UK Cross Sector - Winter 2022/23

SPOTLIGHT

*Savills Research*

# The South West Peninsula

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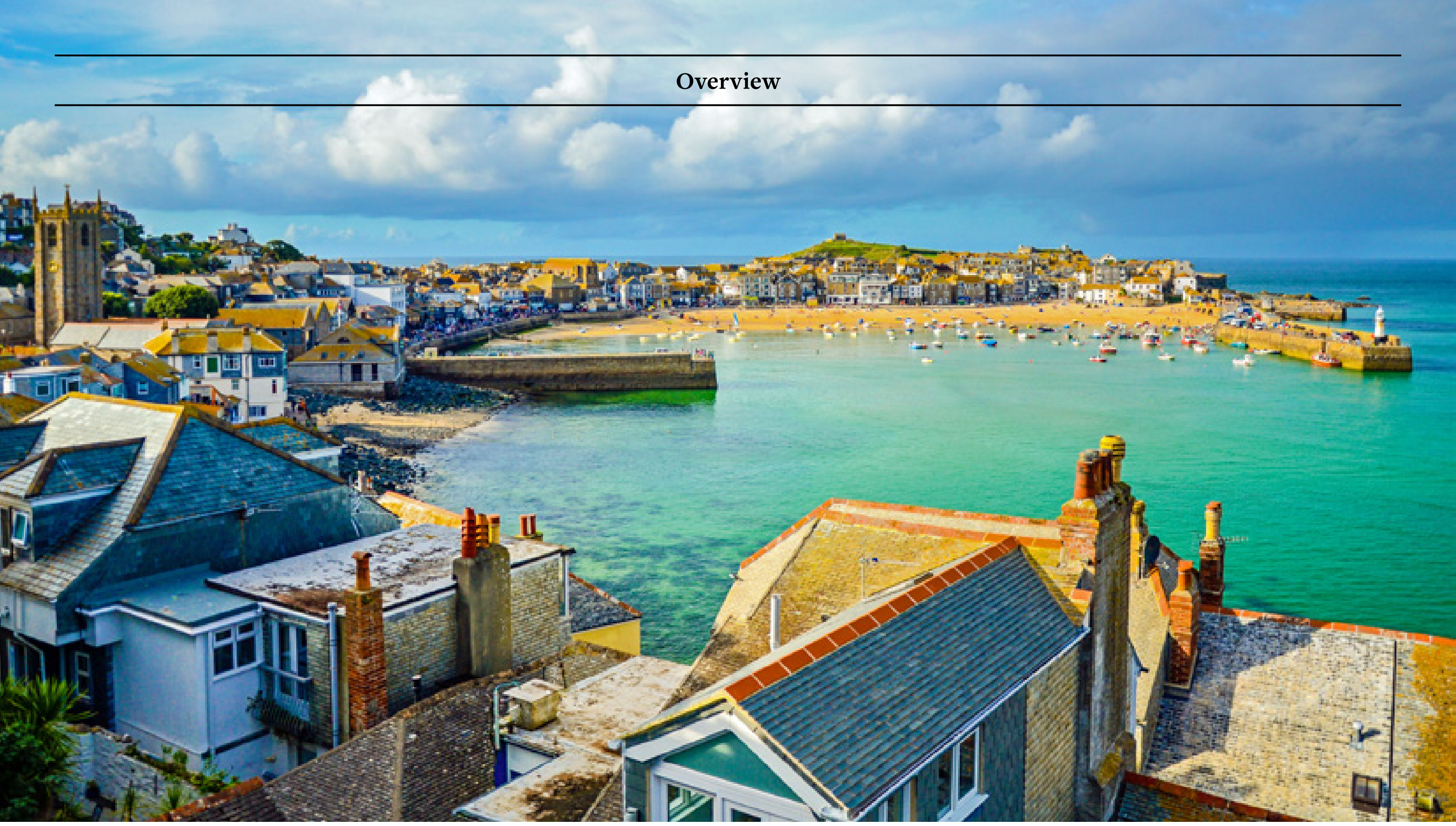
Leisure Investment – Rural Diversification – Land Supply



# Growth after the pandemic

## Domestic tourism is driving the regional economy

The South West has enjoyed strong growth since the pandemic across multiple sectors. Changing priorities around housing choices and the increased ability to work from home has boosted the housing market. Annual house price growth in the year to August 2022 has reached 13.7% in Cornwall and 12.8% in Devon, well above the England average of 8.9%, reflecting the strength of lifestyle considerations in the post-lockdown market.

Leisure and Tourism has become vital to the economy of the South West peninsula, and the sector was boosted during the pandemic by international travel restrictions, which prompted people to take more domestic holidays. In Cornwall alone, tourism accounts for around 25% of GVA, and the South West attracts a quarter of all overnight stays in England. The sector is projected to grow by 34% by 2030 according to Oxford Economics, a rate of growth around 10% higher than the next best performing sectors; Communications, and Science and Technology.

### Has the staycation boom continued into 2022?

The return of international travel meant domestic holiday locations have begun competing with international locations once again. However, a growing awareness of domestic staycation destinations and relatively strong demand has continued to support revenue growth for staycation hotels, particularly in the South West.

Coast and country markets significantly outperformed the UK regional average in terms of post-Covid recovery. The Cornwall and Devon region reported occupancy growth over the summer 2021 period compared to 2019, as pandemic-related concerns increased the appeal of less populated destinations.

Revenue per Available Room (RevPAR) in the Cornwall/Devon region remained above pre-Covid levels over summer 2022, reporting a 16.7% uplift compared to 2019 equivalent levels. However, on a year-on-year basis, RevPAR for the region was down -25.0%, which was largely a result of strong demand over the 2021 summer period, but also surging Average Daily Rates (ADR). VAT rates for the hospitality sector reduced to 5% between March 2020 and September 2021, which may have supported ADR over this period as some of the VAT cut was passed on to the consumer. VAT rates subsequently returned to 12.5% in October 2021, then 20% by April 2022.

Over the summer 2022 period, while ADRs were down year-on-year, they were still 22.2%

### Forecast GVA growth 2020-2030

Arts and Recreation
**35%**

Accommodation and Food Service
**34%**

Information and Communication
**26%**

Science and Technology
**22%**

**Source:** Oxford Economics

## Annual house price growth (August 2022)

**13.7%** Cornwall

**12.8%** Devon

ahead of 2019 levels for Cornwall/Devon. However there was some weakening in occupancy, falling -4.5% below 2019 levels. The Cornwall/Devon region did outperform the staycation market average (based on five key selected markets), which reported occupancy declines of -7.0% over the same period.

### Short-term challenges

The aforementioned uplift in daily rates versus 2019 levels will have helped to drive margins, allowing operators to recoup some of the revenue lost during the lockdown periods. However, we have now reached a tipping point whereby higher room rates will deter some households from travelling in the face of the cost-of-living squeeze. Meanwhile, reducing ADR could apply significant pressure on profit margins for hotel operators, who are currently faced with exceptionally high utility bills and staffing costs.

As a result, we expect demand in the short-term to be constrained whilst inflation remains in double-digit territory and with consumer confidence deteriorating. Real disposable income is forecast to remain in decline until Q3 2023. As a result, we expect RevPAR across UK staycation markets to report weaker performance in the first half of 2023.

However, the outlook remains promising over the longer-term. VisitBritain's October traveller sentiment survey revealed that 58% of respondents are aiming to take more or the same number of domestic trips over the next year, compared to pre-Covid levels. Affordability is likely to remain a key factor to travel in 2023, and staycations are generally seen as a more affordable alternative to overseas travel, particularly in the face of the depreciation of the pound and rising cost of air travel. Meanwhile, in terms of location of choice, the South West remains the most sought-after region according to VisitBritain, with a 19% share of respondents stating it as their destination of choice for their next domestic trip.

### Positive prospects for the long term

Since the easing of travel restrictions, the UK's regional hotel market has experienced robust investor appetite, with buyers ranging from owner operators through to private equity backed platforms.

Investment volumes in the South West reached £92.3 million this year-to-date (Q3 2022), across 11 individual deals. This marks the highest yearly volume for the South West since 2019, with Q4 deals remaining, whilst representing the highest volumes by UK region outside of London and the South East. RedCat-owned Coaching Inn Group continued its regional expansion, acquiring both Forest Park Hotel (New Forest) and Moorland Hotel (Dartmoor) in popular national park destinations.

Confidence across the market has been reinforced by cross-border transactions, while the relatively low value of the pound compared to other currencies could support ongoing interest from some international buyers. Singaporean buyers, Fragrance Group, recently completed the £1.5 million acquisition of the Marine Hotel in Torbay, while their £23 million Corbyn Head Hotel in Torquay is scheduled for a summer 2024 opening.

Rising concerns over debt availability and increasingly squeezed profit margins has begun to impact investor sentiment, resulting in a growing divergence between buyer and seller expectations. In turn, we are experiencing a slowdown in UK hotel investment activity.

Nonetheless, there remains a number of cash-buyers and private equity-backed groups seeking individual regional assets, supported partially by the relatively attractive yield profiles available for smaller regional assets. Despite a slowdown in deal activity in the short-term, the longer-term demand for regional hotel assets will remain resilient, driven in part by strong underlying visitor demand.

# Demand for farmland accelerates

## Sustainability and leisure provide opportunities to diversify

Farming is deep in the roots of the south-west, but with mounting expectations that farmland can assist in combating climate change and nature recovery, the demand and interest in farmland has accelerated. These new factors are introducing further competition to an existing strong amenity and commercial farmland market.

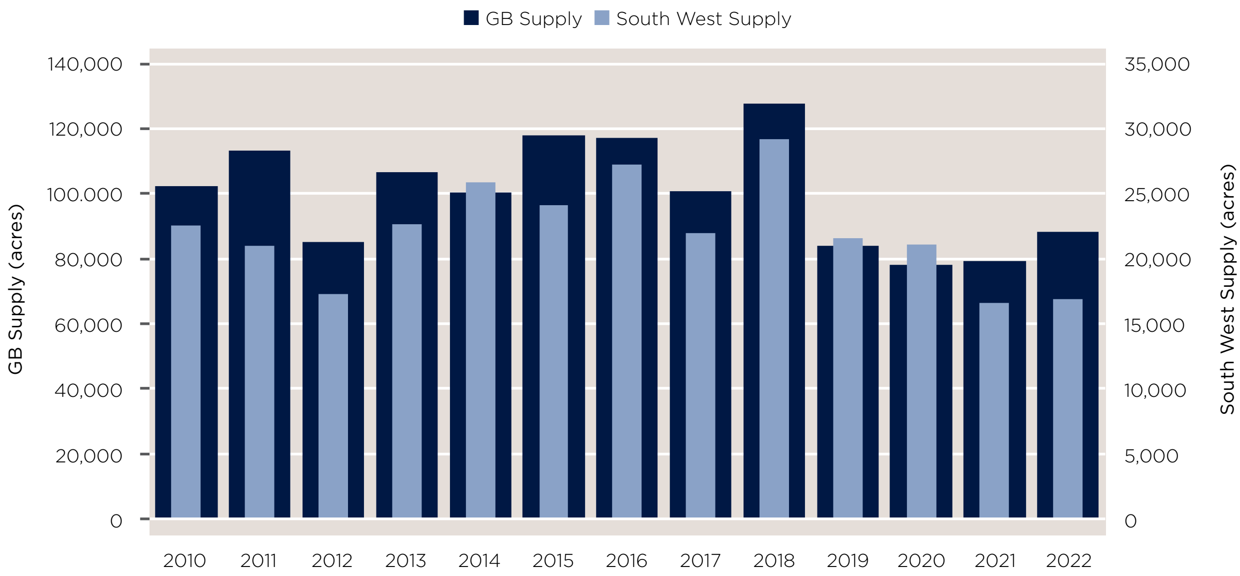
A quarter of England's agricultural holdings are located in the South West of England and agriculture is synonymous with the region's distinctive landscapes. Reflecting changing priorities for the use of land, the natural environment will become a significant market driver, along with the existing but still growing opportunities for farm diversifications in the South West, particularly into the tourism and leisure sector.

### Supply and Demand

The supply of farmland on to the market has slowly begun to recover this year as the economic uncertainty of Brexit and Covid-19 fades. During the first ten months of 2022, the total number of acres publicly marketed across Great Britain increased by 12% when compared to the same period in 2021. However, in the South West region, 16,850 acres of farmland were publicly marketed, an increase of just 1% on 2021. Compared to the last period of relatively normal market conditions prior to the Brexit referendum, the market in the South West is currently still around 24% smaller.

Looking forwards there is a possibility the lump sum exit scheme may contribute to a rise in supply in spring 2023 as farmers seek to transfer their land ahead of the May 2024 deadline. This being said, we anticipate the impact to be fairly small with the majority of retirees meeting the scheme rules by surrendering rented land to their landlord or if owned, transferring it to their successors, or renting it out under a Farm Business Tenancy.

**Figure 1** Acres Advertised (end October)




**Source:** Savills Research

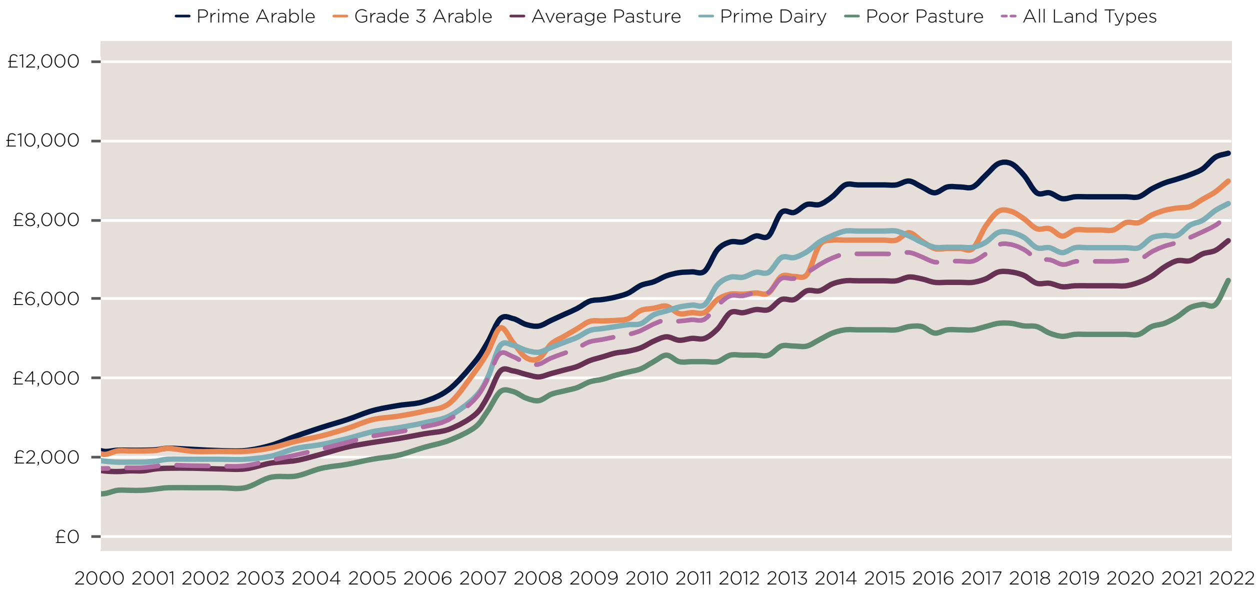
### Values

The continued constrained supply has impacted the market, with a growing pool of buyers frustrated by the lack of opportunity, with the average value for 'all land types' across the South West strengthening by 3.3% in Q3 to £8,100 per acre (figure 2). The average value for prime arable and grade 3 pasture are now £9,700 and £7,500 respectively.

Lifestyle and environmental demands are driving the market. Pasture land is appreciating fastest of all land grades, with poorer quality land, used for BNG or offsetting, increasing by 12 per cent across the South West in the first nine months of 2022. By comparison, prime arable has grown by 6 per cent in the same period.

Historically, economic uncertainty has resulted in both the retention of land. With the Bank of England predicting a recession, we are likely to see supply levels remaining low for the foreseeable future. The demand for land remains such that we will continue to see a supply and demand imbalance that will in turn continue to drive values, despite rising interest rates.

**Figure 2** South West England – average land values by type




**Source:** Savills Research

## Nutrient Neutrality

Nitrogen and phosphorus are key nutrients for crop production, but are also produced from human waste. River catchments only have capacity to handle a given amount of nutrients (from humans and farming) before the balance of the ecosystem is negatively affected.

The concept of "nutrient neutrality" arose in late 2018 concerning the interpretation of the Habitats Directive, following a Dutch case on water quality. Following this case, Natural England issued guidance preventing residential development surrounding the Solent, where river conditions were "unfavourable", unless the local planning authority (LPA) was certain the impact of the nutrients from the wastewater created on site could be mitigated. This guidance has since expanded to 75 local planning authorities across England.

It is important to note that the rules only impact vulnerable catchments within these LPAs, of which large areas surrounding Yeovil, Taunton and Salisbury are all impacted. Any new development in catchments which consists of overnight accommodation must demonstrate that it is nutrient neutral in order to receive planning permission. This effectively creates a moratorium on all new development that would discharge into a protected water system.

Providing "nutrient credits" could present income opportunities for landowners in the catchment areas. Mitigation techniques are subject to negotiations with each LPA, however there are currently three primary land based off-setting solutions under consideration:

1. Upgrading septic tanks
2. Land use change
3. Integrated constructed wetlands (ICW)

## Biodiversity Net Gain (BNG)

Mandatory BNG will mean that all developments must achieve at least 10 per cent net gain in biodiversity levels compared to their pre-development value. This will come into effect for new planning applications from November 2023. Biodiversity uplift can be achieved through habitat creation or enhancement onsite and/or offsite, or through the purchase of statutory biodiversity credits from the government. The provision of offsite biodiversity units offers an opportunity for rural landowners to monetise habitat creation, however landowners should consider the business case carefully due to the minimum 30-year term for the habitat provision.

## Tourism and Leisure

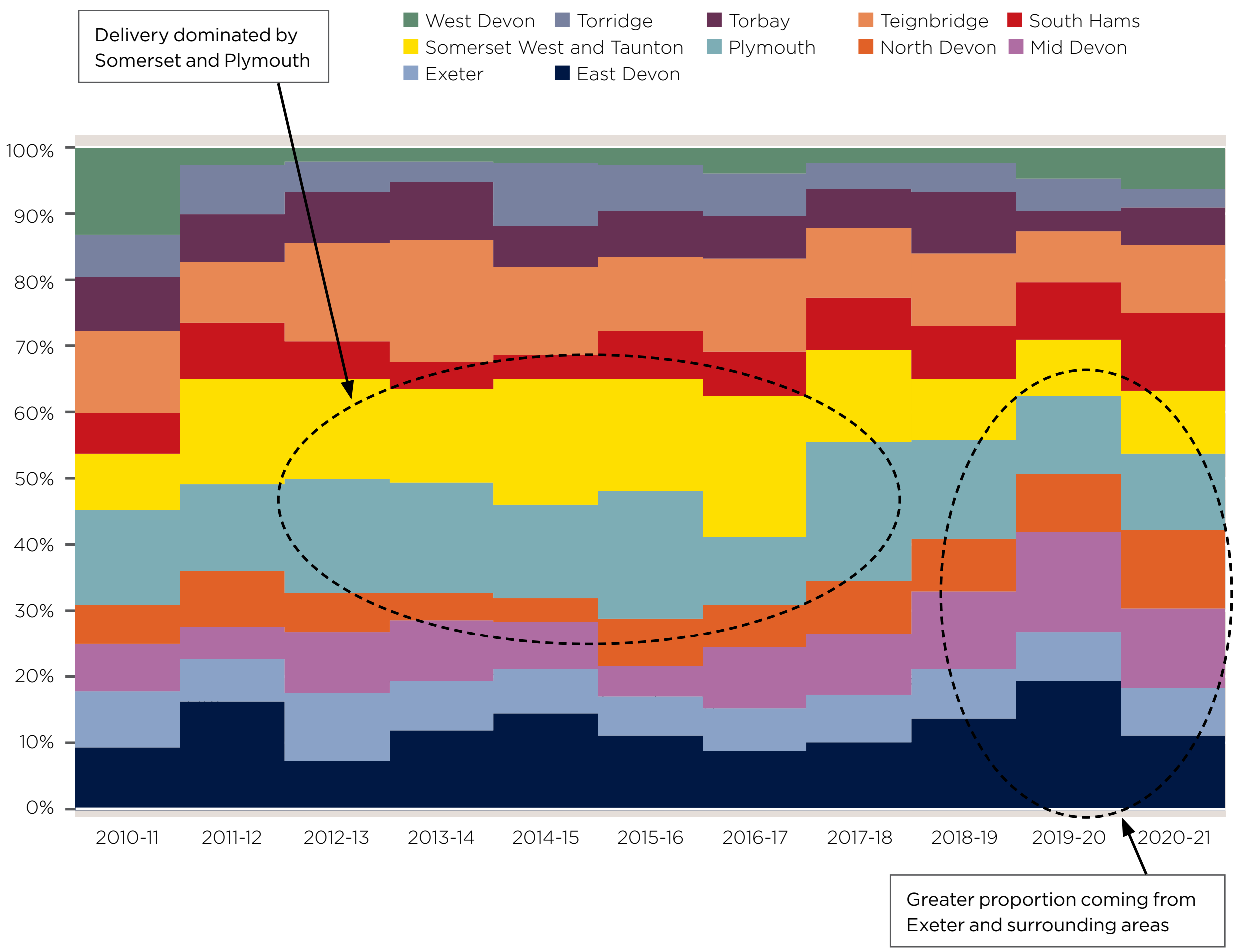
Across the South West, the idea of making the best use of a farm's resources to enhance income from sources other than conventional farm production is not a new phenomenon, with many farms diversifying to create tourism and other new enterprises. It is an opportunity that continues to grow and farm businesses across the South West are well placed to take advantage of the growing consumer interest in wellness, environment and experiences.

# Planning, land and development

## The strong housing market and a shortage of supply boosts land value

New build development in the South West peninsula has consistently averaged around 1.0% of existing stock per annum over the last 5 years, in line with the England average and suggesting a healthy market. But the distribution of delivery has not been uniform. 3,250 new homes have been built in Mid Devon between 2016-2021, equivalent to 1.8% of existing stock. In contrast, the rate of development in Torbay, Torridge and Exeter over the same period has been under 0.7% of existing stock. North Devon has led the way, delivering 175% of need over the last three years, followed by the regional cities of Plymouth and Exeter both delivering 155% respectively. However, Teignbridge, Somerset West and Taunton, and Torbay have failed to meet need in the last three years, delivering between 75% - 86%.

**Figure 3** Shifting focus of development

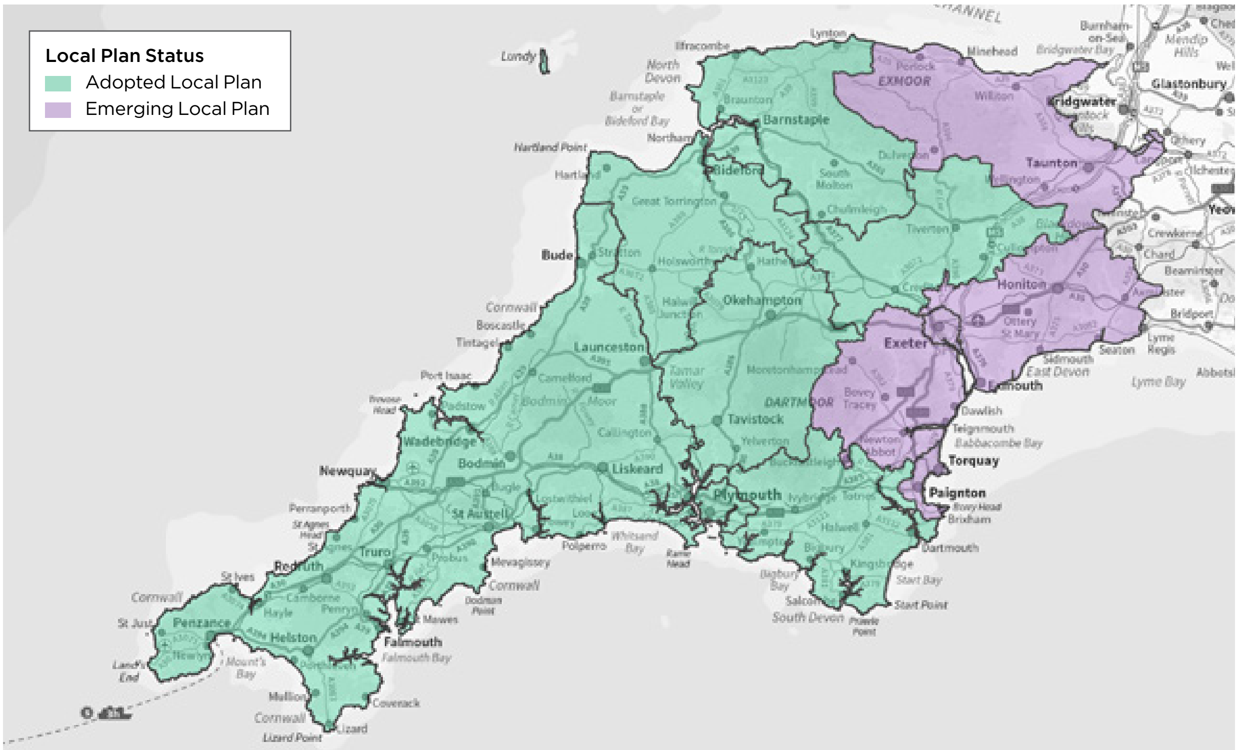



**Source:** DHLUC

### Planning Policy and Future Land Supply

Local plan coverage is broadly up to date, apart from four Local Planning Authorities (LPAs) in the east of the peninsula. The LPAs without a post-NPPF plan are also those which are less able to demonstrate a five year housing land supply. Exeter published a land supply statement of just under five years in August 2022. Somerset West and Taunton only just passes the threshold with a published land supply of 5.4 years, although this does not account for the 10% buffer required under the latest Housing Delivery Test.

**Figure 4** Local Plan status in the South West




**Source:** Savills Planning database

## Local Plan coverage

These LPAs are likely to present the best opportunity to bring immediate sites forward outside of the local plan process, with the presumption in favour of sustainable development applying. For longer term opportunities, several LPAs are required to review their local plans; Cornwall became due for review at the end of 2021, and North Devon and Torridge will need to begin the process in 2023.

## Constraints and opportunities

One of the most pressing difficulties in increasing land supply is the issue of nutrient neutrality, which is affecting sites within the River Camel, River Axe and Somerset Levels catchment. The local planning authorities in this area have been advised by Natural England that permission cannot be legally granted for developments that are not nitrate and phosphate neutral.

As a consequence, the number of homes receiving full planning permission in the affected areas has fallen by 43% over the last three years. Over 270 schemes have been in planning without being determined for over a year, contributing to the lack of land in the development pipeline. Until mitigation schemes can be put in place in conjunction with rural landowners, nutrient neutrality will pose a significant obstacle to meeting housing need and supporting economic growth in the South West Peninsula.

Despite this restriction, the South West will be the beneficiary of significant government investment in the coming years that could unlock development opportunities. Exeter, North Devon, South Hams and Teignbridge are in category 1 of the Levelling Up Fund Index, meaning they are in the highest priority for government intervention. But opportunities will not be limited to only Tier 1 areas; Plymouth received £19 million in the first round of Levelling Up Fund allocations, and significant grant has been given to Torbay and Cornwall from the Towns Fund. Further support is expected to develop the Plymouth and South Devon Freeport, which aims to develop the manufacturing, marine and defense industries already present in the region.

## Land values and demand

The combination of a strong housing market and barriers to bringing land forward for development has led to an exceptionally strong development land market. Greenfield land values in the Savills Development Land Index in the West have risen by 10% in the year to September 2022, out-performing the UK average. Brownfield values were increasing at the fastest rate of any UK region in the year to March 2022, but have remained flat in the last two quarters. Values across the South West peninsula are now at their highest point since the Global Financial Crisis, -9% below their 2007 peak. Urban land values are just -6% below their previous peak.

Development land values are highest in the area around Exeter. The market here benefits from strong housing demand due to high levels of historic undersupply, and from competing demand from other uses, particularly logistics. Greenfield values around Exeter grew by 20% in the last year. Between June 2018 and March 2020, growth in the same area was only 2.8%, highlighting the exceptional strength of the current market. Further west, Truro has seen 15% growth in the last still, a figure that is still well above the regional average.

13% of current residential allocations across the peninsula are in areas affected by nutrient neutrality, further limiting the availability of land for development. The problem is most acute in Somerset West and South Somerset. Therefore, although rising build costs, falling house prices and the increase in the cost of borrowing will exert downward pressure on land values, the shortage of supply means we anticipate there will still be strong competition for unconstrained, well located sites. Appetite is highest for oven ready sites with capacity for 100-200 homes.

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