets behaved in the same way.

Graph 1 (see p.9) shows prime and mainstream price growth, inflation-adjusted to make different time periods more directly comparable. It shows that, most of the time, prime and mainstream markets have behaved in diametrically opposed ways.

WHY HAS VERY PRIME LONDON BEEN DIFFERENT?

At the start of the millennium, UK mainstream markets boomed, growing 87% in 4 years. Very prime London on the other hand, having doubled in value over the previous 5 years, only grew by 18% over the same period. There were other factors impacting this rarefied market which were much less relevant to ordinary homeowners with mortgages.

These factors have much to do with wealth creation and confidence: in the city, in business, in the country and in the real estate market. In particular, the availability of equity, through bonuses, dividends, IPOs and other investment and business activity is more important in prime London markets than is the case with domestic, mortgaged markets.

In these circumstances, the effects of the dot com stock market crash had much greater immediate effects on demand in prime markets than in mainstream. But, by 2004, confidence was back and London's streets were once again paved with gold as purchasers searched for stores of wealth in real assets. Gold and very prime London homes both grew in value by about 80% before the Global financial crises hit both prime and mainstream markets hard.

Prime markets bounced back sooner than mainstream though after 2009, largely thanks to the effects of Quantitative Easing (QE) on stock markets and asset prices. While mainstream markets continued to suffer from the effects of recession and financial turmoil, prime London property grew nearly 50% in the three years leading up to the London Olympics.

The next two years were a rare period when mainstream house prices and prime prices grew substantially by the same amount, side by side. But while mainstream prices, powered by ultra-low mortgage rates and improving economic conditions continued to grow, prime London property began a prolonged period of decline. A combination of factors may account for this. The first is that interest rates had reached an all-time low. The growth in many asset classes, including property, that had resulted from a pronounced downward shift in yields simply had nowhere else to go. Prices hit a high plateau and this may have coincided with a feeling that they also reflected 'peak London' and the start of a shift in demand away from prime neighbourhoods to alternative neighbourhoods and away from London and other big conurbations toward smaller towns and cities, villages and rural property.

COUNTRY MARKETS HAVE BEEN DIFFERENT TOO

Even before the Covid pandemic, there was some evidence that demand for homes was shifting, away from major conurbations toward small towns and cities and back toward rural properties.

Prime country properties suffered a long spell of price stagnation after the 1990s recession during which time prime London prices rose rapidly on the back of unprecedented demand for affluent, city centre living. The appetite for country houses, seen in the 1980s, never quite recovered so that London houses commanded a significant premium over their Country cousins.

Table 1 below shows the results of house price analysis from ONS statistics relating to rural-urban classifications. It uses the structure of the eight market phases to show how different types of property outside London have fallen in and out of favour with house buyers.

This urban to rural shift in demand is further evidenced in table 2 (see appendix, p.20) which shows growing markets in blue and falling or under-performing markets in

TABLE 1: PRICE CHANGES FOR UK HOUSING, COMMODITIES AND EQUITIES 1995-2020

	Pre millennium prime boom *1995-2000*	Dot.com prime slump *2000-2004*	Prime London boom *2004-2007*	Financial crisis *2007-2009*	QE powered London Olympics boom *2009-2012*	Mainstream recovery *2012-2014*	Prime London slump *2014-2016*	Mainstream high plateau, Prime London slump (contd.) *2016-2019*	Covid demand shift *2019-2022*	Last 22 years *2000-2022*
Mainstream growth	60%	87%	21%	-12%	0%	16%	9%	5%	23%	255%
Prime growth	99%	18%	80%	-6%	47%	16%	-5%	-8%	11%	310%
10 yr Gilts	53.4%	9.1%	-2.8%	28.5%	108.2%	-15.1%	63.1%	75.3%	-79.8%	38.6%
Gold Price	-26.5%	24.0%	82.5%	66.3%	47.6%	-25.3%	19.2%	23.9%	32.6%	711.9%
FTSE	74.2%	-21.9%	27.4%	-15.4%	12.7%	11.3%	8.8%	5.6%	3.7%	25.7%
Highest growth (for prime and mainstream) seen in:	Major urban conurbations	Low density & remote rural & urban locations	Isolated dwellings & hamlets in remote locations	Nowhere	Major urban conurbations	Major and minor conurbations, towns & cities	Towns and cities & rural fringe away from London & other conurbations	Minor conurbations and Isolated dwellings & hamlets in remote locations	Rural villages, hamlets and dwellings and isolated dwellings & hamlets in remote locations	Major conurbations and rural villages, hamlets and dwellings in remote locations
Lowest growth (for prime & mainstream) seen in:	Low density & remote locations	Major urban conurbations	Minor urban conurbations	Isolated dwellings & hamlets in remote locations	Low density & remote locations	Remote villages	Rural and remote (except villages)	Major urban conurbations	Nowhere	More remote cities and towns

Source: Nationwide BS, YBC, ONS House Price statistics by rural-urban classification pink during each of the eight market phases. It also shows the pre-millennium shift away from rural properties towards 'major conurbations' (chiefly London). The analysis suggests that after 2014 as prime central London fell out of favour, it was first, smaller cities and towns, then rural and remote properties that were coming into vogue - even before the pandemic. The well-documented demand for rural properties during and after lockdown is then clearly highlighted.

WHY PRIME IS IMPORTANT

Prime markets, in both London and the country, have particular characteristics that make them different from mainstream markets. While mainstream markets have been closely linked to mortgage availability and affordability in the past, purchasers in prime markets are more likely to have access to significant amounts of equity. Leverage is a financial choice rather than an economic necessity for many prime buyers who rarely, especially in London, rely on mortgage borrowing at the point of purchase.

This means that prime markets are driven by different factors other than household income, mortgage rates and loan to value ratios.

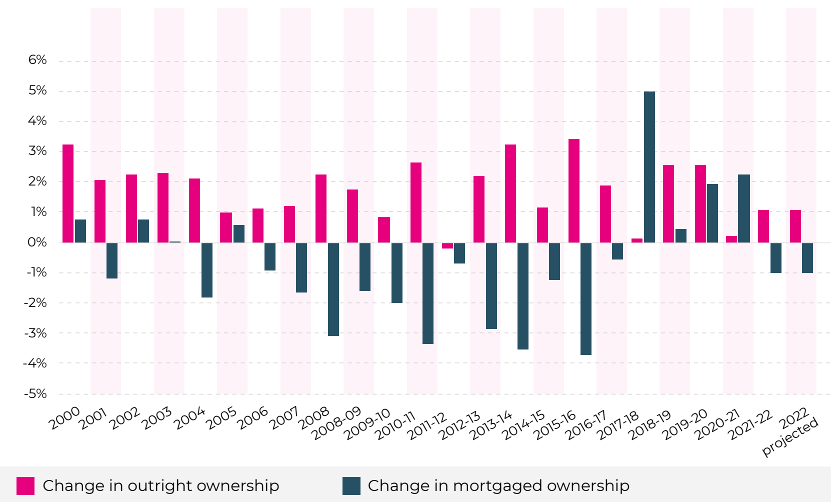
Prime buyers are going to be more influenced by the availability of capital and their access to it. They will also be more concerned with the opportunity cost of capital than mortgage borrowers are. Other investment opportunities and opportunities in other countries will often be available to them. The behaviour of other assets and investments is therefore going to be of much more relevance. Forecasting the behaviour of prime markets means understanding the interactions of these wider factors as well as understanding the greater discretionary nature of both prime buyers and prime sellers. Cash-rich buyers clearly have a great deal of discretion and purchasing power when making acquisitions but equity-rich owners who don't have to sell, or don't have to sell this year, also have a lot of power. The supply-side effects of highly discretionary sellers can be significant in limiting truly available supply in the prime marketplace.

WHY MAINSTREAM IS BECOMING MORE LIKE PRIME

In the years to 2014, an important and significant tenure shift took place in UK housing markets. Although the overall number of owner occupiers had shrunk since 2006, the number of people owing property outright, with no mortgage, had been steadily increasing.

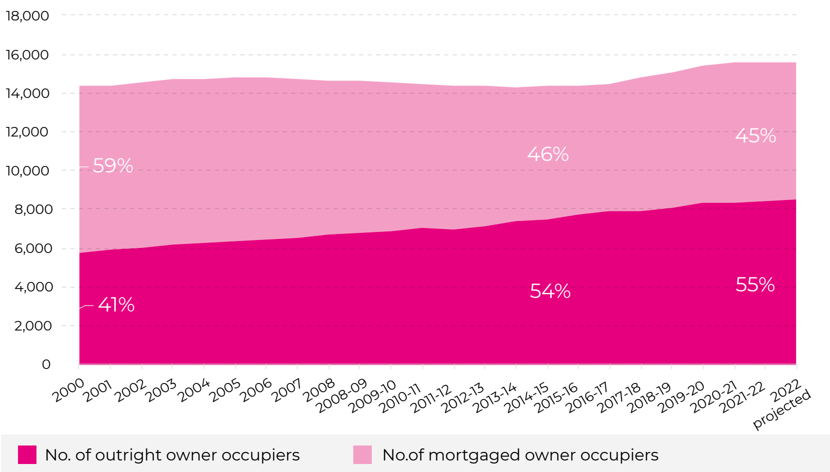
The UK housing market is now less dependent on

GRAPH 2: 22 YEARS OF MORTGAGE REPAYMENT AND CASH PURCHASES



Source: ONS English Housing Survey

GRAPH 3: THE UK HOUSING MARKET IS EQUITY-RICH



Source: ONS English Housing Survey

mortgage borrowing than it has ever been. 55% of owners have no mortgage. Many of those that do, have paid off substantial proportions. An equity-rich mainstream housing market might be expected to behave in different ways to mortgage-reliant markets. In some ways, outright ownership may give some formerly mainstream markets some of the characteristics of prime markets. Supply becomes discretionary as vendors delay or cancel sales or simply stay put for longer. Buyers may weigh up the options of buying or owning property versus all the other things they might be able to do with their money. Understanding what drives prime markets will now also help us to understand mainstream markets.

GEOGRAPHICAL IMPACTS OF HOUSING MARKET EQUITY

Studying the latest census data on tenure reveals some very profound locational patterns which means that markets could behave very differently depending on whether they are borrower-dominated or equity dominated.

The map of England which shows high levels of mortgage borrowing (see top of p.7) is dominated by workplaces and the road and rail networks that links workers with mortgages to their workplaces. Mortgage borrowers, and their homes are concentrated in commuter zones. They are not in metropolitan centres or in cosmopolitan towns (which are the domain of private renters), nor are they in coastal or rural areas (which are the domain of retirees and the more footloose, equity-rich outright owner-occupiers). They are in places with employment and with access to employment, on both sides of motorways, around London and in corridors out of London as well as corridors linking London with the cities of the Midlands and northern employment cities.

The map of outright ownership (see bottom of p.7) is the mirror-image of the mortgage map: rural, remote, coastal and scenic. This is the map of the new prime locations. Like other prime owners, the equity-rich are very much less likely to move than mortgaged counterparts: tenures will be long and turnover is likely to be low in these parts.

OUTLOOK

Just as prime London has behaved differently from the rest of the country in the past, so the 'new prime' places will behave differently from the mortgaged markets in future. The divergence of experiences between the ‘equity haves’ (EH) and ‘equity have nots’ (EHN) will be a major headache for policy makers and planners but an important consideration for any housing market participant, including buyers, in future. Buying opportunities as well as price performance may be very different between the EH areas and EHN areas in future.

EHN areas are going to be more exposed to recessionary effects which impact affordability. They are more likely to experience higher levels of repossessions and turnover generally and will be the places that register price falls over the next 2 to 5 years.

EH areas on the other hand could see more stagnation and less efficient land use. The market will be dependent on investment performance, confidence, and other externalities but may be among the first markets to show growth as the economy recovers.

NOTES:

APPENDIX: TABLE 2

	Pre millennium prime boom	Dot.com prime slump	Prime London boom	Financial crisis	QE powered London Olympics boom	Mainstream recovery	Prime London slump	Mainstream high plateau, Prime London slump (contd.)	Covid demand shift	Whole 27 year period
	1996–00	*2001–04*	*2005–07*	*2008-09*	*2010–12*	*2013–14*	*2015–16*	*2017–19*	*2020–22*	*1996–22*
Urban: Major Conurbation	71.0%	52.6%	26.4%	2.1%	19.3%	13.0%	5.3%	3.6%	14.0%	271.2%
Urban: Minor Conurbation	28.9%	97.2%	17.8%	-3.5%	1.2%	6.4%	8.7%	12.6%	13.1%	253.6%
Urban: City and Town	51.9%	73.9%	20.8%	-4.3%	7.6%	8.5%	11.7%	8.8%	12.4%	258.4%
Rural: Town and Fringe	50.7%	74.9%	19.7%	-5.2%	6.3%	7.6%	10.9%	9.0%	12.5%	245.6%
Rural: Village	59.7%	70.4%	20.2%	-6.7%	5.7%	6.3%	9.1%	6.0%	19.1%	235.5%
Rural: Hamlets and Isolated Dwellings	65.4%	66.3%	23.7%	-7.9%	4.0%	4.6%	4.0%	5.3%	23.9%	218.9%
Urban: City and Town in a Sparse Setting	32.7%	106.9%	18.8%	-5.4%	-1.0%	5.2%	4.3%	7.5%	15.6%	248.2%
Rural: Town and Fringe in a Sparse Setting	43.3%	105.7%	23.5%	-4.1%	-0.4%	5.9%	5.9%	9.7%	14.2%	277.8%
Rural: Village in a Sparse Setting	44.8%	107.8%	26.4%	-7.3%	0.8%	3.8%	5.2%	9.3%	14.7%	273.0%
Rural: Hamlets and Isolated Dwellings in a Sparse Setting	57.0%	91.2%	30.1%	-12.4%	0.5%	4.5%	0.8%	12.0%	23.6%	268.5%

Under performing ■■□■■ Outperforming

Source: ONS House Price statistics by rural-urban classifications

About the author

YOLANDE BARNES

Yolande Barnes has been examining and analysing real estate markets for over 35 years. As Director of World Research at Savills, she provided evidence-based advice to clients and thought-leadership in real estate. She set up and ran their UK residential research department, pioneering and developing new techniques for measuring place potential, land values and sustainable urbanism.

YOLANDE BARNES CONSULTING JANUARY 2023

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