

UK Hotel Investment

Q4 2013



SUMMARY

- The regional hotel market has turned a corner with its sixth month of consecutive profit growth.
- London operational performance is suffering an Olympic hangover but occupancy continues to improve.
- Annual RevPAR and GOPPAR growth is expected to return to the London market later this year.
- The time that transactions take is reducing due to more realistic market pricing.
- Total hotel sales for the first nine months of 2013 total £2.4bn, almost 2.5 times that seen the previous year.
- Year end volumes are expected to hit £3bn. Transactions for 2014 are expected to reach £2.5bn.

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 “A growing consensus on pricing saw more sales complete this year - expectations are that year end volumes will hit £3bn, their highest level since 2007.”
 Robert Seabrook, Savills Hotels

➔ Profit growth returns to the regions

■ The regional hotel market has turned a corner with its sixth month of consecutive profit growth.

■ According to HotStats, August reported an 11.1% growth in GOPPAR (gross operating profit per available room) year-on-year. Year to date this represents a 4.8% uplift driven by continued improvements in occupancy and rates combined with consistent cost control.

■ This is a marked improvement on performance seen over the last five to six years. Despite marginal improvements in rates and occupancy, GOPPAR saw repeated declines as costs continued to increase, with a 2.7% fall reported in 2012.

■ Manchester and Birmingham, which benefited from last year's Olympics as satellite cities for the Games, continued to report improvements in GOPPAR in 2013 with growth of 19% and 9.7% respectively year-on-year in August.

■ London, in contrast, did not avoid the post Olympic hangover. The strong performance in London hotels in the lead up to, and during, the Olympics last year meant that despite improvements in occupancy, rates, and in turn RevPAR (revenue per available room) and GOPPAR, were down year-on-year on both a monthly and year-to-date basis.

■ However, when compared to 2011, a 'normal' year, performance across all measures was up with GOPPAR reporting a 49.0% increase on August 2011.

■ As we move forward, and the post Olympic impact diminishes, we expect to see rate, RevPAR and GOPPAR growth return.

London occupancy holding despite supply increase

■ Despite supply increases in London in the lead up to the Olympics, occupancy has continued to improve.

■ This resilience in occupancy is partly down to the nature of new stock that was delivered. Using AMPM data we have examined the segment, branding and location of new hotels opened in London last year.

■ Of the 7,800 new beds added to existing stock, over half (54%) was in the budget segment. Furthermore, a third were in outer London boroughs, areas where existing supply was limited.

■ The geographical and segment concentration of this new supply suggests that West End four and five-star hotel performance should remain relatively robust. However, concerns remain surrounding the budget sector and how it has fared in the face of such rapid expansion, particularly in those more peripheral locations.

Growth in overseas visitors continue

■ Following the surprise fall in overseas visitors during the Olympics, numbers have since recovered with the first half of 2013 reporting a 3.7% growth on the same period last year.

■ Notably it has been the growing number of tourists from outside North America and Europe that has underpinned this.

■ European visitors continue to dominate. However, it has been the growth in visitors from China and Central & South America that have seen the greatest expansion with average growth per annum of 23.7% and 20.2%, respectively, over the last three years.

■ Visitors from these and other emerging economies will see further increases, but it is Chinese tourism to the UK that has the greatest potential for expansion.

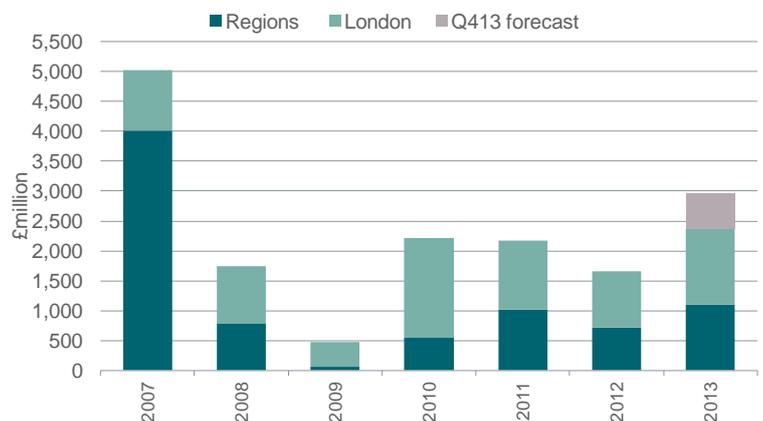
■ France receives over one million Chinese visitors each year, the UK, only 200,000. The cost and difficulty of securing a UK visitor visa is cited as a primary reason for this disparity. However, George Osborne's recent announcement to simplify the visa application process, which could mean that those booking with selected travel agents to come to the EU would not need to submit a separate UK visa, could mean numbers will increase. Albeit it may be some time until we see similar volumes as France.

GRAPH 1 **GOPPAR performance (year-on-year change in rolling 12-month)**



Graph source: Hotstats limited

GRAPH 2 **Hotel transaction volumes (deals £5m+)**



Graph source: Savills; Property Data

TABLE 1
Key transactions: months on market (MoM)

2012 sales	Months on market	2013 sales	Months on market
Crowne Plaza London Shoreditch	10	Novotel Cardiff Centre	2
Von Essen hotels	10+	One Harrington Gardens	3
Crowne Plaza Cambridge	12	ibis York Centre	4
Hyatt Regency Birmingham	14	InterContinental London Park Lane	5
The Cavendish	24	Radisson Blu Hotel Leeds	6

Table source: Savills

Snowballing sales?

■ Hotel sales in the UK accelerated in the first quarter of this year, largely due to three large portfolio deals. Sales volumes reached a staggering £1.9 billion during those three months - exceeding the annual total of the previous year.

■ Since then, the perception has been that investor confidence and a growing consensus on pricing expectations between buyers and sellers has created a 'snowball' effect, with more and more sales being completed. However, sales during Q2 and Q3 were roughly half that of the six month period of 2012.

■ As a result of the strong start to the year, total sales have reached £2.4 billion for the nine months to September 2013, almost 2.5 times the tally of the corresponding year. The vast majority of sales are bank-led or involve hotels in administration.

■ Looking at the £1.5 billion of hotels currently on the market, we expect sales to reach close to £3 billion by year end - the highest level of liquidity since 2007.

Months on market finally reducing

■ Although the number of transactions is not necessarily increasing as the year progresses, more realistic market pricing is increasing the speed of these transactions. Despite the fact that it is now the norm for many stakeholders such as senior lenders, mezzanine lenders, equity holders, operators

and administrators to be involved in the sales process, momentum and competitive tension can still be achieved if the hotel is well priced at the outset. The trend towards an efficient sales process is demonstrated in table 1 above.

Active investors

■ We have seen an increasing number of US investors creating and enlarging their UK operating platforms through the acquisition of portfolios. For instance;

- Following on from its acquisition of the management platform of Sanguine Hospitality, Interstate Hotels & Resorts acquired Chardon Management Ltd;
- Goldman Sachs and TPG bought Kew Green Hotels;
- Starwood Capital bought the Principal Hayley portfolio;
- KSL bought the Hotel du Vin and Malmaison portfolio; and
- Mount Kelleet has re-capitalised Jursy Inns.

■ There are more US players seeking exposure to the sector.

■ There is an insatiable appetite from international players keen to enter the London hotel market but they are frustrated by a lack of product.

■ Specialist hotel investors such as Patron, Westmont and Algonquin are active in the regions, buying at a significant discount to replacement cost and using their asset management and operating expertise to turnaround assets.

New concepts, new locations

The rise of the 'pod'

■ The increase in hotel supply witnessed in London last year, although dominated by established players, saw the arrival of new brands and concepts such as 'pod' hotels.

■ Dutch hotel brand CitizenM opened on London's South Bank in 2012 offering 150 sq ft boutique pod rooms and by all reports have been trading very well. Their selling point - affordable 'high design' luxury.

■ While rooms are small they are attractively designed with laptops, free WiFi and flatscreen TV's. The hotels 'lounging' areas and bar is also seen as a key attraction counteracting the smaller bedrooms. Other 'pod' brands that have emerged include Yotel and ZHotels, with Whitbread announcing the launch of their Premier Inn 'hub' brand in July, with the first site set to open in London's West End in 2014.

■ Land costs, particularly in London, have meant that developers have looked to intensify sites making rooms smaller. Technology and innovation in terms of construction and in-room facilities such as flat screen TV's, attractive lighting and clever storage has also helped new brands offer small rooms that are still attractive.

■ This form of site intensification also offers potential value attractions. Hotel valuation comprises a number of methods but is typically pinned against profitability per room. Therefore, if room count can be increased by providing smaller rooms without significantly impacting on average daily rates, there can - in the right circumstances - be a positive impact on value.

■ We are not about to see a shrinking in room size across all hotel brands. The emergence of the 'pod' hotel is a reflection of brand diversity and increased guest choice rather than being a trend for the entire market.

■ City centre and emerging locations can support this concept where visitors do not want to spend much time in their rooms. The South Bank and Shoreditch being prime examples, the latter to be CitizenM's second London site. They are also aimed at a particular type of guest - young urbanites on short city breaks.

■ Brands that offer smaller rooms will have to provide excellent facilities and something extra in order to be able to maintain rates. Pod hotels will suit some but we equally expect demand for hotels offering larger rooms to continue.

→ ■ UK pension funds are competing fiercely over index-linked hotel leases, particularly when the minimum lease length is 20 years and over. They are increasingly looking at the underlying trading fundamentals of the hotel, including rent affordability and alternative tenants rather than simply relying on the covenant.

■ Residential developers are snapping up freehold townhouse hotels and short-let accommodation for potential future conversion opportunities.

Serviced Apartments

■ Serviced apartments are finally evolving as a recognised sector in the UK as private equity funds enter the market through the creation of their own brands and operating platforms.

■ Year to date transaction volumes total £123.5m and are expected to hit £200m by the year end. Revenue per

available apartment (RevPAA) grew 12.7% in London in Q2 exceeding the 5.4% growth in RevPAR reported for hotels (rolling 12-month basis).

Outlook for 2014

■ Looking to 2014 we expect sales volumes to be boosted by more bank-led portfolios, however, without the flurry we saw in Q1 this year. As a result we expect it to be more in line with the long term average of £2.5bn. ■

OUTLOOK

Year end transaction volumes to reach £3bn, the highest level since 2007.

■ Year-on-year RevPAR and GOPPAR growth will return to the London market towards the end of this year as the Olympic effect diminishes.

■ Tourism from emerging economies to the UK will continue to expand but it is Chinese visitor numbers that have the greatest potential for expansion.

■ We expect sales to reach £3bn by year end. This will be the highest level of liquidity since 2007.

■ In 2014, we expect sales volumes to be boosted by more bank led portfolios but to be in line with the long term average of £2.5bn.

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