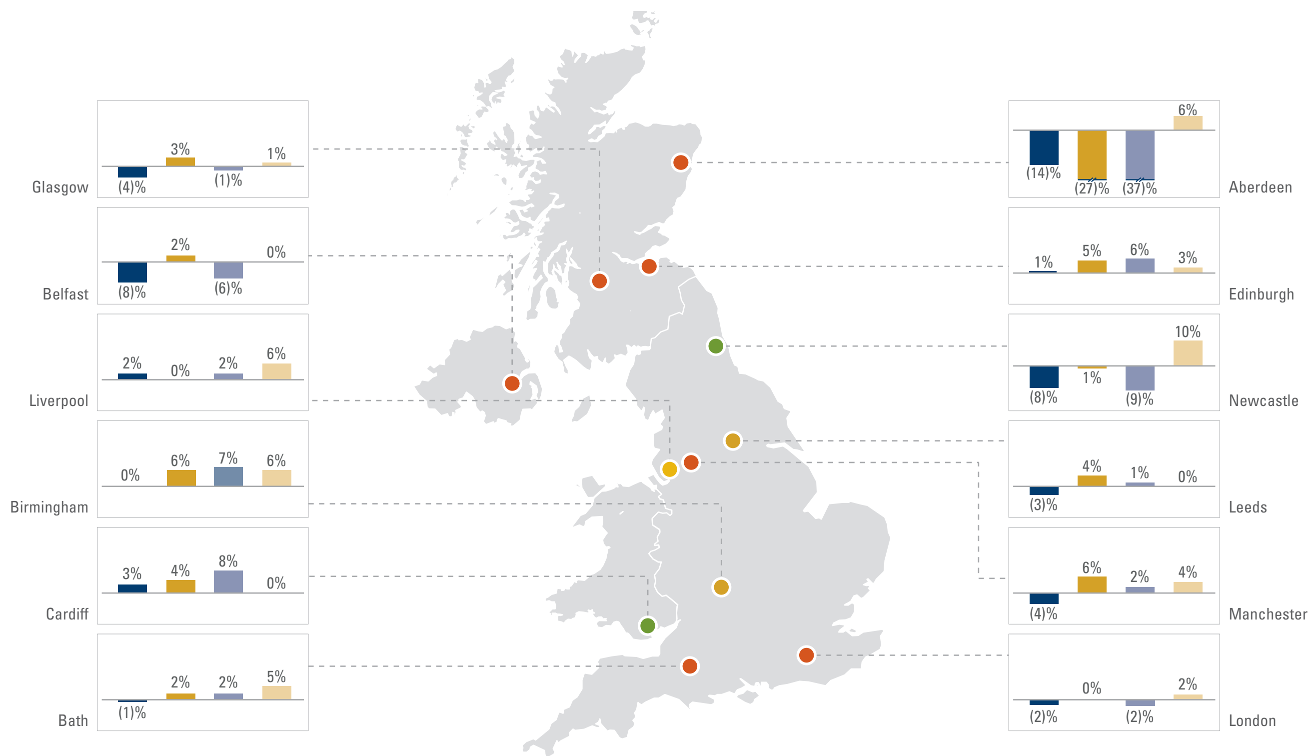
INSIGHT
UK Leisure

Hotel Bulletin: Q1 2016

In this edition of the Hotel Bulletin, average RevPAR over the 12 cities reviewed declined for the first time since 2012. Occupancy has decreased for the last four quarters and rate growth is beginning to plateau. This provides more evidence that we are approaching, or have reached, the top of the market. In this quarter's Focus, we have analysed this in greater detail to determine if, and where, there appears to be room for further growth. Current uncertainty surrounding increased terrorism, Brexit, China and the upcoming US presidential election appear to be delaying investment decisions, as demonstrated by total transaction values in Q1 2016 being the lowest since Q3 2013.

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 2015

Notes: Q1 covers the three months to the end of March | Q1 Y-o-Y compares the average of Q1 2016 to the average of Q1 2015 | 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 years

Demand

Average RevPAR decline in Q1 2016

For the first time in four years, average RevPAR for the 12 cities reviewed in this bulletin declined (3%). This result was skewed by Aberdeen (37% RevPAR decline), however; even with Aberdeen excluded, average RevPAR only increased by 1% in comparison to Q1 2015. This is the lowest increase since Q1 2012. Top line increases have, for the third consecutive quarter, been predominantly rate driven, indicating we may be approaching the top of the market. This is discussed in greater detail later in the Bulletin.

London's RevPAR decreased by 2% in Q1 2016. The city has now recorded five consecutive quarters of flat or declining RevPAR. Given this, hoteliers may be concerned by the large number of bedrooms due to open in the next year. However; investment continues to pour into the market and London remains a popular destination for the burgeoning Russian and Chinese middle classes, as well as domestic holidaymakers following recent terrorist attacks on the continent. Increasing numbers of consumers report safety concerns as a key factor in holiday choices[1].

This quarter's top performer was Cardiff (8% RevPAR growth), as the city hosted over 20,000 participants in the World Half Marathon Championships in March[2]. In terms of RevPAR growth, Cardiff has been in the top three for the last four quarters relative to the other 11 cities reviewed in this Bulletin. There has been very little new supply with only 18 bedrooms opened since December 2011.

Birmingham recorded RevPAR growth of 7% in Q1 2016. Despite supply increasing by nearly 800 bedrooms over the past two years, the city has recorded average quarterly RevPAR growth of 12% during this period. Birmingham Airport has received significant investment during this time, resulting in 12 consecutive months of passenger number increases[3]. This trend is set to continue as a number of airlines including Qatar Airways, CSA and Iberia are due to set up routes from Birmingham.

Aberdeen has once again recorded the worst performance of the 12 cities reviewed (37% RevPAR decline). In absolute terms, average RevPAR in the city for the quarter (£42) is now the lowest of all 12 cities reviewed.

Newcastle hoteliers recorded a RevPAR decline of 9% in Q1 2016. Historically, Newcastle hotel demand metrics have been highly sensitive to increases in supply. For example, a supply increase of 15% between Q2 2011 and 2012 resulted in Newcastle recording seven quarters of RevPAR decline between Q1 2012 and Q3 2013. The recent growth in bedroom supply (10% of current supply in the last year) may be key contributing factor to this current RevPAR decline.

Investment indicators

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

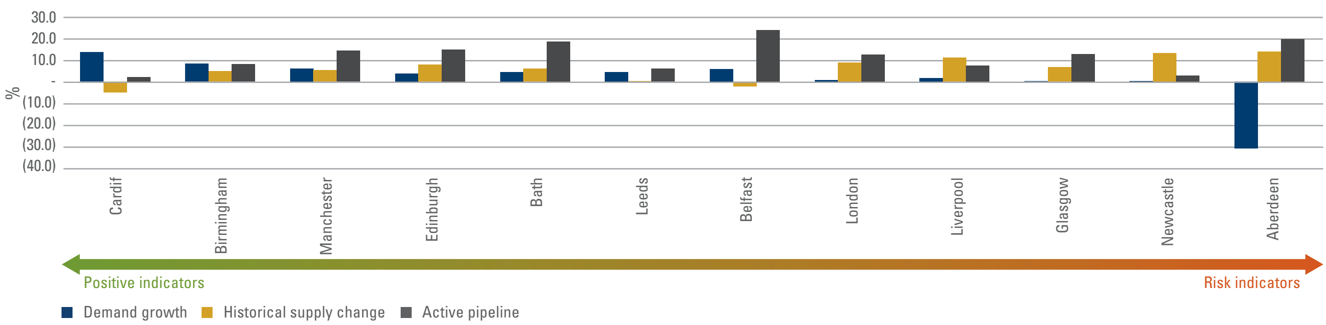
The interaction of demand growth, historical supply change and active pipeline are considered. Demand growth has been calculated as the average RevPAR growth for the last four quarters to provide an indication of recent demand trends. Historical supply change has been calculated as the increase in rooms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

The Hotel Bulletin now provides investment indicators for each of the 12 cities analysed for the previous four quarters (Figure 6 to Figure 17) in order to illustrate the changing profile for each city over the year.

Belfast has achieved strong demand growth over the past three years due to significant investment in business and tourism in the city. Hoteliers have also benefitted from limited new supply during this period (5%). Strong performance has caught the eye of investors, resulting in active pipeline of 24% of current supply. Investors may wish to wait and see how performance is impacted by the new supply before committing to further investment.

Source: 1. World Travel Market 2015 Industry Report, 2. Cardiff.gov.uk, 3. Coventry Telegraph

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 2014 and 2016 | Active pipeline calculated as the active pipeline as a percentage of current supply | The shading of the arrow reflects positive (green) or risk (red) indicator

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. The budget sector continues to dominate active pipeline (48% of total active pipeline).

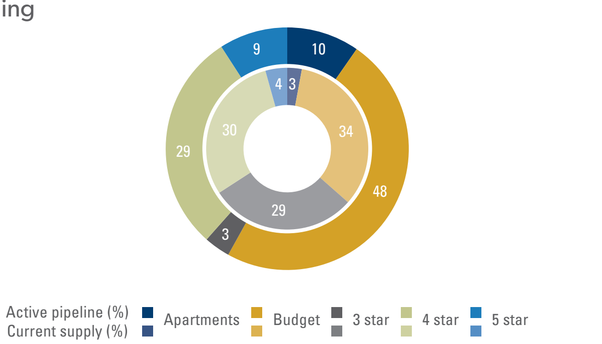
Approximately 60% of the 3,300 bedrooms opened in Q1 2016 were branded Premier Inn. For the third consecutive quarter, Premier Inn has added over 500 bedrooms per quarter; there are now over 64,000 Premier Inn bedrooms in the UK. This relentless schedule of openings raises the question of whether there is a limit to future openings for the brand. Whitbread's management does not appear to share this view with 5,400 bedroom openings, including over 600 extension bedrooms, set to open in the next two years and hub by Premier Inn openings extending the company's presence across the value chain.

Travelodge, by contrast, only had two hotel openings in the quarter; however, 19 further openings are planned in 2016.

Notable new openings and developments this quarter include:

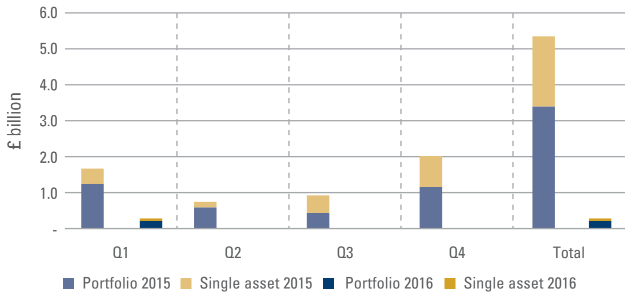
- Z Hotels has opened its sixth London property on Gloucester Place. The 93 bedroom hotel consists of six converted townhouses and a 20 bedroom extension is planned for later in the year. Z Hotels also has its third hotel outside London due to open in Bath in 2017.
- Hinduja Group and OHL Developments have purchased the Old War Office building in Whitehall with plans to convert it to a 200 bedroom luxury five star hotel and residential apartments.
- The 216 bedroom Pullman Hotel opened in Liverpool in February. The four star hotel is the first of the international brand's UK hotels outside London and completes Liverpool's new state-of-the-art waterfront complex.
- In Birmingham, Australian hotel brand StayWell Hospitality opened its first UK hotel, the 253 bedroom Park Regis and Staycity also opened a 170 unit aparthotel at Newhall Square.

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 hotel

FIGURE 4: UK transaction value



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

Transactions

£305 million of transactions completed in Q1 2016, the lowest total quarterly transaction value since Q3 2013. The sale of two London Club Quarters hotels constituted more than half of total transactions during the quarter. Single asset transactions only accounted for £96 million in Q1 2016. Transactions may be significantly lower than Q1 2015 as a result of more completions in Q4 2015 (22% higher than the previous year) as fewer transactions were delayed into the new year.

Total M&A transaction values in Q1 2016 were 36% lower than Q1 2015[4]. Transaction volumes have been impacted by factors including increased terrorism levels, the possibility of Brexit, the forthcoming US presidential election and below-expected growth in China. The hotel sector has not been insulated from this uncertainty, with a number of portfolio transactions stalling.

Existing stakeholders may consider the debt markets as an alternative for partial exit. For example, in April 2016, Travelodge announced plans to raise £390 million to be used to refinance existing debt and repay a portion of shareholder loans. This news followed February's announcement that the company had stalled its £1 billion sale process following reports of inadequate offers.

Notable transactions this quarter include:

- A joint venture between AXA Investment Managers and Danish pension fund ATP has acquired two Club Quarters hotels from Chelsfield Partners for £180 million. The two freehold buildings with 468 bedrooms between them are positioned in prime City of London locations at St Paul's and Gracechurch Street.
- Dubai based Al Habtoor Group has acquired the 361 bedroom Hilton London Wembley for an undisclosed sum, increasing its international portfolio to six hotels. This acquisition marks the beginning of Dhs 2 billion (£375 million) of investments planned for 2016.
- The 147 bedroom Holiday Inn Express in Manchester city centre has been acquired by a Singaporean investor consortium led by Heeton Holdings for £17 million. The transaction is reported to represent a sub 7% yield and continues Heeton's recent investment push into the UK market.

Source: 4. Bureau Van Dijk

Focus on: UK RevPAR trends

In this edition of the Hotel Bulletin we have analysed longer-term performance trends across the cities covered to provide more context around our usual review of latest quarterly KPIs and give a perspective on trading relative to the current economic cycle.

Have we reached the peak of the market?

The hotel sector has long been seen as a barometer of the wider economy, albeit with inevitable regional variances. Buoyed by several years of largely universal consecutive RevPAR growth and despite global economic concerns regarding growth in China, the US presidential election year and an imminent significant EU Referendum, the overall mood of UK hoteliers has been bullish.

However, in recent months there has been a modest but still perceptible shift in sentiment, especially in the investment community where a much greater sense of caution is being adopted over future growth prospects.

Some already believe the market has reached a peak, whether in terms of asset values or trading performance. Inevitably, economic activity relies on confidence, so it will be important to monitor the extent to which any further shift in sentiment manifests itself more meaningfully in market activity during 2016.

Significant spread of post-recession RevPAR performance

The last UK recession began in the H2 2008, which set the previous high water mark against which subsequent RevPAR trends across the cities reviewed can be measured. This analysis indicates a significant spread of post-recession performance ranging between 90% to 140% of 2008 levels on an unadjusted basis, or 73% to 121% when adjusted for CPI based inflation (real growth).

At one end of the spectrum lies Aberdeen, which has a more acute microclimate than the other cities due to its exposure to the global energy sector. The city had been faring extremely well until 2014, arguably unsustainably so, since when it has surrendered all of the gains it had made and more. In real terms, RevPAR is now around 73% of its previous peak.

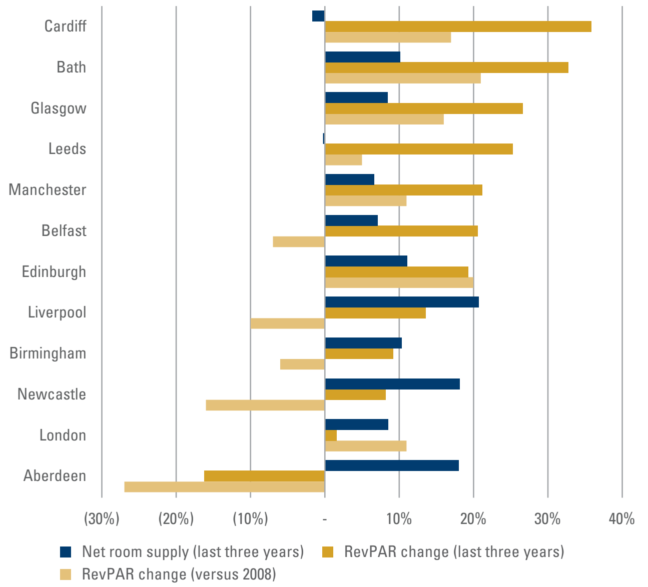
Newcastle (84%), Liverpool (90%), Belfast (93%) and Birmingham (94%) have yet to move beyond recovery mode into real underlying RevPAR growth territory.

Across the remaining seven cities, inflation adjusted RevPAR comparisons in Leeds, London and Manchester are positive but relatively subdued at between 105% and 111% of the previous peak and the highest in Bath, Cardiff, Edinburgh and Glasgow between 116% and 121%.

Supply and demand trends during the current growth phase

Figure 5 illustrates the percentage change in net room supply and inflation adjusted RevPAR across the cities reviewed for the last three years (and RevPAR change since 2008). This represents the period in which many of the larger UK hotel markets had recovered ground lost during the recession and began experiencing growth.

FIGURE 5: Inflation adjusted RevPAR compared to supply change



Source: AM:PM, Hotstats

Cardiff has recorded the strongest real RevPAR growth over the last three years at an impressive 36%, in part reflecting underlying market dynamics but also boosted by the fact that net room supply slightly declined. The city has seen no major new hotel openings for several years, as many developers with memories of previous oversupply issues no doubt focused elsewhere.

Leeds is another city where incumbent operators have enjoyed an undisturbed few years without having to contend with any new hotel supply and this has helped RevPAR grow by around 25%.

Bath and Belfast – the smallest hotel markets in the cities reviewed, have performed impressively with RevPAR growth of 33% and 21% respectively despite 5% to 10% net supply increases.

Glasgow and Manchester, both key UK regional hotel markets also feature positively, with moderate new supply comfortably absorbed by thriving cities generating incremental room night demand.

Across the other cities covered by the Hotel Bulletin, there is an inherently strong correlation between new supply and RevPAR growth trends. It is very apparent that the cities to have recorded the highest growth in new supply (Liverpool, Aberdeen, Newcastle and Edinburgh) all feature in the second half of the rankings for RevPAR growth. In the case of Edinburgh and Liverpool, RevPAR growth of 19% and 14% respectively remained commendable.

Interestingly, the UK's two largest cities, London and Birmingham trail all of the field apart from Aberdeen and Newcastle. In London's case however, it is key to distinguish between RevPAR growth and absolute RevPAR, which is far higher than elsewhere. Also, new supply may appear modest but London has added more new rooms in the last three years than the other 11 cities combined.

Investment indicators for Q2 2015 to Q1 2016

FIGURE 6: Glasgow

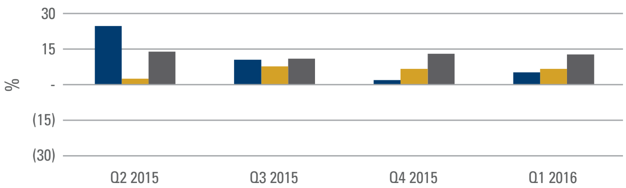


FIGURE 7: Belfast

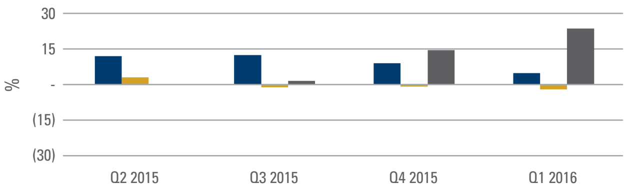


FIGURE 8: Liverpool

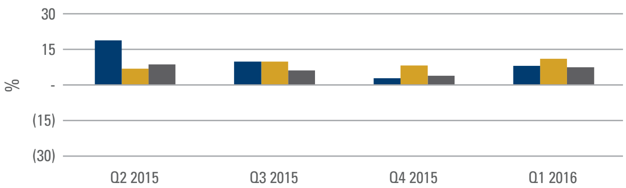


FIGURE 9: Birmingham

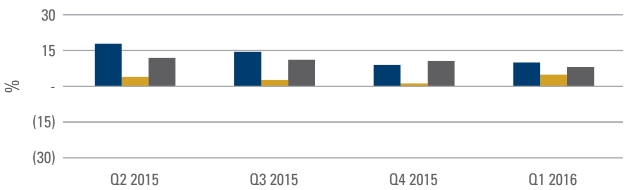


FIGURE 10: Cardiff

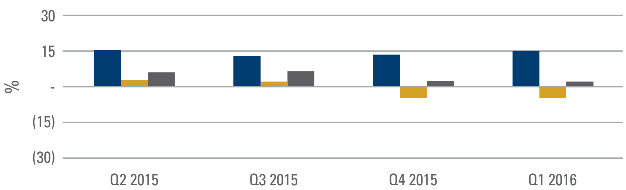


FIGURE 11: Bath

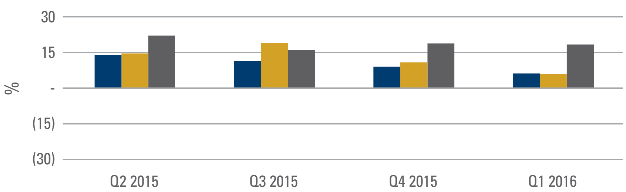


FIGURE 12: Aberdeen

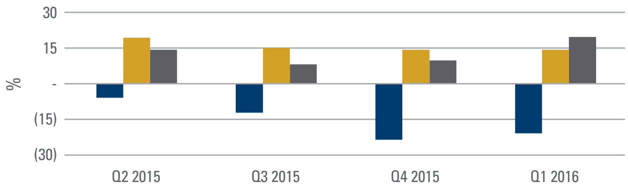


FIGURE 13: Edinburgh

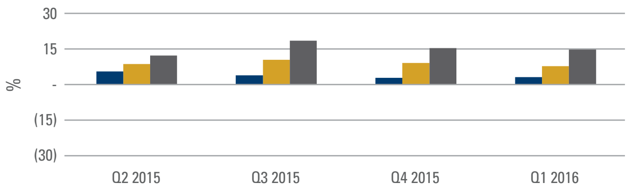


FIGURE 14: Newcastle

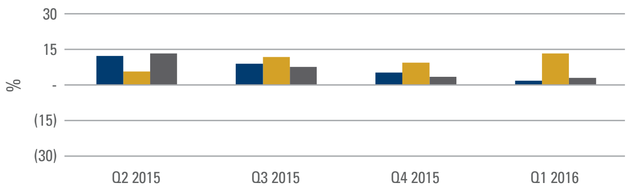


FIGURE 15: Leeds

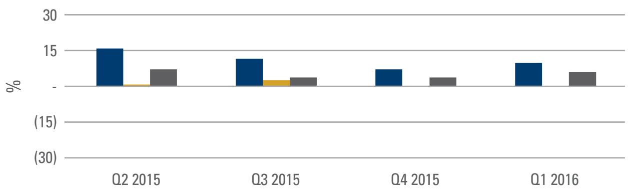


FIGURE 16: Manchester

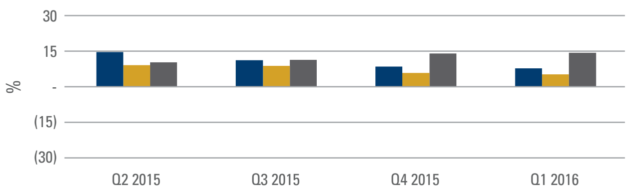
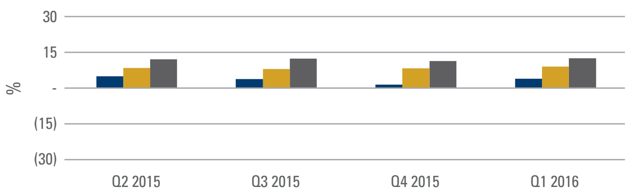


FIGURE 17: London



Key for all: Demand growth Historical supply change Active pipeline

Source for all: AM:PM, HotStats

Notes: Demand growth calculated as the average quarterly RevPAR change for the previous four quarters | Historical supply change calculated as the change in hotel bedrooms in the last two years | Active pipeline calculated as the active pipeline as a percentage of current supply

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