



# Spotlight The UK Extended Stay Market

Winter 2016/17



## SUMMARY

■ Operational conditions in London have been challenging over 2016, but operator confidence has improved over the second part of the year.

■ Greater optimism is being reflected in operators expansion plans. The latest ASAP/Savills operator survey noted an increase in operators who are accelerating expansion plans.

■ 2017 will be a record year for new development in the UK with just over 2,600 units forecast to be delivered, a 13.8% increase on current stock.

■ There may be some short lived absorption issues in certain markets next year, as expected at this early stage in the sectors evolution.

■ The longer term fundamentals of the sector remain robust and we expect RevPAR growth to remain in positivity territory in 2017.

■ Institutional investors have stepped up forward funding activity, driven by improving investor appetite and lack of purpose built stock for acquisition.

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“Operator confidence and appetite for expansion has improved in the face of operational headwinds.”  
.....

Marie Hickey, Savills Research

➔ **Challenging operational conditions but outlook improves**

Operationally, 2016 has been challenging for the extended stay sector, albeit largely restricted to London. Year to date RevPAR (revenue per available room) for London as of October is down 1.7% on the same period in 2015. In contrast regional RevPAR is up 1.2%.

Demand in London, across both extended stay and the wider hotel market, softened over the early part of the year on the back of the Paris terror attacks. While demand recovered during Q2, with overseas business arrivals up 0.7% year-on-year, occupancy on the whole has remained relatively weak. Year to date occupancy, as of October, is down 4.0% on the same period in 2015. Despite the downward pressure on occupancy operators were able to push ADR (average daily rates), which increased 2.3% over the same period.

However, weaker performance in London is not simply a reflection of softening demand.

**Stock absorption issues in London to subside**

While weaker growth in overnight arrivals has played a part in dampening occupancy, it has been this, combined with stock expansion, that has been the real issue. Graph 1 details the net balance between supply expansion and overseas visitor arrivals staying more than four nights (used as a proxy of potential demand for extended stay accommodation) benchmarked against

changes in occupancy. Periods where supply expansion has outpaced growth in demand correlates with weaker and/or declines in occupancy. 2016 is a prime example of this as London supply increased 4.6% (463 units) whereas demand softened.

For a sector experiencing strong growth, particularly off a low base, absorption will always be an issue at this point in its maturity cycle. Going forward, subject to demand levels holding in the face of Brexit, we expect absorption in London will become less of an issue. Stock expansion is expected to average 4.9% per annum through to the end of 2019, with approximately 1,600 units in the development pipeline, marginally below the 10 year average of 5.1% (see Graph 2).

**Operator confidence improving post Brexit**

The real unknown in this scenario is the impact of Brexit on the business visitor market. Looking to the global financial crisis (GFC), total business visitor numbers to London softened between 2007 to 2009 before bouncing back in 2010. Although overseas business visitor numbers did not return to pre-GFC levels until 2015.

While Brexit is a localised political challenge rather than the GFC, which was a global financial issue, the potentially drawn out process of Brexit and its impact on corporate confidence may temper corporate travel budgets going forward. For example, the World Travel and Tourism Council (WTTC) downgraded their

forecasts for UK Business Travel & Tourism spending post the Brexit vote, with their forecasts indicating positive, albeit more muted, growth levels through to 2019. Despite some potential headwinds there has been some positive newsflow for the sector. Both Facebook and Apple announced plans to increase their presence in London post the Brexit vote, suggesting corporate confidence in London and the UK as a long term business location remains. This should have knock on positive implications for extended stay demand.

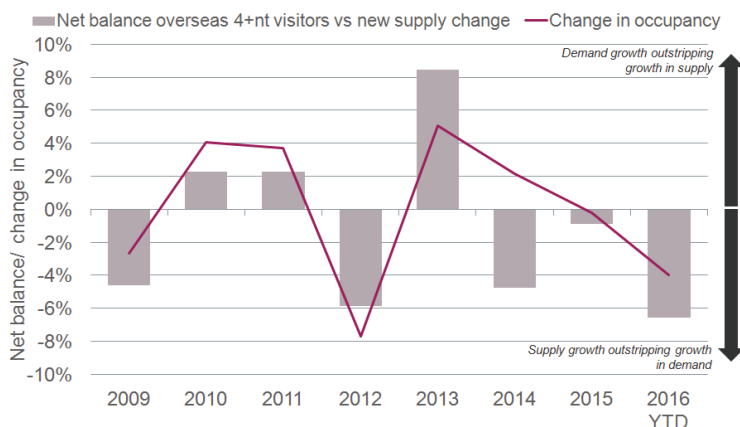
In the event of softening corporate demand into 2017 however, the weaker Pound may help to offset this. While national visitor statistics do not point to a significant increase in overseas holiday visitor arrivals post Brexit, anecdotal evidence for London suggests international visitor numbers have improved. This was apparent in our Operator Sentiment Survey carried out in conjunction with ASAP, a short summary of which can be found on page 3.

While the outlook for corporate demand was not as positive as that for leisure, the net balance of operators reporting an increase in corporate demand did move into positive territory. Thirty-five per cent of surveyed operators expect year end demand to be up on 2015, exceeding the 33% who are forecasting a fall.

**2017 to be a record year for stock expansion**

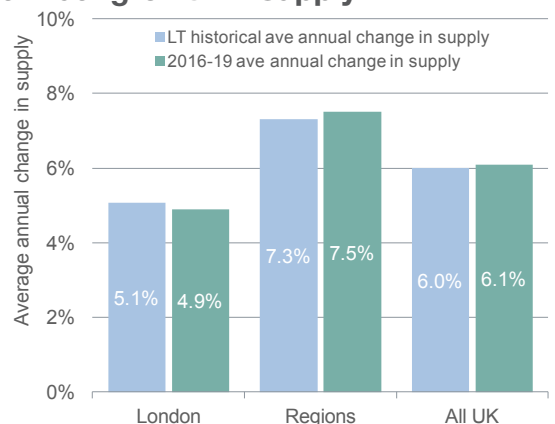
The UK extended stay market is expected to see record levels of stock

GRAPH 1 **Demand vs stock changes Central London**



Graph source: Savills Research; AMPM; STR ASAP; ONS

GRAPH 2 **Forecast and historical average annual growth in supply**



Graph source: Savills Research; AMPM

expansion in 2017. Just over 2,600 units are forecast to be delivered next year, reflecting a 13.8% increase and exceeding the 10 year historical average of 6.0% per annum detailed in Graph 2 (870 units). Albeit the three year forecast points to UK stock growth more in line with the long term average with average growth per annum of 6.1% forecast to end of 2019 (Graph 2).

Expansion in 2017 will be led by the regional markets with total stock expansion next year of 20.5%. London will see a more muted 8.1% increase in stock below its previous peak year of 2012 when stock expanded by 10.2%.

The major regional cities account for the bulk of new stock that is to be delivered over the next three years. Manchester and Edinburgh lead with stock expansion of 73% and 62% respectively over the next three years (see Map 1 on page 4). Aberdeen, which previously led growth projections, has seen a number of schemes placed on hold in response to the slowdown in the city's oil sector. In contrast Liverpool has seen some new schemes come on stream, with stock forecast to expand by 36% by the end of 2019. There are some cities that currently have no new supply in the development pipeline, but we are aware that this may change as some projects come on stream early next year.

In percentage terms the increase in stock levels in some of the UK's key regional cities is significant, although this does reflect growth off a very

low base. Forecast stock levels are still limited particularly in relation to hotel supply. For example, projected extended stay supply in Manchester only accounts for 9.9% of current hotel stock levels.

Considering record levels of new development in the regional cities, the question is whether they will be able to absorb this new stock without denting operational performance.

We suspect that some regional city markets may experience a marginal and short-lived softening in operational performance next year due to absorption issues. However, we forecast that year end 2017 RevPAR growth will remain in positive territory.

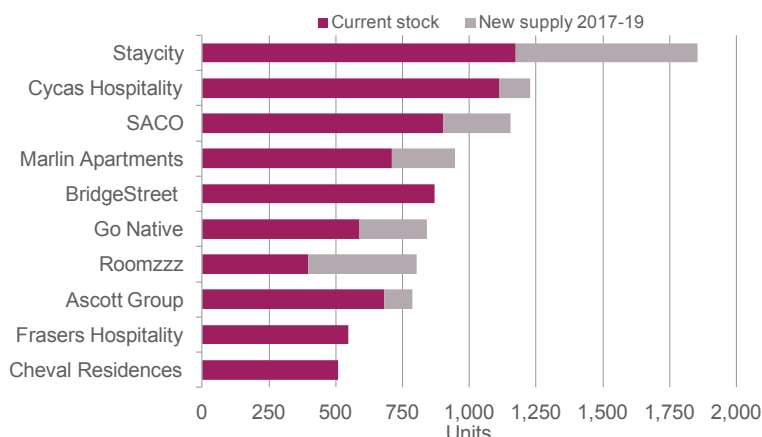
Absorption issues should not be a major concern for operators and investors. The embryonic nature of the sector means that this can be more common, potentially generating some short-lived operational headwinds. What is key however, is that over the longer term the fundamentals, such as the imbalance between potential demand and supply, remain robust.

### Major operators leading stock expansion

The UK's largest operators continue to dominate the development pipeline. Fifty-four per cent of the c.3,800 units expected to be delivered by the end of 2019 will be operated by the 10 largest UK operators.

Graph 3 details stock and development pipeline for the UK's 10 largest operators. Staycity Aparthotels looks

GRAPH 3 **Top 10 UK operators and pipeline to end 2019**



Graph source: Savills Research; AMPM

## Operator Sentiment

### Confidence improves but operational concerns move up the agenda

■ In the latest ASAP/Savills operator sentiment survey it would appear operator confidence has improved post the vote to leave the EU. However, concerns regarding operational challenges have moved up the agenda, albeit these have done little to temper operator appetite for expansion.

■ Sixty-five per cent of operators surveyed said they were slightly to significantly optimistic for the prospects for their business over the next 12 months, up on the 40.0% reported in the August survey. This improved optimism is reflected in the proportional increase in respondents stating they were accelerating expansion plans; increasing from 13.3% to 28.2%.

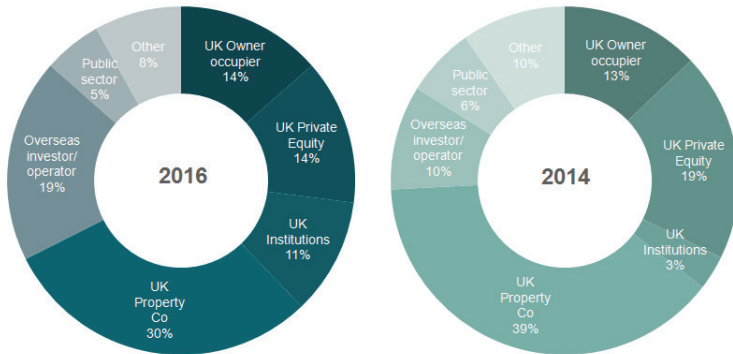
■ There are some operational challenges however, in the wake of Brexit and these are tempering confidence in some parts of the market. The year end outlook points to weaker occupancy and ADR levels compared to 2015, which is being borne out by STR operational data for London. Softening corporate demand, the traditional guest segment for the sector, is partly behind this with almost a third of respondents (32.5%) expecting year end corporate demand to be down on 2015.

■ Softening corporate demand may be offset by increased leisure demand. Operators are already witnessing stronger demand from leisure guests, with close to 40% of respondents saying year to date demand was already up on the same period in 2015. This increases to 60% for the year end outlook.

■ One of the most notable changes in the latest operator survey was the importance placed on future challenges. The August survey cited expansion concerns, such as property acquisition costs and stock availability, as posing the most significant challenges going forward. Five months on and it is operational challenges that are raising the most significant concerns. For example, 27.5% stated that the proposed increase in Business Rates in 2017 present a significant challenge to their business, ranking second to wider economic conditions. In the August survey it only ranked seventh. Having said that, acquisition costs still ranked highly placing third after Business Rates.

■ Going into 2017 the official notification by the UK Government to leave the European Union, and what potential impacts this could have on the economy, will no doubt have the most significant bearing on operator confidence, the effects of which we will be monitoring closely.

→ GRAPH 4 Ownership of active development pipeline



Graph source: Savills Research; AMPM

set to improve its lead as the largest operator in the UK with 680 units in the pipeline, increasing current stock levels by 57.9% by the end of 2019.

### Institutional investors step up forward funding

The biggest barrier to institutional investment in the sector has, and continues to be, lack of purpose built stock. This is against a backdrop of improving investor interest due to the sector's relative similarity to the hotel market. For other investors the potential crossover to PRS (private rented sector) is enhancing the sectors appeal.

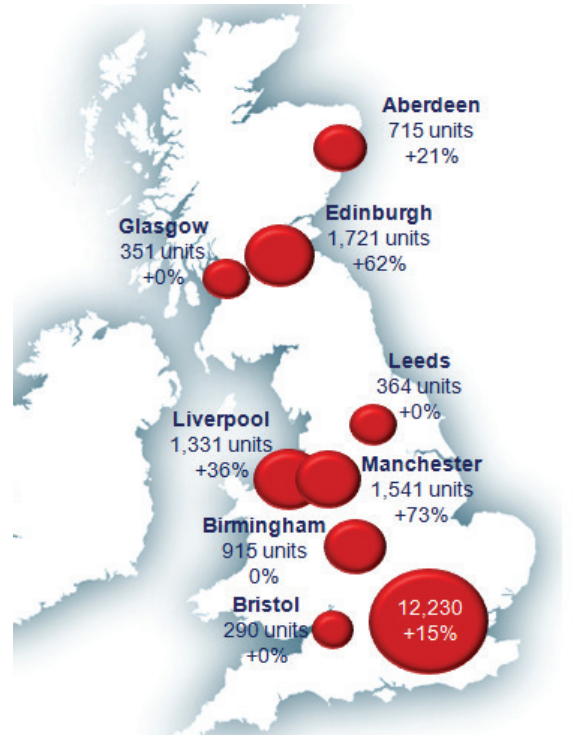
This imbalance between investor appetite and stock availability has meant that we are starting to see institutional investors participate in more forward-funding transactions. It is this activity, along with that of overseas owner-operators/ investors,

that is helping to drive the development pipeline.

Forward funding activity is apparent in the ownership profile of active development projects. UK institutional investors currently own 11% of future development projects (schemes expected to complete 2017-19). In 2014 they only accounted for 3% (Graph 4). Development ownership by overseas owner-operators/investors over the same period has also increased, growing from 10% to 19%.

We have also seen some existing properties transact this year, including Cycas Hospitality's (who operate a number of properties under the Staybridge brand) acquisition of Staybridge Newcastle and the stake held by Patron Capital in their Staybridge Liverpool property. One of the more notable deals was the purchase of Staycity Hayes by

MAP 1 Forecast stock at end 2019 and total growth on current supply levels



Note: projected stock excludes those schemes in the development pipeline that are still awaiting funding and could come on stream early next year.

Map source: Savills Research; AMPM

Schroders UK Real Estate Fund for £32.4m, reflecting a yield in the region of 5.5%.

While we expect transactional activity of built stock will increase as new supply comes to the market, the best and easiest route to market will continue to be through development. However, those opportunities to acquire existing purpose built properties in key locations, we suspect will enjoy strong levels of demand. The only problem is that these types of opportunities are going to remain relatively scarce over the short term. ■

## Please contact us for further information



**James Bradley**  
Hotel Valuations  
+44 (0)20 7409 8771  
jbradley@savills.com



**Tim Stoyale**  
Hotel Valuations  
+44 (0)20 7409 8842  
tstoyale@savills.com



**Richard Dawes**  
Hotel Transactions  
+44 (0)20 7409 8106  
rdawes@savills.com



**Kirsty Perrin**  
Hotel Transactions  
+44 (0)20 7409 8137  
kperrin@savills.com



**David Parker**  
Business Rates  
+44 (0)20 7409 8914  
daparker@savills.com



**Marie Hickey**  
Research  
+44 (0)20 3320 8288  
mlhickey@savills.com

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