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Savills Research

UK Hotels 2024

Strengthening Fundamentals and Increasing Investment Opportunities

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Key points

Robust operational performance continues

» 2024 top-line performance growth has aligned with historical norms. The continuation of growth, albeit slower, reiterates that current average daily rates (ADR) and Revenues per available room (RevPAR) are the new norm.

» Budget hotel performance, particularly in London, has faced some challenges this year, but these are expected to be short lived. By contrast, Luxury Hotels have continued to lead the market, with Edinburgh standing out as a top performer, recording a 14.4% year-on-year increase in RevPAR as of August 2024.

» The improving macro-economic backdrop, both globally and in the UK, will further strengthen hotel demand. There will, however, be nuances across different segments and geographies.

» Despite resilient demand and top-line operational performance, margin pressures persist. Operational cost growth has slowed but this is no longer being offset by RevPAR growth to the same extent as it was in 2022 and 2023.

Investment activity is up but caution remains

» Year to date (YTD) transaction volumes as of Q3 2024 are estimated to have reached £3.82 billion - 185% higher than the same period in 2023.

» Portfolio acquisitions have been the primary driver of activity, accounting for 62% of volumes. There has, however, been an acceleration in single asset deals, particularly in London where volumes are up 91% year-on-year.

» Despite increased investor appetite, caution remains, meaning that yield compression to date in 2024 has been minimal.

Outlook

» Investment activity to pick up pace in 2025, supported by growing investor interest in the asset class, improved confidence in the global economy and the widening yield gap to debt costs.

» Yield compression is anticipated to be more pronounced in 2025; the speed at which this compression materialises could be faster than expected, judging by previous cycles.

Operational outlook

Growth returning to more normalised levels

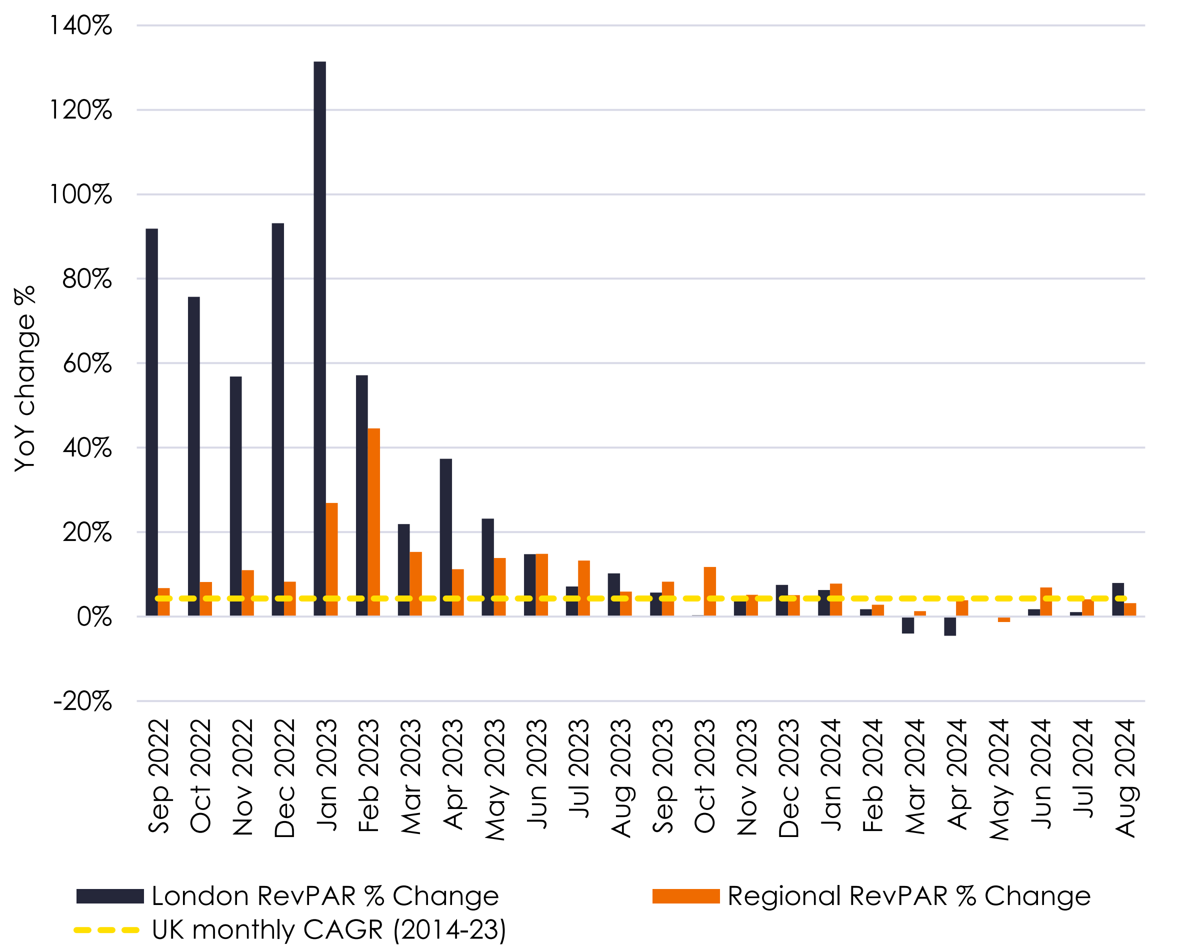
The key trend for UK hotels in 2024 has been a normalisation in top-line performance, following the heady days of early 2023 when growth in revenues per available room (RevPAR) was in double digits year-on-year (YoY). A new post-covid revenue norm has been established.

Year to date (YTD) London and Regional RevPAR performance according to STR Costar was up 1.5% and 3.1% respectively YoY as of August 2024.

In the case of London we did see contraction in RevPAR rates in March and April. In April, this could be partially attributed to some visitors choosing to avoid London during the Coronation. However, subsequent months returned to positive territory, in line with their long-term monthly average.

Beyond London, Edinburgh has been a stand out performer with August YTD RevPAR up 14.4% YoY, making it one of the strongest performing city markets in Europe.

Fig 1: London and Regional monthly RevPAR performance



Source: Savills Research; STR Costar

Budget hotels faced some short term challenges, however, Luxury Hotels continue to outperform

The apparent challenges facing operational performance this year have been largely determined by the economy/budget segment, particularly in London.

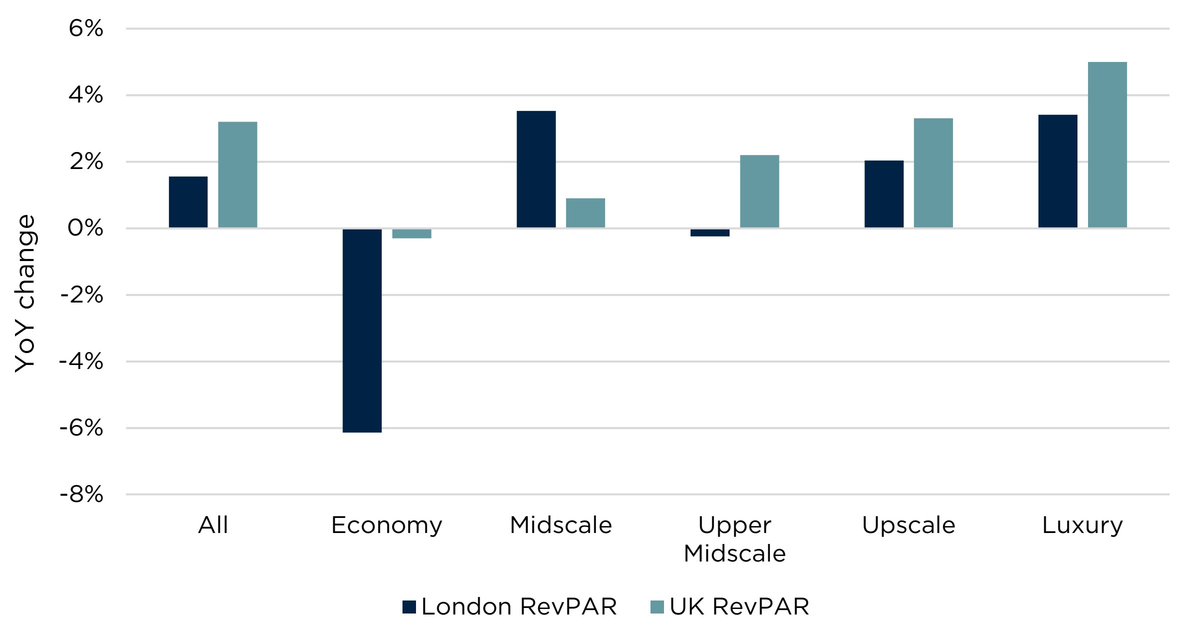
Nationally, this segment reported a marginal -0.3% annual contraction in RevPAR in the eight months to August. At the other end of the spectrum, the luxury segment posted a 5.0% uplift **(see Figure 2).** This differential was more marked in London, where economy posted a 6.1% RevPAR contraction; luxury was up 3.4%.

Why has performance diverged so significantly and what does this mean going forward?

For the economy segment nationally, and in particular in London, the winding down of Government contracted asylum hotels has no doubt had an impact. According to Government data released in April, there has been a 30% decline in the number of hotels being used for asylum accommodation compared to October 2023. And whilst Government data does not provide detail on where these hotels are located, we suspect a considerable number of these exited contracts were for hotels in Greater London, considering their relatively higher cost compared to other parts of the UK. Absorption of this returning stock will have short term implications on occupancy rates and, in turn, on the ability to maintain and drive average daily rates.

Another factor at play, again more so in London, was the fact that economy ADR's had significantly outperformed the rest of the market in 2022/23 and had become closely aligned to some parts of the midscale market. The tight spread on price, dependent on the location, may have led some consumers to move 'up market' seeing it as better value for money.

Fig 2: UK and London YTD August 2024 RevPAR performance by segment



Source: Savills Research; STR Costar

However, we believe these are short term issues. For example, contraction in average rates and occupancy for the economy segment in London has slowed in recent months and we suspect will continue to do so until they find a more sustainable level. And, despite a winding down of Asylum Seeker hotel contracts, a public sector underpin still exists in some parts of the market, with Local Authorities making greater use of hotels for those in need of emergency accommodation **(see below).**

What has been more reassuring, from a structural perspective for the sector, has been the continued performance growth in the luxury space. This is particularly the case given the pressure placed on household finances by the recent high inflationary environment.

London luxury, where average ADR's are 31% higher than they were five years ago, saw further upward pressure over the course of 2024. Occupancy recovery, which had been lagging, reported a robust 2.8% growth year-to-date as of August, bringing average occupancy back in line with pre-pandemic levels. A similar trend has been seen nationally.

This normalisation in top-line performance has, and will, generate challenges when it comes to off-setting pressures on operators' bottom lines. While cost pressures have slowed considerably, they are still experiencing upward pressure particularly in more labour intensive operations. This suggests the challenges of maintaining and improving margins will persist. However, looking to the macro economic and demand drivers, this may tail off as we move through 2025.

Ongoing use of Hotels by government and Local Authorities

277 Hotels
Down 30%

Number of hotels being used for asylum accommodation has reduced by 121 between October 2023 and April 2024.

17,750
+150%

Number of households in temporary accommodation classified as bed & breakfast/ hotels in England in Q1 2024. This is a 150% increase on 2004 levels, with London Local Authorities making greater use of hotels.

3.1%
Of Hotel Rooms

Estimated share of England hotel rooms being used as temporary Accommodation by Local Authorities.

Source: Savills Research using ONS and Homelessness statistics

Demand fundamentals strengthening

One of the most attractive aspects of hotels, and the wider overnight hospitality accommodation sector, is the strength of its demand fundamentals. An expanding middle class in large emerging economies in Asia, growing consumer appetite for travel and experiences and expansion in low cost budget airlines, amongst other factors, have fuelled growing demand for overnight accommodation, particularly in leisure demand. These underpinning factors are clearly apparent in the speed and strength at which the UK hotel market bounced back from the pandemic.

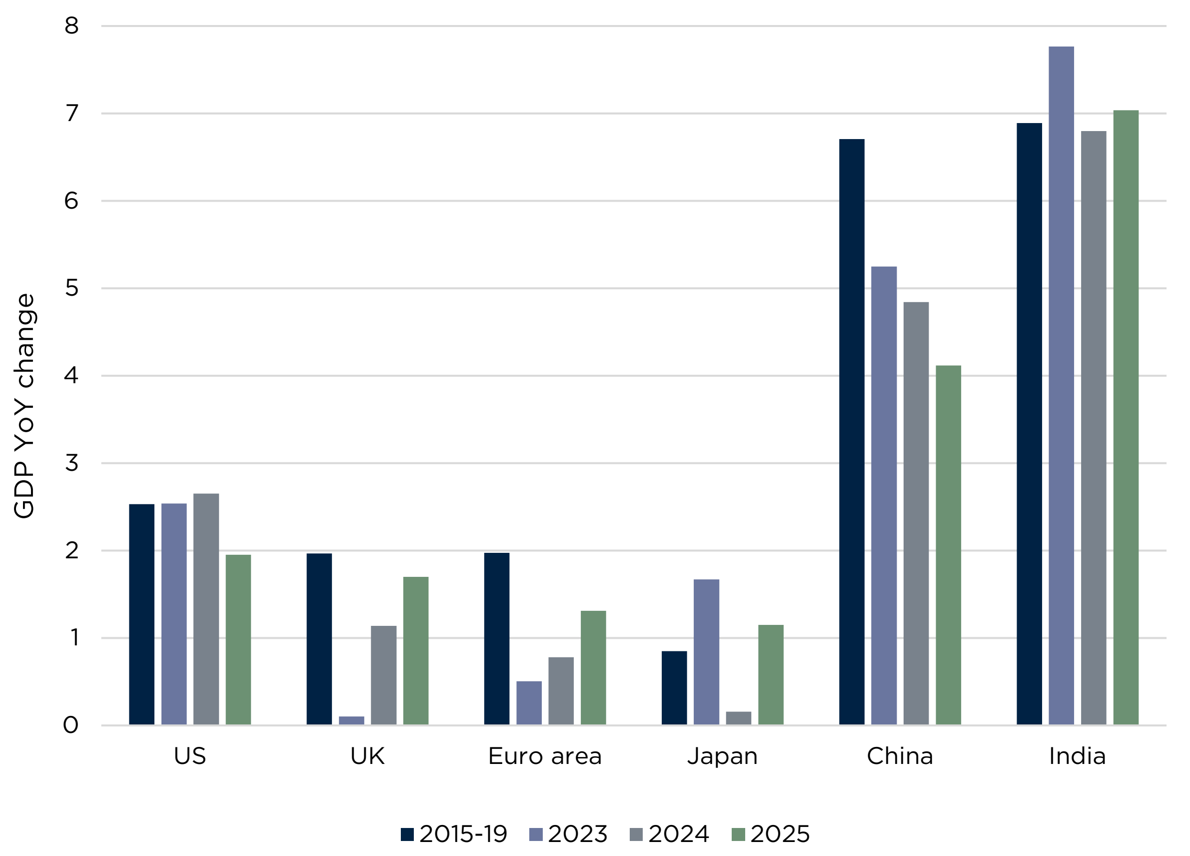
Looking forward, these drivers are set to strengthen. The soft landing forecast for major global economies, alongside slowing inflation and in turn positive real wage growth, has translated into improved consumer confidence across major economies.

This will feed positively into hotel demand across the European region, with Oxford Economics forecasting international arrivals into Europe to increase by an average of 8.5% per annum through to the end of 2026. For the UK, this will have positive implications for London and Edinburgh, two major destinations for international tourists.

In particular, the forecast acceleration in Euro area economic growth, which is the biggest international source region for the UK, bodes well for demand and in turn top-line performance **(see figure 3)**.

Despite improving top-line demand fundamentals, this may not be fully realised by the luxury segment in London over the short term.

Fig 3: GDP growth forecasts (major global markets and regions)



Source: Savills Research using ONS

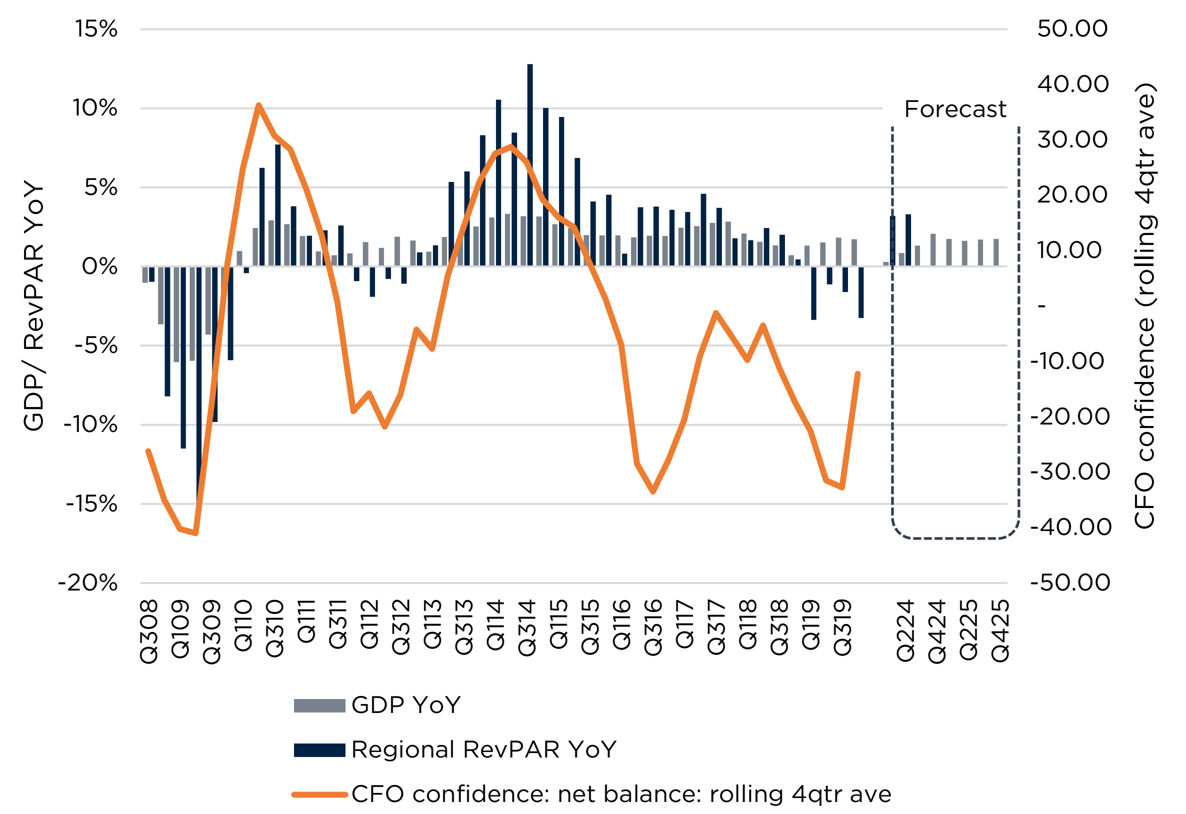
While we expect to see further growth in this segment, the rate of growth may be mitigated by a slowing US economy, a key source market. This may also be exacerbated by growing tensions in the Middle East, which might translate into weaker arrivals from the region. Albeit, based on historical events, we suspect this potential impact will be relatively short-lived. Similarly, slowing growth and weaker consumer confidence in China may also exert an influence through to Q2 2025.

Beyond London, an improving economic outlook will also exert a positive influence on domestic leisure and corporate demand in the UK. Historically, there has been a close correlation between UK GDP, CFO confidence and regional hotel RevPAR **(see Figure 4).**

The improving outlook for the UK economy, which is already being reflected in corporate (CFO) confidence, will no doubt support positive leisure and corporate demand going forward.

Despite this, corporate demand has, and will remain, more nuanced. Greater use of video conferencing will exert an influence on project-related hotel demand. It is worth noting that even prior to the pandemic, GB domestic business traveller numbers in 2019 were still 12% below where they were in 2006 prior to the Global Financial Crisis (GFC). However, corporate event demand is expected to rebound significantly as businesses increasingly seek to bring staff together in response to the growing adoption of agile working practices.

Fig 4: UK GDP benchmarked against CFO confidence and regional RevPAR



Source: Savills Research, OE, Deloitte CFO Survey; STR Costar

Staycation markets

Structural shifts in consumer spending, particularly amongst younger cohorts, is supporting demand and performance in the UK's 'staycation' markets

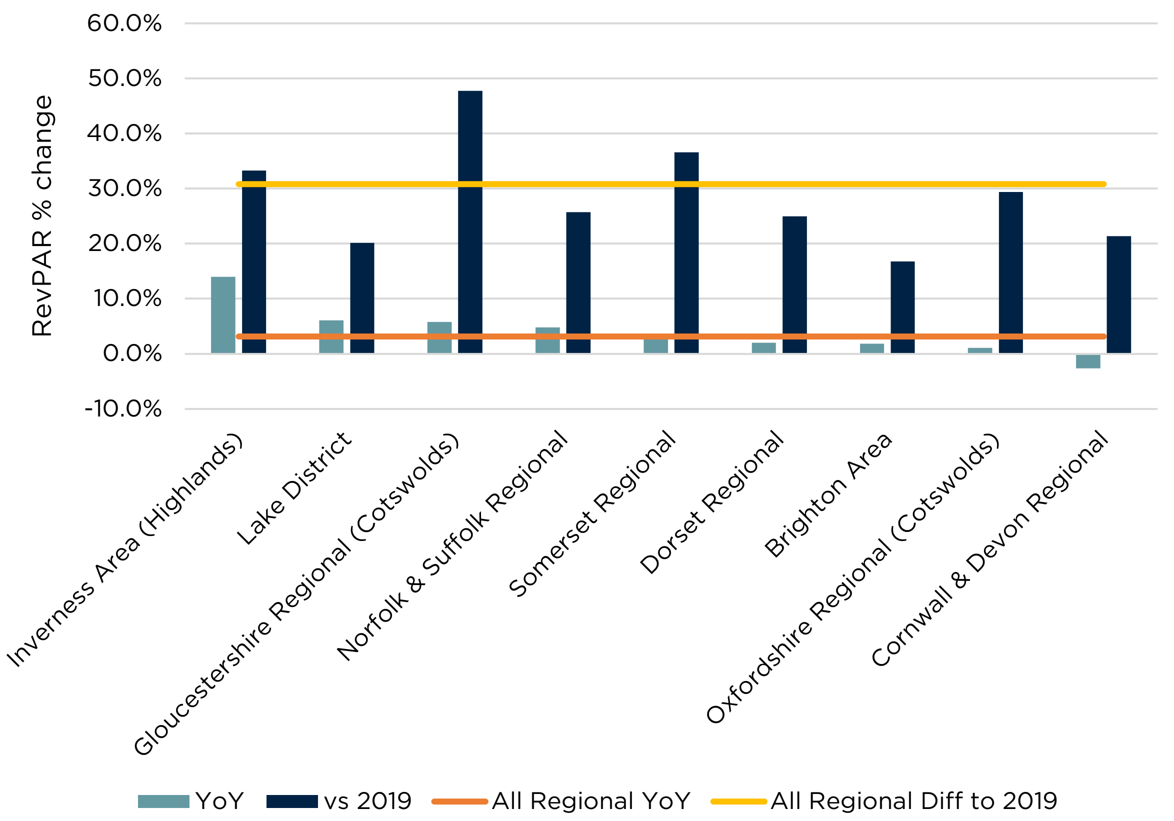
Staycation markets in the UK, those that predominantly rely on domestic leisure demand, have largely stabilised, with many continuing to report relatively robust performance **(see figure 5)**.

In line with national trends, there has been a slowdown in performance over the course of 2023 and into 2024. A number of markets have seen contraction in monthly RevPAR rates YoY, largely driven by declines in ADR. This has been most acute for traditional UK summer holiday destinations in the South West, which were the primary beneficiaries of restricted international travel in the immediate aftermath of the pandemic.

For example, Cornwall & Devon regional (excluding urban markets) reported YTD August 2023 and 2024 RevPAR declines of -1.5% and -2.6% respectively. By contrast, the Inverness area and Lake District reported YTD RevPAR above the all region average, of 14% and 6% respectively in 2024.

What was largely universal across staycation markets, despite differences in YTD performance, was weaker performance in high season/ school holidays (Easter and summer) and an acceleration in the shoulder months. For example, Cornwall & Devon regional monthly RevPAR was down -10.8% YoY in April (Easter holidays) with the summer months of July and August seeing similar contractions.

Fig 5: Selected UK staycation markets RevPAR YTD performance (August 2024)



Source: Savills Research, STR Costar

Yet, the shoulder months of March and May saw increases of 8.8% and 2.5% respectively. A similar trend was seen in the Lake District; April RevPAR was down -7.4% whereas March and May were up 13.6% and 10.1%.

What this suggests, is that while longer length staycation trips may be in decline compared with their post pandemic highs, growth in shorter trips (1-3 nights) continues, in line with longer term trends. This correlates with the longer term structural shifts in spending, with consumers prioritising 'experience' spend. This has been more pronounced amongst younger cohorts.

According to Visit Britain domestic overnight visitor data for England, 2023 saw a 9% increase in domestic holiday trips by those defined as 'younger independents' (16-34 year olds with no children). Trips by those aged 25-34 years were up 11% over the same period.

This is in sharp contrast to the 11% decline seen in total holiday trips within England. Likewise, trips by families were down 14% and those by retirees and older independents contracted by 18%.

This divergence across customer segments seen in 2023 is largely in line with historic trends. For example, domestic holiday trips by families had declined by an average of 0.2% per annum between 2016-2019, whereas those by younger independents had grown 4.0% per annum.

Clearly the profile of the staycation customer is evolving. Families still account for the majority of domestic holiday trips, but trips by younger independents outnumber those by retirees and it is a segment that is growing. These trends will have an important bearing on the types of assets that are likely to outperform going forward.

6.8 Million

Number of domestic holiday trips by young independents in England in 2023

3.1%

Average annual growth in domestic holiday trips taken by young independents in England between 2019-2023

Pipeline delivery

Short-term acceleration in new room deliveries set to slow as high construction and Debt Costs impact new projects

Projections indicate that the total hotel room supply across the UK is expected to grow steadily throughout 2024 and 2025. This is following a slowdown in new delivery in 2022 and 2023 that saw UK stock growth average 0.7% per annum.

Based on schemes under construction and in final planning (committed pipeline), just over 17,000 new rooms are anticipated to enter the market in 2025. This represents a 2.5% increase on anticipated year end 2024 stock. However, with 70% of this yet to start on site it is expected that a significant proportion of this 2025 pipeline will, as a minimum, drift into 2026, which would put the annual growth rate closer to 1.5%.

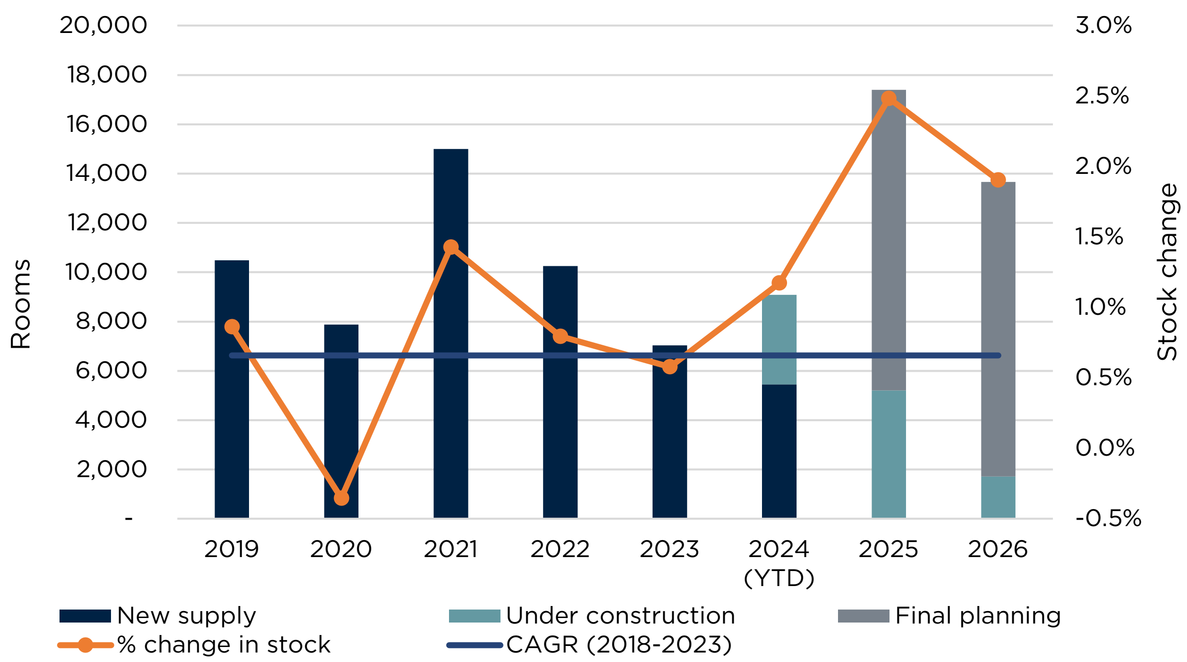
The projected increase in new supply over the next two years, from its 2023 low, is largely attributed to project delays in 2020 and the spike in construction costs in 2021/22 that led to delivery dates on some schemes being pushed back.

Beyond 2025, we expect this trend to reverse, with new delivery likely to slow. This is a response to the fact that construction costs are c20% higher than they were five years ago, exacerbated by the current high interest rate environment, which has undermined the viability of some schemes.

Looking to development hotspots, London remains a major driver of new supply, with c9,300 rooms under construction or in final planning with a proposed delivery date prior to the close of 2026. In growth terms this equates to an average annual rate of 1.8%, in line with the 15 year average.

Regional cities by comparison are forecast to see stronger growth in percentage terms, with the major cities of Birmingham, Manchester, Liverpool, Edinburgh, and Glasgow dominating new delivery through to the end of 2026.

Fig 6: UK Hotel pipeline



Source: Savills Research, STR Costar (Note*: committed pipeline includes units under construction and in final planning.)

But, in line with the national trend, new supply in the regions is also set to taper off over the next three years for the reasons already cited.

Manchester and Edinburgh are standout markets. Manchester is projected to experience an annual growth rate of 3.6% to the end of 2026, with an additional 2,300 new rooms in the committed pipeline.

Edinburgh is expected to see a significant acceleration in new delivery, with a projected annual growth rate of 4.5% (2,280 rooms) to the end of 2026, double the rate seen over the preceding five years.

This new supply will be largely located on the city fringe, meaning supply in the city centre will remain constrained.

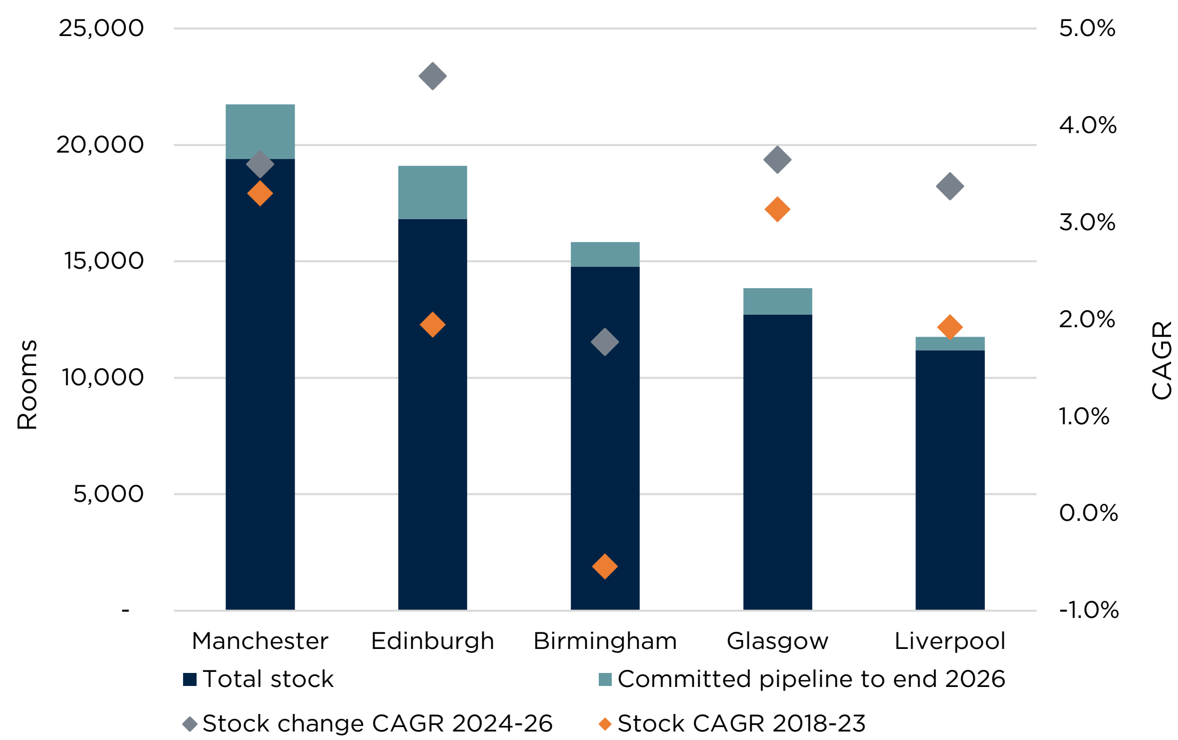
Does this new delivery pose a challenge to operational performance?

Any new delivery can create short term absorption challenges, subject to the specifics of the micro location and prevailing market conditions. However, in the 10 years to 2019 all major UK cities, bar Aberdeen, saw positive annual RevPAR expansion while also seeing stock growth.

For example, Manchester which has seen a 16% growth in stock since 2019, making it one of the fastest stock growth markets in the UK, has at the same time seen average annual RevPAR growth of 2.9% over the same period. This again highlights the strength of the structural drivers supporting demand and top-line performance.

Looking forward, this new delivery is unlikely to have a long term detrimental impact on top-line performance.

Fig 7: Major regional cities stock and pipeline



Source: Savills Research, STR Costar (Note*: committed pipeline includes units under construction and in final planning.)

Investment market outlook

Portfolios have been driving the resurgence in headline transaction volumes in 2024, but London single asset volumes are also on the up

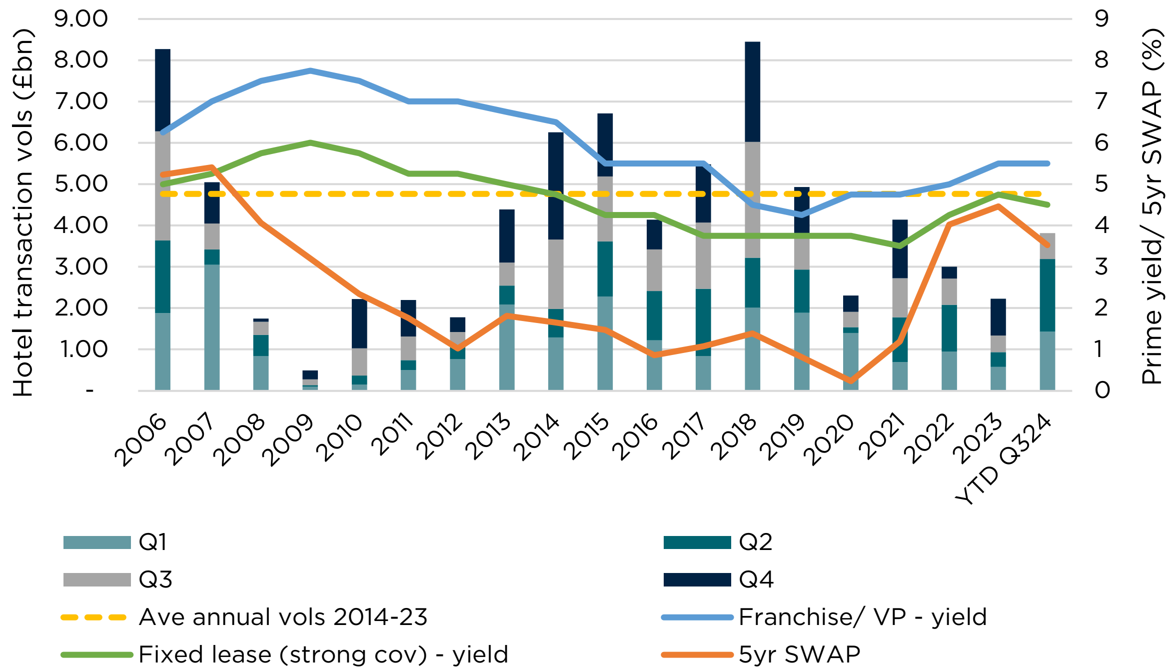
Total 2024 UK hotel volumes in the nine months to September reached an estimated £3.82bn. This is 185% above the same point in Q3 2023 and the highest level since 2019, when volumes over the same period reached £3.71bn.

Portfolio acquisitions have been the driving force, accounting for 62% of YTD volumes, ahead of the preceding three year average (38%). Notable deals include Blackstone's acquisition of the Village portfolio for a reported £850m and Starwood's estimated £800m purchase of the Edwardian portfolio.

Considering their lot sizes and the higher interest rate environment, this type of activity highlights the strength of investor confidence in the sector, supported by its strong demand fundamentals.

There has also been an acceleration in single asset acquisitions. Estimated year-to-date single asset volumes totalled £1.45bn, up 32% compared to the same period in 2023. And this has largely been driven by activity in London, which is up 91% YoY, having previously lagged behind the regional market.

Fig 8: UK hotel transaction volumes and indicative prime yields



£3.82 billion

UK Hotel year-to-date transaction volumes as of Q3 2024

The widening gap between vendor and buyer expectations in 2023, driven by strong operational performance on the vendor side and rising borrowing costs on the part of buyers, created a significant headwind for transactional activity, particularly London. The recent normalisation in top-line performance and softening debt costs have helped to close that gap. This has also brought more stock to the market, a trend we expect to continue into 2025.

However, investor caution remains despite the improving market conditions. The increased level of due diligence and asset scrutiny associated with acquisitions, particularly around cladding and M&E, means that deal timelines have extended, increasing the risk of deals being aborted. This is likely to be exacerbated over Q4 in response to growing tensions in the Middle East and uncertainty around the result of the upcoming US election, and ultimately what this could mean for the global economy.

It is this caution, prevalent across the wider real estate market, that has mitigated yield compression despite improving investor appetite and activity.

Prime franchise/VP yields as of Q3 2024 stand at 5.50%, in line with where they were at the start of the year. Whereas a lack of product and strong institutional appetite saw prime yields for core assets on fixed leases come in by 25bps in April, holding at this level since.

We believe that we are at a turning point.

The widening yield gap to debt costs alongside the materialisation of a soft landing for the global economy, points to more widespread yield compression as we move into 2025, suggesting the window of opportunity for opportunistic investors may be starting to narrow. And, judging by previous cycles, the speed at which this compression may finally materialise could be faster than expected.

Navigating the debt market

"During the course of this year, we have seen exceptionally strong liquidity in the debt market. Whilst there are isolated cases of lenders having restricted capital, in general lending appetite has increased.

Having been focussed on existing positions in 2023, Bank lenders have come back in force, joining the large number of non-bank lenders that have been enjoying enhanced returns in the elevated interest rate environment.

That being said, this wall of liquidity has been met with disappointing deal volumes, leading to intense competition for any viable investment and development deals that have come to market.

Borrowers are increasingly seeking tailored solutions to refinance additional debt obtained during the Covid period.

These solutions include refinancing of expensive mezzanine debt, ground rent transactions to release capital and general refinancing opportunities as ADRs, occupancy and interest rate dynamics improve.

The Savills Debt Advisory team remain very active and are working with a wide range of clients to review their business plans and help them proactively refinance."

Adi Gokal

Director
Savills Capital Advisors - Debt Advisory

Outlook

Top-line performance growth to continue and accelerate in some parts of the market

Normalisation in performance growth will continue into 2025. However, the challenges facing budget hotels in 2024 are expected to dissipate, meaning a return to growth and more stabilised performance in that segment.

Improving macro-economic backdrop to further strengthen demand

Expectations of a soft landing for the global economy, coupled with slowing inflation and positive real wage growth, will further support consumer and corporate confidence recovery, which will feed positively into hotel demand.

Window of opportunity for opportunistic investors to narrow as investor confidence and activity accelerates in 2025

The underlying financial and economic fundamentals have finally turned the corner but wider investor caution has meant limited yield compression. This provides an opportunity for value add/opportunistic investors that are confident in the underlying fundamentals. This window will continue to narrow as we move into 2025, with growing confidence driving an acceleration in investment activity.

Asset rather than market approach to become more entrenched

There may be segments and geographies of choice but it will increasingly be the specifics of the asset that determine performance - is it the right offer, in the right location, with the right operator?

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Savills Hotels

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