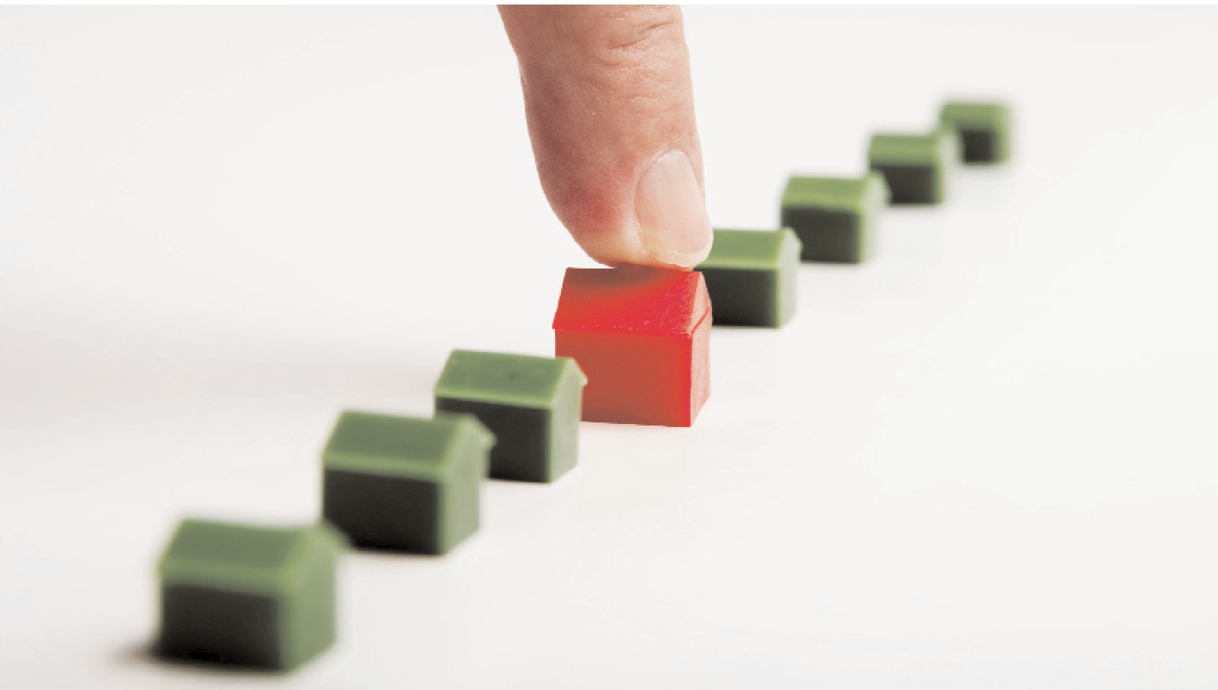
# Hotel Research

# UK Hotel Investment report

2009



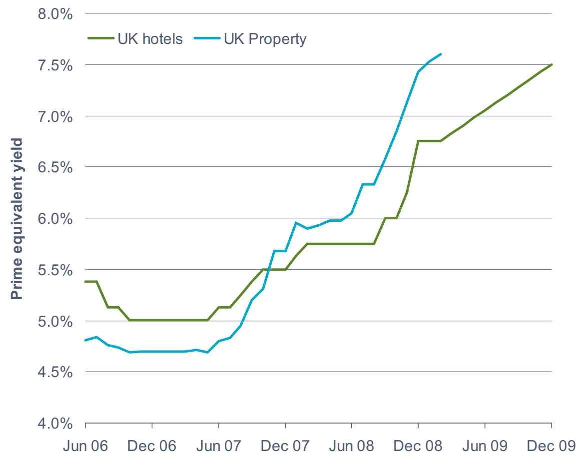
## “Are the next investors hoteliers?”

**Philip Johnston, Head of Hotels**

- As with all UK property sectors, the hotel sector has certainly not escaped the general economic downturn. With a strong tourist and corporate travel dependency, London is expected to feel the full force.
- Prime yields for hotels have risen, but not at the same speed as the correction seen within the wider property market.
- Hotel investment yields remain low compared to other commercial property sectors although hotels tend to experience a 12-month lag.
- Hotel assets tend to be well invested to maintain trading performance providing a fully reusable asset on lease expiry.
- Due to the difficulties in funding management contracts, hotel operators may need to rethink their expansion strategies. This may lead to ownership going ‘full circle’ with hoteliers becoming owner-operators.
- Restrictive supply of hotel investment opportunities, driven by owners’ reluctance to bring the asset to the market, will act as a brake on yields softening too far.
- Unsurprisingly, average room values have fallen this year. This reflects a decline that started gathering pace during Q4 2008 and quick response by valuers. Distressed sales will ensure a further fall throughout 2009, but at a lower rate of decline than the first couple of months.

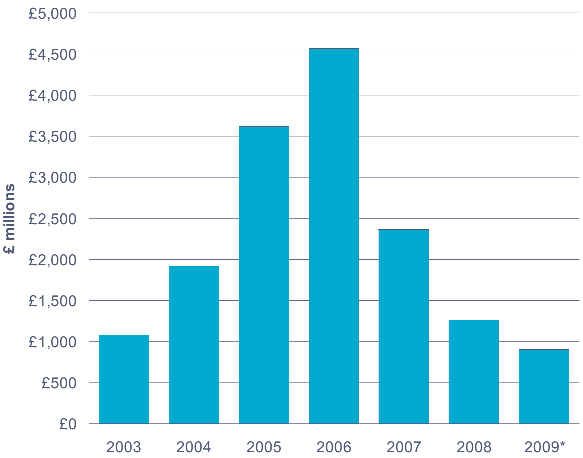
# Hotel investment performance

**Hotel yields will move towards the wider market**



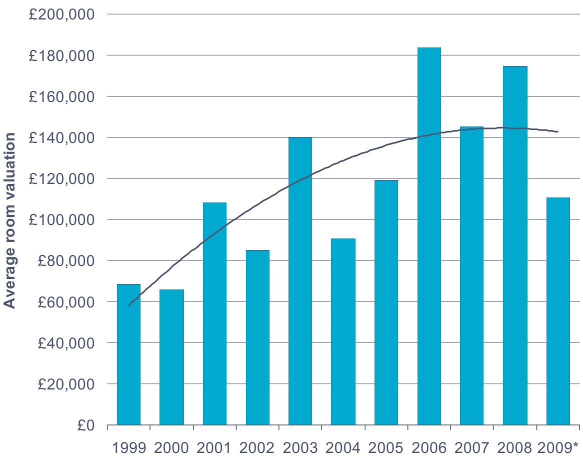

*Source: Savills*

**Investment volumes fell significantly in 2008**




*Source: Property Data*      ** Savills forecast*

**Savills data shows declining room average values**




*Source: Savills*      ** as at early-March*

### Yields

The hotel investment sector has certainly not escaped the general economic downturn. Consequently, yields have risen consistently since end-2006, but this rise has been markedly less than the other commercial property sectors in the UK.

This has been due to continued strong trading performance of hotels, which only started to decline in Q4 2008 and will continue to do so for the remainder of this year. This will have a negative impact on hotel investment yields and we expect a further 100 basis point softening within the next 12 months.

### Funding

The few hotel investments that are funded tend to be for hotels subject to leases. Management contracts are becoming increasingly difficult to fund. There will be more money heading to quality assets. The Travelodge deal in January 2009 at a 6% yield shows the attractiveness of a good covenant and a 35-year lease.

Encouragingly, there is a weight of money waiting to come in. The general decline in availability of capital will ensure better deals for those with money to spend. Additionally, there will be forced sales in 2009, which tend to be at significant discounts to true market value.

### Opportunity

Falling investor confidence, as a result of the global economic turmoil pushed transaction levels lower last year. However, the relative weakness of Sterling also presents investment opportunity in the UK that will enhance returns for overseas investors.

Supply will reduce as the market does not present an attractive environment to bring assets for sale. This will restrict the supply of investment opportunities and will act as a brake on yields softening too far.

### Hoteliers the new owners?

Due to the difficulties in funding management contracts, hotel operators may need to rethink their expansion strategies. This may lead to ownership going ‘full circle’ with hoteliers becoming owner-operators.

As costs rise and sales fall, profit margins will be squeezed. Therefore, operator rents may have to fall when agreeing new leases.

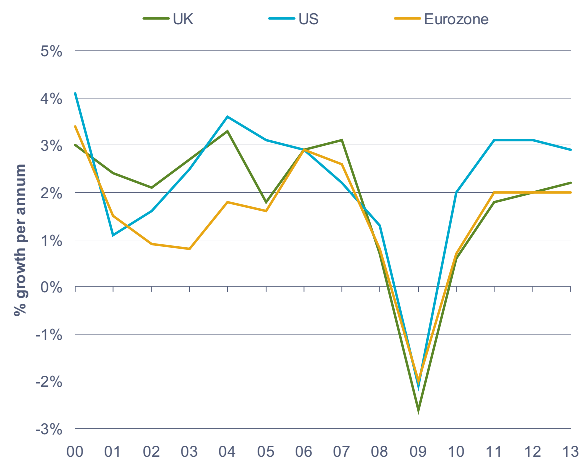
### Valuation Index

Savills Hotel Valuation data presents the movement in hotel room average values. The database has recorded over £13 billion of hotel valuations.

So far in 2009, the average room values have, unsurprisingly, fallen again. This reflects a decline that started gathering pace during Q4 2008. It is expected that room values will continue to fall for the remainder of 2009, especially as distressed sales become more and more common. However, the rate of decline will be at a lower rate than the first couple of months of 2009.

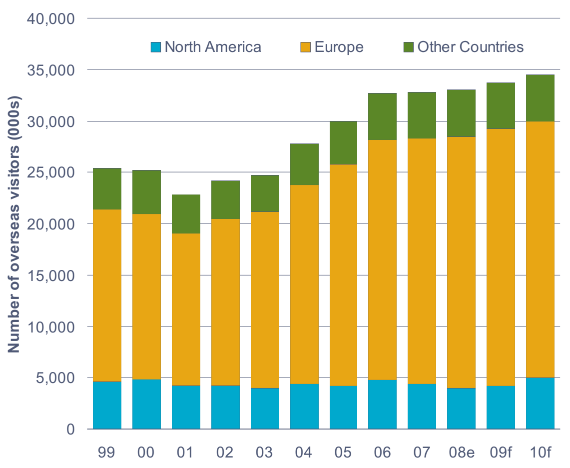
# Market drivers

**The economic downturn remains a 2009 event**



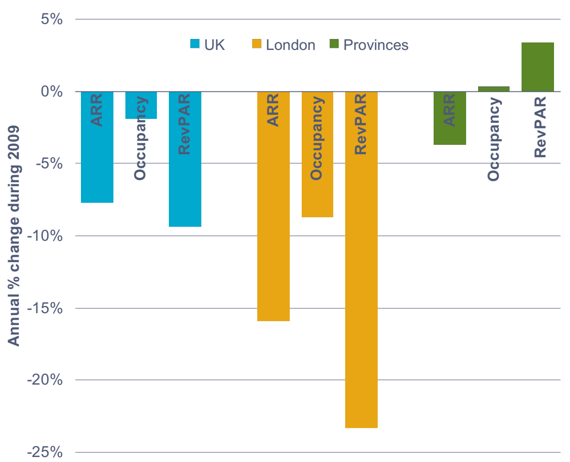

*Source: Consensus Economics*

**UK visitor number remain on an upward trend**




*Source: Office for National Statistics*

**London will feel the full impact of global events**




*Source: PricewaterhouseCoopers (November 2008 model)*

### Economic squeeze

2009 is expected to see a major reversal of economic growth. While previous recessions have been country specific, the effects of global financial trading has spilled across borders.

The effect of the credit crunch was initially seen as a concern for the major industrialised economies. However, the effect of the global meltdown has spread this around the globe and emerging markets are beginning to bear the brunt of the bad news.

The positive fact from the economic forecasts is the clear expectation of a recessionary period in 2009 only with a ‘bounce back’ in 2010.

### Sterling fall, tourist increase?

The future of London as a financial centre has been called into question amidst the global turmoil. However, current events are unlikely to harm London any more than other financial centres. Corporate travel will be affected, but will recover.

With UK base rates now at 0.5%, the lowest in their 315-year history, the value of the Pound will continue to decline. Cheaper Sterling will add to the attractiveness of some assets for overseas investors.

Latest data shows that Sterling, compared to the Euro, is 18% cheaper than a year ago. This will lend support to the London market and is the reason why the European visitors take an increasing share of the forecast for this year.

We are seeing an increase in visitor numbers to many of London’s attractions, which bodes well for hotel trade.

### UK hotel trade forecast

PricewaterhouseCoopers produce forecasts for the UK hotel market. The UK is expected to see a near 10% fall in RevPAR this year.

The severe impact in London is the result of a significant decline in corporate travel and associated spend this year. Firms are tightening up their cost control procedures.

There are an increasing number of distressed sales and closures of provincial boutique hotels. Whilst luxury class hotels may continue to trade reasonably well in the Capital, we expect more closures of such assets outside of London.

Latest data from the airport authority shows that passenger numbers are 4% lower than the same time last year. This trend will ensure that the PwC forecasts are realised.

The forecasts suggest that 2009 will have to be a year of survival. Maintaining profitability will be the challenge.

# Savills services and contacts

## Hotels and serviced apartments

Savills are market leaders, having sold and transacted more than 300 hotel and serviced apartment sales in Central London alone. Sales include trading hotels at both corporate and private levels, from tourist class to 5 star deluxe hotels. Based throughout the UK and Europe, we provide the complete package from acquisition and planning stage, through to lease, management contract or turn-key negotiations and sale of investment.

Savills have provided advice regarding Marriott, Radisson, Park Plaza, Park Inn, Hilton and David Lloyd portfolio's in the UK and advised on the sale of the Pelham Hotel in London and Prince de Galle Hotel in Paris as going concerns, as well as the Hilton hotel portfolio.

Savills remain one of the most experienced agents and valuers in the industry. Annually, we handle some €5bn worth of hotel assets transactions and valuations across the UK and Europe.

## Research

Savills Research provides detailed advice to clients in locations throughout the UK and overseas. We are unique in our ability to advise across all property sectors - commercial, residential, rural and leisure - providing detailed market data and analysis for each. We provide specialist advice to the public and private sectors including development feasibility, relocation consultancy, demand analysis, local and structure plan reviews, inward investment advice, development strategy and data mapping and catchment analysis.

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