Scotland

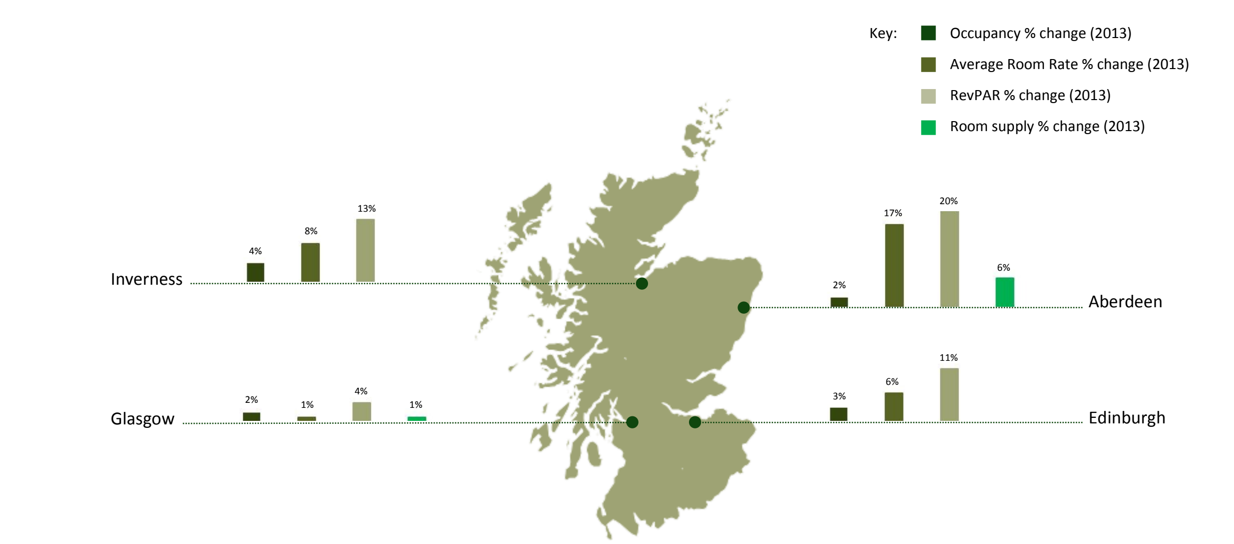
Hotel Market Review 2014

AM:PM hotels
Hotel data and intelligence

Key highlights

Podium performance from Scottish Hotels in 2013

Hotels throughout Scotland produced solid and improved results in 2013, with KPI trends comparing favourably against other UK regions. The four largest hotel markets - Edinburgh, Glasgow, Aberdeen and Inverness - were at the heart of this performance as they benefit from a more balanced mix of corporate and leisure demand. Smaller and rural markets with a heavier reliance on more seasonal leisure demand also showed positive signs of recovery in line with generally improving economic conditions.



Source: AM:PM, HotStats

Buoyant 2013 trading in key cities

Based on HotStats UK Chain Hotels data for 2013, the four largest hotel markets in Scotland produced very strong results last year. Double-digit RevPAR growth ranging between 11%-20% was evident in three cities.

Aberdeen led the field with 20% RevPAR growth. In part, this was boosted by the biennial Offshore Europe conference, but this essentially cemented an already strong year driven by high corporate demand.

Edinburgh and Inverness absorbed high levels of new supply in 2012 and were also impacted by softer tourist numbers who took a UK sabbatical during the London Games. Both markets rebounded strongly in 2013.

In comparison with its Scottish counterparts, Glasgow had a relatively muted year and 'only' recorded 4% RevPAR growth. However, this was a decent result in a UK context and belies the fact that Glasgow is a consistently solid market. It regularly hosts major international conventions, many of which are confirmed for several years providing security of demand.

2014 shaping up to be another strong year

Last year's strong momentum provided the ideal platform for what is widely expected to be a memorable year for Scotland and its hotel sector in the Year of Homecoming 2014.

Hotels are expected to receive a boost from a coordinated program and number of major international events, including:

- In June, commemorations are planned to mark the 700th anniversary of the historic Battle of Bannockburn
- In July, Glasgow is host city for the 20th Commonwealth Games with events being held throughout the city.
- In September, Gleneagles in Perthshire will host one of golf's largest tournaments, the three-day Ryder Cup
- In November, the MTV Europe Awards will be held at the new SSE Hydro Arena in Glasgow

The Scottish Independence Referendum will also be held in September. Regardless of the outcome, considerable attention and hotel demand from international media seem likely.

Market structure

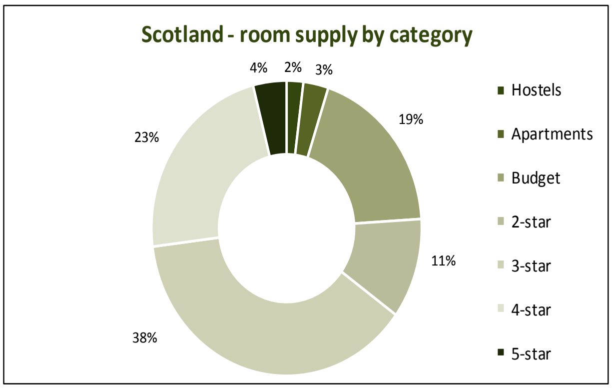
National statistics conceal city versus rural split

The hotel sector in Scotland consists of 1,870 hotels with 64,600 bedrooms, an average property size of 35 rooms.

Scotland represents 8% of the UK total population, however its share of hotel bedrooms equates to 11% of the UK total. There are 82 permanent residents in Scotland for every hotel bedroom compared with the UK equivalent of 108 residents.

There are seven hotel markets with over 1,000 rooms (Edinburgh, Glasgow, Aberdeen, Inverness, Dundee, Paisley and Fort William). These account for around 25% of hotels and 48% of total room supply.

Rural hotel markets account for 62% of hotels but only 38% of rooms because rural located hotels are typically smaller than their urban counterparts. This reflects several factors including an older average age of property than in urban markets (where new hotels are usually larger than the current national average and more efficient to operate) and more seasonal demand.



Source: AM:PM

Room distribution by hotel grade is fairly well spread but conceals a significant contrast between rural hotels (mainly in the 2-star or 3-star categories) and the larger urban markets (more typically polarised between budget and 4-star hotels).

There are just under 100 separate hotel brands in Scotland. Approximately 46% of total rooms are operated under global, international or national UK brands, however there is a considerable geographical spread of brand density and penetration.

In the larger cities of Edinburgh, Glasgow and Aberdeen, these brands account for 60-70% of room supply but in rural counties such as Eilean Siar, Orkney Islands and Shetland Islands, virtually every hotel is operated without any brand.

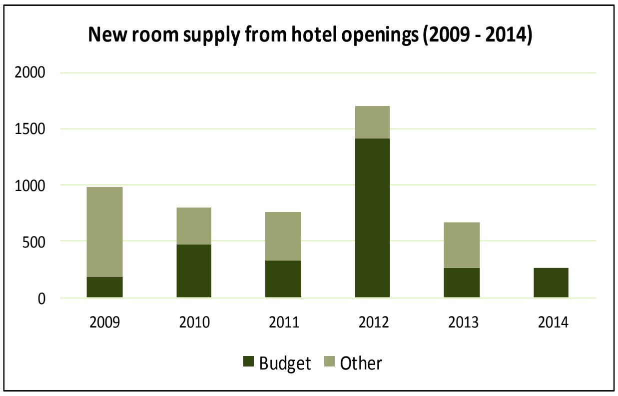
Hotels in rural locations are mostly independently owned and operated. In the larger markets, hotel are commonly subject to lease, management and franchise agreements, which leads to a greater percentage of properties owned by hotel investors.

New supply

Brands gaining market share, with key city focus

There is strong appetite from developers and investors to open new hotels in Scotland. A very high proportion of this continues to be focused in Aberdeen, Edinburgh and Glasgow.

Almost 8,500 new hotel rooms have opened in Scotland over the last decade (at an average property size of 67 bedrooms) and 67% of this total has been located in these three cities.



Source: AM:PM

Several key reasons for this are underpinned by perceived lower risks and higher return on capital of opening a new hotel in the larger Scottish cities compared with other locations.

The hotel markets are larger and well established, demand KPIs are stronger and the prospects of securing debt funding to build a new hotel are much higher. In Glasgow, the additional availability of BPRA tax relief has been attractive to investors.

A primary factor however has undoubtedly been that in line with the wider UK trend, the leading hotel brands (Premier Inn, Travelodge, IHG, Hilton, Accor and Marriott) increasingly account for a large proportion of new hotels - 73% of all new rooms opened in Scotland since 2004 have been under global, international or national UK brands.

In general, many of these brands are best suited to larger cities where there is good all-year demand from a mix of segments including key corporate and leisure markets.

Budget brands have expanded significantly, accounting for over half of all new rooms built in the last decade. Premier Inn and Travelodge have been especially active, adding around 1,200 rooms each followed by Ibis and Holiday Inn Express with around 500 rooms each.

Several new brands have entered the Scottish hotel market over the last few years including Waldorf Astoria, Residence Inn by Marriott and Courtyard by Marriott. New international budget brands have included citizenM (Netherlands), Motel One (Germany) and Tune Hotels (Malaysia).

New hotel pipeline

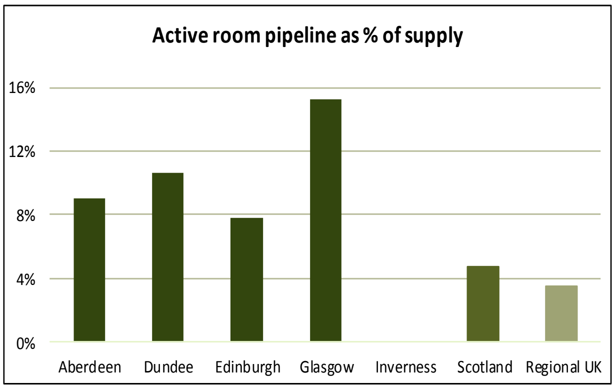
Room supply to rise by 5% in the next three years

There are 3,088 bedrooms in active pipeline, which is defined as development projects with an expected opening date in the next three years, i.e. by the end of 2016.

Almost 70% of active pipeline rooms relate to new build hotels, 25% relate to the change of use of property from a different planning class (mainly office conversions) with the remainder extensions to trading hotels.

Branded hotels account for over 95% of active pipeline rooms. In turn, this is underpinned by the budget segment, which accounts for over 60% of the total. The average active pipeline project size is 97 bedrooms.

A significantly higher number of potential bedrooms exist in pipeline projects that are on hold or regarded as speculative. Based on historical trends, a proportion of the latter is likely to become active and open by 2016, primarily for those hotel projects with a shorter design, planning and build period.



Source: AM:PM

Room supply is set to increase by 5% in Scotland over the next three years, a little above the Regional UK figure. The majority of this growth will however be in the four largest cities where room supply is expected to rise between 8% and 15%.

New brand entrants to Scotland

2014	2015	2016	Unconfirmed
De Vere Village	Hub by Premier Inn	Sleeperz	MGallery
Hampton by Hilton	Hyatt Place		Moxy
Ibis Styles			Urban Villa
Z Hotels			Wyndham Grand

Premier Inn and Travelodge account for 21% of forecast new rooms and will continue to gain market share. One-third of active pipeline is from new brand entrants to Scotland, some of which are part of brand stables with an existing presence.

Long-term supply trends

Hotel closures and continued structural change

Hotel supply exists to satisfy hotel demand, either current or expected. This demand is generated because people need or want to travel for a variety of business or personal reasons and require accommodation or other hotel services as a result.

Many factors influence hotel demand. It is largely discretionary and therefore affected by economic cycles. People, money, time and transport are key drivers - these vary by location and over time as societal trends continually evolve.

As with most areas of the UK, new hotel supply in Scotland has added around 1-2% p.a to room supply but this has been offset by a steady trend of hotel closures of around 0.5-1.0% p.a.

However, these figures are at a national level. Significant regional variations exist and several key trends are evident in long-term changes in supply:

- Cities and other larger urban markets have experienced the greatest growth from new supply and are likely to do so
- Rural markets have suffered most from hotel closures and are likely to do so
- Independently owned and operated hotels have closed at the highest rate, with branded closures relatively rare, resulting in a net rise in brand penetration
- The highest closure rates have been for hotels rated 2-star or 3-star at the time of closure
- The average size of hotel to close in recent years has been 21 bedrooms, lower than the 35-bed average for supply and significantly lower than new supply and active pipeline

Besides general economic reasons and subject to funding structure, hotels typically close due to at least one and often a combination of the following factors:

- Demand has substantially or permanently declined
- The hotel size is no longer operationally efficient to run and cannot be readily or reasonably extended
- The property is no longer fit for purpose and would cost too much to renovate to at least meet latest requirements
- New brands or hotels have entered the market
- Conversion of the hotel or demolition for alternative use is expected to generate a better return on capital

The Scottish hotel market is well established but is not mature. With new supply regularly introduced and redundant supply exiting, significant structural change is likely to continue.

Scotland 2014

Current industry issues

At a macro level, current industry issues facing the Scottish and UK hotel sector commonly include:

Distribution and consistency of national hotel supply
Hotel supply across different product, price and service points can vary significantly. Consumers do not have the same availability of choice with variations between urban and rural areas.

Meeting the expectations of today's globally aware consumer
Most hotels used to offer consumers a 'wow factor' over their home living standards but this is increasingly rare. Consumers are more discerning, demanding, globally aware and vocal.

Revenue management
'You can't sell last night's empty room today'! Hoteliers are increasingly practising the art of optimising revenue to reflect different levels of demand during the year but the resources required to do this effectively favour larger hotels and groups.

Inventory management
The internet offers the potential to level the playing field for independents to compete against larger players. Many have though ended up becoming reliant on OTAs and TPIs for online bookings and have lost control of selling their own rooms.

Ability to attract and retain staff
Average remuneration in the hotel industry is much lower than many others so this is a perennial issue that leads to high staff turnover. This can be most acute in rural areas where providing staff accommodation may also be necessary and costly.

Availability of finance
Access to funding has generally improved but banks and other investors continue to have selective underwriting policies.

Maintenance capital expenditure
The hotel sector is all about people but hotels are buildings and need regular maintenance. Many hotels fail to make the necessary investment until it is too late and trading suffers.

Keeping up with technology
Technology in used increasingly in all areas of hotels, both staff and consumer facing. 'Future-proofing' is a real issue. In rural areas, availability of good broadband is not always widespread.

Scotland 2020

Assessing future prospects

City and urban markets are likely, subject to fluctuation through economic cycles, to continue growing in terms of hotel supply and demand for room nights. Market forces and greater options for an alternative property use tend to determine which hotels thrive, survive or enter demise.

Brand penetration is likely to continue rising and a 'Yes' vote in this year's Independence Referendum is unlikely to impact this. Most brands operate in many countries so an independent Scotland would be just one more operational jurisdiction.

Despite brand ascendency, there will always be a place for good independent operators because not all consumers want what brands offer. Also, outside urban centres, brand appetite for expansion will most likely remain very limited.

The outlook for rural markets is less positive than for cities and in some cases concerning. Large parts of Scotland are almost virtually reliant on leisure tourism and served by relatively few hotels that are finding it increasingly hard to survive. They are closing with greater frequency for the reasons identified earlier and where they do close, the loss of supply is often permanent.

This supply loss contrasts with tourism trends and expectations of continued growth in overseas visitors that would ordinarily suggest rising demand in many of these locations.

One conclusion to be drawn from this apparent disconnect is that loss of supply is not necessarily a direct result of a lack of demand, but possibly that the demand is for accommodation (hotels or otherwise) that is not being provided.

The dilemma for the industry is how to stimulate or encourage greater investment in these areas to ensure that hotel supply evolves to meet consumer requirements and expectations. There are successful examples of this but more are needed.

A final thought and slight tangent. In Scotland, many bemoan the weather and amount of rainfall. However, mother nature's capital expenditure sculpts the country's terrain, trees, hills, lochs and rivers. These in turn directly attract tourists and support a range of outdoor pursuits that create hotel demand. Let's start being more thankful for Scotland's rain!

AM:PM are a leading source of market intelligence for the UK & Ireland hotel industry. The company maintains extensive data and an online hotel database of hotel supply, future new hotel development and hotel construction pipeline.

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