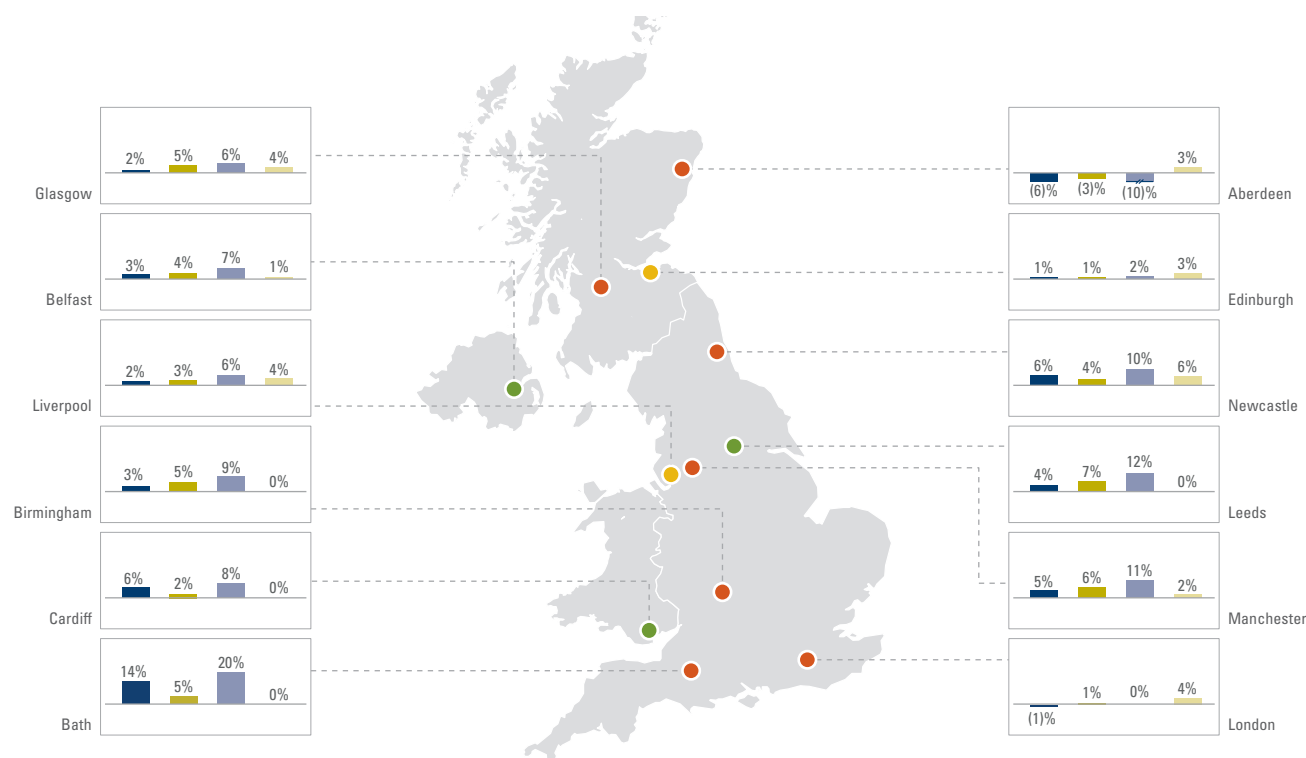


Hotel Bulletin: Q1 2015

The majority of the 12 cities reviewed in the Hotel Bulletin recorded RevPAR growth in Q1 2015. Strong, widespread growth has been delivered for the last eight quarters; we have questioned how long this can continue. The start of 2015 has been very active for transactions and assets coming onto the market. As valuations continue to increase, investors priced out of London and prime regional cities have begun to shift their focus to secondary UK locations and Europe. This edition's city focus is on Aberdeen. We have examined market trends to determine whether the recent trading decline is temporary or part of a longer term trend.

FIGURE 1: Selected UK hotel markets – demand and supply



■ Occupancy percentage change⁽¹⁾ (Q1 Y-o-Y) ■ Average room rate percentage change (Q1 Y-o-Y) ● ● Active pipeline >10%, 5 to 10%, <5%
 ■ RevPAR percentage change (Q1 Y-o-Y) ■ Supply percentage change since 31 March 2014

Notes: Q1 covers the three months to the end of March | Q1 Y-o-Y compares the average of Q1 2015 to the average of Q1 2014 | Supply and pipeline analysis relate to numbers of hotel bedrooms |
 (1) Occupancy percentage change represents actual rather than absolute percentage change | Active pipeline refers to hotel bedrooms with an opening date in the next three year

Demand

Tourism advances enable Bath to lead the way

Q1 2015 has been another robust quarter, with RevPAR in the 12 cities reviewed growing by 7% on average. This is lower than the 19% average RevPAR growth seen in the last two quarters but is still well in excess of GDP growth.

In London RevPAR declined by less than 1%. Since Q1 2011 the number of hotel bedrooms has increased by 19%. The average RevPAR increase of 14% in the same period confirms the resilience of the London market.

Outside of London, the 11 cities reviewed recorded average RevPAR growth of 7%. Unlike in previous quarters, several cities, including Bath, Cardiff and Newcastle, saw increases in occupancy levels rather than rates driving RevPAR. Historically, rates tend to follow occupancy growth so further rate driven RevPAR growth may follow in these locations.

Bath recorded the highest RevPAR increase (20%) of the 12 cities reviewed. This key city on the tourist trail welcomes in the region of 30 million overseas visitors per year. Bath looks to have benefited substantially from loosening Visa requirements for Chinese tour operators in June 2014 and relaxation of business Visa requirements in October 2014. The city expects a 40% increase in the number of Chinese tourists in 2015.¹

Aberdeen was the only other city reviewed to record a decline in RevPAR in Q1 2015 (10%) against Q1 2014. Since Q2 2013, the number of bedrooms has increased by 14% in response to unrivalled demand growth. This quarter's decline suggests that there may be an imbalance between demand and supply in Aberdeen. Later in this bulletin we discuss whether this trend is a temporary blip or a sign of a longer term trend.

Is recent growth sustainable?

The majority of cities reviewed have now surpassed pre-downturn RevPAR levels in absolute terms. In real terms, however, only five of the 12 cities reviewed, including Bath and Edinburgh, have surpassed previous benchmarks. As the economy continues to grow, there is likely to be scope for further growth.

Source: 1 Visit Britain

Performance in the UK market is polarised. The major cities have enjoyed a significantly greater resurgence since the downturn than other secondary locations. Recovery in other locations is likely to bolster average regional RevPAR growth.

There are, however, signs of maturity in the market. Occupancy growth is beginning to plateau in many cities and supply has increased by an average of 8% in the 12 cities reviewed in the last two years. Active pipeline of 11% of current supply will put additional pressure on future performance.

A number of macro factors may impede continued growth. An eventual increase in interest rate is likely to limit disposable income which may temper hotel demand. US market activity should be monitored closely as changes across the Atlantic have historically preceded trends in the UK.

We can never fully determine what the next major factor to impact UK hotel market performance will be. Given the real gap to pre-downturn levels, however, demand appears to have room to grow over the coming years.

Investment indicators

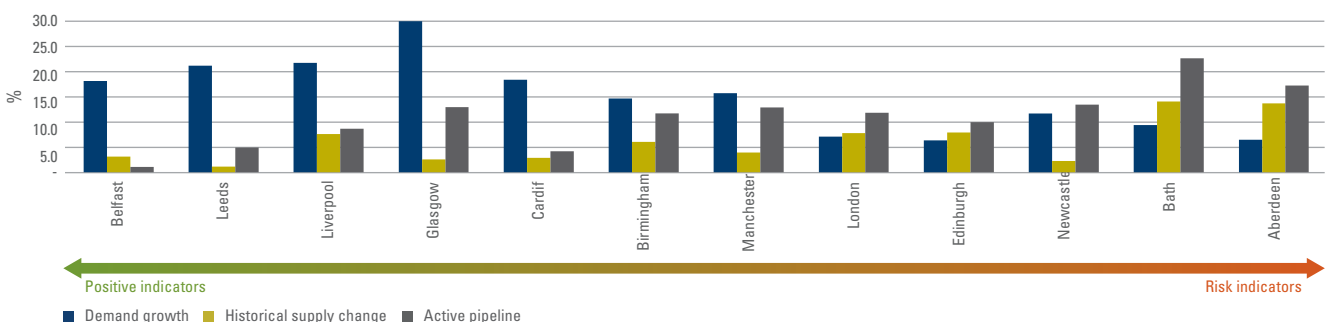
Although high-level demand and supply metrics alone will never fully inform an investment decision, the graph below highlights data for cities that may attract, or concern, investors.

The interaction of demand growth, historical supply and active pipeline are considered. Demand growth has been calculated as the average RevPAR growth for the last four quarters to provide an indication of recent demand trends. Historical supply has been calculated as the increase in rooms in the last two years in order to contextualise recent trading performance. Active pipeline has been included in the analysis to provide an insight of each city's hotel market in forthcoming years. Only bedrooms with confirmed opening dates are included.

Liverpool's metrics show strong growth in demand despite the number of hotel bedrooms increasing by 7% in the last two years. Current pipeline may concern investors to a lesser degree in this seemingly robust market. Aberdeen's demand is suffering from supply increases and for the first time moves to the bottom of the 12 cities reviewed.

Note: Real RevPAR is calculated using CPI inflation

FIGURE 2: Investment indicators



Source: AM:PM, HotStats

Notes: Demand growth calculated as the average quarterly RevPAR change for the last four quarters | Historical supply change calculated as the change in hotel bedrooms between March 2013 and 2015 | Active pipeline calculated as the active pipeline as a percentage of current supply | The shading of the arrow reflects positive (blue) or risk (red) indicators

Supply and pipeline

In Figure 3 below, we compare the proportion of current supply (inner circle) and active pipeline (outer circle) in the UK market by sector. In a continued trend, the proportion of budget and full-service hotels increase as investors avoid developing three star hotels.

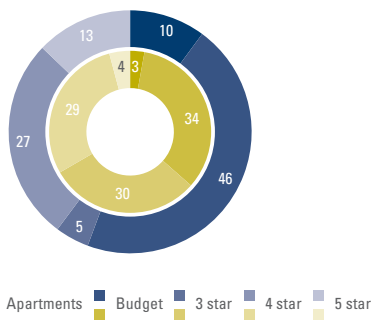
Premier Inn and Travelodge opened 882 bedrooms in Q1 2015, including hotels in Great Yarmouth, Exmouth and Southend-on-Sea. Hotels in these locations have been heavily impacted by decreasing performance which, in many cases, has resulted in under-investment. The Premier Inn and Travelodge hotels are likely to be attractive in comparison to existing supply.

15 hotels (830 bedrooms) opened in London in Q1 2015, nine of which were aparthotels accommodating an increasing demand for this type of offering. Developers are having to search further afield for affordable opportunities in London, with noteworthy openings in Brentford, Bexleyheath and Vauxhall.

Notable new openings and developments in the quarter include:

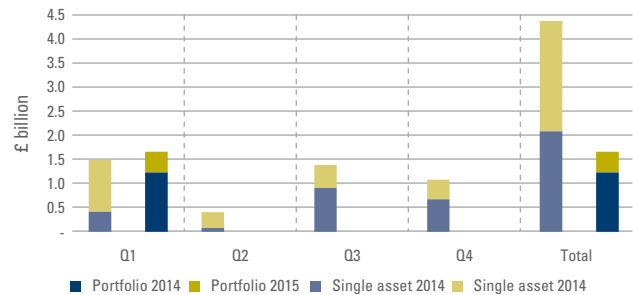
- ▶ Accor signed seven UK hotels with a total of 880 rooms in February, including rebranding four Ramada Encore hotels owned by Carillion and run by Kew Green to Ibis Styles in 2015. Two more Ibis Styles are to open in Greenwich and Heathrow in 2016.
- ▶ Ryan Giggs and Gary Neville’s £24 million 4 star Hotel Football opened opposite Old Trafford Stadium in Manchester at the end of the quarter. The hotel includes an indoor football pitch and a second ‘Café Football’ following the first one which opened in London last year.
- ▶ Two hotels opened in Brentford in the quarter, Union Hanover’s first Urban Villa extended stay offering and a 124 room Premier Inn. These hotels are likely to benefit from development in the surrounding areas due the opening of Crossrail in May 2015.
- ▶ Amazing Venues opened the private island hotel and party venue No Man’s Fort in March 2015. The 22 bedroom venue, located in the Solent, includes five function rooms and offers luxury activity packages.

FIGURE 3: UK current bedroom supply and active pipeline by grading



Source: AM:PM
 Note: Active pipeline includes developments with a confirmed opening date in the next three years
 The budget category includes hostels, budget and two star hotels

FIGURE 4: UK transaction value



Source: HVS
 Note: Only disclosed hotel transactions over £6 million included in this analysis

Transactions

Q1 2015 has been yet another bumper quarter for transactions, with £1.7 billion of acquisitions completing, primarily driven by over £1.2 billion of portfolio transactions. The total quarterly transaction value was £165 million greater than Q1 2014.

The transaction market is unlikely to slow with several large portfolios concluding and new ones coming on the market already in 2015. These include the Malmaison/Hotel du Vin portfolio and QHotels. Kew Green has appointed advisors to investigate the possibility of a sale with value estimated at over £400 million. A number of high value individual hotels have also been put up for sale this quarter, most notably Grosvenor House and Gleneagles.

There is still a density of US funds and private equity investors in the UK hotel market. In addition, there is increasing interest from Chinese investors who are attracted to higher yields in the UK. Valuations in the market have led to experienced investors shifting focus from London and prime regional cities to secondary and tertiary locations and Europe.

Competition is sufficiently high that buyers requiring up front debt financing are excluding themselves from processes. Potential purchasers put off by stiff competition may turn to opportunities in alternative real estate asset types.

Notable transactions include:

- ▶ Lone Star followed its acquisition of Moorfield’s legacy fund assets by purchasing the Jurys Inn group for a reported £680 million. The 7,300 bedroom portfolio includes 30 hotels in the UK and Ireland and one hotel in the Czech Republic.
- ▶ The eight hotel and 726 bedroom Feathers Hotel Group was acquired by Topland Group in a deal worth £65 million. Topland Group’s UK portfolio now comprises of 29 hotels (2,720 bedrooms).
- ▶ Cerberus acquired LRG Acquisition’s remaining 18 regional UK hotels from its IHG branded portfolio for a reported £225 million. This follows Kew Green’s acquisition of 21 IHG hotels from LRG in the previous year.

Focus on: Aberdeen

The market

Aberdeen’s economy flourished during the mid-20th century as a result of its proximity to the significant oil deposits in the North Sea. It is estimated that an estimated half a million jobs were created during this period. Today, Aberdeen is known as the ‘Oil Capital of Europe’, despite production decreasing past its 1999 peak. Britain’s biggest oil company, BP, now produces 160,000 barrels of oil a day in the North Sea. Aberdeen’s hotel sector has traditionally catered for the corporate market, receiving a steady stream of business from those working in the oil and gas industry.

Aberdeen has increased its conference and leisure offering in the past few years. Two hotels with conference facilities have opened in the past two years and Donald Trump opened the nearby Trump International golf course in July 2012. The city’s leisure market is sustained by the golfing industry. There are over 50 golf courses located in and around Aberdeen, making it a popular venue for golf holidays and weekend breaks.

Temporary blip or long term trend?

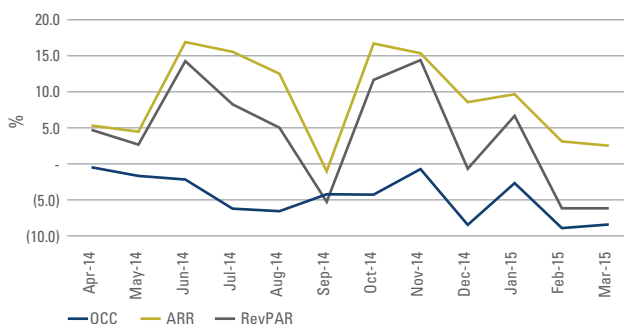
Aberdeen has consistently recorded strong performance over the past four years, peaking at 25% RevPAR growth in Q3 2013, the highest of the 12 cities reviewed in this bulletin. Supply has increased substantially in response to this demand. 194 new bedrooms came onto the market in Aberdeen in 2014, including the 148 bedroom Village Urban Resort, following 303 bedrooms the year before. In the last two years, the number of hotel bedrooms in Aberdeen has increased by 12%.

The city’s performance is now stagnating suggesting that there is an imbalance between supply and demand. Occupancy rates have fallen for the last six consecutive quarters. Until now, hoteliers have managed to increase rates to compensate for this fall but in Q1 2015, for the first quarter in four years, quarterly RevPAR decreased in comparison to the previous year.

In the past 12 months, the price of oil has decreased from highs of \$110 per barrel in April 2014 to \$45 per barrel in January 2015 at its lowest.

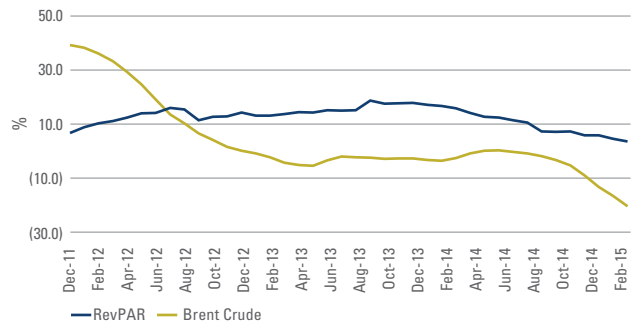
Source: The Economist, Oil & Gas UK, Telegraph, Brent Crude Oil Index

FIGURE 5: Aberdeen’s year-on-year change in demand by month



Source: AM:PM, HotStats

FIGURE 6: Year-on-year monthly rolling growth of Aberdeen’s RevPAR v Brent crude oil monthly average spot prices



Source: AM:PM, HotStats, Brent Crude spot prices

At the end of March 2015, the price was at \$54 per barrel. Traditionally, Aberdeen’s RevPAR has been closely linked with the price of crude oil as hotel demand has been supported by business travellers working in the industry.

The UK North Sea oil and gas industry made a loss of £5.3 billion in 2014, the worst outcome since the 1970s. Fears that oil prices will not return in the short to medium term have prompted oil companies to reduce their investment. Globally, major oil companies are cutting back on exploration and capex projects, including in Aberdeen. BP cut 10% of its workforce in January 2015 and annual investment in oil projects is expected to fall from £14.8 billion in 2014 to £2.8 billion in 2018.

Staff and investment cuts are likely to reduce the number of people travelling to the city and, as such, impede hotel demand. In an effort to restore profitability, oil companies are expected to implement cost saving measures, including scaling down work forces and delaying investment decisions, which are likely to further impact demand of bedrooms and ancillary revenue streams.

Given Aberdeen’s hotel market’s reliance on the oil and gas, the changes outlined above are expected to have a material impact on performance. In addition, with 997 bedrooms in the active pipeline, the current imbalance between supply and demand in Aberdeen may become accentuated.

Aberdeen’s hotel market is less exposed to oil and gas industry than it was a decade ago. Aberdeen hosted several high profile conferences in the past year including the SNP Spring Conference in April 2014. The 2014 Scottish Open held at Royal Aberdeen attracted over 65,000 spectators and was watched by a worldwide audience of approximately 120 million golf fans. There are also plans to further develop Aberdeen’s conference offering with the £333 million New Aberdeen Exhibition and Conference Centre approved in March 2015.

Despite efforts to broaden its offering, Aberdeen’s performance is still heavily reliant on trends in the global oil market. The substantial issues highlighted above are not likely to be resolved in the medium term and, as such, we expect hotel performance trends to decline further before recovering.

Year-on-year monthly rolling growth

FIGURE 7: Glasgow

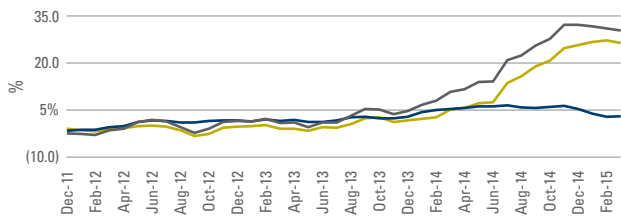


FIGURE 13: Aberdeen

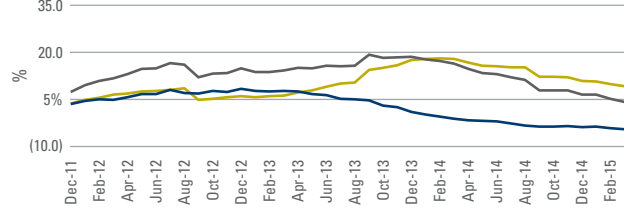


FIGURE 8: Belfast

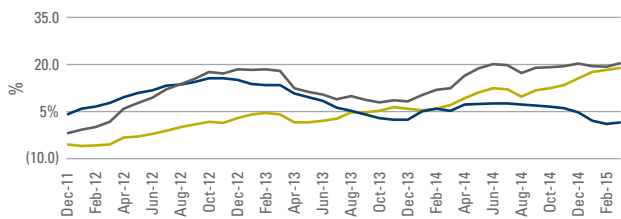


FIGURE 14: Edinburgh

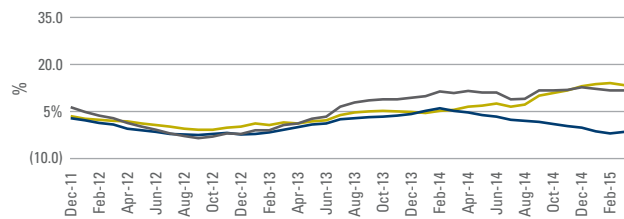


FIGURE 9: Liverpool

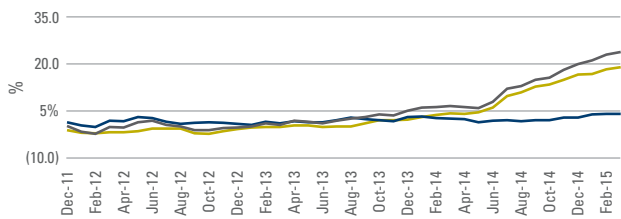


FIGURE 15: Newcastle

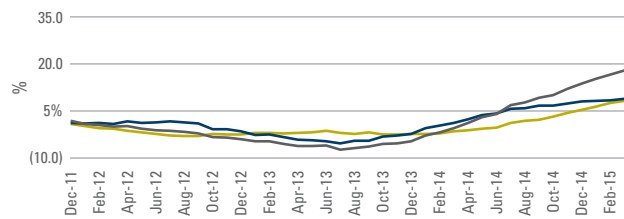


FIGURE 10: Birmingham

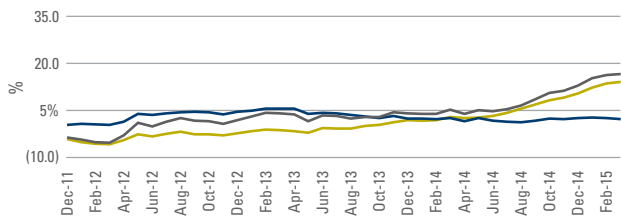


FIGURE 16: Leeds

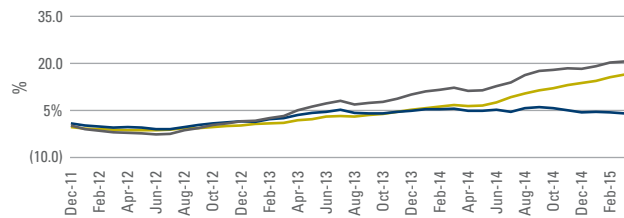


FIGURE 11: Cardiff

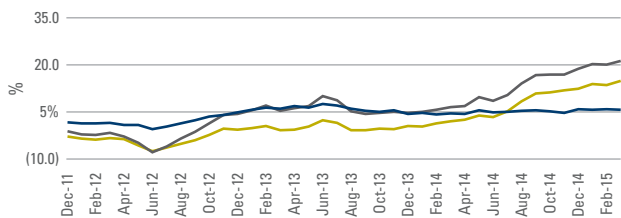


FIGURE 17: Manchester

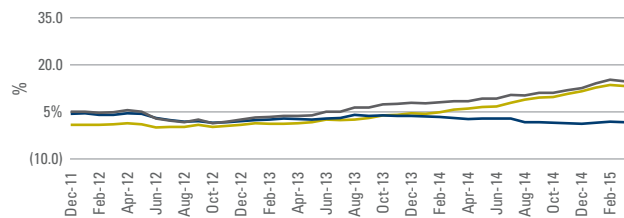


FIGURE 12: Bath

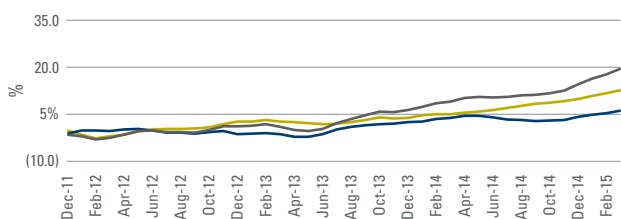
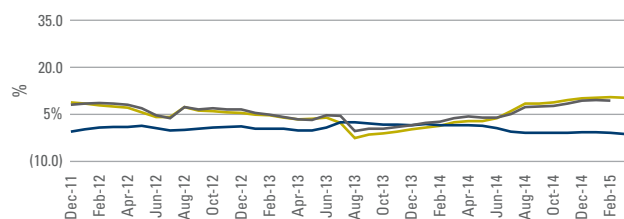


FIGURE 18: London



Key for all: — Occupancy — Rates — RevPAR
 Source for all: AM:PM, HotStats

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AM:PM are a leading source of market intelligence on the UK & Ireland hotel industry. We maintain extensive data relating to hotel supply to help clients gain a comprehensive and unrivalled understanding of the size and structure of the hotel industry.

We offer a suite of subscription-based online products that allow clients to search, analyse and benchmark the hotel sector. This includes access to a unique hotel database with details of over one million hotel rooms covering the past, present and future hotel supply throughout the UK & Ireland.

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