London

Economic prospects and the housing market

December 2021

OXFORD ECONOMICS

MITHERIDGE

Report Commissioned by Mitheridge Capital Management

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About Mitheridge Capital Management

Mitheridge Capital Management LLP (MCM) is an alternative investment firm that sees things differently. We are real estate investors who find opportunities created by evolving demographics. Founded in 2010, Mitheridge has a thematic investment approach based on rigorous macroeconomic research, underpinned by fundamental analysis and the use of big data. Through the collective experience and expertise of our Management Team, Investment Committee and Advisory Group, we ensure our investments address society's needs, while generating long-term value for our investors. We do this by targeting capital constrained sectors of the market and creating innovative financing solutions. All our employees are invested in the Mitheridge Funds. The Mitheridge Group includes our wholly owned property development company and our charitable entity, the Mitheridge Foundation. Mitheridge is authorised and regulated by the Financial Conduct Authority.

MCM commissioned Oxford Economics to conduct independent research into the fundamental economic indicators for London and the impact on the housing market. This report sets outs in detail the results of Oxford Economics' research; identifying and forecasting key drivers in relation to London's economy, current housing situation and the future housing requirement. It provides a valuable and timely insight into the London residential sector post BREXIT and COVID-19.

The key fundamentals MCM has identified in relation to its Affordably Priced Home strategy is supported by the conclusions of this report. MCM maintains a high conviction in pursuing a strategy addressing the growing demand for affordably priced homes, which has favourable government and investor support. The analysis hereafter provides a range of statistical data and comparisons to other major cities across the UK, Europe and globally, outlining the opportunities for creating more homes in London, where there is already a chronic level of undersupply.

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MITHERIDGE

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Executive summary

9 million

London's population in 2020

-

London's population has expanded by 2.3 million people since 1983

The London success story

London is one of the world's leading cities. For several decades its economic growth has matched or exceeded that of its direct rivals, thanks to high levels of competitiveness across a range of sectors, including financial and professional services, communications and culture, academic research and tourism. London has a particularly highly qualified workforce, and has benefited from the inward migration of young people from both the rest of the UK and the rest of Europe, and indeed the world. There has been substantial investment in transport and other types of infrastructure, and many parts of the city have experienced significant regeneration, with the 2012 Olympic Games typifying a much larger story. In 2019 (so just before the Covid pandemic), London accounted for one quarter of the UK's economic output, and one sixth of jobs.

Furthermore, although in recent years London has faced some growing challenges, it has continued to out-perform other comparable European cities, as well as cities in the UK. The challenges include rising costs; a slowdown in UK economic growth; Brexit; and Covid-19. But it is striking that London's population has continued to grow, reaching 9 million in 2020. And thanks to both natural increases (the excess of births over deaths) and net inward migration, London has a young population by UK and European standards. This is helpful in terms of economic growth, while also helping to shape patterns of demand within the housing market.

Demand for housing has outstripped the growth in supply

In that context it is important that for a decade or more London has accumulated a growing excess of demand for housing over supply, with the number of new homes being provided not keeping pace with the growth in population. Between 1997 and 2019 the city's population grew by 1.95 million (28%), but the housing stock increased by just 0.57 million (19%). Hence, there is considerable pent-up demand. That, together with continuing growth in employment, incomes and population—all of which we forecast—should mean growing demand for housing.

London has also experienced marked changes in housing tenure, especially for new-builds, and particularly among young people. In 1990 57% of London residents aged 25-34 were owner-occupiers; but in 2019 only 29% were. And between 2006 and 2019 the proportion of new-builds that were 'build to rent' rose from 9% to 26%. The share of owner-occupied new-builds would have collapsed were it not for the government's Help to Buy scheme, which targets young people, and which is due to come to an end in 2023. Albeit that a replacement scheme, namely the Deposit Unlock Scheme has already been introduced and targets a wider audience.

Government policies and capital flows both positive

That scheme is just one of several ways in which the UK government has shown its commitment to the UK housing market, with policies to encourage a major expansion in the UK's housing stock, amounting to 300,000 new homes a year nationally by the mid-2020s, while also supporting the demand side of the market. The latter is partly aimed at averting any risk of a fall in house prices. The last decade has been a sharp rise in London house prices, relative to incomes. That in part reflects the increase that has occurred in financial asset prices globally, as a result of expansionary monetary policies following first the Global Financial Crisis and more recently the Covid pandemic. But London residential property has clearly been seen as an increasingly important component of investors' portfolios, with significant international capital inflows. Market data suggests that investment from abroad in UK residential assets (much of them in London) was higher in 2020 than in any of the office, retail or industrial sectors, having been a fraction a decade earlier.

10 million

London's population in 2035

-

Both natural change and inward migration will contribute to future population growth

Forecasts of continuing economic growth

Of course, the Covid pandemic hit the UK capital hard in 2020. But a strong rebound is currently under way, with London's economy expanding by more than 7% in 2021, according to our estimates. And over the period to 2035 we forecast that London's economy will comfortably outpace that of the UK. The factors that have helped London in the past continue to favour the city, even if the gap with other UK and European cities has closed somewhat.

As part of that, London continues to see a large number of major regeneration projects, as well as transport improvements, such as the extension of the Northern line and the new Elizabeth line, and improved transport links to east London's outer boroughs, where considerable regeneration is under way.

And, as we noted above, we forecast that by 2035 the population will have reached 10 million. We expect international migration into the UK, and especially into London, to remain strong. While the UK government has introduced qualification requirements for migrants from the EU, it has also pledged to meet the nation's skills needs, and for non-EU nationals it has made the migration regime easier than it was before Brexit.

Furthermore, we do not believe that changing working and living patterns, instigated by the Covid pandemic, will seriously disrupt the continuing growth of London. Survey evidence increasingly points to the pandemic as having an incremental rather than a radical impact on the economies of large cities such as London.

Our forecasts also suggest that London's employment numbers will continue to be driven by high value-added sectors, notably professional services and communications, with the finance sector remaining very large. We do, however, expect to see some decline in the number of people working in lower skilled occupations, such as administrative support. A possible implication of that is a continuing tendency for wages at the lower end of the skills spectrum to fail to keep pace with those at the top end.

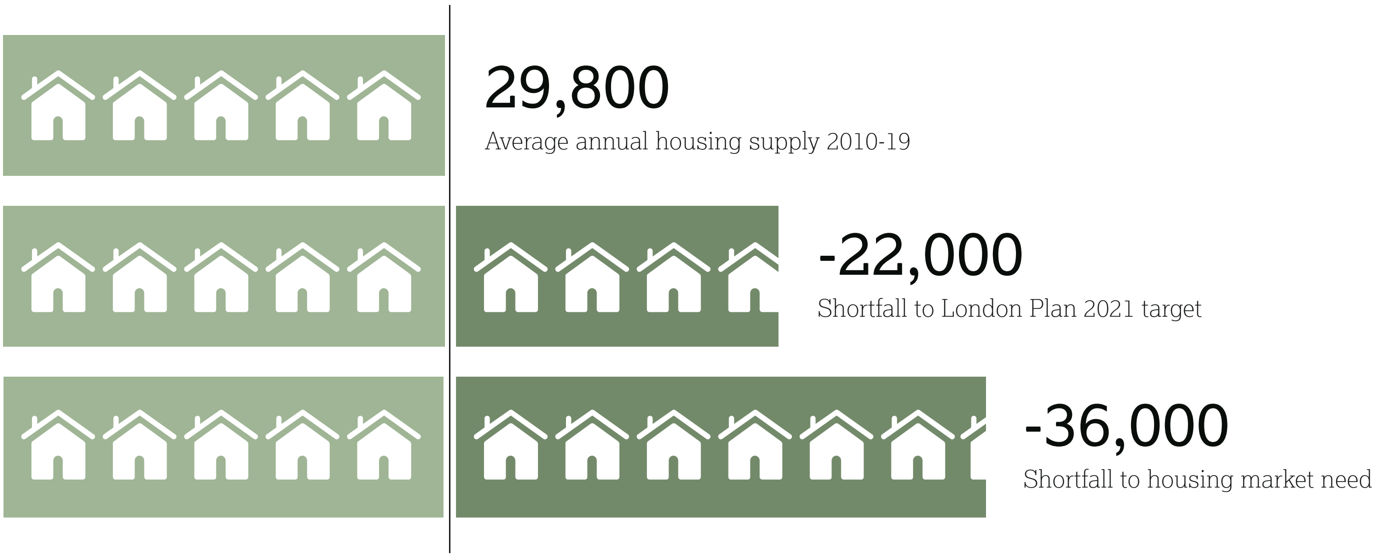
A sharp increase in housing supply needed to match demand

In our baseline forecast, we estimate that London house prices will increase through the mid-to-late 2020s. Overall, we expect median house prices in the capital to rise by 3.1% a year on average, broadly in line with average earnings, to £766,000 in 2035. This is a desirable development for investors, but if those on low incomes are not keeping pace, then it means that housing affordability could become increasingly problematic for many people. This is therefore a subject that will continue to be a political priority in London. And indeed, the London Plan 2021, recently published by the current London Mayor, calls for 52,000 new homes a year to be built between 2019 and 2028, with 50% of those described as affordable, and the majority of them accounted for by single- or two-bedroom units.

Our own projections for housing demand suggest that a very similar figure, 50,000 new homes a year, is needed,

The shortfall in annual housing supply in London

Source: Oxford Economics



based on our population projections and our expectations regarding average household size. In contrast the London Strategic Housing Market Assessment, produced in 2017, suggested a rather higher figure of 66,000, with the difference between that and our own estimate largely reflecting a desire to unwind the existing overhang of past unmet housing needs, and not simply meet newly emerging demand. But even the Mayor's target of 52,000 a year, if achieved, would be a much higher rate of house building than London has seen in the past, with on average just under 30,000 new homes built a year during the 2010-19 decade, creating a shortfall that has accumulated through time and threatens to continue doing so.

To address this challenge, the London Plan sets out a number of ways in which it says the 52,000 could be achieved. These include the use of plentiful brownfield sites, significant infilling of small sites, and the repurposing of, for example, car parks and some retail sites.

In addition, the London Plan argues for more imaginative ways to deliver new housing, including through build to rent schemes, which as we noted above have already been rising in importance. They are common in other countries and are now becoming increasingly important in the UK market. The London Mayor suggests that build to rent offers advantages in terms of attracting new investment, as well as conferring various economic and social benefits: promoting long-term tenancies; encouraging investment in place-making; and resulting in better quality homes than the private sector has tended to deliver at the affordable end of the market.

Conclusions

Overall, we anticipate that the London economy will continue to support growth in the London housing market, assisted by favourable government policies and capital inflows into residential property. Our forecast for London house prices is that they rise in line with average earnings, and that should mean that they outpace construction costs, which tend to grow broadly in line with consumer prices. And while there are risks associated with such forecasts, they are not confined to the London economy, nor the London housing market, both of which have strong fundamentals.

66,000

The annual increase needed in housing

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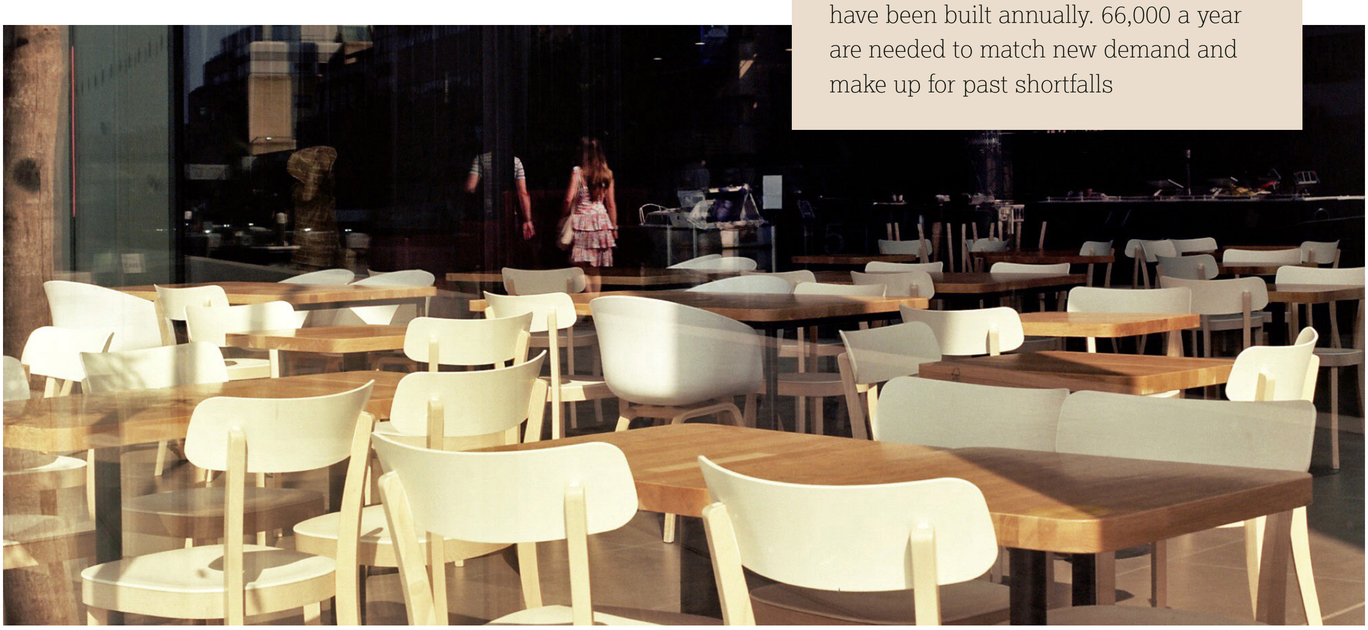
In the last decade 30,000 new homes have been built annually. 66,000 a year are needed to match new demand and make up for past shortfalls



1. The London story, to 2019

2012

London hosted the Olympics

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A small part of the wider story of London's economic transformation

1.1 London's success

For most of the past four decades, London has clearly been one of the strongest city economies in the world. During the 1980s the UK capital experienced a sharp pick-up in economic growth, initially led by the financial services sector (the 'Big Bang' in the City of London), but later spilling over into a variety of sectors including advertising, the creative industries, digital technology, software and management consultancy, legal services, and many others.

London also had—and still has—an unusually large number of highly qualified people in its workforce, and has benefited from important factors such as widespread knowledge of the English language, and the ubiquity of the English legal system, with a large proportion of cross-border global business deals being agreed under UK law.

A light regulatory burden, thanks to the UK securing opt-outs from many EU restrictions, has also been particularly helpful with respect to employment: companies find London to be a relatively easy place in which to recruit and reward talent. During the opening decades of the 21st century, this has become an increasingly important determinant of city competitiveness, and London has been helped by the presence of some of the world's highest-ranking research universities, either in or close to the capital.

In addition, long-standing problems with respect to, for example, poor transport infrastructure have been addressed, even if not completely solved, with significant investment in the Underground network and in suburban rail, and the soon-to-be opened Elizabeth line (Crossrail).

Related to that, the quality of London's government has improved: since 2000 London has had a directly elected mayor, plus a system of strong independent boroughs with responsibility for service delivery. This has enabled high levels of regeneration in the capital, not least in east London, exemplified by the 2012 Olympic Games. Major regeneration schemes currently under way include Nine Elms, Old Oak Common, and a large number of projects in east London, mainly focused on housing but also including, for example, plans for two major film studio facilities on large, abandoned industrial sites in Dagenham.

As a result, in 2019 (using that year to avoid any pandemic-related distortions) the London economy generated almost a quarter of all economic activity in the UK economy, and contributed one in six of the nation's jobs. It was also the UK's most productive region: each job generated on average around £76,000 of value-added, around a third more than the next-most productive region, the South East (£58,000 per job).

1.2 London has grown in the face of rising challenges

Almost inevitably the extent to which London outranks other cities has reduced somewhat over the last decade. As Figure 1 illustrates, in the period 2000-08 London's gross domestic product (GDP) grew significantly faster (3.7%) than that of Paris (2.4%; defined here as the core district of Paris plus neighbouring Hauts-de-Seine, home to La Défense, so broadly equivalent to Inner London). In the period 2009 -19 London has still grown faster than Paris, but by a smaller margin: 2.1% versus 1.6%.

2.1%

London's GDP growth, 2009-19

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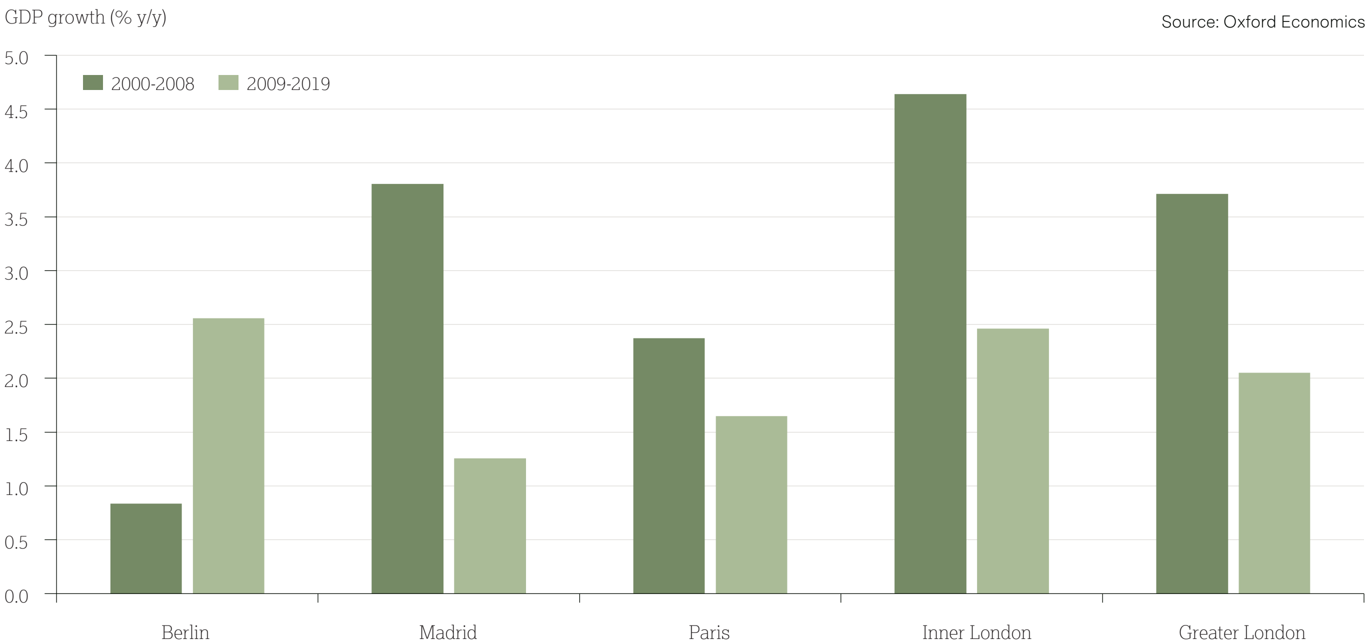
Other comparable cities such as Paris grew more slowly

Fig. 1. London's economic growth relative to other major European cities



There are several factors behind this. London's success has made it a more expensive city, in terms of real estate prices, wages, consumer prices, construction costs, and indeed most other metrics. Average earnings in London are 41% higher than in Birmingham. In the construction sector they are 46% higher than in the West Midlands region. It costs 60% more to build a high-rise apartment in London than in Dublin, and close to twice as much as in Paris (all based on 2019 data). Inevitably, that has caused some activity to switch elsewhere. Nevertheless, London has continued to grow both as a place of work and as a place to live. Employment and population have both risen faster in London than in any of the cities in Figure 2 over the period 2010-19.

Fig. 2. London and other cities, cost and price comparison

Average earnings and house prices, 2019

	London	Birmingham	Manchester	Leeds	Liverpool
Residents' average earnings, £ per week	724	514	491	540	525
Average house prices, £	471,078	188,187	181,198	185,446	133,432

Cost of building high-rise apartments, 2021 estimates

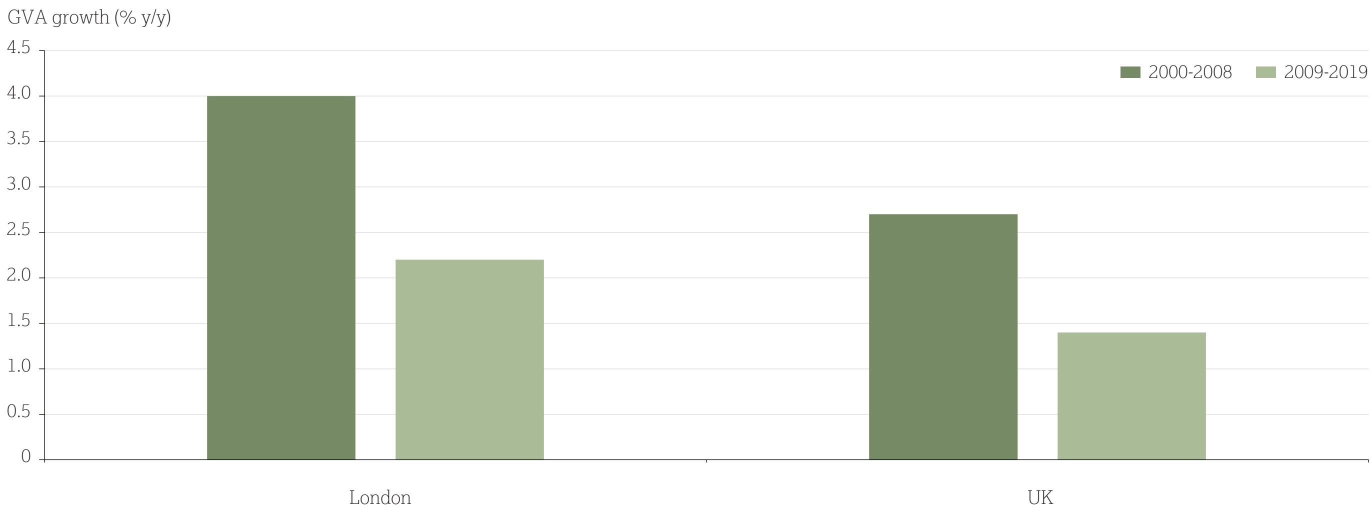
	London	Birmingham	Manchester	Leeds	Liverpool
£ per m^2 of internal area	5,095	3,199	2,785	3,183	2,560

Sources: Oxford Economics, Turner & Townsend

The second reason why London's dominance is not quite as marked as it once was, is that the UK economy as a whole has slowed. London, despite being highly internationalised, is not immune to that. London exports business services and financial services, plus consumer services such as journalism and the media, to the rest of the UK, and so is inevitably affected by slower demand, nationally. In the period 2000 to 2008 the UK grew by 2.7% a year, but since then it has slowed to 1.4% a year, pulling down London's growth rate with it.

Fig. 3. Average GVA growth rates in the UK and London

Source: Oxford Economics



The third factor is Brexit, which has probably had some modest negative impact, making it harder for London to grow quite as fast as it might otherwise have done.

But the expected large hit to the financial services sector has not materialised. There is now an agreement in place covering the bulk of that sector, under which the EU and UK authorities regard one another's regulatory rules as being equivalent to each other's, and therefore allowing barrier-free cross-border trading in most assets. Of course, that may not last indefinitely, and major investment banks and others have sought to reduce their risks by raising their presences in cities such as Paris and Amsterdam, causing a dip in financial services employment in London in 2017, following the referendum. However, 2018 saw a rebound in financial sector employment in London and in 2019 (just before the pandemic struck) financial services employment in Inner London was 9% higher than in 2015. In Frankfurt it was only 5% higher, and in central Paris it was just 1% higher.

Brexit has also impacted migration flows and the labour market, and has probably meant that some nationals from the rest of the EU have either chosen to return to their home countries, or been required to do so—or have not chosen to move to London in the first place. This relates to highly skilled people in key sectors such as digital and financial services; to those at intermediate level working in for example the construction sector; and to people doing relatively low-skilled jobs such as hospitality or social care.

9%

Rise in London's financial sector employment since 2015

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London has seen faster financial employment growth than other European centres

But any such impact has been overshadowed by Covid-19, which has doubtless led some visitor workers to return to their cities and nations of origin. The pandemic has meant many job losses in the hospitality and cultural sectors, as well as causing both higher-skilled individuals and employers to reappraise their location decisions in the light of the surprisingly effective capability of digital services to replicate office-based employment remotely. But these are challenges that all major cities now face, albeit complicated in London's case by coinciding with the UK's departure from the EU. Admittedly it has perhaps become marginally harder for London to distinguish itself from rivals, when its great strengths as a meeting place and a physical marketplace are rendered less important by new technology. But as we discuss in Chapter 3, the evidence suggests that remote working will have an incremental rather than a radical impact. So London's competitiveness will remain largely intact.

Related to that is the fifth challenge that London has begun to face, which is that long before the pandemic other cities were clearly catching up, in the sense of becoming more competitive. This is partly because digital technology is available everywhere, but also because those cities have also experienced regeneration, both in terms of physical assets and in terms of the spread of, for example, leading retail and hospitality brands. While the appeal of London to many people is undiminished, the 'liveability' of provincial UK cities such as Bristol, Birmingham and Manchester, and the competitiveness of some European cities such as Amsterdam, have increased in purely relative terms over the last decade.

1.3 London is still set to outperform its rivals

However, even together, these factors do not alter the likelihood that London will continue to outperform rival cities in the UK and beyond, over the medium and long term. As we discuss in more detail in Chapter 3, we estimate that London's economy grows by about 6.5% in 2021, significantly faster than Paris and other major European cities. Over the long term from 2020 to 2035, we project annual GDP rises of 1.8% a year. The population has already risen above 9 million, despite the Covid pandemic, and is set to continue growing, helped by continuing net inward migration from both the rest of the UK and abroad.

London's most successful sectors, notably information and communications, and professional, scientific and technical services, will continue to drive growth, and will create growing demand for highly skilled people. These sectors cover much of what is commonly referred to as the 'tech' sector. In 2019 they employed 491,000 and 782,000 respectively: significantly more than financial services at 407,000.

All of which also implies growing demand for housing in London, but also rising challenges in terms of affordability, and a need for supply to respond to demand more effectively than it has done in the past—something that is central to the London Mayor's plans for London.

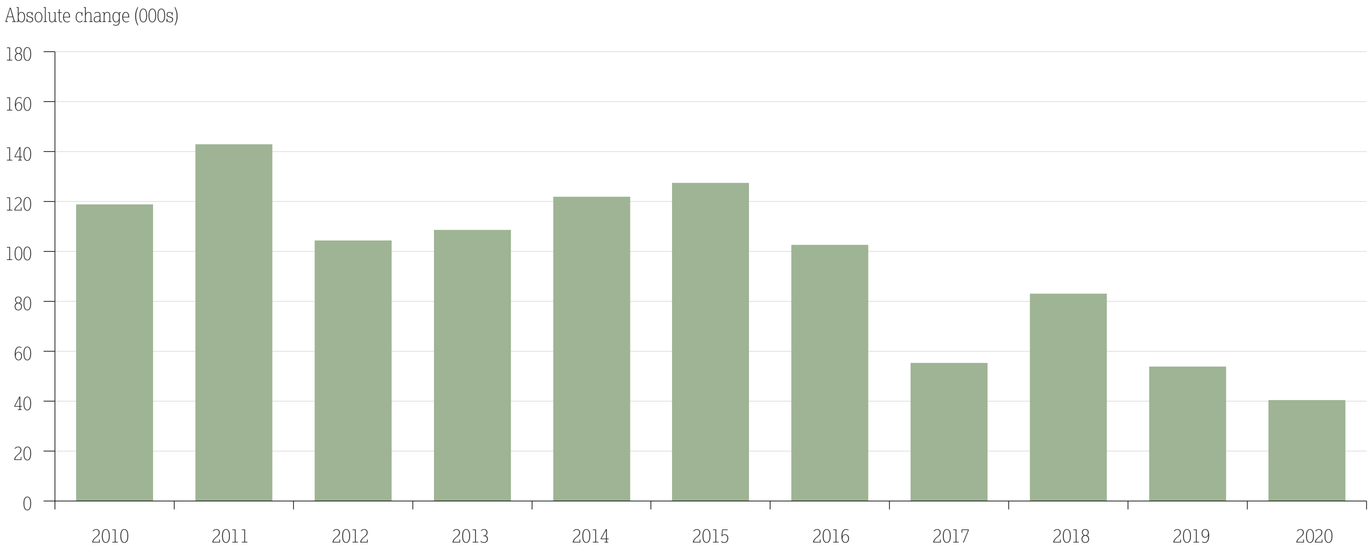
2. Growing need for housing

2.1 Population growth: robust demand for housing

Associated with the economic growth described in the previous chapter, London's population has grown rapidly since the early 1980s, swelling by 2.3 million people, from 6.8 million in 1983 to 9.0 million in 2020. This was much faster than the UK average: 0.8% a year compared to 0.5%.

Fig. 4. London annual population change, 2010 to 2020

Source: Oxford Economics



Related to the strong growth in population is a second important characteristic of London and its housing market. The UK capital has a younger population profile than other major UK cities, and also younger than other major European cities. As Figure 5 shows, in 2019 40% of London's population were aged 20-39, compared with 35% for Manchester, 32% for Paris and 30% for Berlin.

A young population is helpful to the London economy, because young people tend to have more up-to-date skills than older workers, and they are large consumers of city-based services such as bars, restaurants and cultural facilities. It also affects the types of home that the housing market requires, in terms of size, tenure and location. We return to this, below.

40%

London's population aged 20-39

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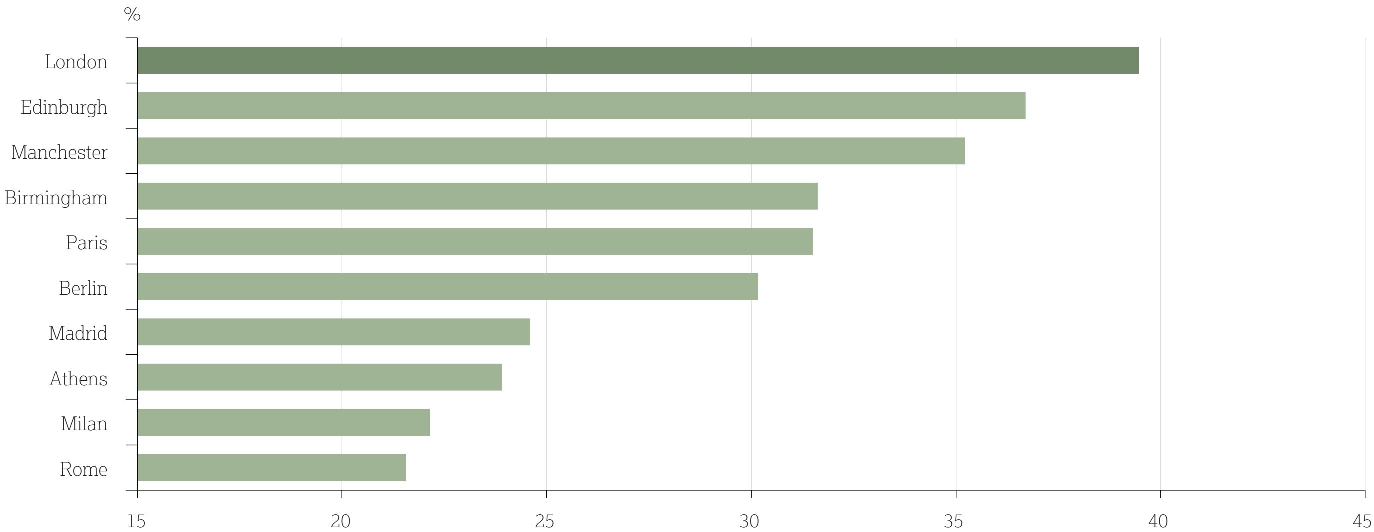
London's adult population is younger than that of Manchester, Paris or Berlin

Fig. 5. Proportion of population aged 20-39, selected European cities, 2019

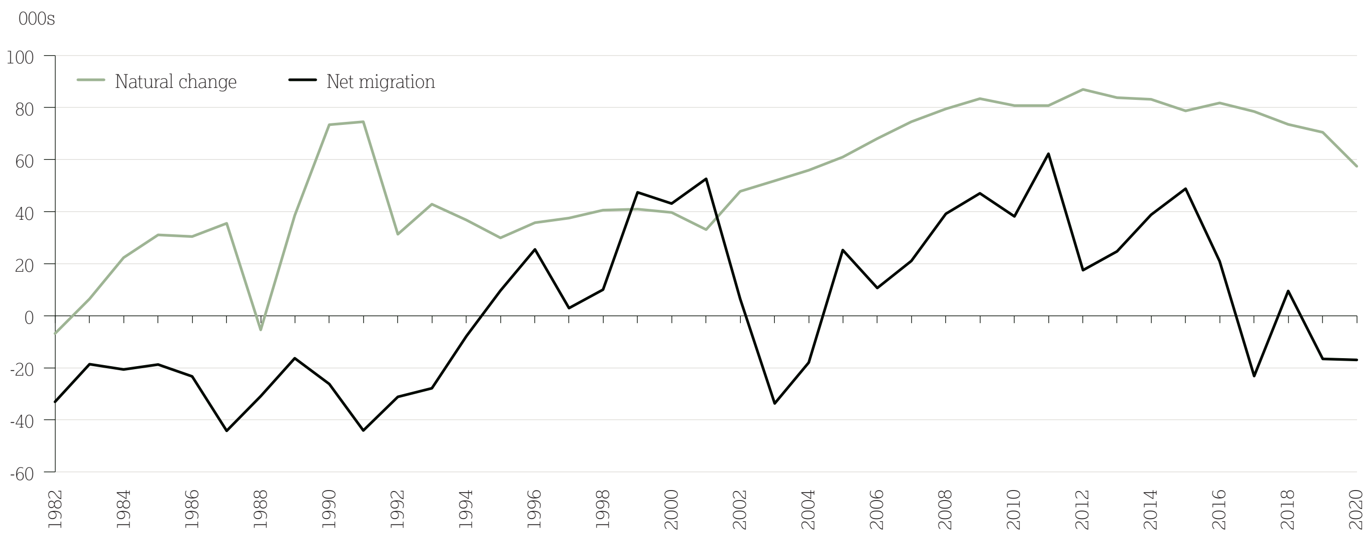
Source: Oxford Economics



This combination of strong population growth and a young population reflects both natural change (births minus deaths) and net inward migration (people moving to London, minus those moving away). Figure 6 shows the data from 1982 to 2020 for these two.

Fig. 6. Components of population change in London, 1982-2020

Source: ONS



Several messages stand out. The first is that in the past four decades, natural change has almost always been a larger driver of population growth than migration. So even if net inward migration falls or turns negative, London's population continues to rise. And it can be seen that, even though the rate of natural change started to level off as long ago as 2009, and since then has been drifting down, it has remained strongly positive.

A second important point is that net inward migration has tended to be quite erratic. Up until the mid-1990s it was negative, with more people leaving the capital than moving to it. But as London's economic success increased, net migration gradually became less negative, and in 1995 turned positive and has mostly remained so. There was a reversal in 2003 caused by the dotcom collapse, but that proved only temporary, and in some recent years the numbers have also been negative—but only modestly so.

Figure 7 looks at the net migration numbers in more detail for recent years, distinguishing between international and domestic flows. The figures relate to the 12 months ending in June of each year. It can be seen that international net inflows peaked back in 2015, at 126,000. The decline since then partly reflected both Brexit and exchange rate movements (with the latter an obvious determinant of relative pay rates in London compared with cities outside the UK). But the 2016-19 average was still substantial, at 90,000 per year. Pre-pandemic London therefore continued to be attractive to international migrants, albeit perhaps slightly less so than prior to the Brexit referendum. (We discuss the impact of the pandemic in Chapter 3.)

97,000

Annual net international migration into London, 2016-19

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Despite Brexit, and pre-pandemic, London continued to attract large numbers of international migrants

Fig. 7. Migration components of population change, London

	2012	2013	2014	2015	2016	2017	2018	2019	2020
International In	176,300	170,100	200,900	212,800	208,600	190,400	201,900	192,900	200,400
International Out	107,200	90,200	93,500	86,400	94,400	106,900	89,100	115,500	115,800
International Net	69,200	79,800	107,400	126,400	114,200	83,500	112,800	77,400	84,500
Domestic In	203,600	196,600	204,400	205,500	198,300	229,400	237,300	255,300	218,900
Domestic Out	255,300	251,600	273,100	283,100	291,600	336,000	340,500	349,300	320,300
Domestic Net	-51,700	-55,000	-68,600	-77,500	-93,300	-106,600	-103,200	-94,000	-101,400
Domestic Net by age									
0-19	-33,400	-34,600	-39,900	-42,800	-46,400	-51,900	-52,000	-52,500	-47,500
20-29	36,900	35,500	36,500	38,000	33,800	32,300	35,900	46,000	29,100
30-39	-20,600	-22,000	-25,800	-30,400	-34,500	-38,900	-38,500	-38,200	-36,600
40-64	-25,300	-24,900	-28,700	-31,400	-35,000	-36,900	-37,500	-38,000	-35,800
65+	-9,300	-9,100	-10,800	-10,900	-11,100	-11,200	-11,000	-11,400	-10,600

Sources: ONS

The table also shows that domestic net migration reflects a combination of two factors: a very strong tendency for young adults to move to London as students or as their first career move, while older people (and in some cases their children) move away, either when their children start to grow up or when they are approaching retirement. Many of these will continue to work in London while commuting from outside. In 2019, for example, there was a net migration inflow of 46,000 adults in their twenties, and a net migration outflow of 88,000 people in older age groups. In the year to June 2020, there was a reduction

in net inflows of young adults, reflecting the temporary impact of the pandemic, with people postponing their moves, but no rise in outflows of older adults, contradicting anecdotal claims of large numbers moving away from London.

2.2 London's housing supply not keeping up with demand

Unfortunately, since at least the late 1990s, the increase in London's housing stock has failed to keep pace with population growth. Between 1997 and 2019 London's population rose by 1.95 million (28%) but the housing stock increased by just 0.57 million (19%), causing the Greater London Authority (GLA) to suggest that, had the supply of homes increased at the same rate as the population in that period, there would have been an additional 274,000 homes in London.[1]

More recently there has been some pick-up in the rate of home-building, although the picture here has inevitably been distorted by the Covid pandemic. Over the 2010 to 2019 period the average annual number of new homes delivered was just under 30,000, but in 2019 it rose to over 40,000. In 2020 the supply fell by 17%, using the standard definition from the Department for Levelling Up, Housing

274,000

Estimated shortfall in London homes, 1997-2019

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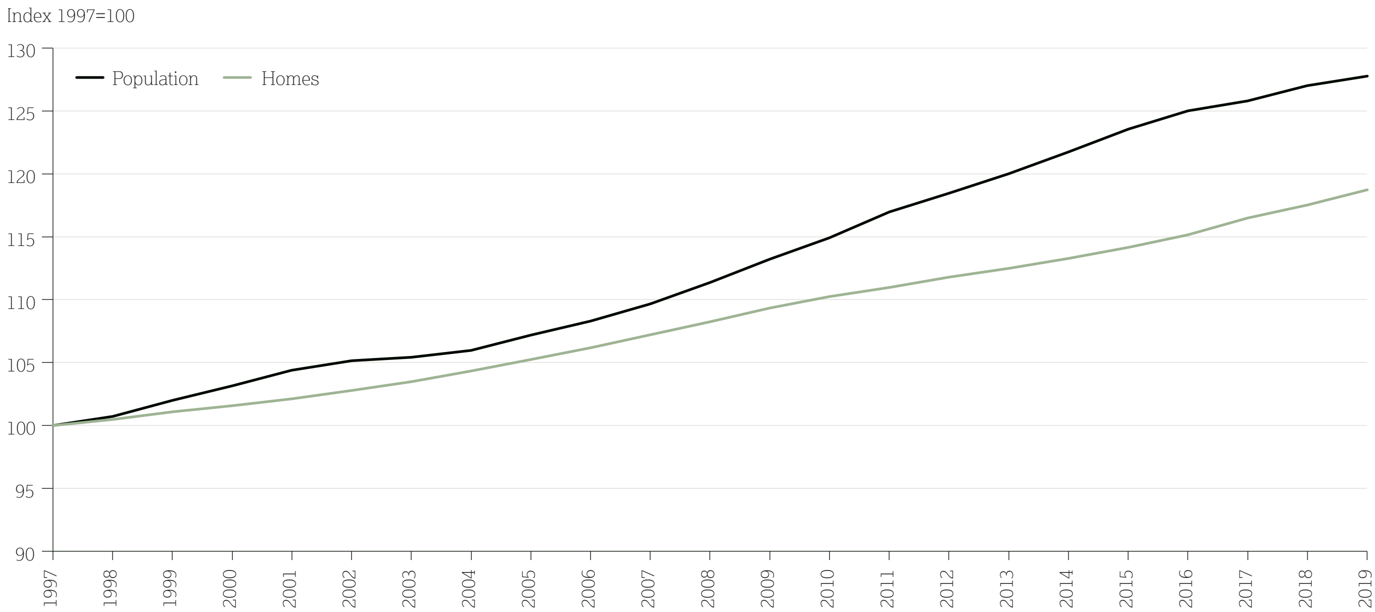
Population rose by 1.95 million or 28%, the housing stock by 0.57 million or 19%

1. Housing in London 2020, GLA.

Fig. 8. Trend in people and homes in London, 1997 to 2019



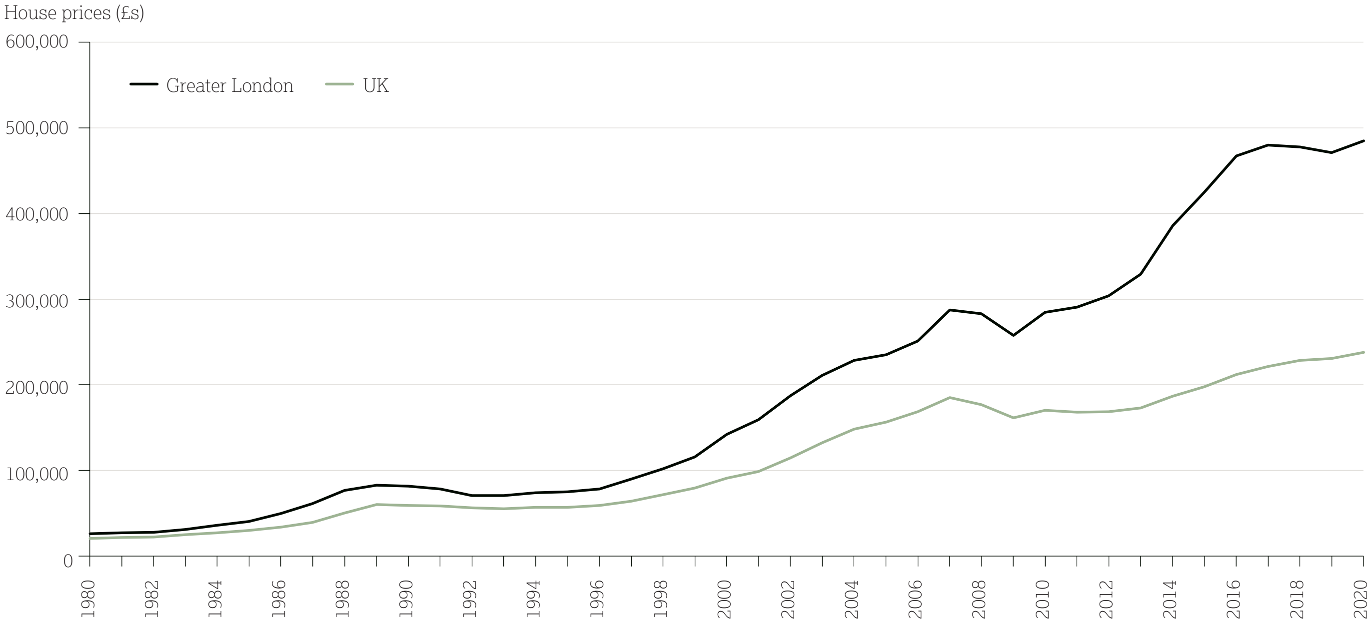
Sources: Oxford Economics

and Communities, or by 11% according to independent data from Molior. But 2021 is clearly seeing a strong recovery, as the economy rebounds. Nevertheless, and as we discuss below, even the pre-pandemic peak seen in 2019 is not sufficient to cope with the likely future growth in London's population, let alone close the historical deficit created by previous undersupply.

An obvious consequence of the mismatch between supply and demand is that London house prices have been rising strongly for many years. Figure 9 illustrates this. London house prices rose by an average of 7.6% a year over the period 1981 to 2020, while UK prices increased 6.3% a year.

Fig. 9. House prices, London vs UK, 1980 to 2020

Sources: Oxford Economics



Common housing market terms

Affordable Homes Programme: a government scheme that provides grant funding to contribute towards the cost of building affordable housing.

Affordable housing: the government definition of affordable housing is "social rented, affordable rented and intermediate housing provided to eligible households whose needs are not met by the market". Affordable rent is no more than 80% of local market rates. Intermediate housing refers to homes for sale and rent, provided at a cost above social rent but below market levels.

Build to rent: large-scale corporate investors in entire residential blocks, with the intention of professionally managing the properties to rent. They are principally interested in net operating income over the medium to long term rather than capital gains. This is also commonly referred to as PRS (private rented sector).

Buy to let: investors who buy one or more homes in a development to be let out on completion, but for many of whom short- to medium-term capital gain is the motivator for purchase.

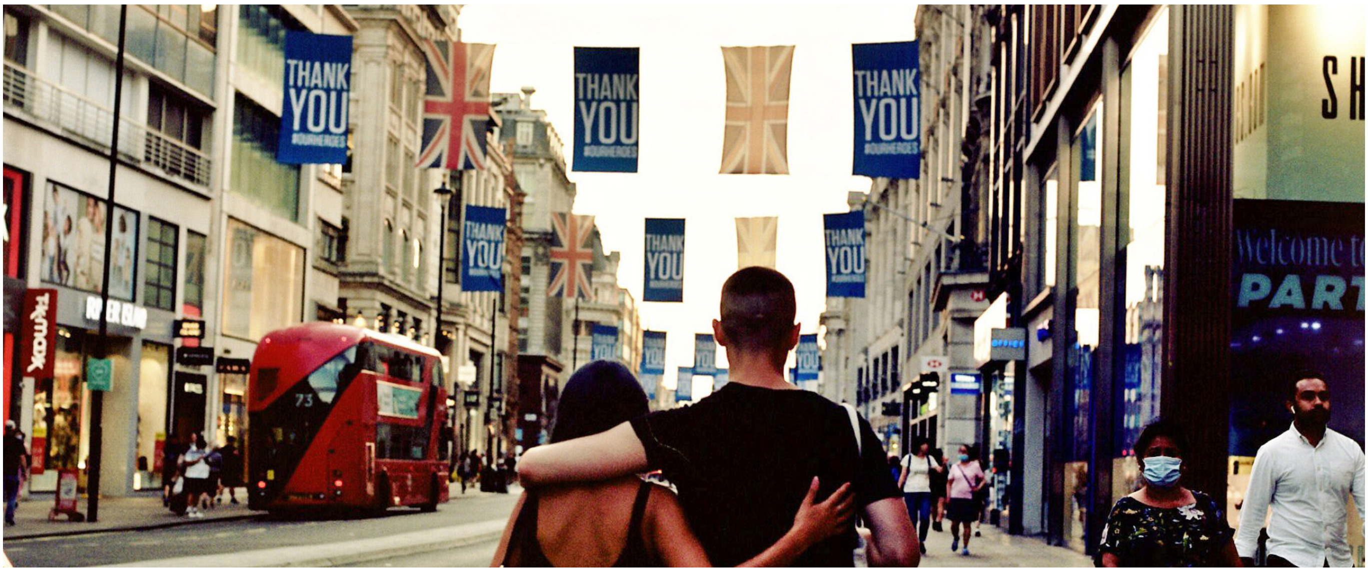
Buy to sell: speculators and wholesalers who will buy early in the development process, with the purpose of selling on at a profit and usually prior to construction completion.

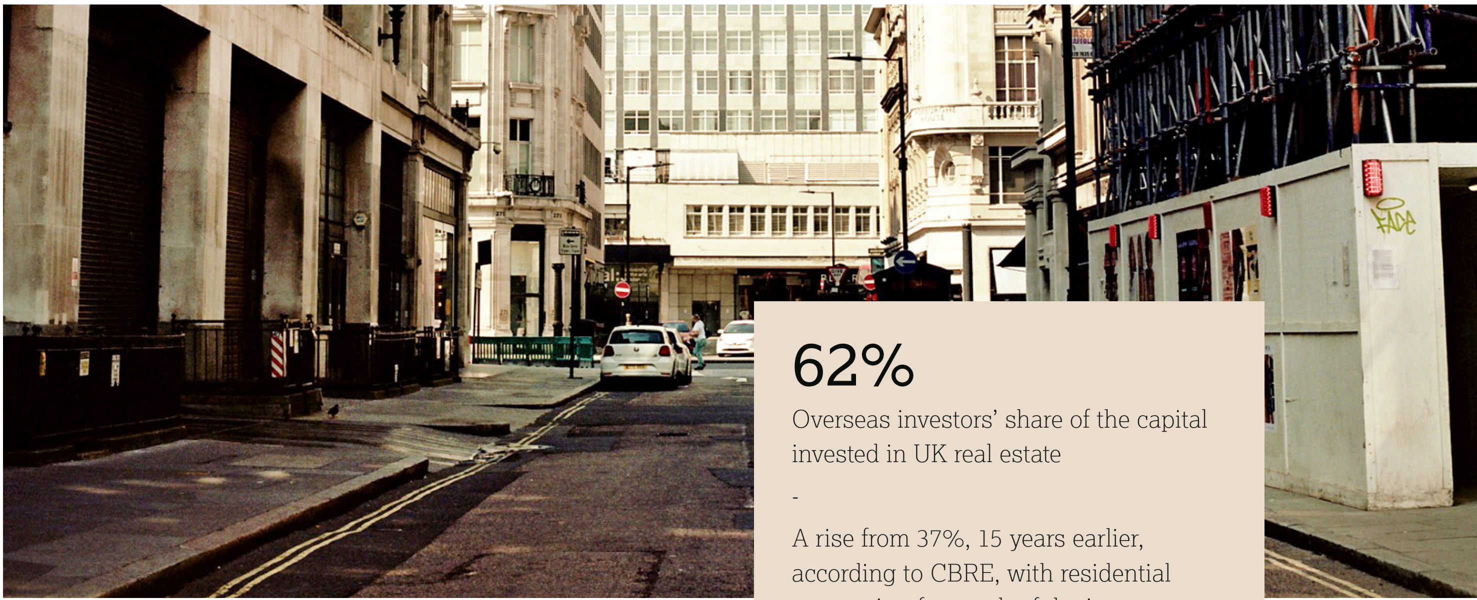
Help to Buy: a government scheme introduced in 2013. The current version of the scheme provides first-time buyers with an equity loan (up to 40% in London) towards the cost of buying a new-build home (up to £600,000 in London). This loan is interest-free for five years; in year six and subsequently interest is charged. The scheme is committed to continue from 2021 to 2023.

Owner-occupiers: individuals and families who will live in the completed homes, usually financing their purchase through a mortgage, and in recent years often with the help of the Government's Help to Buy equity loan scheme.

Social rented accommodation: housing provided to individuals and families by local authorities and housing associations, normally at below-market rents.

Stamp Duty: Stamp Duty Land Tax (SDLT) is a tax that must be paid on the purchase of a property or land over a certain price in England.





62%

Overseas investors' share of the capital invested in UK real estate

-

A rise from 37%, 15 years earlier, according to CBRE, with residential accounting for much of the increase

2.3 Global capital inflows have supported the market

Of course, the price appreciation also has other drivers and enablers. It would not have been possible without a willingness on the part of Londoners to take on the associated debt, either for the sake of living in London, or in the expectation of making future capital gains. We discuss this and its implications in terms of affordability in section 2.4 below. The price rises have also relied upon expansionary monetary policy on the part of the Bank of England, that has allowed banks to provide the necessary funding. That has been part of a broader phenomenon of global rises in financial assets prices, facilitated by central banks, which began as a response to the global financial crisis, and which has been heavily ramped up to support the global economy during and following the Covid pandemic.

In addition, the upward movement in London house prices has led to particularly significant financial inflows from global investors. These inflows have in turn generated further upward pressure on prices. Estimates from CBRE suggest that over the past 15 years, overseas investors' share of all capital committed to UK real estate rose from 37% to 62%, with much of this associated with substantially increased investment in residential property.[2] CBRE figures also suggest that in 2020, total investment from abroad in residential assets was, at over £6bn, higher than in the office, retail or industrial sectors. Back in 2010 it was less than a tenth of that amount.

2.4 Government support for the housing market

The housing market has also been supported by the UK government, which has sought to encourage a major expansion in the UK's housing stock, amounting to 300,000 new homes a year by the mid-2020s. It has outlined a 'once in a generation' series of planning reforms aimed at shaking up planning permissions for new home construction.[3] It is also in the process of removing many of the existing restrictions on the conversion of office, retail

2. https://www.cbre.co.uk/research-and-reports/UK-Capital-Flows-In-Out
3. https://commonslibrary.parliament.uk/research-briefings/cbp-8981/

and other properties to residential use, and it is providing funding. It created the Affordable Homes Programme: an allocation of funds to housing associations and local councils, to develop affordable housing for rent or sale. In 2017 the government made £3.2bn available, of which £1.7bn was allocated to London. It has recently allocated a further £8.6bn of a new £12bn programme covering 2021-2026. London has been allocated £3.5bn in that first wave.

But as well as encouraging increases in housing supply, the UK government has simultaneously been keen to support demand, in order to reduce any risk of a significant decline in residential prices, which would create difficulties for borrowers and homeowners, and which could be politically very damaging. In 2013 it launched the Help to Buy scheme, which subsidises those new homeowners who are buying new-build properties. The scheme is scheduled to end in 2023, although it may be extended, and will be in existence alongside the Deposit Unlock Scheme which will further support housing demand.

Another example of government support has been the temporary removal of stamp duty (a transactions tax levied on house purchase) during the period of the Covid pandemic. This meant that home buyers were not required to pay tax on the first £500,000 of a purchase price between July 2020 and June 2021, and on the first £250,000 between July 2021 and October 2021.

2.5 Tenure and affordability

Linked to these developments—demographic, financial and policy-driven—have been major changes in ownership patterns and the tenure of households, across the UK but primarily in London.

The proportion of owner-occupied housing was on a rising trend in London to 2000, when it peaked at 60%. It then fell rapidly to 51% in 2010, and has been at or about that level since then. Much of that reflects a sharp decline in the proportion of young adults who are owner-occupiers: down from 57% for those aged 25-34 in 1990 to just 29% in 2019 (see Figure 10).

Alongside that has been a decline in the share of the social renting sector, which accounted for 35% of all homes in 1981 to just 23% in 2019. In contrast the private rented sector has increased its share of London homes from 17% in 1981 to 27% in 2019, reflecting both the decline in young people who are owner-occupiers and the relative decline in availability within the social renting sector. (See box on page 18 for this and other definitions.)

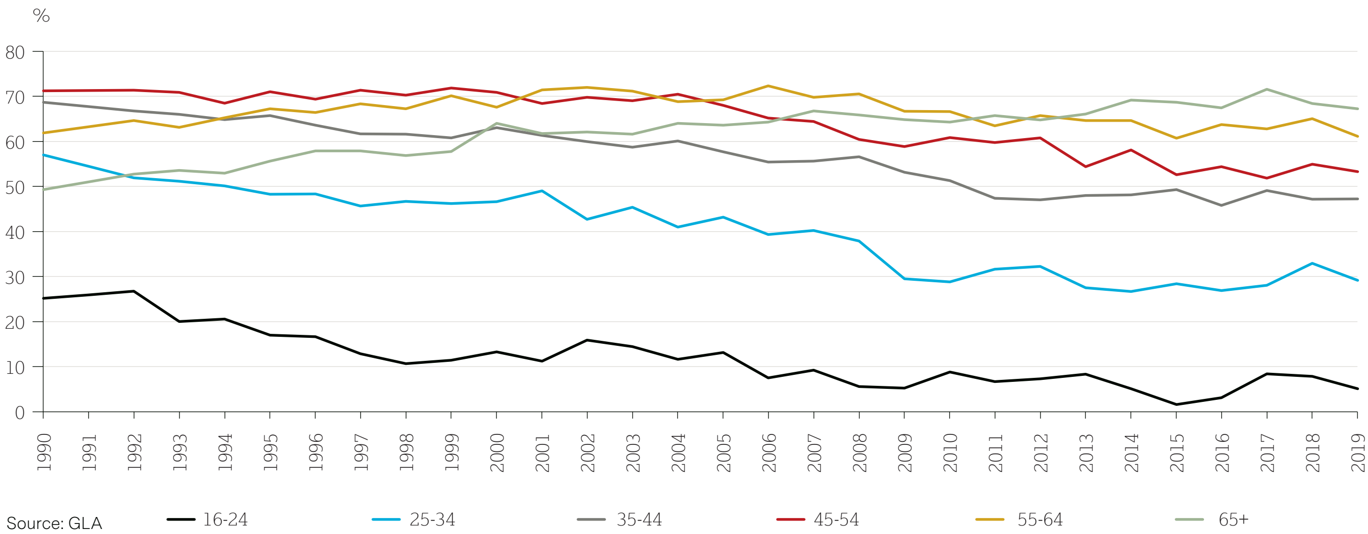
57% vs 29%

Young adults who were owner-occupiers, 1990 and 2019

-

It is increasingly difficult for Londoners, in particular young adults, to own property in the city

Fig. 10. Proportion of each age group that are owner-occupiers



Source: GLA

These shifts relate to all homes including existing ones: there are associated changes in the market for newly built properties. In 2006 55% of these were either build to rent or buy to let. By 2019 that share was down only slightly to 52%, but the composition had changed markedly, with the majority accounted for by market developers building to rent, and the old buy to let sub-sector seeing a decline. At the same time, buy to sell by speculators and wholesalers has also fallen out of favour, falling from 16% of new-build sales in 2006 to just 2% in 2019.

Fig. 11. Tenure of new homes in London

Proportion of buyers of new market homes

	2006	2013	2019
Buy to let	46%	48%	26%
Individuals	*41%*	*44%*	*23%*
Companies	*5%*	*4%*	*3%*
Build to rent	9%	8%	26%
Market developers	*6%*	*3%*	*25%*
Affordable housing providers	*3%*	*5%*	*1%*
Buy to sell (speculators and wholesalers)	16%	5%	2%
Owner-occupied – without Help to Buy	30%	32%	10%
Owner-occupied – with Help to Buy	0%	0%	32%
Converted to affordable	0%	7%	5%

Sources: GLA

These changes are indicative of it becoming increasingly difficult for private individuals to afford to buy housing in London. Figure 12 shows that the ratio of London house prices to wages rose from around 4.9 times in 1999 to 13.7 times in 2016, since when it has levelled off. This rate of growth far outstripped the UK average. It has clearly been linked to the phenomenon described above, of fewer young people being owner-occupiers, and to the government policy initiatives described in the previous section. And although it is true that in 2019, owner-occupiers accounted for a substantial 42% of the new-build market, three quarters of those were taking advantage of the government's Help to Buy scheme.

9% vs 26%

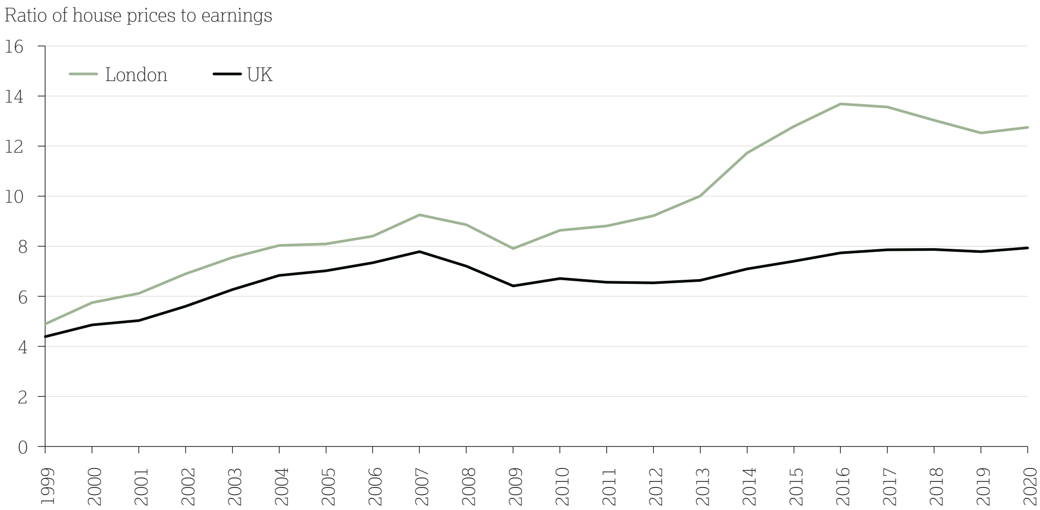
Build to rent as share of new homes, 2006 and 2019

-

The growth of the build to rent sector has grown in response to London's affordability crisis

The affordability issue in London means that while wages in London are higher on average than in other parts of the UK, housing typically represents a large part of many residents' total living costs. In the financial year ending 2020, 27% of London individuals were living in households with less than 60% of median income, after housing costs, compared to 22% in the UK.[4]

Fig. 12. Housing affordability ratio, London and the UK 1999 to 2020



4. Department for Work and Pensions, individuals living in households with less than 60% of contemporary median household income after housing costs.

2.6 Other housing challenges

Affordability is linked to other social challenges, including shortfalls in the quality of many London residents' housing. On most dimensions of social need, such as income, employment, education or health, London performs well. There are of course variations between neighbourhoods, but the pattern of these closely matches the national average. However, many London neighbourhoods have unusually large challenges in terms of housing-related issues such as homelessness, overcrowding, the distance of people's homes from essential services, and the proportion of housing which is in poor condition or which lacks central heating.[5] In 2019, London boroughs accounted for 24 of the 32 most deprived areas in England in terms of their average ranking for housing, and 15 of the 32 most deprived in terms of living environment.[6]

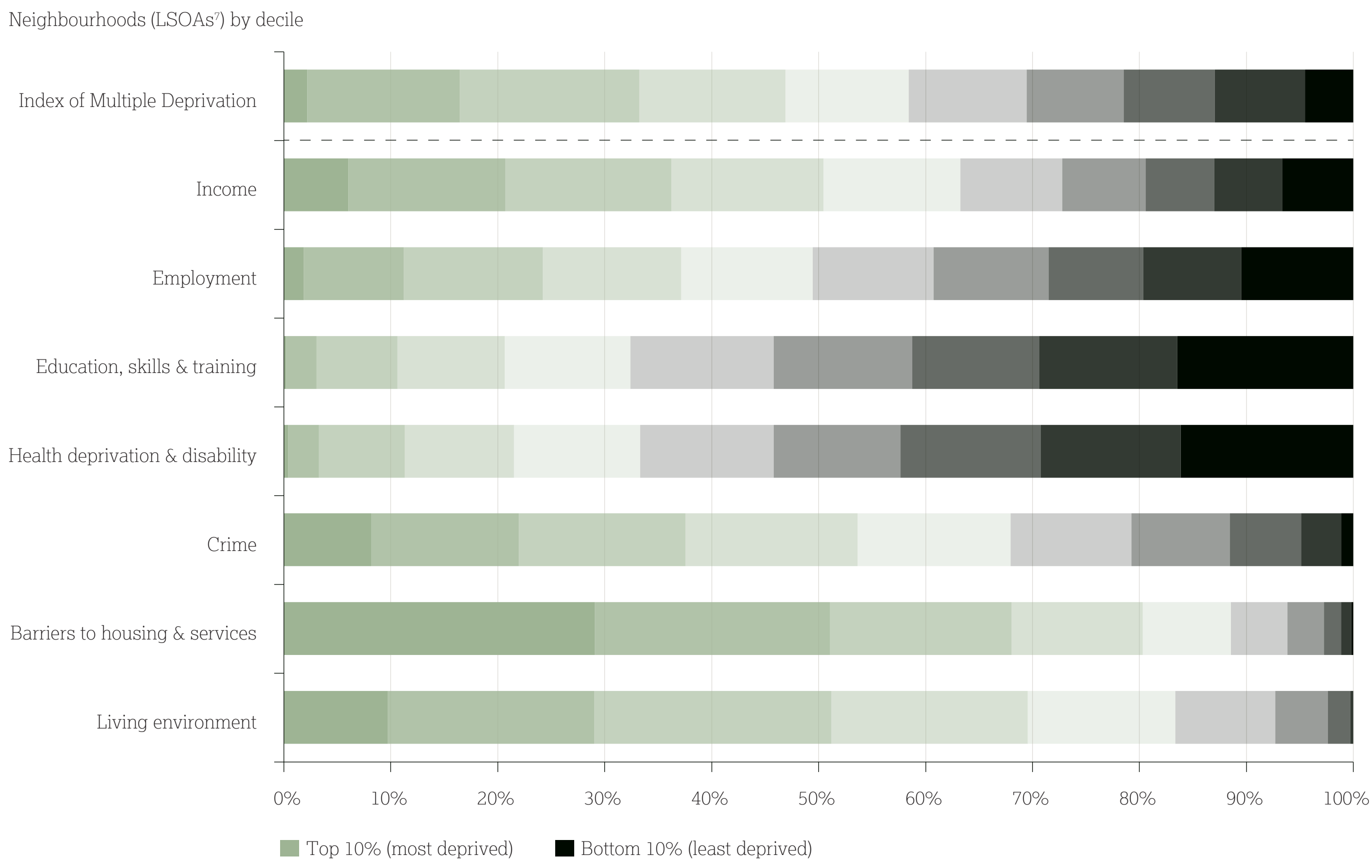
24 out of 32

London's share of England's most deprived neighbourhoods, in terms of housing

-

Londoners compare well in terms of many factors such as employment or quality of education, but are more likely to have unmet housing needs

Fig. 13. Types of relative deprivation, London neighbourhoods, 2019

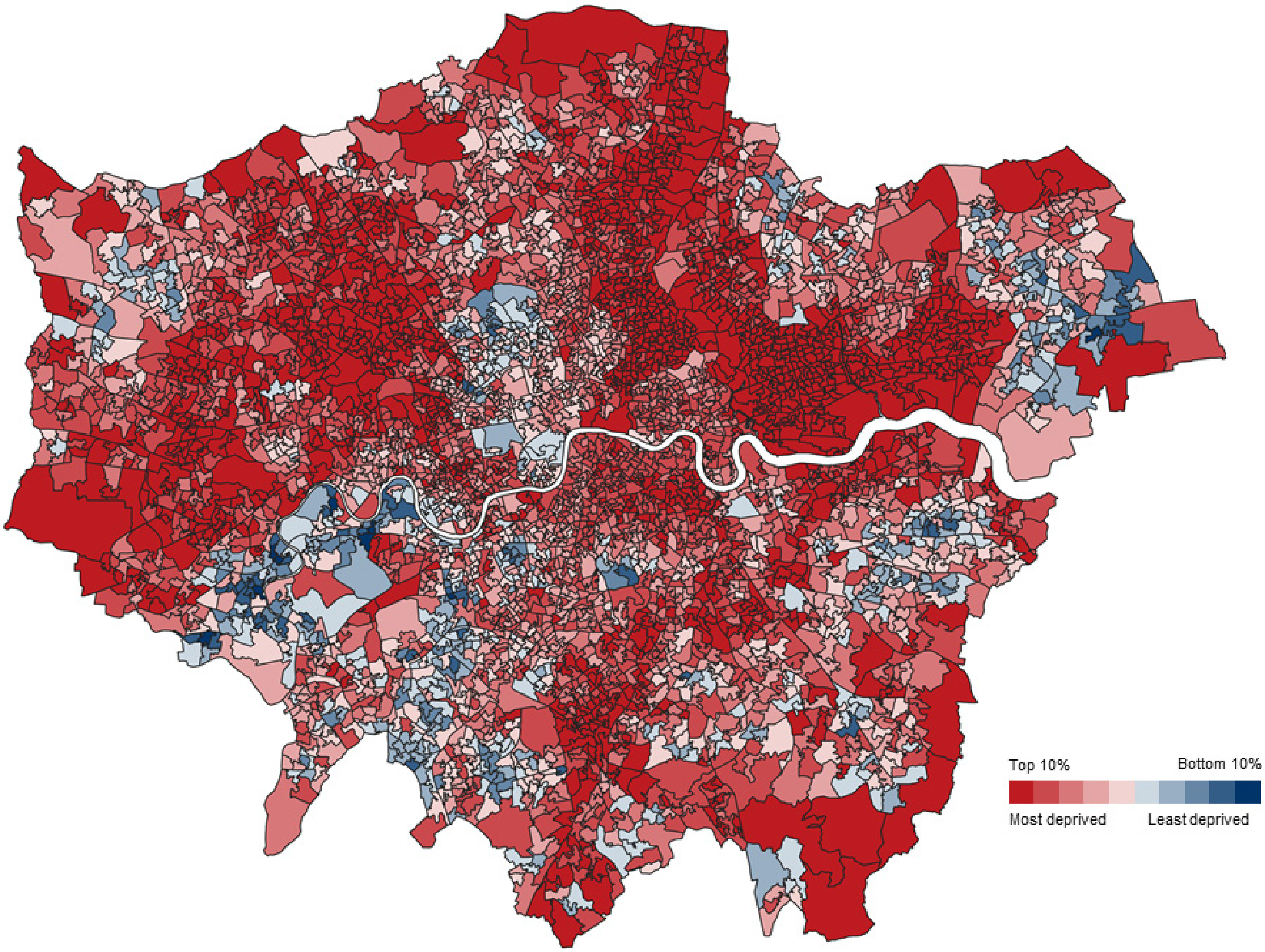


5. https://data.london.gov.uk/blog/indices-of-deprivation-2019-initial-analysis/
6. https://www.londoncouncils.gov.uk/members-area/member-briefings/local-government-finance/indices-deprivation-2019
7. Lower Layer Super Output Areas.

As the map in Figure 14 shows, these issues with housing deprivation occur in neighbourhoods all over London, both Inner and Outer, north and south, east and west.

Problems with poor housing quality, which affect a minority of London residents, are of course also present in many, indeed most, cities around the world. And as we noted in section 2.4 the government has provided funds for addressing housing affordability and is keen to encourage increases in both supply and demand. Going forward, however, much will depend on the overall trajectory of the London economy, and also on the extent to which the London Mayor, the Greater London Authority and London boroughs are able to bring their own resources, and those of central government—and indeed the private sector—to bear, to shape the role of housing in the economy. The following chapter addresses that.

Fig. 14. Housing deprivation in London neighbourhoods, 2019



Source: Indices of Multiple Deprivation, 2019, MHCLG

3. Economic forecasts, 2020-35

3.1 Coronavirus and London in 2020 and 2021

As we noted in Chapter 1, over the period 2009 to 2019 London's economy grew by 2.1% a year. Then, in 2020, the Coronavirus pandemic struck, having a significant and disruptive impact on the global economy, with London suffering alongside other cities and local communities around the world. As a result, GDP (Gross Domestic Product) shrank in London in 2020 by an unprecedented 9.3%.

Employment, however, declined by much less in 2020: 1.9% or just over 100,000 jobs. This partly reflected the UK government's Coronavirus Job Retention Scheme, which meant that large numbers of London residents and employees were furloughed. Furthermore, much of the fall in output was concentrated in the early months of the pandemic, so that by the second half of 2020 the economy was already recovering. It has continued doing so, albeit gradually and with fluctuations along the way. These have reflected the UK government's need to maintain and sometimes tighten restrictions on activity, including requiring hospitality and leisure businesses to remain closed for large parts of 2020 and 2021, with similar curbs on cultural and sporting activities and on international travel.

Most of the restrictions have now been reduced or removed entirely, the main exceptions being to do with travel to and from some countries. Meanwhile, working from home has been a great success in London, allowing the city's important desk-based service sectors to continue operating, although at the expense of reduced sales for retailers and hospitality businesses, particularly in the city centre, even when these were allowed to open.

Overall, as Figure 15 shows, we nevertheless estimate that London's GDP will show a strong 2021 rise of 6.5%, after 2020's decline of over 9%. By way of comparison, we estimate GDP will rise 4.8% in Paris in 2021, 6.7% in Madrid and 3.3% in Berlin.

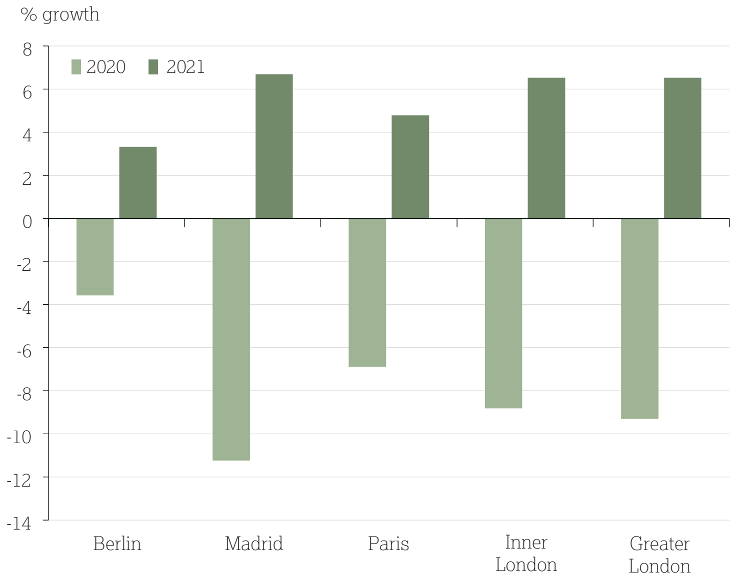
6.5%

London's GDP rise in 2021

-

We estimate that London is rebounding more strongly than European rivals, as the Covid pandemic eases

Fig. 15. London's economic growth relative to other European cities



Source: Oxford Economics

It is also clear from data published by the ONS, that London's population continued to expand during at least the first half of 2020, so that by June it exceeded 9 million for the first time. More international migrants settled in London between June 2019 and June 2020 than left, and at a rate similar to that seen over the previous decade. And although the data shows that more domestic migrants left London than arrived, this too was on a scale similar to recent years.

This means that speculation about a mass exodus of population from London, as a result of home working, students remaining with their families, young people not moving to the capital, and international migrants returning home (with the last of those caused by Brexit as well as by the pandemic), has not been supported by the facts.[8]

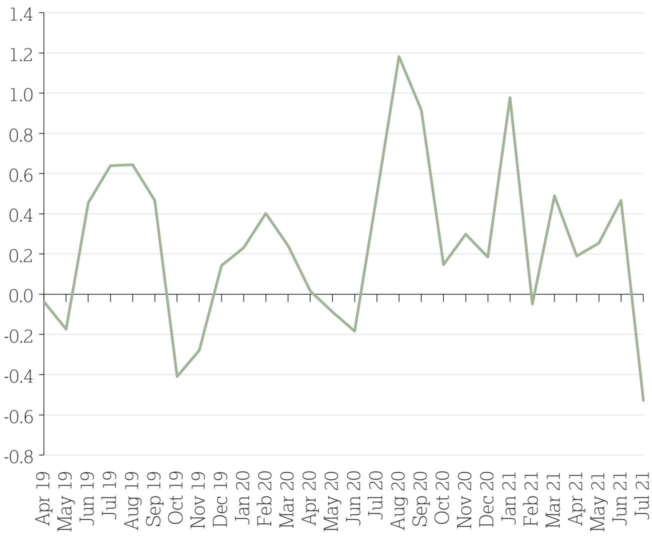
8. See O'Connor & Portes report https://www.escoe.ac.uk/estimating-the-uk-population-during-the-pandemic/ and PWC report https://www.pwc.co.uk/press-room/press-releases/2021-uk-and-global-economic-outlook.html

A similar story applies with respect to the housing market. Suggestions at the start of the pandemic that London would see a major fall in house prices have proved to be unfounded. This is partly because both employment and population held up, but also because of the government support to the housing market that we described in Chapter 2. The latest figures for July show London house prices 2.4% higher than a year earlier.

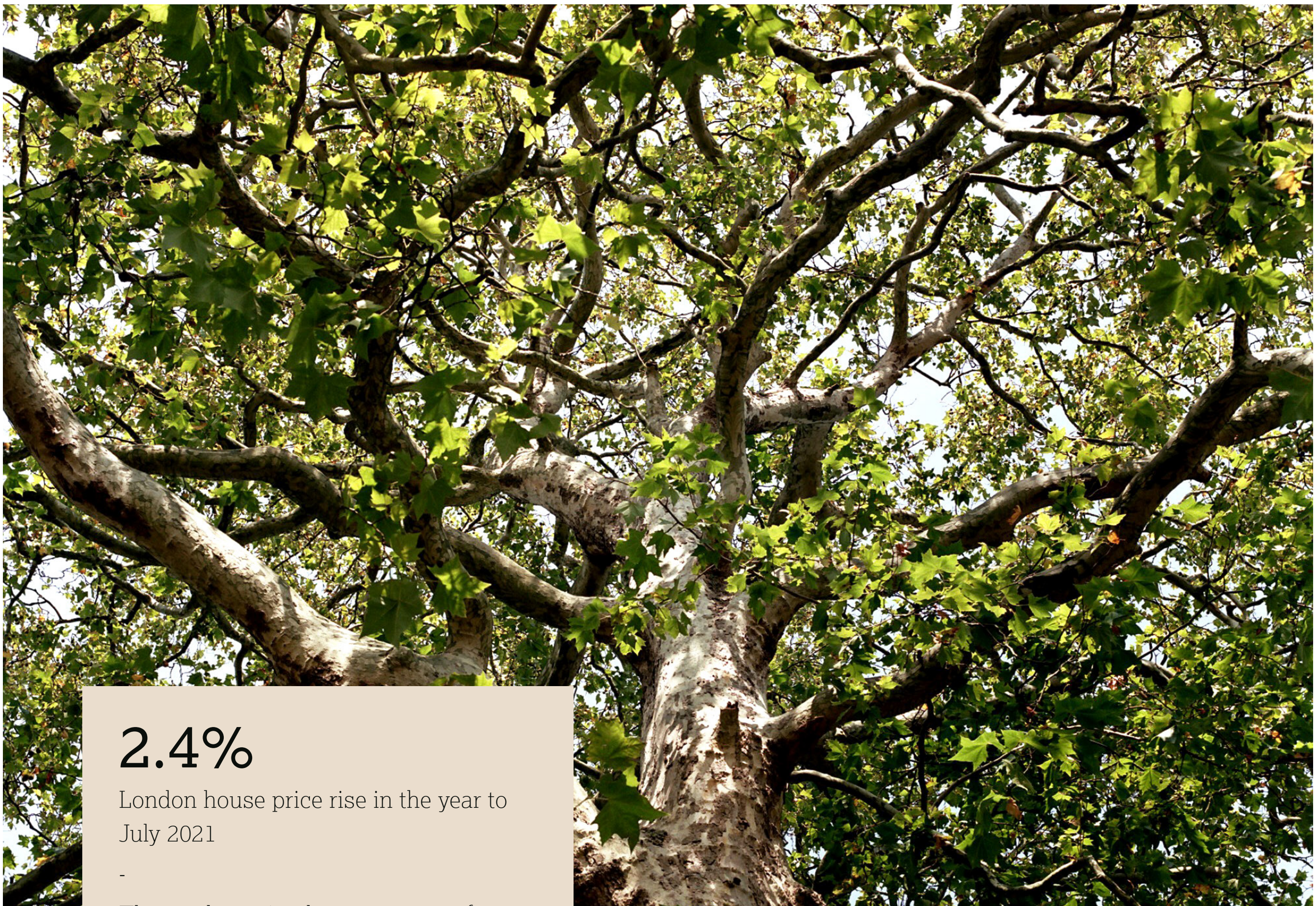
The decline witnessed in July in the three month rolling average growth figure is as a result of the tapering off of the Stamp Duty Land Tax holiday. This was introduced during the Coronavirus pandemic to incentivise house purchases by removing the levy applied to the first £500,000 of the transaction.

Fig. 16. London monthly house price growth, April 2019 to July 2021

3-month rolling average growth, %



Source: HM Land Registry



2.4%

London house price rise in the year to July 2021

-

The market gained some support from the government's Stamp Duty holiday

3.2 Forecast growth of London's economy

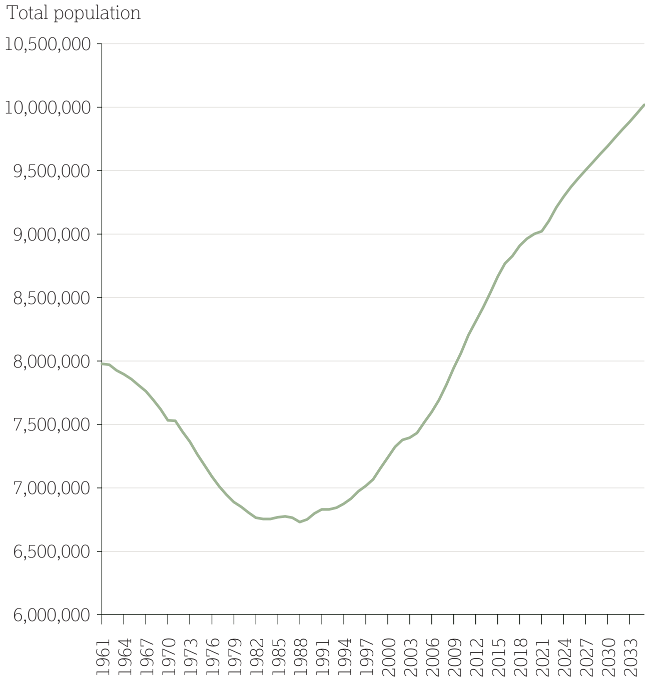
Over the five-year period 2020-2025, we expect that London will see the fastest rate of GDP growth of any UK region, at 1.7% per year, compared with 1.4% for the UK as a whole. On this basis London's GDP will have comfortably recovered to pre-pandemic levels by 2022. Over the longer term to 2035, we expect London to maintain a similar growth advantage over the UK and its main rivals, returning 1.8% per year between 2020 and 2035 compared to 1.4% for the UK, 1.5% for Paris, 1.2% for Madrid and 1.6% for Berlin

This outperformance reflects the fact that London has a larger concentration in the sectors that typically see faster growth, such as professional services, and digital and financial services, than other parts of the UK. Although the relocation of some activities by London firms to lower-cost locations elsewhere, discussed in Chapter 1, is likely to continue, that will probably happen less rapidly than in the past, essentially because non-core activities have mostly moved out already. That will leave London offices to increasingly focus on core operations at the higher value-added end of the spectrum. These are the ones that are likely to most benefit from economies of scale, and from co-location with other related activities—corporate lawyers in close proximity to investment bankers, located near to corporate head offices, who in turn locate near to advertising agencies, and so on. Over the medium to long term, London is therefore still likely to outperform other regions, even if not as dramatically as it once did.

3.3 Forecast growth of London's population

We also expect that London's population will continue to grow more quickly than the UK average, reaching 10 million people by 2035, as shown in Figure 17. That represents growth of 0.7% a year between 2020 and 2035.

Fig. 17. London's long-term population history and forecast



Source: Oxford Economics

1.8% a year

Annual GDP growth, 2020-35

-

London is expected to grow faster than its rivals and the UK, with the latter's GDP rising by 1.4% a year

This growth in population will continue to be largely driven by natural change, with an average of 59,000 more births than deaths per year in the years to 2035. This is lower than the average of 80,000 a year over the previous decade, but it means that London will continue to have a young population. Our forecasts are based on ONS projections for fertility and death rates by age cohort, which take into account a temporary distortion due to the Covid pandemic, plus our own projections for inward and outward migration.

We also expect that net inward migration will continue to increase London's population over the medium and long term, by an average of 8,000 people a year. We expect that international migration into the UK will be lower than historically, partly due to Brexit, but that some of the shortfall will be offset by increased migration of non-EU nationals. Although the UK government has introduced restrictions on migration into the UK from the EU, it has simultaneously reduced entry requirements for non-EU nationals. These rules can, and no doubt will, change through time, partly due to changing political priorities, but it is nevertheless realistic to assume that successive governments will tend to adjust the system with the aim of avoiding serious shortages of skills within the UK.

We also expect domestic migration to be lower than historically, both into and out of London. An important driver here is that the housing wealth built up by many mature London residents will allow them to move away from the capital quite easily, so that movements of such people away from London will continue to be a positive sign of the city's economic success. Meanwhile, young people are likely to continue to want to live in the capital for both lifestyle and career reasons.

A consequence of the overall trends in population and migration through our forecast period, is that we expect London's working age population to grow more quickly than the population as a whole, rising by 0.8% a year between 2020 and 2035 compared with 0.7% for the total population. That reverses the historical pattern. London's working age population rose by 0.5% a year between 2015 and 2020, compared to 0.8% for the total population.

In contrast we forecast that Paris' working age population will decline by 0.2% a year between 2020 and 2035, while in Amsterdam (0.2%), Berlin (0.2%) and Madrid (0.1%), working age population growth is expected to be positive. but weaker than is forecast for London. Thus, London looks strong in terms of international comparisons.

0.8% a year

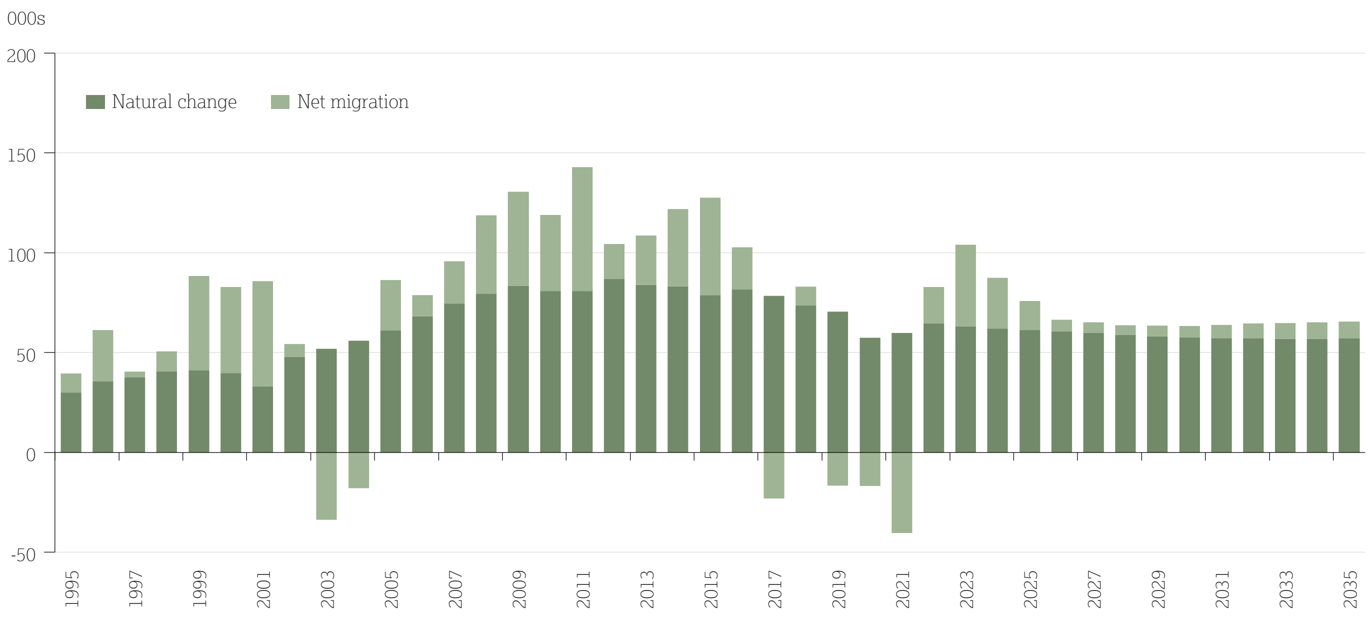
Growth in working age population, 2020-35

-

In Paris, in contrast, the working age population looks set to decline over the same period

Fig. 18. London's annual population growth,1995-2035

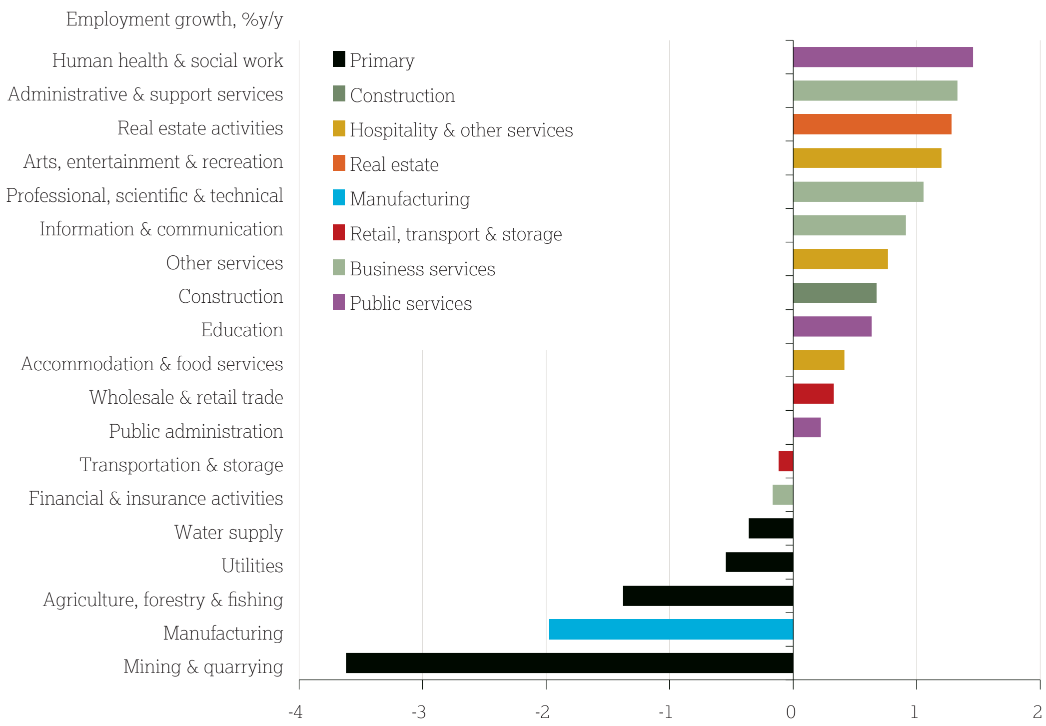
Source: Oxford Economics, ONS



3.4 Forecasts for employment, income and unemployment

Underlying these views on migration are our expectations for healthy growth in London employment and household incomes. We forecast that workplace employment in London will return to pre-crisis levels in 2022.[9] Over the longer term between 2022 and 2035, we expect London to create an additional 830,000 jobs, net, delivering workplace employment some 12% higher than in 2019, before the pandemic struck.

Fig. 19. Annual average employment growth by sector, London, 2020 to 2035



Source: Oxford Economics

Within that we project that information & communication will be the fastest-growing sector in output or GDP terms, averaging 2.6% growth a year to 2035, while professional, scientific and technical services will be very close behind at 2.5% a year. As Figure 19 shows, the workforces of both sectors will grow more slowly than that, but will nevertheless continue to expand. By 2035 they add 79,000 and 172,000 additional jobs respectively, compared with 2020. The administrative & support service sector, such as for example facilities management and employment agencies, will also be among the faster-growing sectors in GDP terms, at 2.3% a year. By 2035 the sector will have added 165,000 jobs—the second-largest increase in employment, behind professional services.

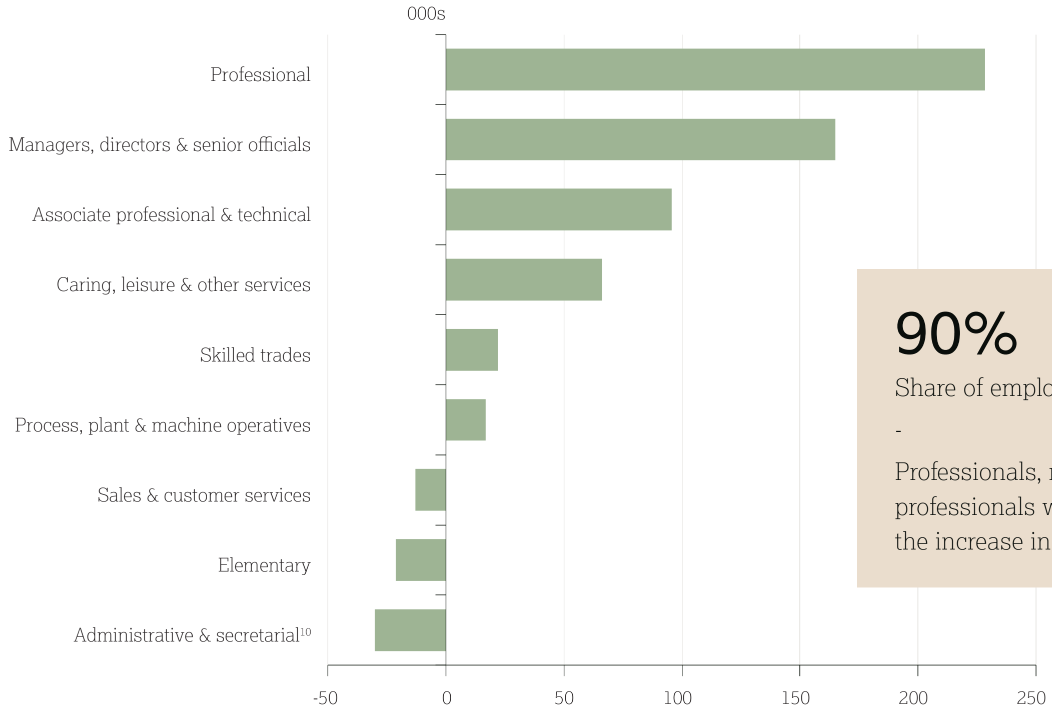
Outside these sectors, human health & social work is forecast to grow at 2.4% per year in GDP terms, the third fastest-growing sector on this basis in London, but the fastest-growing in terms of employment. As a result, the sector is expected to create an additional 155,000 jobs over the period to 2035.

The evolving sectoral mix of employment will also affect the occupational structure of the workforce, with an increasing requirement for higher-skilled occupations. In the period to 2035, over 90% of net additional employment will be in the three occupational categories of professional occupations (228,000 workers), managers, directors & senior officials (165,000 workers), and associate professional & technical occupations (96,000 workers). And we

9. Because of commuting, there have always been large differences between residence-based employment in London and workplace-based, with the former smaller than the latter because of the scale of net inward commuting. In this context 'workplace' refers to a person's normal place of work, so includes people temporarily homeworking, even if they live outside the capital. This reflects standard statistical practice. Our expectation, as we explain in the box on page 32, is that home-working will continue in the future but at a much diminished rate.

expect to see some net decline in occupations that tend to be lower skilled and lower paid. (These occupational classifications are related to but differ from the sectoral breakdown discussed in the previous paragraphs, so that for example not all lawyers work in the legal sector, and not everybody in the health sector is a medical professional or associate professional.)

Fig. 20. Employment change in London by occupation, 2020 to 2035



Source: Oxford Economics

90%

Share of employment growth, 2020-35

-

Professionals, managers and associate professionals will account for almost all the increase in jobs in London to 2035

This shift towards a larger share of employment accounted for by higher-skilled occupations will support overall income growth: we forecast that both workplace and resident earnings will grow in London by 3.2% per year over the period to 2035. However, the gap between the wages of those at the higher and lower ends of the wage range may increase, reflecting the relative balance of supply and demand in the marketplace. We nevertheless forecast that unemployment, having been boosted by the pandemic, will gradually fall from its 2020 level of 5.6% (measured by Labour Force Survey data), although settling at a slightly higher rate than that seen pre-Covid of around 4.5% by 2025.

10. Administrative & Support Services and Administrative & Secretarial categories are defined by the ONS and reflect two different groups.

Has the pandemic radically altered the future of London?

Our forecasts reflect our assumptions about the extent to which the Covid pandemic will or will not generate significant and permanent shifts in economic behaviour, with both economic activity and population moving away from London (and similar large cities) towards smaller cities and perhaps rural areas, and with that happening alongside a simultaneous shift away from office-working and towards home-working. Both phenomena would be facilitated by the continuation of online working that has been such a feature of the pandemic.

The available data suggests that there will not in all likelihood be a radical change, sufficient to cause a change in direction for the London economy. Instead there will be incremental changes, on the scale implicit in our forecasts and discussed in Chapters 2 and 3. UK-level data from the ONS Business Insights and Conditions Survey (BICS), collected in April 2021, shows that 24% of employers intend to use increased home-working as a permanent business model going forward. In the information and communication sector, which most lends itself to home-working, only 49% intend to do so, compared with 81% currently working from home.

Other ONS research clearly shows that home-working is most prevalent among senior staff, who have the autonomy (and also perhaps the homes) to facilitate such working. The most recent survey shows that younger workers are less likely to report an overall positive view of home-working than older workers, with fewer respondents aged between 16 and 29 years reporting 'improved work-life balance' or 'completing work in a shorter time' as characteristics of home-working, compared with those aged over 30.

Young people are also the only age group to report more distractions when they are working from home than in the office. And around 20% of businesses report 'reduced communication', 'negative impact on working culture' or 'reduced productivity' as reasons for not intending to use home-working as a permanent business model. For individuals, 'harder to work with others' and 'fewer job opportunities' are identified as the main disadvantages of working from home.

For London, a possible implication is that, since the city has a young workforce but also a high proportion of very senior workers, there may be a split in working behaviour, with the former working almost entirely in the office, and the latter working more at home than before the pandemic. If that is associated with a modest overall reduction in office requirements, and a consequent tendency for office buildings to be repurposed for residential use, then some neighbourhoods within the city's central core may shift towards more mixed use, with increased residential inflows of young people, creating opportunities for central London retail and hospitality sectors that have been hard-hit by the pandemic.

In other research, Ipsos asked London residents about the likelihood that they would move out of London in the next five years. In 2019, 36% said they were either likely or certain to do so, and 52% said they were unlikely to do so or certainly would not. The equivalent figures for 2021 were 44% and 47%, indicating that there has been a modest shift towards a greater willingness to at least contemplate moving away. That is consistent with our forecast for a gradual rebalancing of migration flows. In the same survey, 25% of London residents thought the capital would rebound strongly, economically and socially, from the pandemic, and 57% thought it would recover slowly, with only 11% expecting it would never fully recover. More than half (55%) said they could work from home some or all of the time.

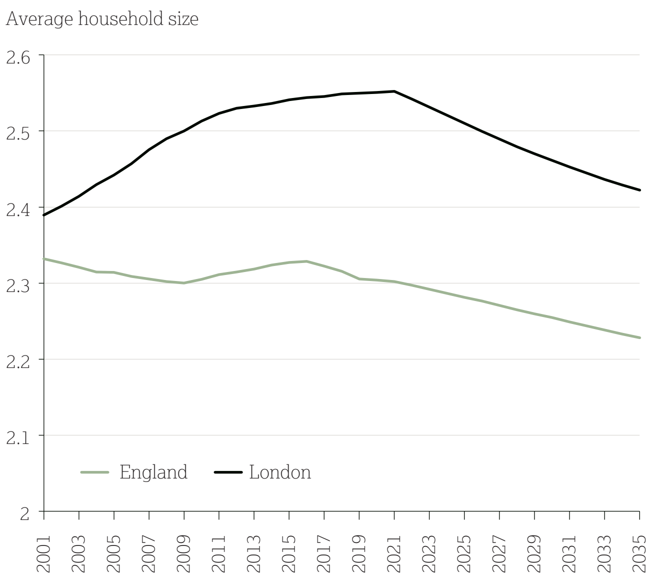
4. Future of housing in London

4.1 Future demand for housing

The forecasts for growth in population, employment and income set out in Chapter 3, all feed through to rising demand for housing in London. The scale and composition of that demand will, however, also depend in part on residents' needs and preferences with respect to household size, which are clearly influenced by such factors as relationship status, and whether or not people have children, or dependent parents.

Since the late 1990s, the average household size in London has been rising, while it has been flat or falling in England as a whole. For our forecast we adopt ONS projections on average household formation by age band, to determine future growth in the number of households. This methodology generates an expectation that the average household size will fall in the future, with the number of people living in each London household reaching around 2.4 by 2035, compared with 2.6 in 2020. That will still be significantly higher than the UK, at 2.2 people per household in 2035.

Fig. 21. Average household size, London and England, 2001 to 2035



Source: Oxford Economics, GLA

2.4 people

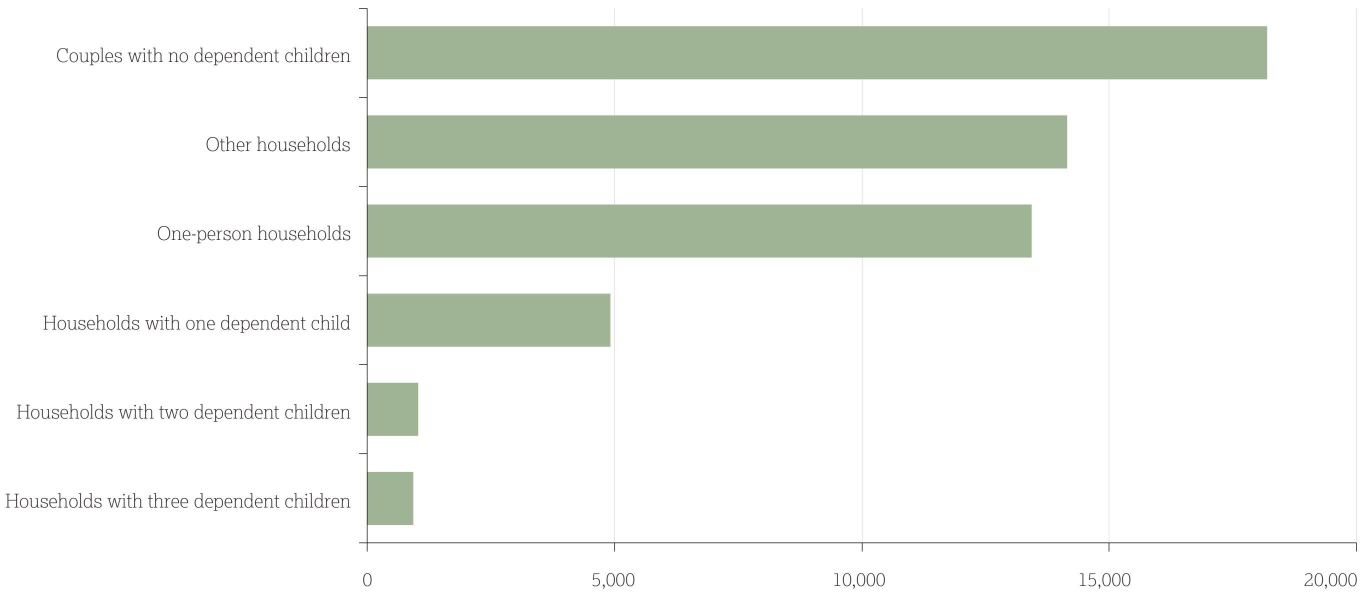
Average household size, 2035

-

A decline from 2.6% in 2020 will contribute to London's increasing demand for housing

Figure 22 breaks this down into more detail. The GLA forecasts that one-person and multiple-adult households without dependent children will account for most of the projected growth in households over the 2020 to 2035 period in London. Households with children will contribute only around a tenth of annual growth over the period.

Fig. 22. GLA projections of annual new households, by type, 2020-35



Source: GLA

By combining ONS assumptions about household composition and size with our own demographic projections, we forecast an average increase in the number of homes required in London of 50,000 a year between 2020 and 2035. As a result, the number of homes required rises from 3.6 million in 2020 to 4.4 million in 2035. We expect much of this growth to occur in Outer London, accounting for an average of 57% of the new housing stock per year over the next 15 years.

This 50,000 a year figure compares with the figures in section 2.2 above, of an average annual number of new homes built over the 2010-2019 period of just under 30,000, and a figure of over 40,000 in 2020. But considerable care is needed in interpreting these numbers. It is a feature of how the ONS undertakes its calculations on household size that the projected decline in size mainly reflects the projected change in London's

50,000

New homes a year, 2020-35

-

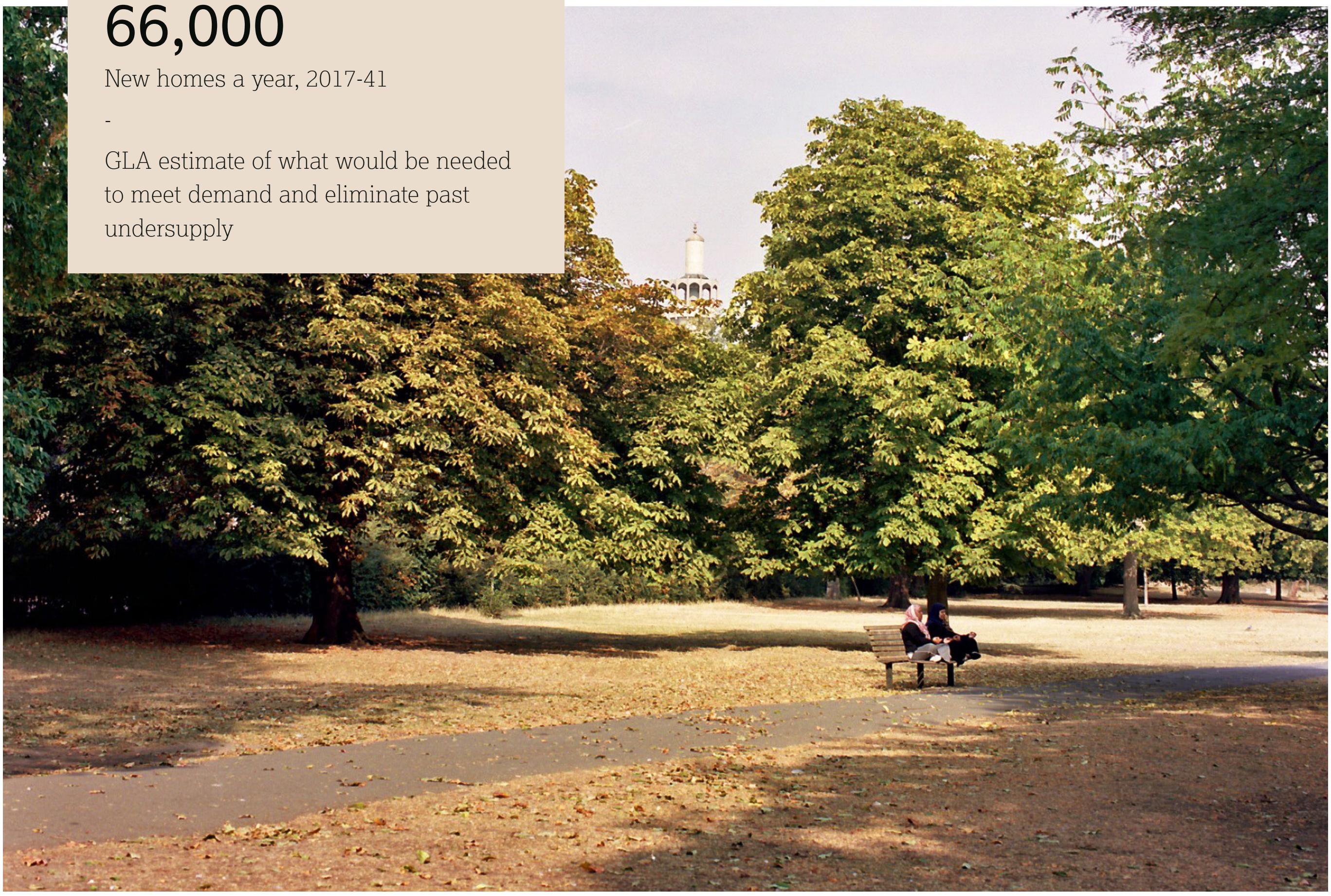
Our forecast for likely annual demand for new housing

66,000

New homes a year, 2017-41

-

GLA estimate of what would be needed to meet demand and eliminate past undersupply



demographic profile, whereas the historical rise in average household size was clearly the result of the rising affordability challenges discussed in section 2.2.

It is realistic to think that if housing affordability were to be significantly improved going forward, then more people—especially young people and those on low incomes—would form independent households, and hence that demand for homes would rise by more than 50,000 a year, while average household size would fall faster than in our projections.

The implication is that the 50,000 figure can best be thought of as a lower bound for housing demand. Indeed, the GLA Strategic Housing Market Assessment 2017 calculates a need for 66,000 additional homes a year over the next 20 years, to address pent-up demand and eliminate overcrowding. That implies a range for future housing demand of 50,000-66,000 new homes a year.

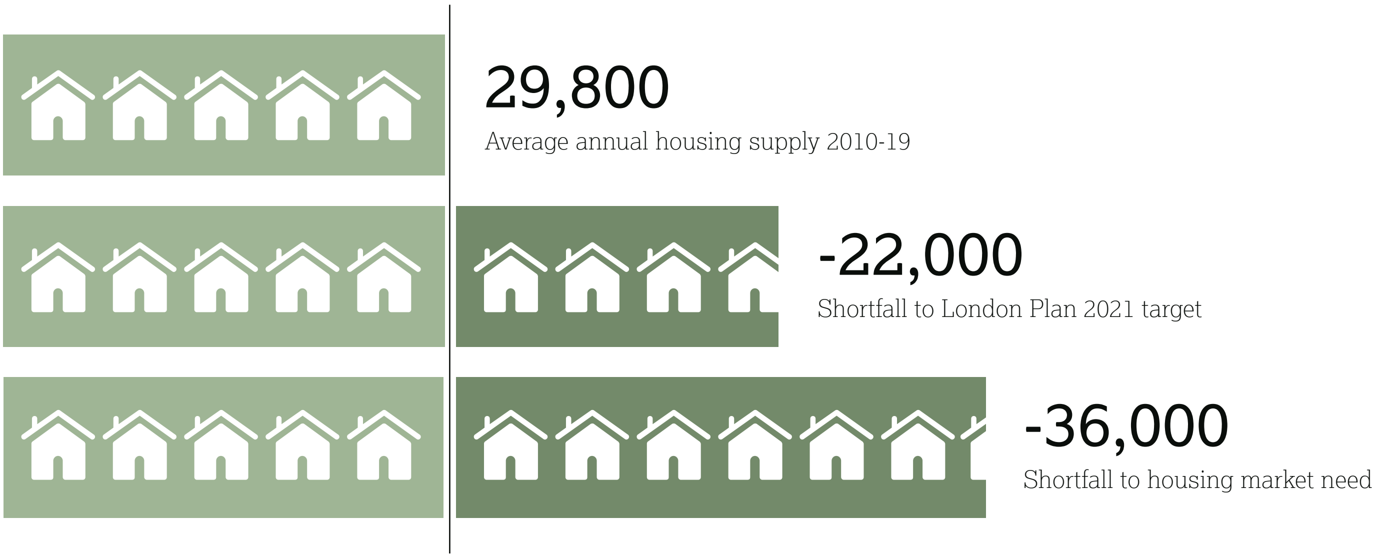
4.2 Housing supply: the role of the London Plan

But will 50,000 or even 66,000 new homes be built, each year? While the GLA suggests that the potential need is for 66,000 new homes a year, the recently approved London Plan 2021 contains a less-ambitious target of just 52,000 a year between 2019 and 2028—so very close to our own projection.

Effectively, the Plan accepts that 66,000 would be an unrealistic target, but it suggests says that 52,000 a year can be achieved, by increased use of brownfield sites and by the mixed-use redevelopment of car parks, low-density retail parks, supermarkets, commercial, industrial and leisure sites, public sector owned sites, and so on.

Fig. 23. Annual impact of shortfall of housing delivery against targets

Source: Oxford Economics



Calculating how many new homes London needs

The London Plan 2021 sets a target of 52,000 new homes a year between 2019/20 and 2028/29. The previous London Plan (2016) had a target of 42,000 homes a year. The 2017 London Strategic Housing Market Assessment (SHMA) identified a significant overall need for housing, and for affordable housing in particular. It suggested that London needed 66,000 new homes each year, for at least 20 years, and that 43,000 of them should be genuinely affordable. However, in its September 2017 consultation paper 'Planning for homes in the right places', the Department for Communities and Local Government (DCLG) proposed a standard method for estimating annual housing requirements in every local authority in England. Applying this approach produced an estimated requirement for over 72,000 additional homes a year in London over the 10 years 2016 to 2026. This timescale was considerably shorter than that used in the SHMA, which covers the period 2016 to 2041 and so allows for a slower rate of unwinding past shortfalls in supply. Combining the DCLG formula with the longer time period would generate an annual need of just over 68,000 homes for London.

There is a particular emphasis in the London Plan on increasing housing in supported regeneration zones, notably but not exclusively in outer boroughs. Indeed, the plan suggests that large sites can accommodate 40,000 extra homes a year, and that increased delivery from small sites will be expected to account for the remainder of the target. In support of those ambitions, a recent report from AECOM found that there were enough brownfield sites within walking distance of London's town centres for 400,000 new homes.[11]

The London Plan also sets out similarly ambitious affordability criteria for the delivery of new homes in the capital. Indeed, it suggests that 50% of new homes should be affordable, based on the GLA's definition of affordability, and delivered on site rather than elsewhere in the capital.

The London Plan also places a priority on rented accommodation, and discusses associated concepts such as 'London Affordable Rent' and 'London Living Rent'.[12] We noted earlier that build to rent has seen rapid growth in London, but this has been from a very low base—the sector represents only a small proportion of the UK and London housing stock. Analysis by Savills of mature markets such as Germany, the Netherlands and the USA leads it to conclude that the UK is not close to its potential in terms of scale.[13] The London Plan stresses the importance of diversifying housing delivery to reduce reliance on a small number of developers, and it states that boroughs should take a positive approach to the build to rent sector, to:

- attract investment that otherwise would not exist,
- accelerate housing delivery on individual sites,
- deliver more readily across the housing market cycle,
- offer long-term tenancies,
- ensure a commitment to and investment in place-making through single ownership, and
- provide better quality homes than much of the mainstream private rented sector delivers.[14]

The London Plan also prioritises the delivery of small units with one bedroom, which currently tend to be out-numbered by new two-bedroom units. The 2017 London SHMA calculated that 55% of new homes should be one-bedroom properties and a further 16% should have two bedrooms.[15] The London Plan endorses that, and states that well designed one- and two-bedroom units in suitable locations can attract people wanting to downsize from their existing homes, thereby freeing up existing family stock. The Plan also suggests that one-bedroom units reduce the pressure to sub-divide existing properties into smaller units.[16]

And the Plan sets out other objectives, such as increasing sustainability, reducing carbon emissions, and helping to revive local town centres within London.

55%

Percentage of target that should be single-bedroom

-

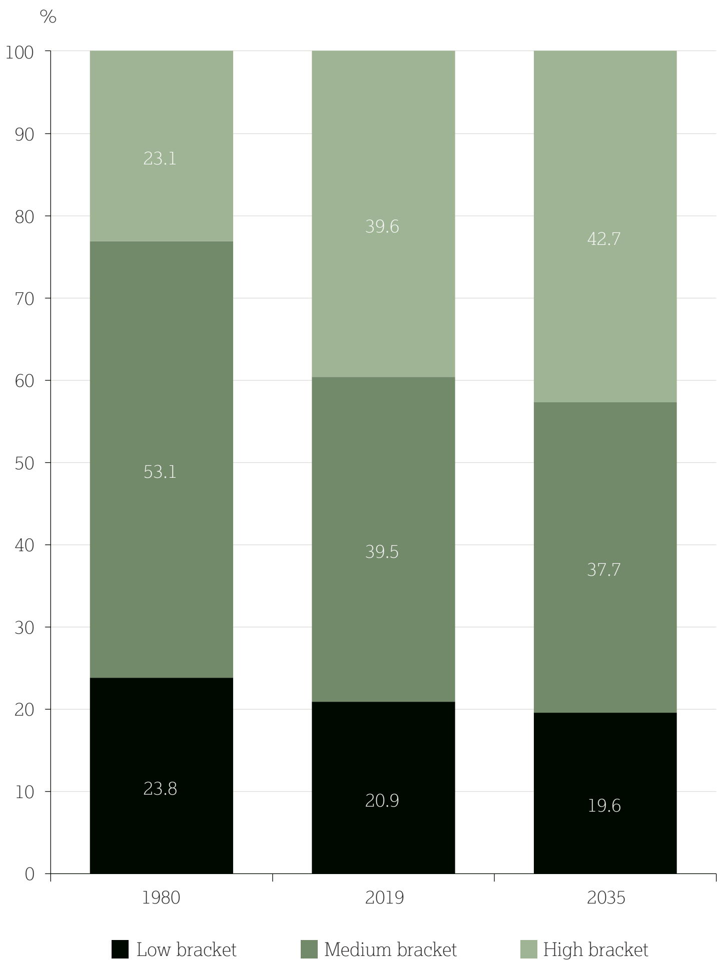
GLA target is 52,000 homes a year, with 55% single-bedroom and 16% two-bedroom

11. London 2070, AECOM
12. https://www.london.gov.uk/what-we-do/planning/london-plan/new-london-plan/london-plan-2021
13. Savills UK | Market in Minutes: UK Build to Rent – August 2021
14. London Plan 2021
15. https://www.london.gov.uk/sites/default/files/london_shma_2017.pdf
16. London Plan 2021

In setting out these expectations, the Plan does of course reflect the political values of the current Labour administration in London. It is possible that future administrations will have different ambitions. However, given the population trends, our expectation is that issues of overall housing availability will remain important for the foreseeable future. And as Figure 23 illustrates, any tendency to underdeliver in one year creates an increasing challenge for future years.

In addition, the issue of affordability is likely to continue to be a political priority. As Figure 24 (which summarises the data already shown in Figure 12) shows, we forecast that an increasing proportion of those who work in London will be in professional and managerial jobs. Low-skilled jobs will in contrast become less plentiful. The likely consequence is a widening in the gap between high and low incomes—making the affordability challenge all the larger. So it is realistic to expect that future London Plans will continue to stress a need to create more affordable homes, irrespective of the political complexion of London's government.

Fig. 24. London's share of employment by broad occupational group, 1980, 2019 and 2035



Source: Oxford Economics

4.3 Forecast for London house prices

In our baseline forecast, we estimate that London house prices will increase through the mid-to-late 2020s. Overall, we expect median house prices in the capital to rise by 3.1% per year on average, to £766,000 in 2035. This growth will be in line with median earnings, meaning that in average terms, the affordability ratio will remain broadly unchanged. If, as we think possible, higher earnings will grow faster than lower earnings, then for those at the bottom of the income scale, the issue of affordability will become more challenging. The same will be all the more true for those living on state benefits, which (except for pensions) are unlikely to keep track with pay.

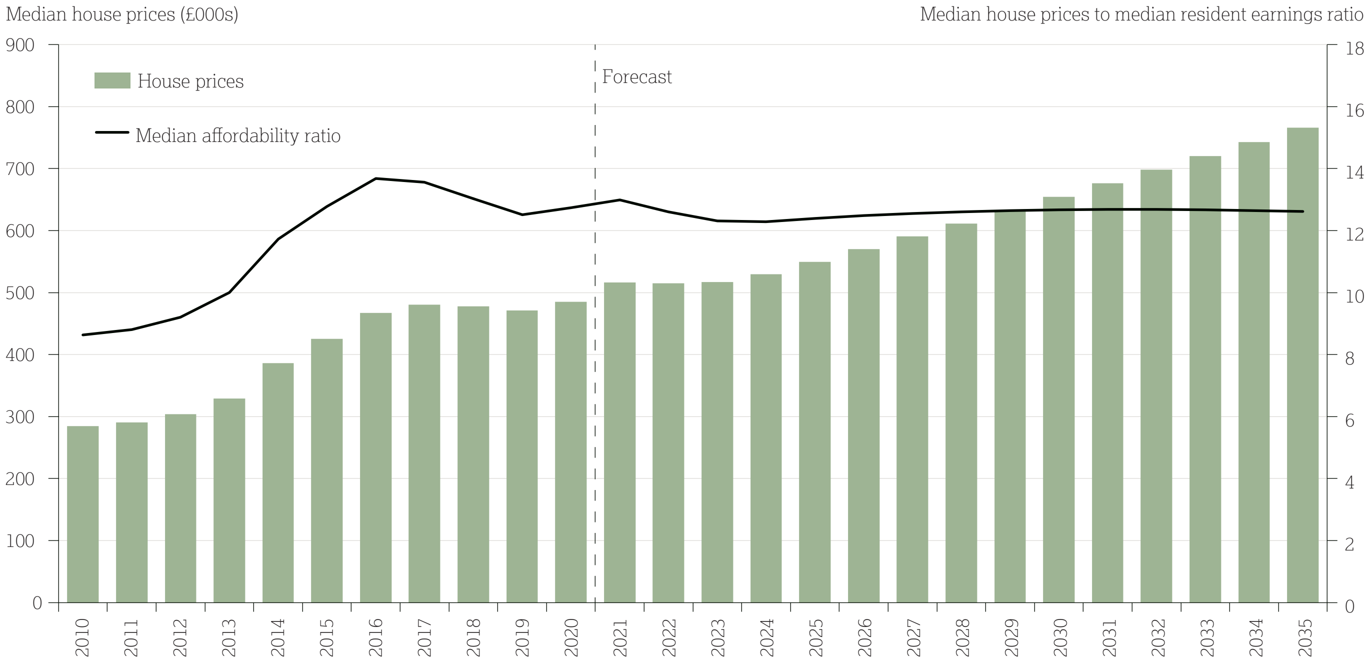
3.1%

Forecast increase in house prices, year on year

-

We forecast that in 2035 the median price of a London home will be £766,000

Fig. 25. London house prices and affordability ratio, 2010 to 2035



Source: Oxford Economics

Of course, if our forecast that the number of new homes built will broadly match the Mayor's target does not happen, then it is likely that prices will rise faster. The historical evidence of disappointment with respect to housing provision suggests that this is indeed a possibility. That also implies, however, that in terms of the fundamentals of housing supply and demand, the likelihood of a large decline in London house prices is very low. Only in the context of a global collapse in financial asset prices does it seem reasonable to be bearish on London house prices.

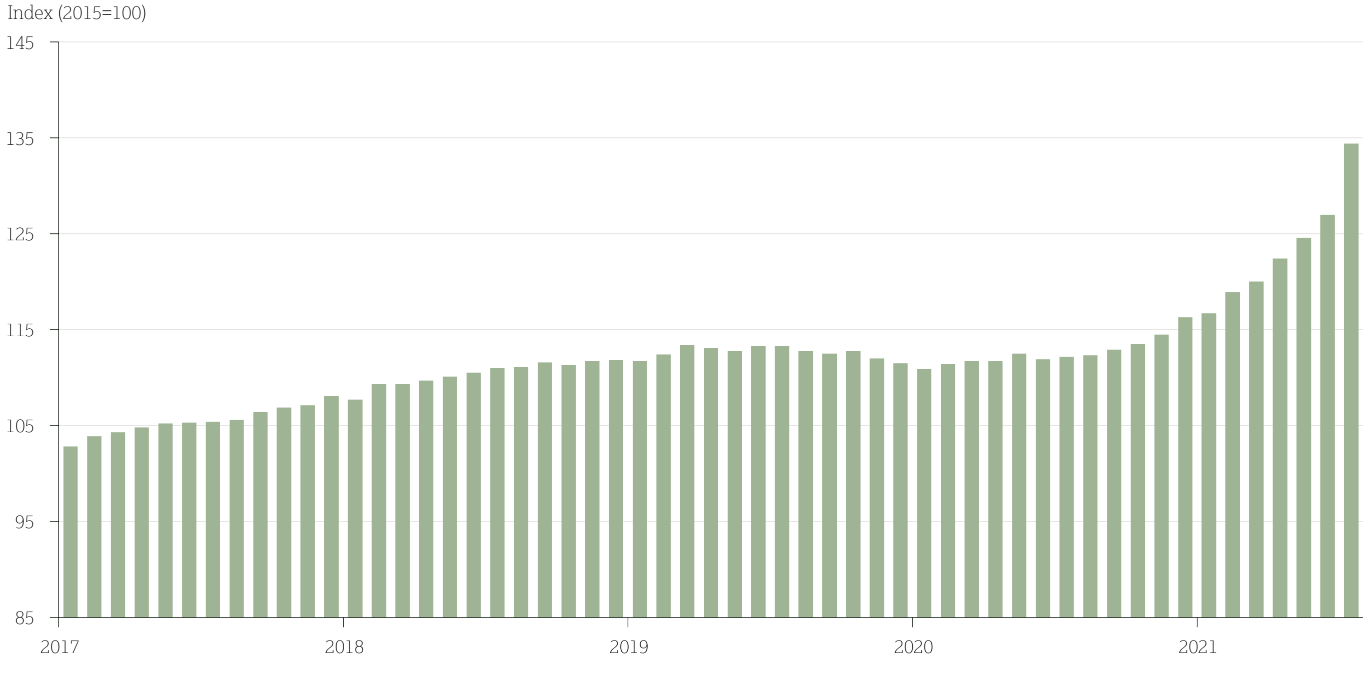
In that context there is some evidence that availability of finance, particularly for first-time buyers, is now improving as the UK economy recovers. In response to the financial turbulence caused by the pandemic, most home lenders removed deals with high loan to value ratios from the market. There is evidence that these are now returning.

4.4 Housing supply: the role of cost factors

Clearly, however, the private sector's ability to deliver on the bulk of this extra housing will also depend in part on the viability of future housing construction, and hence on housing costs. We do not expect that to be a constraint.

We noted in Chapter 1 that London is an expensive city in which to build. Furthermore, costs have recently been driven up by the Covid pandemic, and the recent reductions in restrictions on activity. These have caused sharp increases in construction costs, mainly due to shortages of materials, supply-chain disruptions, and in some cases labour shortages. Brexit may also have added to the pressure. The ONS index of UK construction material prices for new housing rose by 19.8% between July 2020 and July 2021.

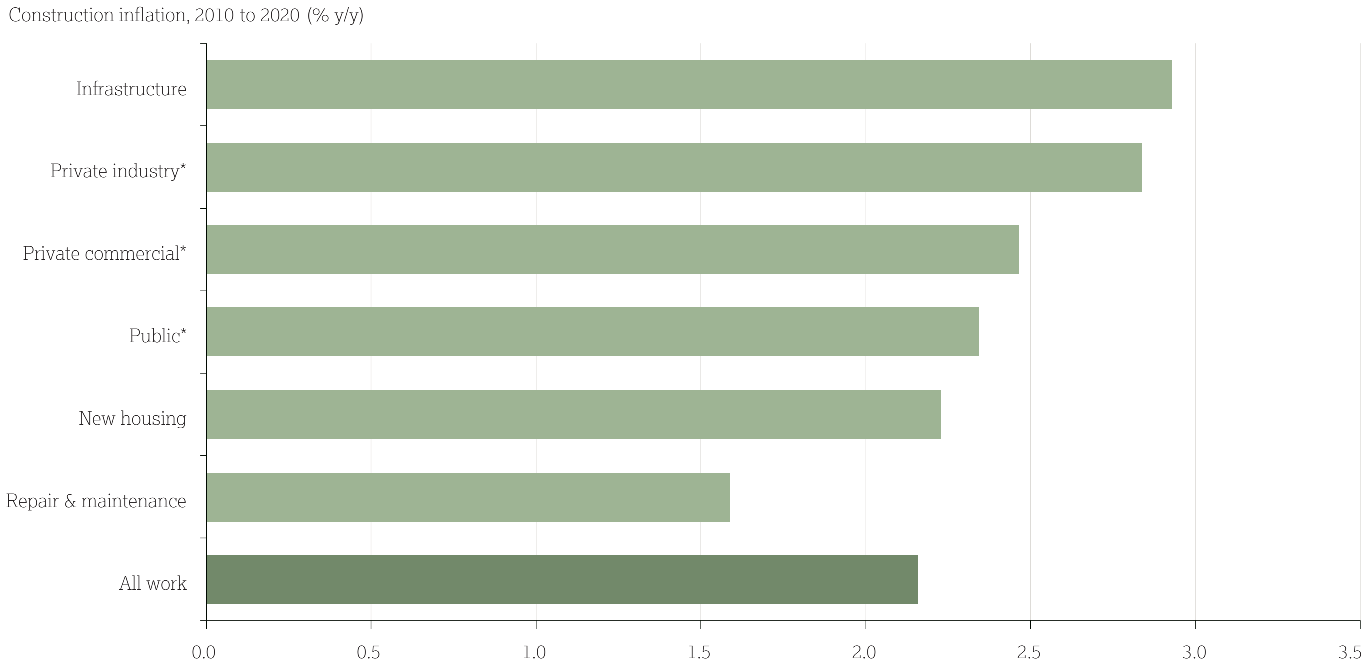
Fig. 26. Monthly Construction Materials Price Index, UK, 2017 to 2021



Source: ONS

But this is a global, not just a London, story. In its International Construction Market Survey 2021, Turner & Townsend rates London as the eighth most expensive market in the world—so down from a previous ranking as the third most expensive. Furthermore, these international comparisons are calculated on the basis of office buildings, shopping centres and distribution centres, as well as homes. For a city such as London, the very high cost of building at scale in the congested and historic central business district has a big impact on the overall figures. The cost of building homes in suburban London boroughs and in those districts undergoing regeneration is likely to continue to be appreciably less. At the UK level the historical pattern, illustrated in Figure 27, has been for new housing construction costs to rise almost in line with the average for construction as a whole, whereas commercial property and infrastructure costs have risen faster, while repair and maintenance costs have increased more slowly.

Fig. 27. Construction inflation by type of activity, UK, 2010 to 2020



Source: ONS, Oxford Economics

* Excludes infrastructure

Looking ahead, cost pressures are likely to remain strong throughout 2021 and early 2022, until the supply chain is able to meet the rise in demand, and until the demand itself starts to slow, as the backlog of projects winds down. Over the medium term, however, and in contrast to some industry sources, we expect construction cost rises—in London, nationally, and globally—to moderate. Over the last 10 years, UK construction inflation for all construction work, as measured by the ONS, averaged 2.2% per year, closely comparable to 2.0% for consumer price inflation (CPI). A similar tendency for the sector's costs to track consumer prices is likely, going forward. Furthermore, as Figure 28 illustrates, even those industry sources that expect construction costs to increase rapidly in 2022 or 2023 expect them to then moderate.

Fig. 28. London & UK construction and consumer prices, 2021-25

Construction prices

	2021	2022	2023	2024	2025
MACE Source: London data	1.5	2	3.5	2.5	2.5
Gardiner-Theobald Market Intelligence Source: London data	2	1.5	1.75	2	-
BCIS All in Tender prices Source: UK data	3.9	3.2	4.2	3.8	3.9
Turner & Townsend Source: UK data	2	3	4	-	-

Consumer prices

	2021	2022	2023	2024	2025
Oxford Economics CPI Source: UK	2.2	2.7	1.9	1.8	1.9

5. Conclusions

In Chapter 1 we noted that in the last decade, London's economy, despite facing some emerging challenges, has continued to outperform other leading cities in both the UK and Europe. In doing so it has built on considerable competitive advantages accumulated since the 1980s, with rapid growth beginning in the financial services sector, but spilling out to include a wide range of other (mainly tech) sectors, such as professional, scientific and technical services, information and communications, and the creative industries. A highly qualified workforce, a light regulatory burden, investment in infrastructure, and well-managed city and borough level governments, have all contributed.

Leading on from that, in Chapter 2 we noted some emerging characteristics of London's housing market, including increasing worries over affordability and possible overheating, plus difficulties in matching rising demand for homes with an equal increase in supply. We noted that problems are especially apparent at the affordable end of the market, and that there has been a large decline in the proportion of Londoners who own their own homes.

However, in Chapter 3 we suggested that we nevertheless expect that over the next decade and a half London will continue to grow faster than other comparable cities in terms of output and employment, with the reasons for past success substantially remaining in place. And in Chapter 4 we suggested that over the medium to long term, house prices will continue rising, even if at a slower rate than historically. We also suggested that we think this is consistent with something of the order of 50,000 new homes coming to the market annually.

That figure would be broadly consistent with the 52,000 target for new homes set out by the London Mayor in the London Plan 2021. It would be significantly higher than the 30,000 achieved annually over the 2010-19 decade, but also lower than the 66,000 that the Greater London Authority estimates would be needed, to match both a rising population and the removal of the shortfall in supply that has accumulated over past years.

The London Plan sets out a number of reasons for thinking that 52,000 a year of additional housing can be achieved. This includes the use of plentiful brownfield sites, but also significant infilling of small sites and the repurposing of, for example, car parks and some retail sites. It also focuses on increasing the housing supply within supported regeneration zones of the outer boroughs. In addition, the London Plan argues for more imaginative ways to deliver new housing, including through build to rent—a type of housing provision that has historically been under-exploited in the UK, but which offers a number of advantages in terms of attracting investment that otherwise would not flow, and which the Mayor hopes will promote long-term tenancies, increased investment in place-making, and better quality homes than the traditional private-rented sector has tended to deliver.

Overall, however, favourable macroeconomic conditions will also remain important, as will continuing strong interest on the part of both domestic and international institutional investors, and also support from the UK government. Both of these seem likely to remain in place, with the former encouraged by the latter, but also by London's continuing outperformance in economic terms. As a result, we think that London house prices will at least keep pace with average wages over the medium and long term, which implies in turn that they will outpace construction costs, which tend to grow in line with consumer prices. Hence, while of course sharing in the same risks and uncertainties that currently affect all economies and markets globally, both the London economy and the London housing market have strong fundamentals.

66,000

The annual increase needed in housing

-

66,000 homes a year are needed to match new demand and to make up for past shortfalls when fewer than 30,000 a year were built

MITHERIDGE

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