UK Living

Capital Markets

Q2 2020

Introduction

After 100 days of lockdown due to Covid-19, the first steps towards the process of recovery are now being taken.

While the social and economic impact of the pandemic has been severe, the reduction in social distancing measures and relaxation of other guidelines are a welcome return to some degree of normality.

In the face of widespread disruption and many challenges, the Living sectors have performed well in recent months. With uncertainty clearing, we anticipate a strong increase in activity and demand across these markets over the rest of the year.

Nick Whitten
Head of UK Living Research

"Despite the scale of disruption over the past three months from Covid-19, the Living sectors continue to show a high level of resilience. Occupancy levels and rent collection rates in the private rented sector are in line with historic averages, while leasing for student housing ahead of the new academic year is higher than the same period last year.

The crisis has also highlighted the strengths and weaknesses of the care system, not just for the elderly but across all age groups. There is a role for modern purpose-built accommodation to help support physical and mental health challenges caused directly and indirectly by the Covid-19 crisis which will present further challenges in the months and years ahead.

With tentative steps being taken to come out of the lockdown, there will be many opportunities for development, investment and funding deals ahead. Late 2019 showed what can happen when uncertainty is removed and pent up demand in the capital markets can be unleashed.

The underlying fundamentals behind Living sectors remain robust and we expect more investors to diversify into these sectors as the benefits become clearer. How we work and shop may significantly change, but households of every age will still need somewhere to live."

Simon Scott
Lead Director, UK Living Capital Markets

Student Housing

Investors' focus remains on university openings, how students will be taught and ultimately what actual student numbers will look like in at the beginning of the academic year. Universities are busy with preparations for the 2020/21 academic year and are expecting to be open and delivering a blended mix of online and face to face teaching.

How long these proposals will be in place depends largely on the pace and timing of restrictions being eased. While this has led to concerns over the potential impact on demand in the short term, there are growing signs from UCAS that students are prepared to accept this disruption as other options are less appealing.

Domestically, there is a risk that new students could defer their start to higher education until a return to normality in September 2021. However, with travel options limited, a weak jobs market in the retail and hospitality sectors especially and another 12 months being stuck at home; an enforced gap year may provide little benefit. UCAS have said that there has been a modest increase in deferrals, but this is being offset by an increase in cancelations by students who had already deferred.

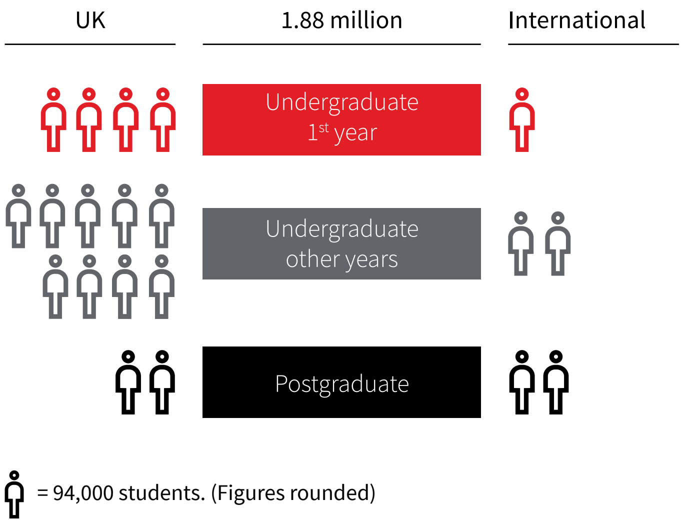
Domestic students account for 80% of all full time students, making it a significant segment which is likely to be more robust. International demand for both universities and Purpose Built Student Accommodation (PBSA) is the harder section to predict. We expect the first year international numbers to be volatile around the world regardless of desire to study overseas. We do consider there to be less risk of existing international students withdrawing from their course to study given the financial and time investment they will have already made.

Operators are looking at a range of options for next year with flexible start dates to mirror any deferred university openings, as well as rent free periods for any international students required to quarantine on entering the UK amongst the considerations.

One area where demand could surprise on the upside is postgraduates. During the worst of the Global Financial Crisis in 2009 and 2010, postgraduate demand increased by over 15%. With the UK forecast to enter an unprecedented recession in Q2 and an immediate recovery in Q3 unlikely, more newly qualified graduates may choose to stay at university to strengthen their CV.

From a capital markets perspective, the underlying fundamentals behind the sector remain positive over the medium term. There is a distinct lack of good quality opportunities in the market as investors adopt a wait and see approach. Whilst there is a reduction in buyer activity this is not driven by a lack of confidence in the sector but concern about near term implications. There continues to be an overriding confidence in the fundamentals of the market, although these are currently being tested.

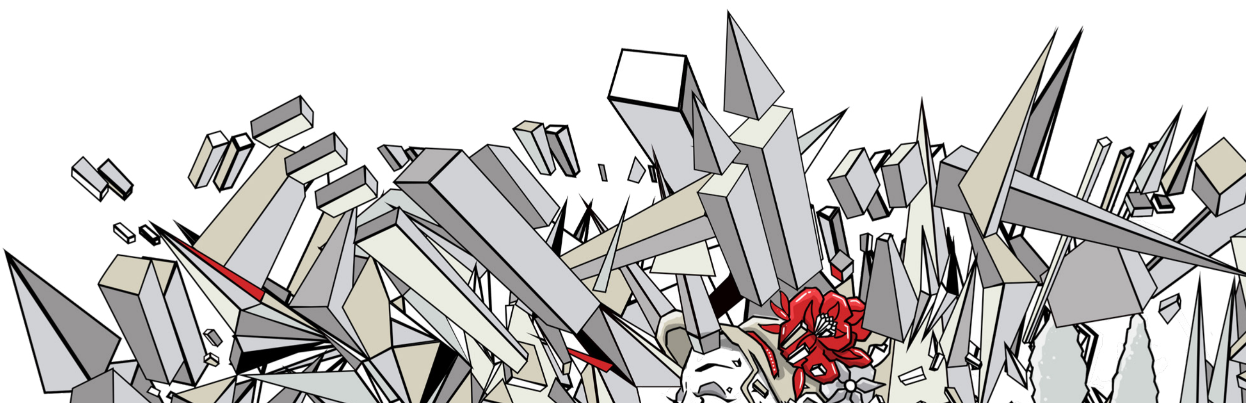
Full time student demand



Source: JLL, HESA

Key contact:

Huw Forrest
Director, Student Housing



Coliving

The flexible nature of the sector and the associated intense management structure has allowed Coliving to adapt to the challenges of Covid-19. Analysis by JLL shows that beds let on longer term leases have maintained high occupancy rates since the lockdown was introduced in March, whereas the short term, hospitality style beds have suffered as a direct consequence of reduced travel and the stay at home measures.

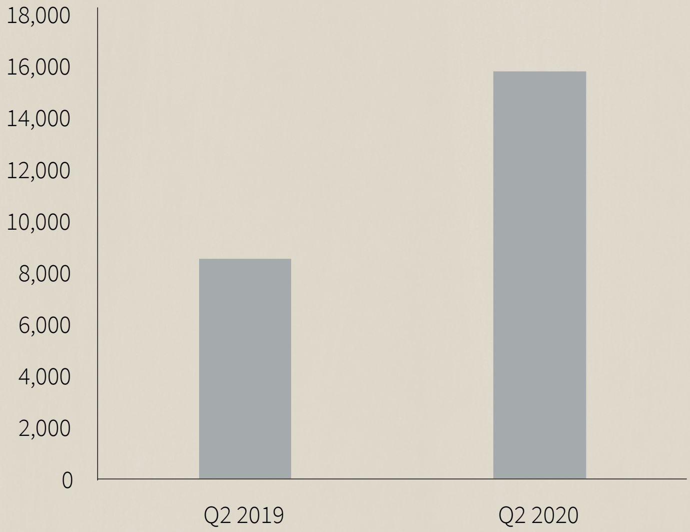
The social element of shared living space will remain central to Coliving, however Covid-19 has allowed operators to think about what shape and form this space might take once life returns to normal. From an operational perspective, we can expect more rigidity around movement in communal areas and more intense management incorporating sanitisation which may result in larger private spaces as a result.

Urban living, particularly for young professionals, is still set to be a key driver for demand. A higher prevalence of working from home will also emphasise the importance of quality coworking and collaborative space in these developments, as well as access to leisure and social facilities.

The Collective has secured two planning consents in Wandsworth during the quarter, while there are two regional sites progressing by Downing in Manchester and Watkin Jones in Bath, both developers who have primarily focused on student housing previously before moving into the wider Living market.

There are several site and funding opportunities about to come to the market, which will provide a useful barometer for where investor appetite for the sector is sitting and what effect if any the pandemic has had on pricing. The sector is also well placed to capitalise from other asset types, whether that is a result of a fall in student demand or closures in the hospitality sector.

Size of UK Coliving market



Note: includes pipeline

Source: JLL

Key contact:

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Director, Coliving

Multifamily

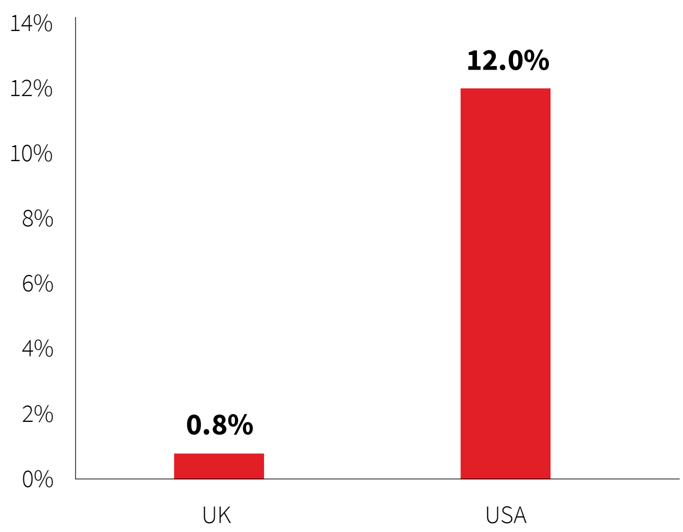
Multifamily has performed well over the recent months, showing a high level of resilience to Covid-19 compared to other commercial property sectors. Longer term occupation and the multi-let nature of the sector means that rent collection rates have typically been in line with historic averages. On this basis, the RICS has removed the material uncertainty clause due to the timely receipt of rents and lack of uncertainty across the sector.

Our rent forecasts for 2020 have been amended to reflect the changing economic outlook with a 2% fall expected this year, before a steady return to growth from 2022 onwards. This forecast is for the private rented sector rather than specifically multifamily. The anticipated introduction of urban, for sale flats by housebuilders into the rental market is likely to contribute towards the suppression of rents. However, the distinction between the wider private rented sector and purpose-built multifamily with shared amenities and serviced management will become more obvious, reinforcing the premium between the two.

Development remains a key component of the multifamily market. A growing number of development opportunities are expected to arise for high street sites, helping the expansion of the sector into new markets outside of the main regional cities. The role of permitted development rights could also help expediate this growth, as well as enable development viability with building material costs reduced.

A certain level of market activity has continued during the quarter. JLL sold a 158-bed forward funding scheme for £36 million in Stratford to Aberdeen Standard Investments, which has also purchased 170-beds in Barking for £50 million – both deals with a 4% net initial yield. Elsewhere, Godwin Developments has purchased a site in Sheffield for a 300-bed scheme as part of its expansion in the sector.

Multifamily as % of private rented sector



Source: JLL

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Alice Smith-Hilliard
Senior Surveyor, Multifamily

Later Living

Covid-19 has had a disproportionately high impact on the elderly, with care homes paying a heavy cost from a virus that hits those with underlying health conditions hardest. The number of fatalities from the virus has been in steady decline since peaking in late April, and the number of deaths in care homes is now in line with the long-term average rate.

The contentious issue of moving patients from hospitals into care homes to free up bed space across the NHS will be heavily scrutinised in due course. It does however raise questions about the need for separate short term intermediate care provision in order to protect long term patients in care homes.

Many care home operators are having to manage staff absences, hiring agency staff, sourcing extra PPE and other infection control measures. The larger operators and those mostly reliant upon private pay residents will have greater scope to absorb these extra costs, whereas many smaller homes with greater dependency on local authority funding will come under even more pressure. This issue has been exacerbated by falling occupancy rates caused by restrictions on taking in new residents while social distancing measures are in place.

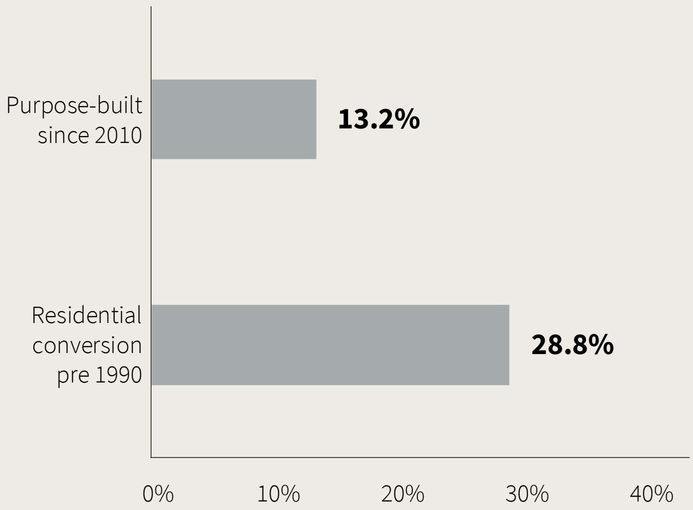
However, if there is one positive to come out of the crisis, it is the recognition of social care as a key service and reform of how the sector is funded is likely to become a political priority in this parliament. The structural undersupply of care beds and later living options to support an ageing population means that there is going to be a heightened focus on development longer term.

With less than half of UK care homes purpose-built and over a third of bedrooms without an en-suite, the sector is in urgent need of new, purpose-built supply at a scale that improves operational efficiencies and can accommodate isolation measures if required in any future pandemic.

Other opportunities to deliver a more sustainable approach to social care include respite centres for short term stays to remove the risk of bed blocking, as well as retirement villages and later living schemes. Both are viable alternative uses for distressed retail and hospitality sites. The adaption of technology to allow virtual GP appointments during the crisis has also been a welcome trend that can bring far reaching benefits to public health.

While much of the market has been on hold, there has been an undercurrent of activity with portfolio, single asset and forward funding deals all progressing or going under offer since March. Legal & General's Inspired Villages has purchased a development site in Bedfordshire for £120 million, as well as secured planning consent for over 650 new units across five sites nationwide.

UK care home supply by age and type



Source: JLL, Laing Buisson

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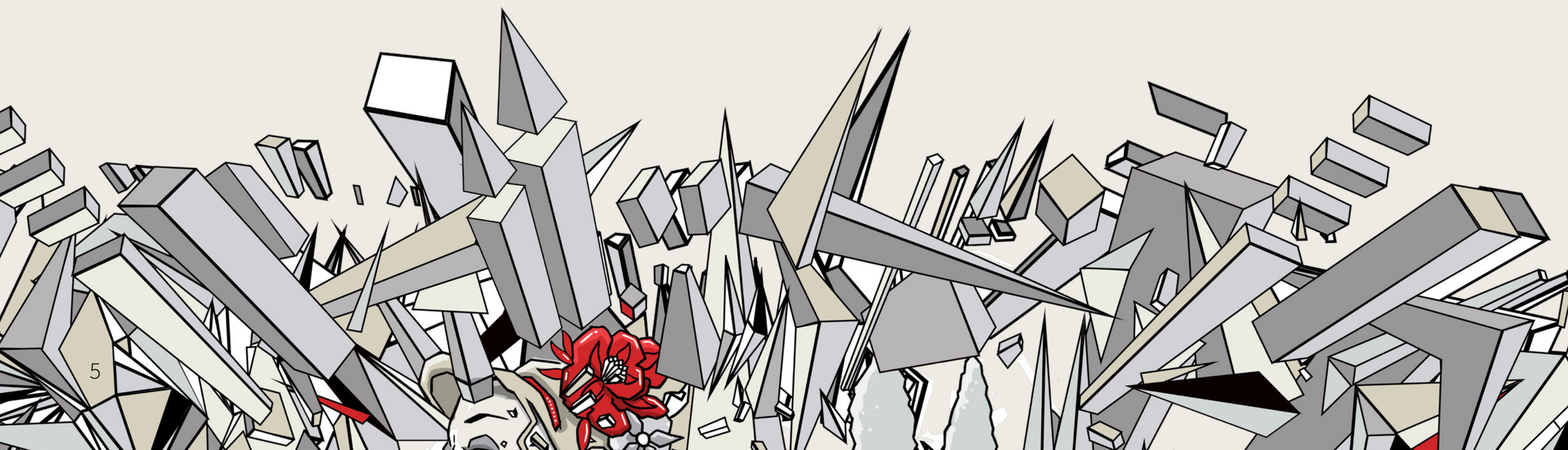


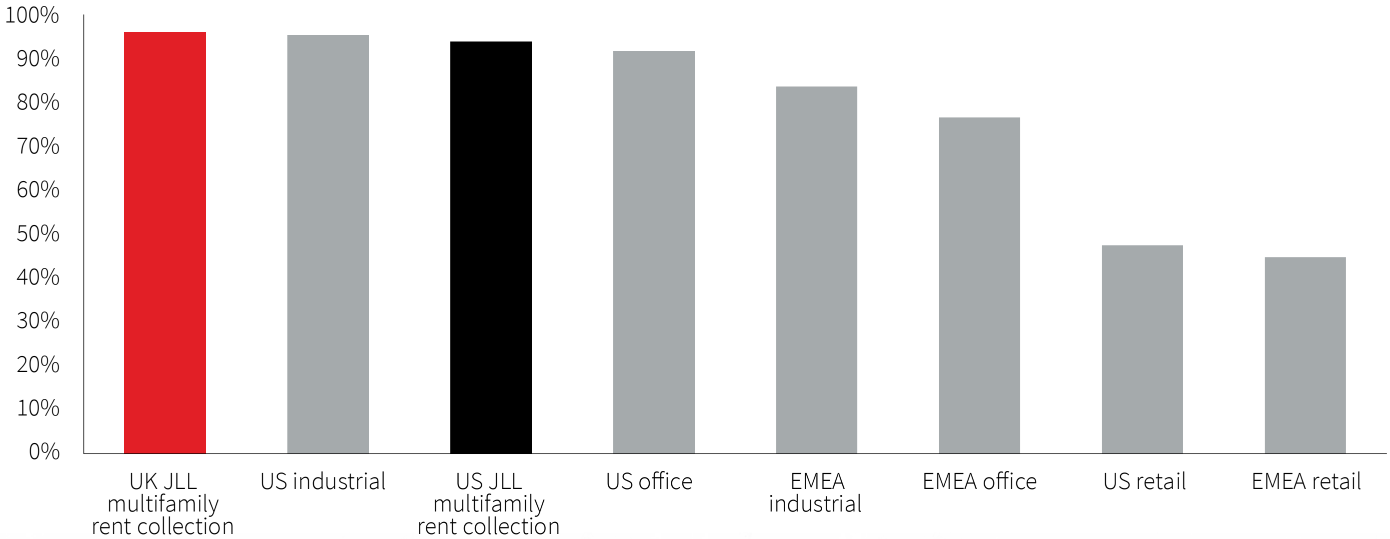
Research focus
Multifamily rent collection and occupancy

New JLL analysis of more than 1.1 million privately rented units across the UK and US reveals rent collection in excess of 94% in both markets, with occupancy also remaining firm at the onset of the Covid-19 pandemic. Both fundamentals illustrate resident prioritisation of rent payments and their desire to stay within their homes despite mounting hardships.

Offering income-stability and capital-value resiliency through economic downturns, the multifamily sector is commonly regarded as a defensive asset class. Driven by a persistent need for housing and flexible lease terms, contractions tend to be shorter while periods of growth are prolonged. For such reasons, 84% of investors targeted the sector pre-Covid-19, according to JLL research.

The pronounced economic impact of the Covid-19 pandemic led to immediate and unprecedented concerns surrounding rent collections, occupancy, asking rents and concession packages. However, the situation has also resulted in meaningful communication between tenants and landlords, with multifamily operators choosing to engage with their tenants, to allay concerns and fears during this period.

How does multifamily compare with other sectors?



Source: JLL

* based on analysis of EMEA listed sector reporting at the end of Q1.
** US NAREIT as of May collections

Outlook

Much of the recovery period form Covid-19 depends on the difficult balancing act between public health and the economy. Any further reductions to and the eventual removal of social distancing measures will have a profound impact on how we work, live and study.

Both the Chancellor and the Bank of England appear prepared to take further measures to stimulate demand and drive the recovery. An emergency budget is expected either in July or early Autumn which could help determine the shape and pace of the economic recovery after what is expected to be a record fall in GDP for Q2.

Encouragingly, there has been a consistent level of market activity that has continued throughout the pandemic, ranging from deals taking place to planning consents being granted. Elsewhere, the Dow Jones has returned to the same level as January, while the FTSE is also making ground. On this basis, we expect stalled deals to resume and those mandates held back until some certainty returns to come forward in the second half of the year, especially if new investors seek to enter the market because of the strong fundamentals underpinning the Living sectors.

Unlike the Global Financial Crisis, liquidity shouldn't be an issue. Current indications are that IRR pricing has moved out by 50 to 100 basis points on pre-Covid levels, and we expect the widespread use of guarantees, either for build costs or rental income in the short term at least as a way to mitigate some risk.

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