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Q4 2016 Hotel Bulletin: pound depreciation continues to boost leisure demand but uncertainty leads to decrease in M&A activity

In the final quarter of 2016, the impact of the UK's decision to leave the EU has brought mixed fortunes to the hotel industry. Further depreciation of the pound has made UK hotels more attractive to foreign visitors and staycationers. However, the uncertainty created by the UK's decision to leave the EU and other geopolitical concerns may have played a part in 2016 transaction levels being less than half that of the previous year.

DEMAND

In our last bulletin, we observed a performance divide between leisure- and corporate-focused markets. Cities with a more developed tourism industry performed noticeably better. In Q4 2016, this split has become more striking, with demand metric growth in the majority of leisure- focused markets outperforming their corporate counterparts.

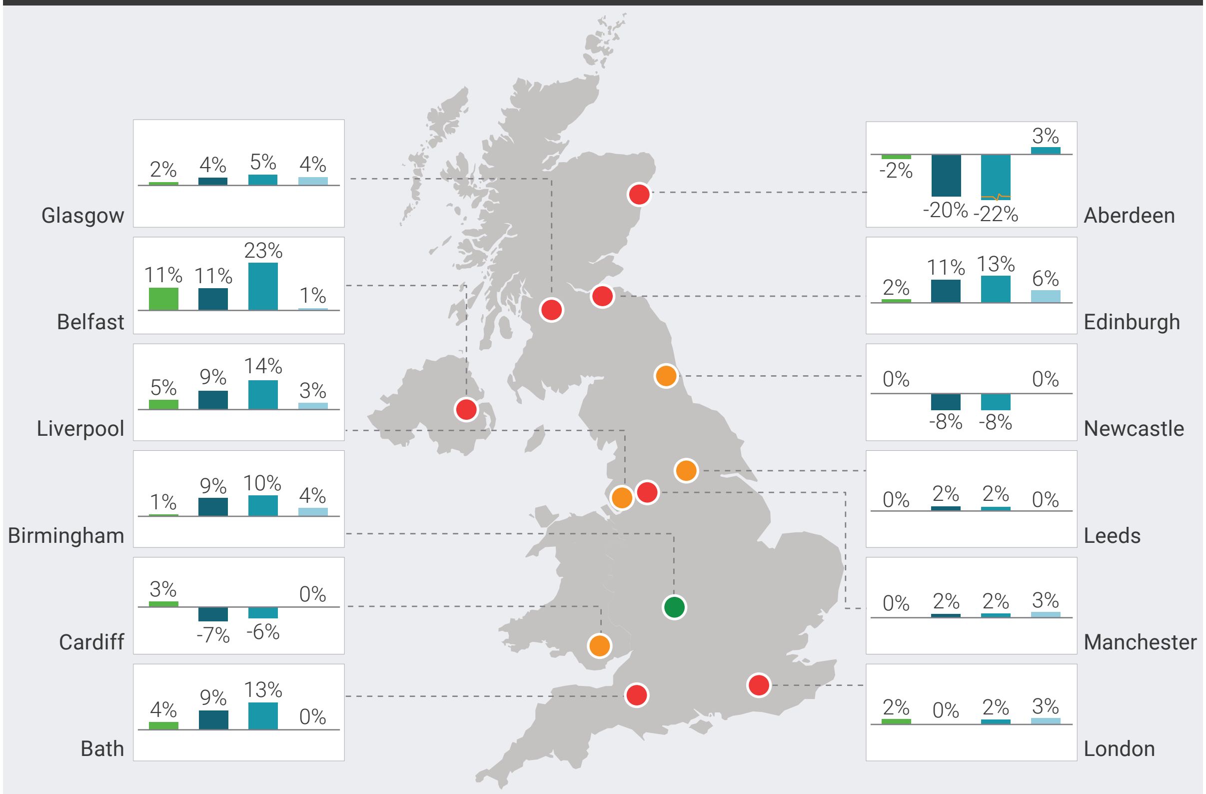
The pound finished 2016 16% down on the dollar compared to before the Brexit result was announced[1]. Belfast, Bath, Liverpool and Edinburgh benefited from a weaker pound, making UK vacations cheaper for foreign visitors and staycations more attractive to cost-conscious Brits.

By contrast, cities more traditionally focussed on corporate visitors, like Newcastle, Glasgow and Aberdeen have reported falling revenue per available room (RevPAR) compared with last year.

The average Q4 2016 RevPAR growth over the 12 cities we reviewed in this bulletin was 4%. This modest figure disguises performance polarity, with RevPAR growth ranging from 23% growth in Belfast to a fall of 22% in Aberdeen.

[1] XE.

FIGURE 1: Selected UK hotel markets – demand and supply



- Occupancy percentage change[2] (Q4 YoY)
- Average room rate percentage change (Q4 YoY)
- RevPAR percentage change (Q4 YoY)
- Supply percentage change since 31 December 2014
- Active pipeline[3] >10%, 5 to 10%, <5%

Notes: Q4 covers the three months to the end of December | Q4 YoY compares the average of Q4 2016 to the average of Q4 2015 | Supply and pipeline analysis relate to numbers of hotel bedrooms

London recorded a 2% growth in RevPAR, a strong performance given Q4 2015 comparators included visitors attending the Rugby World Cup. As the most popular city for UK visitors[4], London is particularly well placed to benefit from a weaker pound attracting foreign tourists and British staycationers. Although London faces some challenges, including declining occupancy in seven out of the eight previous quarters and the potential for certain companies to move staff out of the capital, it overall remains a robust and attractive city for investment.

Belfast was Q4 2016's top performer with 23% RevPAR growth. Belfast's leisure market has benefited from significant investment in the city as a tourist destination in recent years. The city was voted Best UK City in the 2016 Guardian and Observer Travel Awards and has recorded ever increasing visitor numbers (inbound passenger numbers increasing by over 17% in 2016[5]). In particular, visitors from the Republic of Ireland, looking to take advantage of the deflated pound, are believed to have bolstered performance. The hotel market in Belfast is relatively small, with less than 4,000 bedrooms in current supply and fewer than 100 bedrooms being added in the last three years.

The future may be less bright for current hoteliers; an active pipeline of 29% of current supply is likely to put pressure on the market.

Aberdeen was once again the worst performing city of the 12 reviewed (with a 22% RevPAR fall), marking the city's eighth consecutive quarter of falling RevPAR. The city continues to suffer from low oil prices that are reducing the level of oil and gas activity in the area. In October 2016, drilling activity in the North Sea was reported to be at its lowest for the past 35 years[6].

RevPAR in Cardiff fell by 6% when compared with Q4 2015. However, this drop off does not tell the whole story, as the city hosted a number of high profile Rugby World Cup matches in October 2015, boosting RevPAR. Compared with Q4 2014, which did not have any material anomalies, Cardiff recorded RevPAR growth of 14%.

We saw an average quarterly RevPAR growth of 0% in London and 2% regionally, compared to 1% and 4% respectively in 2015, as new openings impacted top-line growth. Active pipeline is currently 13% of current supply (compared with 10% in 2015), which will add top-line pressure in 2017.

[2] Occupancy percentage change represents actual rather than absolute percentage change.
[3] Active pipeline refers to hotel bedrooms with an opening date in the next three years.
[4] VisitBritain.
[5] Belfast Telegraph.
[6] Bloomberg.

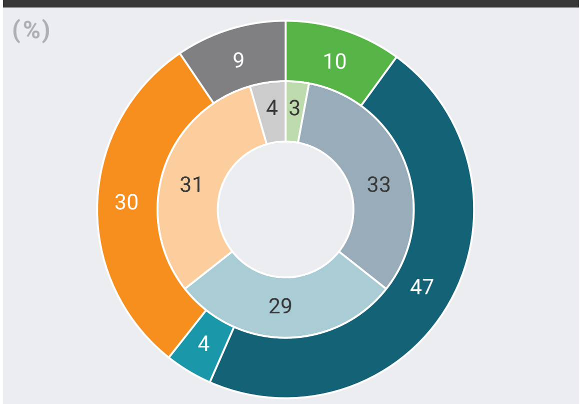
SUPPLY AND PIPELINE

In figure 2, 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 make up the largest proportion of both the UK's supply and active pipeline as brands such as Premier Inn and Travelodge continue their aggressive expansion projects. Together these two brands accounted for just below 70% of budget bedrooms opened in 2016.

Notable new openings and developments this quarter include:

- Another budget brand, easyHotel, announced plans to open properties in Leeds, Sheffield and Reading. If all of its planning applications are successful, the brand is due to more than double its current UK bedroom supply over the next two years.
- Marriott has opened the first UK property under its Moxy budget lifestyle brand – the 200 bedroom Moxy Aberdeen Airport. The brand has four further confirmed openings for the next two years, with three in London and one in Glasgow.
- Whitbread plans to open a 602 bedroom Premier Inn beside Heathrow's Terminal 4 in this year. Whitbread currently operates three hotels at Heathrow with more than 1,100 bedrooms.
- Singapore's M&L Hospitality opened the 358 bedroom Hyatt Place London Heathrow Airport. This follows the Hyatt Place London Heathrow Hayes that opened in May 2016.

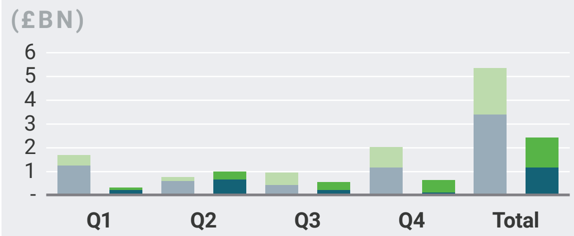
FIGURE 2: UK current bedroom supply (inner circle) and active pipeline (outer circle) by grading



Active pipeline (%) / Current supply (%): Apartments, Budget, 3 star, 4 star, 5 star

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 3: UK transaction value



Portfolio 2015, Single asset 2015, Portfolio 2016, Single asset 2016

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

TRANSACTIONS

Transaction values in Q4 2016 totalled £0.6 billion, significantly lower than the £2.0 billion of transactions recorded in Q4 2015. Overall transaction levels in 2016 (£2.4 billion) were less than half that of the previous year's record level (£5.3 billion).

The low level of transactions reflects the sentiment in the M&A market as a whole (M&A activity in the UK was 55% lower than in 2015[7]). There remained significant levels of uncertainty in the market in Q4 2016 over what form Brexit will take and further political uncertainty from the US as a result of Donald Trump's election victory.

Uncertainty is expected to continue in 2017, but there are signs that investors are returning to the hotel market as performance continues to be robust. UK real estate remains an attractive asset class for domestic and international investors. Certain sectors such as serviced apartments that demonstrate strong fundamentals and a growth opportunity, are expected to generate significant investment appetite in the medium term.

Notable transactions in Q4 2016 include:

- Cairn Group has acquired five Hotel Collection properties from Lone Star for a reported £75 million. This transaction adds 665 bedrooms to Cairn Group's UK portfolio of approximately 3,000 bedrooms.
- Blackstone has sold the 582 bedroom DoubleTree by Hilton Hotel – Tower of London to the Bhatia family for a sum reported to be in excess of £300 million. The Bhatia family already own a number of Hilton-branded hotels in London including the Waldorf Hilton.
- Whittlebury Park LLP has acquired Whittlebury Hall, financed by a £20 million loan from OakNorth Bank. This purchase adds hotel facilities to the neighbouring golf course that the purchaser owns.

[7] Reuters.

FOCUS ON: LATEST TRENDS IN UK HOTEL SUPPLY

The UK hotel sector is one of the longest-established in the world. The sector currently has around 14,200 properties with 625,000 bedrooms that are commercially operated[8]. These are distributed across a range of conventional hotel segments that have recently been joined by the fast growing concepts of branded budget hotels and serviced apartments.

Notwithstanding economic fluctuations, UK bedroom supply has increased on a net basis (after hotel closures) in every one of the last 20 years. Growth has averaged 1.6% p.a. over this period and only fell below 1% in 2013 which proved a hangover year following particularly strong growth in the previous year.

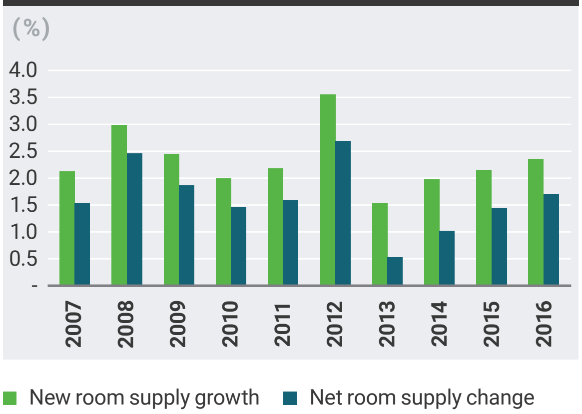
In 2016, an additional 14,600 new bedrooms represented a 2.4% annual supply increase which reduced to 1.7% on a net basis after 4,000 bedrooms were removed through hotel closures. As illustrated in figure 4, both percentage figures were the highest annual increase since 2012 but only marginally above the mean average for the last ten years.

Latest forecasts indicate around 20,000 new bedrooms will open in the UK in 2017, which would represent a supply growth of 3.3%. Although this is higher than the long-term average, this figure doesn't incorporate any offset from hotel closures, which will inevitably occur. Also, pipeline projects and scheduled completion dates are often subject to delays and so the actual year-end outcome is likely to be lower.

Significant regional variations in net supply change

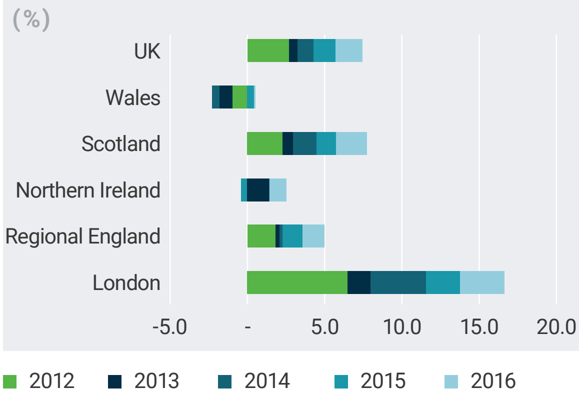
The UK has seen net supply change of around 7.5% in the last five years, but we continue to see significant regional variations throughout the country as illustrated in figure 5.

FIGURE 4: UK hotel room supply: 10-year change



Source: AM:PM

FIGURE 5: UK five-year net bedroom supply change by region



Source: AM:PM

London has consistently achieved the strongest annual growth. The capital's 17% five-year net supply change distorts the overall UK average position, which has only been replicated in Scotland. In marked contrast, Wales has recorded a net decline in supply since 2012 of almost 2% due to limited new supply being overshadowed by hotel closures. Cardiff hotel development lagged behind most major UK cities over the medium-term.

Continued structural change

Beneath the surface of modest supply growth, there are several distinct trends that are contributing to significant longer-term structural industry change. From a regional perspective, supply growth is consistently more pronounced in metropolitan and major urban centres. Meanwhile rural markets (featuring many smaller owner-operated hotels) and coastal resorts continue to suffer slow net decline due to more regular distressed closures or alternative property use, typically for residential purposes.

Independents account for a majority of hotel properties in the UK, but hotel brands remain on an apparently relentless ascent and now represent almost two-thirds of all hotel bedrooms in the UK. This is largely due to successful growth and market share consolidation by the leading major groups and the continued proliferation of new brands across the sector.

There has been a seismic shift in the segmentation of the industry in the last 20 years. The primary driver behind this has been the evolution of the branded budget hotel sector, which now accounts for 25% of all hotel bedrooms in the UK. Four-star and five-star hotels (combined 34%) and serviced apartments also continue to gain market share. The main casualties throughout this period have been two-star and three-star hotels, which have each conceded 10% market share as consumers increasingly trade up or down the amenity, experience and price scales. **A**

[8] Excluding smaller B&Bs and guest houses with fewer than 15 bedrooms.

INVESTMENT INDICATORS FOR Q1 2016 TO Q4 2016

FIGURE 6: Glasgow

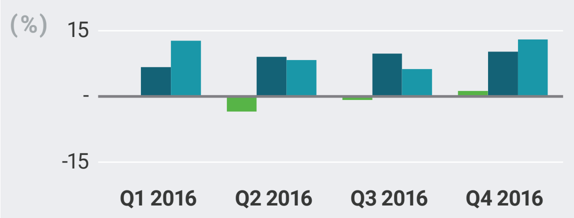


FIGURE 7: Belfast

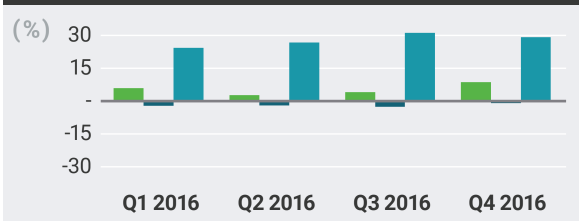


FIGURE 8: Liverpool

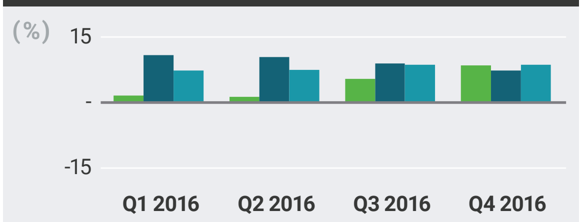


FIGURE 9: Birmingham

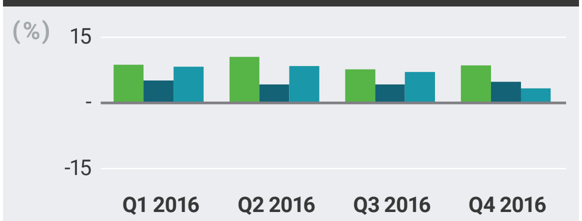


FIGURE 10: Cardiff

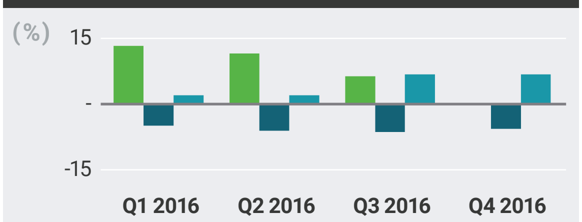


FIGURE 11: Bath

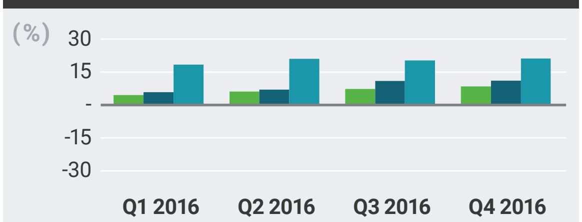


FIGURE 12: Aberdeen

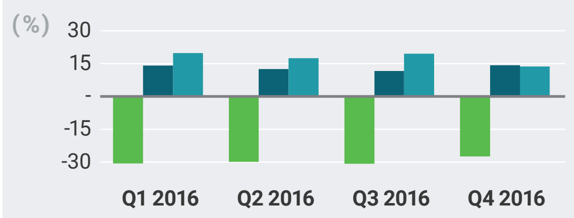


FIGURE 13: Edinburgh

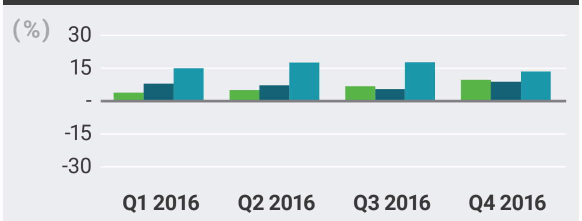


FIGURE 14: Newcastle

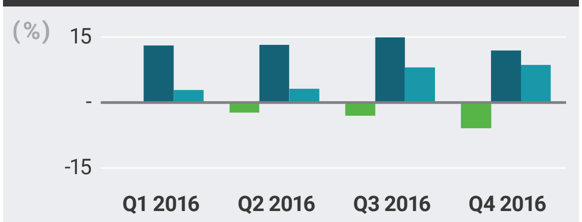


FIGURE 15: Leeds

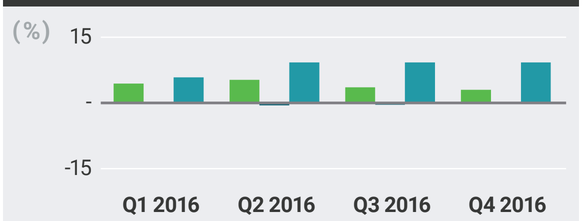


FIGURE 16: Manchester

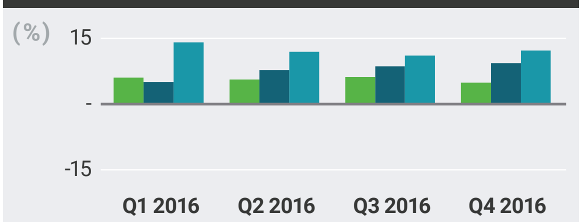
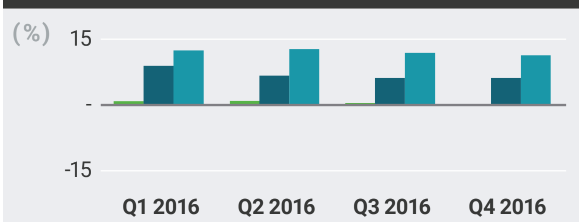


FIGURE 17: London



Key for all: Demand growth[9] Historical supply change[10] Active pipeline[11]
Source for all: AM:PM, STR

[9] Demand growth calculated as the average quarterly RevPAR change for the previous four quarters.
[10] Historical supply change calculated as the change in hotel bedrooms in the last two years.
[11] Active pipeline calculated as confirmed pipeline bedrooms as a percentage of current supply.

ABOUT AM:PM

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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HVS is the world's leading consulting and services organization focused of the hotel, mixed-use, shared ownership, gaming and leisure industries. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, investors, lenders, operators and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 35 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.

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