ST BRIDE'S MANAGERS

Bull and Bear

Hotels and Residential

This week, Bull and Bear discuss the contrasting fortunes of the Hotel and Residential sectors.

Bull: So, are we agreed?

Bear: Agreed on what?

Bull: That we are going to keep this morning's session short and sharp.

Bear: Absolutely! Our respective Mrs Bs won't thank us for escaping for too long on Mother's Day. Anyway, what's on the agenda this morning?

Bull: Hotels and Residential. I know St Bride's have been focusing on both recently, albeit for differing reasons.

Bear: Okay. Let's start with hotels. Can you actually recall the last time you spent a night in one? I can't. It's hardly a surprise that this sub-sector has suffered so badly.

Bull: Trust you to start with a negative! But you are right. It's been an extremely difficult time for hotel operators. Lockdowns, social distancing, no overseas tourists. I suspect that without the Government's financial stimulus and the flexibility and support offered by the lending banks, we would have seen a significant level of distressed hotels brought to the market already.

Bear: You didn't mention landlords, especially those owning budget hotels. Many of them have taken a massive hit, especially when it comes to rent collection and valuations. Have you forgotten about Travelodge's CVA or Premier Inn's request for a 50% rent reduction?

Bull: Of course not.

Bear: To be fair I have some sympathy for Premier Inn. They only made their request in December on the back of only having a quarter of their rooms in their 800-hotel portfolio occupied in November. They scrapped their shareholder dividend, furloughed 27,000 staff and warned they could cut 6,000 jobs. Unlike many of their peers, until then they had paid their rent in full since the pandemic began.

Bull: But Travelodge's CVA was their second one in eight years. Once is misfortune. Twice is, well, careless at best. Those investors who had paid low yields for a supposedly secure, long-term income stream can rightly feel very aggrieved.

Bear: And it's not just the income stream they have lost. Yields for some regional hotels have softened over the last twelve months. It's only the prime hotels that have held up.

Bull: The main thing that got to me was that Travelodge is owned by GoldenTree, Avenue Capital and Goldman Sachs. The last time I looked, none of them were short of money!

Bear: But not all UK hotels are owned by the likes of them. Spare a thought for those smaller, independent hotel operators who have not been able to welcome any guests recently.

Bull: I feel their pain. I just hope they can survive until 17 May when they will be allowed to reopen. The pent-up domestic demand is enormous.

Hotel Investment Yields	March 2020	February 2021
Prime London Vacant Possession	4.75%	4.75%
Prime London Management Contract	5.75%	5.75%
Prime London Lease	3.85%	3.85%
Prime Regional Vacant Possession	6.50%	7.25%
Prime Regional Management	7.75%	8.00%
Prime Regional Lease	4.50%	4.50%

Source: CBRE, February 2021

Bear: But I'm still unconvinced whether hotel investors are going to pour back in as a result. Investors will want reassurances. UK hotel investment declined by 70% last year to just over £1.8 bn. 81% of that occurred in Q1 2020... before we had ever heard of the word 'furlough'. Volumes will remain down for a while I reckon.

Bull: I disagree. The long-term fundamentals remain strong. Like previous downturns, the UK hotel industry will adapt and survive. Not being a homogeneous sector will help it. Once these boring restrictions ease, liquidity in the marketplace will increase at a healthy pace. There are plenty of investors keeping an eye out for opportunities, especially those in core locations where there is an opportunity to add value and/or repurpose.

Bear: Shall we move onto Residential? What did you make of that IPF Webinar on Thursday morning? I thought it was fascinating.

Bull: So did I. I knew there had been a stampede by the UK institutions into Residential and Student Accommodation, but I was blown away by the growth since the end of 2012. What were the numbers again?

Bear: £35bn owned in UK Private Rented Sector (PRS) investments and £21bn in Student Accommodation as at the end of 2018. That equated to growth of over 23% p.a. of PRS investments held by mainstream investors in only six years.

Bear: Similarly, CBRE estimate that 2020 was a record year for multi-family residential investment with £3.5bn invested.

Bull: This demonstrates the resilience of the sector in what has been an extremely challenging year.

Bear: I accept that institutional appetite has been exceptional. That can't be argued. But…

Bull: But what?

Bear: The Residential sector still remains a relatively small, albeit growing, proportion of most institutional investors' portfolios. Particularly compared to the potential scale of the market. For example, only around 3% of the UK PRS market is estimated to be owned by institutional investors.

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Bull: But those numbers will only grow, especially given the UK housing shortage. You mark my words.

Bear: Probably, but the Government must do more to help. For example, a more simplified planning regime and the removal of the 3% SDLT surcharge for second homes and large-scale residential rental investment would see even more institutional investment into the sector. Given this penal rate, it's no wonder they are buying through corporate structures.

Bull: The Government does at least appear to be trying to address the UK's housing shortage.

Bear: Really? What makes you say that?

Bull: Take last month as an example. Homes England and United Trust Bank launched a £250m “housing accelerator fund” for SMEs, providing construction loans of between £1m-£10m at up to 70% loan to gross development value. This should really help. I know St Bride’s have agreed something similar in South Yorkshire.

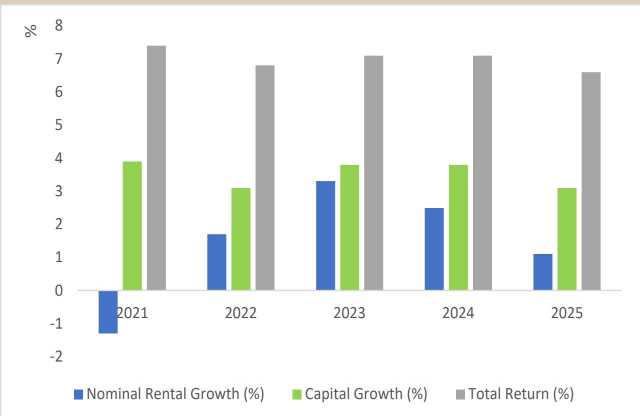
Bear: That sounds interesting. So, do you think Residential will continue to deliver the strong performance it has? I have my doubts.

Bull: Yes! CBRE are forecasting that Residential will outperform the other sectors over a five-year horizon. Residential delivered 3.50% last year. That was the second-best performing sector behind industrials, remember?

Bear: But there is little prospect of real wage growth in the near-term. This is bound to subdue rental growth this year.

Bull: Perhaps, but it will then rebound. Plus, a highly competitive market will underpin pricing and yields. CBRE are forecasting total returns to average 7% per year to 2025. I'd take a bit of that!

Residential Return Forecasts 2021-2025



Source: CBRE, Q4 2020

Bear: In this current low returns environment, I have to agree. I must say though that I’m rather surprised you haven’t yet mentioned Savills' *Mainstream Residential Property Forecasts* that were released on Tuesday. ‘Uplifting’ is the word that probably sums them up best.

Bull: You call forecast average UK price growth of 21.1% over the next five years as merely ‘uplifting’? It was all positive. House prices rose by 7.3% last year. 2020 transaction levels were only 11% below those of 2019. Home buyers spent a record £120.5bn in Q4, 22% above the previous high in Q3 2007.

Bear: But that was all in 2020. Remember, most people spent much more time at home last year than they would have expected or wanted! As a result, the housing market performed well as those with the financial security to do so sought homes that could act as workplaces and schools, as well as places to live. I’m far from convinced this strength will continue this year and beyond.

Bull: What makes you say that?

Bear: There are still a lot of questions that hang over the market. Like, how important have the various stamp duty holidays really been to the strength of demand? What happens when they come to an end? What impact will the vaccination programme have on buyer sentiment as it is rolled out? Questions. Lots of questions.

Bull: And the answers?

Bear: Well, Savills would say that they have revised their forecast for house price growth in 2021 up from 0% to 4% across the UK as a whole. They reckon it will be a relatively strong start and end to the year, sandwiched by a more subdued middle.

UK House Price Growth	
2020 Actual	7.3%
2021 Forecast	4.0%
2022 Forecast	5.0%
2023 Forecast	4.0%
2024 Forecast	3.5%
2025 Forecast	3.0%
Five Years to 2025 Forecast	21.1%

Source: Savills, 9 March 2021

Bull: That sounds encouraging. And, of course, the prospect of a prolonged period of low interest rates means the capacity for price growth across all markets remains. The BTR sector has shown its resilience, with sturdy occupancy levels, a flow of new viewings and robust rent collection statistics. What’s there not to like?

Bear: The stiff competition for product! There is an increasing number of investors now looking at this sector, albeit there is a growing recognition that they will have to take a more hands-on approach with their assets. Finding the right investments to deliver the desired returns is a challenge. Investors are being forced to broaden their horizons to meet their requirements.

Bull: This will continue, especially as the sector matures. Further downward pressure on yields seems inevitable to me. So, on that positive note, shall we call it a day? Same time next week? It’s the turn of offices if I remember correctly.