Briefing

Global hotel investment overview & outlook

January 2013

SUMMARY

■ Cross border investment in the US, UK and Asia Pacific hotel markets was a key feature in 2012. In the case of the US and UK markets investment was largely focused on trophy assets.

■ US hotel investment sales activity in 2012 totaled approximately US$11.7 billion ($176,335 per room). Savills expects 2013 activity to be higher.

■ Manhattan led the US hotel investment market last year with sales volume totaling US$2.8 billion (US$587,595 per room).

■ UK 2012 hotel investment volumes were relatively resilient at US$2.6 billion. This was driven by activity in London as investors focused their attention on prime hotels in the face of weakening UK economic performance and the continuation of the Eurozone crisis.

■ Overseas investors continued to dominate transaction activity in London, focused on the top end/luxury segment.

■ Asia Pacific investment volumes decreased by 9.6%, from US$5.7 billion in 2011 to US$4.7 billion in 2012. Hong Kong investors accounted for 29.7% of all investment sales in 2012.

■ Asian cap rates increased slightly in the last quarter of 2012; however, yields remain more compressed than in western markets. An average yield of 5.8% for prime assets was recorded in 2012, which is the lowest for years.

State of the US lodging market

Construction activity in the past two years has been on the rise and the number of rooms in the national lodging pipeline is steadily increasing. The majority of new hotel openings in 2013 will be in the select-service category. Overall room supply in the US is expected to grow at 0.8% in 2013.

As compared to the previous peak, hoteliers will be able to sell more room nights in 2013 pointing to improving demand. However, occupancy growth in many markets, besides Manhattan, will likely suffer in the short-term due to the influx of new supply. Overall demand in the US is expected to grow by 1% bringing average occupancy to 61.9%. In Manhattan, the market quickly absorbed new hotel rooms following the 2010 construction boom. With supply anticipated to increase approximately 4.6% in 2013, average occupancy in Manhattan is expected to remain close to 85%.

Market gains in 2013 are expected to be led by room rate growth. Average daily rates (ADR) in the US are expected to grow by 4.6% across the board and improving group demand should significantly lead to the enhanced performance of higher priced chain scale segments. Hotels that rely on substantial government business may witness weaker growth due to the freeze in government per diem rates and fiscal uncertainty.

The use of technology is advancing quickly, presenting opportunities to provide customised services to guests. This allows guests to use their mobile devices to enhance their stays. Separately, hotel owners are increasingly hiring third-party operators and asset managers to help boost operating margins at their properties. Numerous multi-property and portfolio owners are delegating these services to companies with a regional focus so they reap the benefits of all the possible synergies between properties located close to each other. Following the recent trend in umbrella companies introducing new brands, these flags are now beginning to set defined standards to be able to distinguish themselves from their sister flags. Brands are requiring owners to implement complete property improvement plans in order to be more competitive with neighboring hotels. While maintaining new brand standards can prove to be expensive for owners, flags are working closely with owners and managers on ways to cut operating costs. Several new full-service hotels in core markets are adopting a select-service operating model by leasing their food and beverage facilities to third-party operators and avoiding becoming unionised.

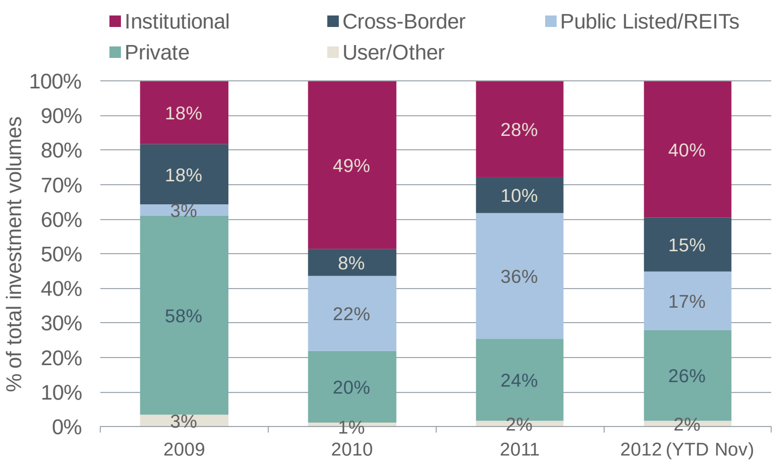
Numerous buyers are currently seeking value-add investments in secondary markets in the US. There has been a continuing trend of opportunity funds searching for underperforming institutional quality assets in non-core markets. The Savills Hotel Group worked on multiple sell-side advisory assignments that followed this pattern in 2012. All hotels sold by the group were bought by, or are in contract with, private / opportunistic investors at prices lower than the replacement cost and require a property improvement plan and management and brand change. This strategy provides significant upside for the new owners. Other key trends include foreign investors and publicly traded REITs seeking trophy assets in major cities like Manhattan, Washington DC, Miami, Chicago, Los Angeles and San Francisco, where they can purchase and hold a hotel for a longer period. Large cap investors continue to follow the trend of buying or partnering with existing brands and inheriting an already existing portfolio of hotels with a vision to grow within the US and overseas markets.

National hotel investment sales activity in 2012 totaled approximately US$11.7 billion ($176,335 per room). Although there was a strong push to strategically dispose of properties to take advantage of the favourable tax situation in 2012, transaction activity this year is anticipated to be higher. Manhattan led the national investment market last year with volumes totaling US$2.8 billion (US$587,595 per room). Notable transactions include the Plaza and Shops at the Plaza, Setai Fifth Avenue and the Essex House.

Looking to 2013, occupancy levels in secondary markets may experience a slight pause while absorbing new supply, but overall demand levels should improve. While performance was driven by occupancy over the past few years, 2013 will a year of average room rate growth. An increase in national corporate group travel and international visitors to major tourist destinations will contribute to the ability of hoteliers to charge higher room rates. In an attempt to add value to their assets by implementing significant renovations and management and brand upgrades, opportunistic investors will continue to seek underperforming institutional assets in non-core markets, while large cap companies including foreign capital and publicly traded REITs will pursue trophy purchases in major cities. Savills believes that in 2013, hotel operating fundamentals should be stronger than ever and the availability of multiple sources of capital coupled with continued favourable interest rates will drive property values to record levels.

GRAPH 1

US hotel investment by buyer type



Graph source: Savills Research; RCA

UK investor activity held up in 2012

With the UK moving back into 'technical' recession in Q2 12 and with the Eurozone crisis lumbering on, it was unsurprising to see the return of investor uncertainty. Despite this, hotel investment activity during 2012 was relatively resilient with volumes totalling US$2.6 billion.

Key transactions included the US$304 million buy-back by Principal Hayley of six hotels from AAIM, who purchased them from Principal Hayley in 2006 for c.US$440 million. Principal Hayley then sold the freehold to Pramerica on a sale & leaseback basis for US$158 million (4.0% yield). Other notable transactions included The Cavendish in St James by Singapore based Ascott Group for US$255 million representing a cap rate of c.5.0%.

The difficulty of securing debt remains the biggest barrier to investment. This has led some investors to take a more 'creative' approach to equity raising, such as the sale of freeholds in return for long term ground leases as seen with the Principal Hayley buy-back. Cap rates as low as 4% are being achieved on the most secure element of the EBITDA with rents set at around 25% of the open market value.

On a national level, investment activity has been relatively resilient, but this has been driven by London as investors have focused their attention on prime assets. London volumes in 2012 totaled US$1.49 billion, accounting for 56% of UK volumes.

In contrast, activity in the regions remains subdued. There was a 30% decline in regional volumes this year. Furthermore, as evidenced by the US$1.9 billion of unsold regional hotels on the market, conditions outside the Capital remain challenging. Having said this, we would expect to see appetite for good performing hotels in strong regional markets at the right price.

In the case of London, it is overseas investors who are driving activity accounting for 62% of London 2012 volumes. Asia Pacific investors dominated (79%) followed by those from the US with 16% of overseas investment. This represents a shift away from the Irish investors who dominated prior to the 2008 crisis.

However, this overseas interest has been very much focused on the top end/luxury segment, partly as it is a segment seen to offer strong capital protection but also due to the cache of owning and/or operating a well known London hotel. This is demonstrated by the changing ownership profile of Central London four and five-star hotels over the last five years.

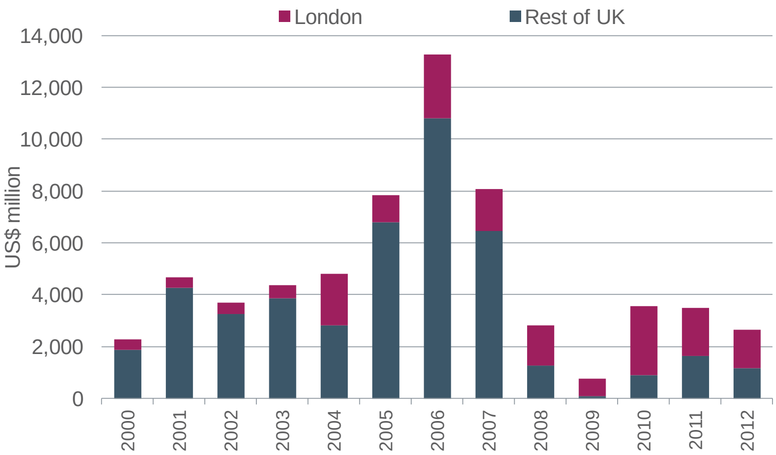
Examining the current ownership of Central London luxury hotels, UK owners continue to dominate with a 47% share of bedroom supply (see Graph 3). However, in line with the trend seen in investor activity, this share has fallen over the last five years by 11 percentage points as investors/operators from Asia Pacific, North America and Middle East capitalised on the favourable exchange rate and debt issues facing a number of UK hotel investors/operators to enter the London market or expand their existing portfolio. In terms of number of bedrooms, the greatest gains have been by investors/operators from India, Pakistan, Singapore, Canada and the US.

Investment activity last year was down on forecasts as a number of large transactions expected to complete were delayed, largely due to their complexity. With these deals set to complete this quarter, Q1 volumes are likely to total approximately US$1.6 billion, 60% of 2012 levels, suggesting year end activity for 2013 is likely to be in excess of that seen last year.

While activity outside the capital is expected to remain subdued the number of prime/trophy London hotels expected to come to the market this year could deliver an increase in London volumes. The high profile nature of these assets will prove attractive to overseas investors, particularly those from the Middle East and Asia, increasing the international ownership of the top end London hotel market.

GRAPH 2

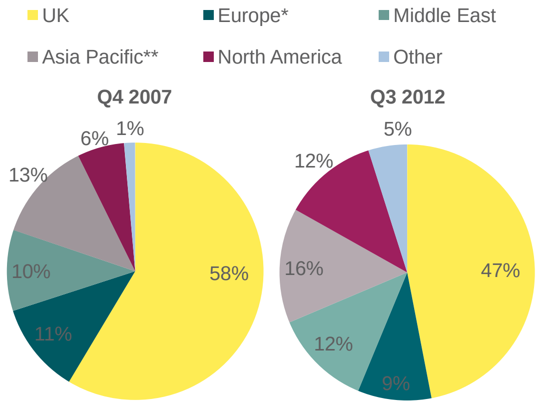
UK hotel investment volumes (deals US$8 million+)



Graph source: Savills Research; Property Data

GRAPH 3

London luxury hotel owner profile by bedroom count



Graph source: Savills Research
Note: Europe* includes Russia; Asia Pacific** includes India and Pakistan

Investor sentiment in Asia Pacific remains positive

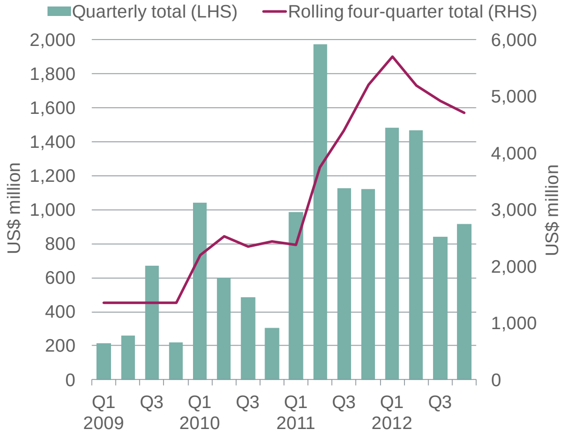
Approximately US$4.7 billion worth of investment transactions were recorded in 2012, representing a 9.6% decrease on 2011's US$5.7 billion, and bringing the total volume in Q4/2012 to US$918 million.

Investor sentiment in Asian markets deteriorated towards the end of 2012, influenced by the global economic outlook for 2013. However, at the end of the year, capital values were still high, while yields compressed throughout the year.

In 2012, the Tokyo and Hong Kong markets illustrated the different approaches of overseas and local investors in regards to property pricing, with Asian buyers often willing to pay more for properties with yields that overseas buyers find irrelevant.

GRAPH 4

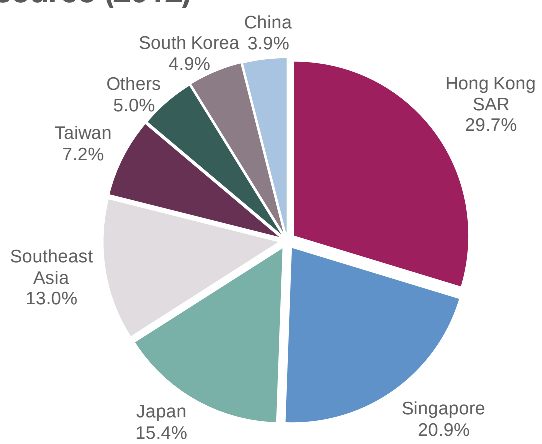
Asia Pacific hotel investment volumes



Graph source: Savills Research; RCA

GRAPH 5

Asia Pacific investment volumes by source (2012)



Graph source: Savills Research; RCA

Tokyo and Hong Kong are currently enjoying very low interest rates, and a widespread belief that pricing is about to bottom out and that institutional investors will increase their exposure to hospitality related assets.

Northern Asia[1]

It was a busy year in Japan as there were more and more deleveraging opportunities available. Local banks still hold a large proportion of bad loans on their balance sheets, and there has been almost no political pressure so far because they remain relatively healthy and have no proper commercial incentive to sell. However, more deals will appear on the market as several commercial mortgage-backed securities (CMBS) are believed to mature this year. Generally, prices are discounted by between 30% and 40% from 2007 levels, with a yield spread of 500 basis points (bps) over ten-year government bonds.

Overseas investors are still having some issues getting a foothold in the Korean market, as property assets tend to be traded between domestic players and it is still difficult to find the same level of transparency that overseas buyers are used to in Japan or Singapore. The market is currently dominated by the country's pension funds, which have more capital to place than the market can absorb at the moment. Nevertheless, some opportunities are expected to appear on the market in 2013 at average cap rates of 6% in Seoul, with a spread of 100 to 150 bps.

Eastern Asia[2]

Having the right partner in China is more favourable than having the best property, as cap rates tend to compress for stabilised assets and there is potential for distressed assets, mainly in development. This is largely due to the Chinese government which continues to enforce regulations limiting developers' access to bank debts and loan to value ratios. Developers have to generate cash flow by accepting discounted prices to sell inventory.

Hong Kong has recorded a strong stream of transactions this year. However, it is still only the high net worth individuals from Hong Kong or Macau that can afford to buy at the moment, and pay in cash when an opportunity is available on the market. There are not that many overseas funds which are in a buying mode or are trying to sell, unless they need to exit. Banks were hesitant to finance deals during the first half of 2012, mainly because of a shortage of liquidity caused by European macro problems. Nonetheless, this uncertainty ended around the middle of 2012 and the market is now back to normal.

Southeast Asia[3]

Southeast Asia has seen a 64.3% increase in investment in 2012, as investors have been more active in Indonesia, Viet Nam and the Philippines. More recently, several investors began moving into more emerging regions such as Cambodia, Mongolia, and even Myanmar, where international sanctions were only removed in 2012.

The likely prospect of strong economic growth in these counties over time means that long investment perspectives make sense. Jakarta, with low inflation and investment levels now returning to those seen before the 1998 Asian financial crisis, presents good prospects for growth. Viet Nam has seen little investor activity this past year as a result of political disturbance and poor economic conditions. However, investor sentiment is currently so negative that it could now be a good time for counter-cyclical buying, although these cycles can take quite a long time to reverse in Viet Nam.

Investor sentiment

Some destinations in Asia have been very active on investors' radar screens, such as Jakarta, Kuala Lumpur, Bangkok and some secondary cities in China. This infatuation is probably the result of the ongoing yield compression in developed markets such as Tokyo, Hong Kong and Singapore, especially for core assets. However, market penetration is still difficult and the higher risk attached makes opportunities relatively limited, as these locations currently provide opportunistic returns. In 2013, we expect REITs to be active buyers in the region, as they are now more easily able to make overseas purchases, particularly Singapore REITs.

1. South Korea and Japan
2. China, Macau, Hong Kong and Taiwan
3. Thailand, Viet Nam, Malaysia, Singapore, Indonesia and the Philippines

OUTLOOK

The pursuit of trophy assets is likely to be a key driver of investment activity in 2013 across all regions

United States

■ Trophy assets in the US will continue to be the most attractive targets of global capital.

■ Secondary markets may experience a slight pause in occupancy this year while absorbing new supply, but overall demand levels should improve.

■ While occupancy was the primary driver of performance over the past few years, 2013 will see strong average room rate growth.

■ Opportunistic investors will continue to seek underperforming institutional assets in non-core markets looking to add value through significant renovations and management and brand upgrades.

■ Savills believes that in 2013, hotel operating fundamentals should be stronger than ever and the availability of multiple sources of capital coupled with continued favourable interest rates will drive property values to record levels.

United Kingdom

■ The slow down in revenue and profit growth in the London full-service market is expected to continue into the immediate future.

■ 2013 investment volumes expected to be up on 2012 levels of US$2.6 billion driven by overseas investor interest in prime London hotels as a number of high profile assets are expected to come to the market. However, regional conditions likely to remain challenging.

■ Debt availability to the sector is anticipated to remain restricted for the foreseeable future with shorter loan periods, higher margins and lower debt to equity ratios.

Asia Pacific

■ Due to yield compression, investors are having some difficulties at the moment finding assets which provide the returns expected from their investment committees.

■ In 2013, investors in the region will monitor Japan for distressed assets from CMBS servicers, as well as the possibility of distressed developments in China arising from developers' cashflow problems.

Please contact us for further information

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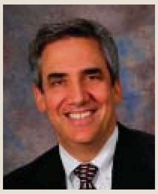
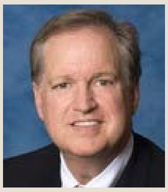
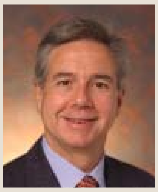

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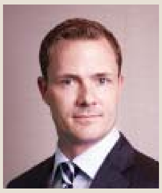



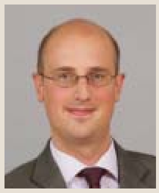

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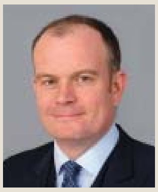


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