Market Outlook
London Bed Sector

COVID-19 has had an unprecedented effect across the real estate sector with every type of property use impacted to some extent. Over the short-term the focus has been on tenants' ability to trade and their financial strength. The medium-term implications will depend on issues such as how quickly a vaccine can be found that enables the world to return to some sort of normality.

The impact of COVID-19 across the bed sector has been varied. The Private Rented Sector (PRS), including the co-living sub-set, has proved to be relatively defensive, with high levels of occupancy and rent collection being maintained. In contrast, student housing and serviced apartments have struggled to maintain occupancy and hotels have been hit hard due to the inability to trade.

Investors are likely to continue to target the defensive parts of the bed sector as they look to diversify their investment portfolios away from commercial real estate. The medium-term prospects for student housing and hotels look less certain. COVID-19 could bring about more online learning at universities, allowing students to study from home. Meanwhile, it is likely that there will be less business and leisure travel for some time, leading to a structural oversupply of space in real estate sectors catering for tourism and hospitality.

Hotels
Short Term View

The short-term prospects for the hotel market will continue to be severely impacted by government restrictions. Even when these are eased, and hotels are able to trade again, any requirement for international travellers to quarantine when they first arrive in the UK will limit the amount of non-essential travel. Prohibitive company policies in relation to employee travel are also likely to reduce hotel demand for the foreseeable future. It is likely that very low levels of occupancy will be seen for the remainder of 2020, regardless of the room rates charged.

Savills have predicted a fall of 60% for global international air travel in 2020, and a slow recovery over 2021 and 2022 whilst consumer and public confidence is low. Domestic travel is expected to fair better than international, indicating leisure hotels should perform better than those that rely on business use.

Global domestic and international RPKs, indexed 2019 = 100

Source: Savills, 2020

Hotels Continued
Medium Term – Vaccine Found

If a vaccine is found then a gradual pick-up in occupancy levels can be expected, however it is uncertain whether demand will return to pre-COVID levels over the next two years. The increase in familiarity with on-line meetings is likely to reduce the amount of business travel in the future, especially as companies consider the efficiency of this way of working in conjunction with their ESG policies. Serviced Apartments (and short-stay co-living) will also provide added competition for the business market. These factors could lead to a structural over-supply of hotel space over the medium-term which will limit RevPAR (Revenue per Available Room) growth prospects.

Medium Term – No Vaccine Found

Without a vaccine, it is hard to see how international travel will be able to return to normal, as governments are likely to keep quarantine periods in place for visitors from certain locations. This would be a disaster for the hotel sector and would require hoteliers to substantially reconsider their business models in order to be able to operate. Revenues and occupancy would remain low for a prolonged period of time causing many operators to fail. A substantial drop in hotel investment values should be expected under this scenario.

Serviced Apartments
Short Term View

Pre-COVID, serviced apartments had been performing strongly and their greater reliance on extended stays, ability to facilitate isolation, and limited amenities meant that they were still able to operate during lockdown, albeit at significantly reduced occupancy rates (estimated to be c.25%). Occupancy is only likely to deteriorate during lockdown while restrictions on travel persist, however it is more likely to rebound quicker than the hotel market as restrictions ease. Business travellers and tourists may well show a preference for this type of accommodation, particularly over the short-term while concerns over the safety of social interaction remain.

Medium Term – Vaccine Found

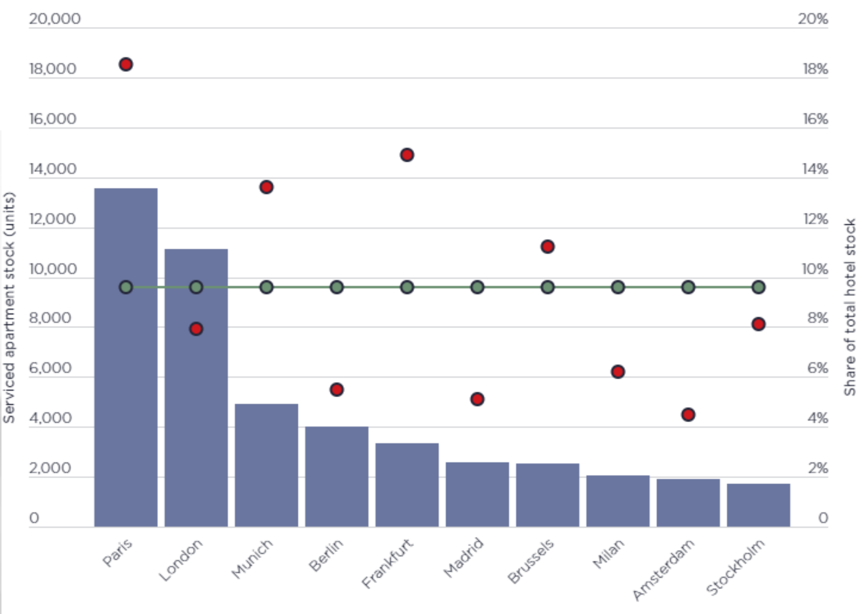
The serviced apartment market could be the quickest of the short-term bed sectors to recover should a vaccine be found. There has been a trend in recent years towards serviced apartments (at the cost of hotels) and the pandemic is likely to accelerate this trend. A fundamental change in corporate policies on overseas travel and working is a potential threat, the risk of which will become clearer as businesses move towards a new normal.

Medium Term – No Vaccine Found

Serviced apartments would be better suited to providing short-term accommodation for visitors than hotels under a no vaccine scenario. The operational model for serviced apartments is more flexible, with visitors able to have their own self-contained studios/flats. That said, continued travel restrictions that significantly reduce visitor numbers would still have a significant impact on occupancy levels.

Serviced apartment stock by city (top 10 European gateway cities)

In comparison to Paris and Munich, London's Serviced Apartment stock relative to hotels is low at 7.9%. London has a relatively constrained supply compared to hotels, and provides some indication of future growth potential.



Source: Savills, 2020

61.8%

Average serviced apartment occupancy levels in London in Q1 2020, above the 59.4% average for hotels.

Short-term

The private rented sector has been the most insulated of all the property sectors during the lockdown period. Rent collection rates have remained around the 90-95% level and occupancy levels only marginally affected by a minority of people choosing to move out of London during the lockdown period. Re-letting space is likely to be more of a challenge. However, lease renewal rates will probably remain higher than normal, whilst movement is restricted. Stresses on personal finances imposed by the virus will undoubtedly build over the coming months, causing a decline in rent collection rates and an increase in the need for rental deferments. This in turn will lead to an increase in write-offs once the lockdown period ends and landlords are able to evict due to the non-payment of rent.

Medium Term – Vaccine Found

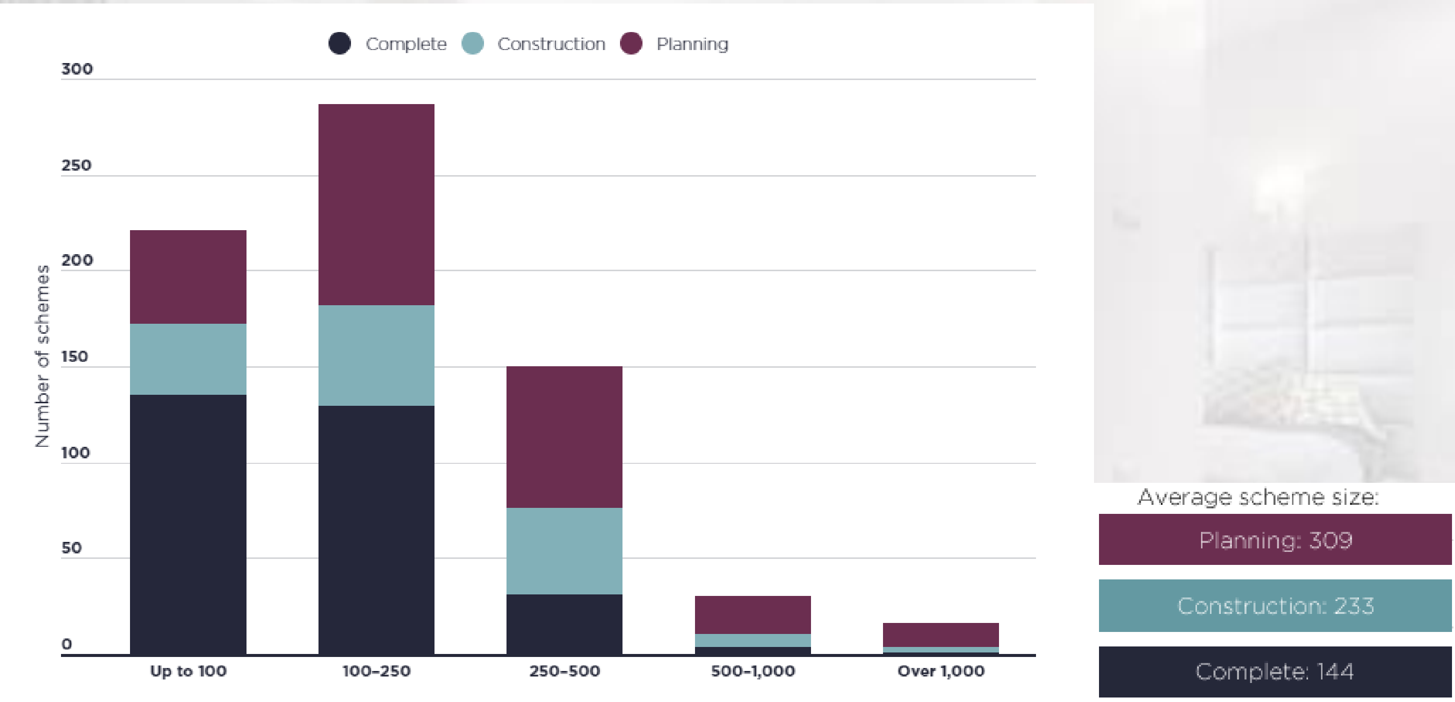
We expect activity in London's PRS to return to normal under the scenario that a vaccine is found. There are a number of factors that are likely to influence demand and supply over the medium-term. There will be those people who have not enjoyed lockdown in central London (particularly those with young children) that may seek to move out to the suburbs. Affordability issues may be a factor for some as a result of personal finances, especially if the economy takes time to recover. However, many of those people looking to buy may well have had their deposits wiped out as a result of financial hardship and may need to rent for longer in order to build them up again. These contrasting factors means that the overall impact on demand remains uncertain. The supply of new housing is likely to remain constrained as development activity slows, with the lack of development finance causing many projects to be put on hold. Overall, short-term uncertainty is likely to cause rents to decline over the next 12 months, particularly in central London, before recovering over the medium-term as demand and supply imbalances re-emerge.

Medium Term – No Vaccine Found

The London PRS sector would continue to be relatively defensive under a no vaccine scenario. Issues with rent collection and tenant financial distress would become more prevalent but occupancy levels are unlikely to be significantly impacted. The trend of people moving out of central London is likely to persist until a vaccine is found as people place greater importance on access to outdoor space. This and wider economic impacts could cause rents to remain depressed for a prolonged period of time.

"We expect activity in London's PRS to return to normal under the scenario that a vaccine is found"

The growing scale of Build to Rent schemes



Source: Savills, 2020

Co-Living
Short-term

Long-stay co-living is most closely aligned with the PRS sector and, as such, occupancy and rent collection has been relatively resilient during lockdown. The inability for renters to carry out inspections has made it difficult to let rooms once they become vacant. However, the percentage of renewals has been higher than pre-COVID levels limiting the impact of license expiries. Occupancy rates have fallen by c.10% and rent collection has averaged around 90% since April. If the pandemic passes in 3-6 months, then we do not expect capital values to move significantly. However, should the disruption last longer, then valuers will start marking down property valuations if transactional evidence suggests that prices have fallen. This will affect investors whose assets are periodically revalued for performance measurement or loan purposes.

There is still some uncertainty over how occupancy will be impacted as restrictions on movement are eased. We may see some renters who have stayed longer than anticipated vacate, but also there may be pent up demand for co-living that sees vacant units let up quickly. It will be an interesting time for observing how the concept of co-living is being viewed by renters in a post-COVID world. The ability for rooms to be let for shorter periods may be appealing for students who are concerned about committing to renting a room for the full academic year. Nevertheless, this is set against a backdrop of much lower numbers of international students expected this coming academic year.

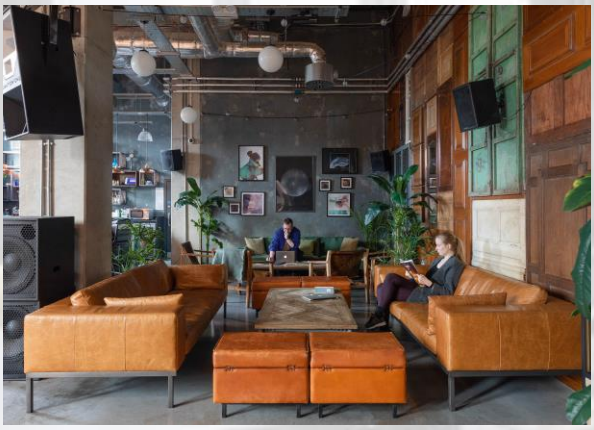
Short-stay co-living is more aligned with the serviced apartment and extended-stay hotel sectors and has been forced to close during lockdown. Recovery is likely to be slowed by on-going travel restrictions. The self-contained studios offered by large scale co-living are more likely to appeal over the short-term and could result in a quicker recovery than the wider hotel sector.

Market medium-term – vaccine found

Co-living should be able to recover quickly from COVID-19 with occupancy levels on long-stay occupation returning to pre-COVID-19 levels. As an emerging sector, there is currently very limited supply of co-living accommodation and medium-term demand should, if anything, have been enhanced as a result of the pandemic. Many renters living in poorly configured house shares with limited access to amenities and working space are likely to see the benefits of co-living together with the social interaction it offers. Access to co-working space will be considered to be particularly beneficial as people spend a larger proportion of time working from home going forward. We would also expect the short stay model to recover strongly. The combination of the private studios and a high level of amenities should be more appealing to visitors in a post-COVID world than the traditional hotel format.

Market medium-term – no vaccine found

The defensive characteristics of the long-stay co-living model should continue to benefit the sector, although occupancy levels may fluctuate if we have a number of periods of lockdown. However, there is no reason to believe that levels will be materially lower over the medium-term. Co-living assets are likely to appeal during a lockdown era as people can still maintain some social interaction whilst also having the ability to safely distance. Although demand is likely to hold-up, achievable rents may be affected if some of the amenity space has to remain closed. The short-stay model would continue to struggle under a no vaccine scenario, and this could cause future development to increasingly focus on long-stay provision.



Spacious Living Areas for members

"Co-living should be able to recover quickly from COVID-19 with occupancy levels on long-stay occupation returning to pre-COVID levels."

Student Housing

Short-term

Student housing operators have been partially insulated by the impact of COVID-19 to date with many students having paid for their accommodation for the remainder of the academic year in advance. Some operators concerned about longer-term reputational impact have provided students that are no longer occupying the space a partial refund on their rent. However, many others have resisted. The focus now is on pre-let rates for the next academic year. It is still uncertain whether universities will commence with physical lectures or whether courses will start on-line. As a result, it is difficult to see that pre-lets will increase significantly over the coming months on the c.70% level that was achieved pre-COVID. There is also the potential that refunds may be provided to students who decide to defer their studies. The number of international students is expected to be significantly lower for the next academic year, particularly from China, which has been the principal driving force behind rental growth in the sector in recent years.

Medium Term – Vaccine Found

With decisions being made now for the next academic year it seems inevitable that occupancy figures will be affected over 2020/21 even if a vaccine is found before the calendar year end. Many overseas students will be deterred by the coronavirus pandemic and will either delay their studies or decide to study elsewhere. UK demand may also be down as a larger proportion of students than normal decide to study from home. However, if a vaccine is found there could be a strong bounce back in demand for the 2021/22 academic year as those who postponed their studies return alongside the next year's applicants. The crisis is likely to bring an end to the supply pipeline, with little new stock being built over the coming years. There are some potential medium-term threats to the sector. COVID-19 has seen the emergence of on-line lectures and learning that could fundamentally change the way that university courses are delivered in the future. A return to normal lectures may well curtail the advance of on-line learning, however it is trend to monitor.

Medium Term – No Vaccine Found

If no vaccine is found then clearly there is a potential for future occupancy to be disrupted. If the UK is perceived as a country that is unable to manage COVID-19 effectively then overseas students will increasingly elect to study elsewhere. This is likely to cause universities to change their business models and consider making greater use of on-line teaching, which could have significant implications for the student housing demand over the medium-term.

For more information on this topic please contact:

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