Briefing notes

Addressing topical issues in UK rental markets

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Rental potential

Using affordability to assess headroom for rents

The rental market experienced an unprecedented surge in rents in 2022, caused by the convergence of a range of factors.

Firstly, with the pandemic under control, people returned to cities in large numbers, often to find that renters who had remained, had upgraded – which concentrated demand on the remaining rental properties. This demand was further boosted by the desire for more space per person to take advantage of increased opportunities for working from home. Additionally, a strong employment market increased earnings, at least in nominal terms, making it easier for renters to afford higher rents. Many also had savings from income during the pandemic.

Secondly, the rental market experienced a reduction in supply as buy-to-let investors left the sector in the face of an increasing tax and cost burden, putting pressure on rental stock levels. This shortage was further compounded by the change in HMO licensing, which squeezed box rooms out of the system while others were repurposed as home offices.

Dataloft, with its vast dataset of rents paid and renter incomes, can shed light on the changes in rental markets. In this Briefing note, we analyse affordability to judge the capacity for further rental growth. By segmenting affordability by income bracket we can judge which parts of the market have more capacity.

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Dataloft is an independent consultancy, delivering intelligent, data-driven insight on housing market economics.

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dRMA Dataloft Rental Market Analytics

Dataloft Rental Market Analytics (DRMA) is the UK's largest and most comprehensive single source of achieved rents. It includes over 5 million references, with around 30,000 new tenancies and 50,000 new tenants added each month. Extensive rental data and insight is available semi-automated or in conjunction with bespoke Dataloft Consult analysis.

What does the **evidence** say?

- Affordability is central to the outlook for rents. **Affordability ratio is: rent as a percentage of gross income**.
- According to the data, **rental affordability** in London and Manchester has **remained consistent over the last 8 years**, with only small variations.
- However, **average affordability** in both cities has **now reached the upper limit of the usual range** (London, Q4 2022 c32% and Manchester 28%). Note that tenant referencing typically uses **a ratio of 30% as a measure of affordability**.
- Stretched affordability ratios will start to limit rental growth. Indeed, in London and Manchester **over Q4, rental levels paused at Q3 levels** (Q3 is normally the seasonal peak in demand).
- For **higher earners** in both London and Manchester, the data shows they **spend a smaller proportion of their earnings on rent**, leaving potential headroom for rental growth. In London and Manchester in 2022, higher earners spent a lower 24% and 18% of their earnings on rent respectively.
- **In London 36% of renters earn more than £50k and in Manchester 21% earn more than £40k**.
- Segmenting this further would show the top earners pay an even lower proportion, **London renters earning over £70k spend 21% of earnings on rent**.

Affordability: higher earners

London

£50k+pa

spend less than

24.1%

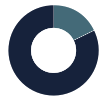
of income on rent

Manchester

£40k+pa

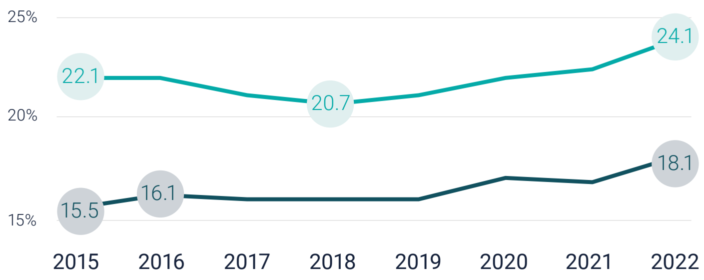
spend less than

18.1%



of income on rent

Higher earner's % spend of gross income on their share of rent



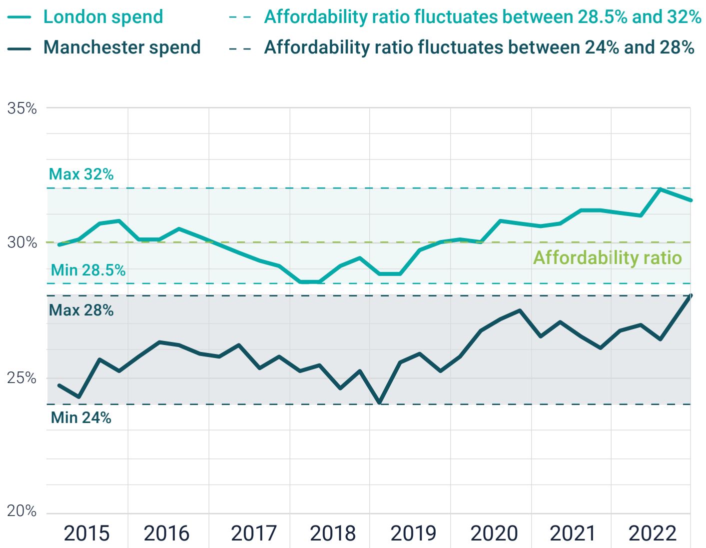
Dataloft, DRMA, based on each tenant's share of rent, flats only, Manchester is defined as Local Authorities of Manchester and Salford. London earners over £50k and Manchester over £40k

Affordability: all earners

Ratio used as a measure of affordability by tenant referencing

30%

All earner's % spend of gross income on their share of rent



Dataloft, DRMA. Based on line by line individual tenant's share of rent data, flats only. Manchester based on Local Authorities of Salford and Manchester, incomes £10k to £500k

What does this mean?

Although average rental affordability in London and Manchester has remained relatively consistent over the long term, the upper limit has been reached, and that will limit future rental growth. However, rising earnings should help to mitigate the risk of rental falls.

Rental growth potential depends on the prevalence of renters with the headroom to choose higher quality/more space or absorb rental increases. Stretched affordability will cause renters to reconsider the affordability of home ownership too.

Renters unable to afford new rental levels can be expected to make different choices, such as cheaper locations, smaller spaces or sharing. For the main, we expect rental growth rates to ease back as the market adjusts or until earnings catch up.

As rents rise, renters will look to more affordable options further from the city centre. This can cause a ripple effect as demand spreads to peripheral locations, creating competition and pushing up rents, which in turn creates different opportunities for investors.

Even as overall rental affordability reaches its upper limit, higher earners still allocate a lower portion of their income to rent. This means there is still an opportunity for rents to rise at the top end of the market, if these renters can be persuaded to spend a higher proportion of their earnings. In areas where there is currently an underprovision of quality rental stock, higher rents may be justifiable to meet the demand of these higher-earning renters.

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