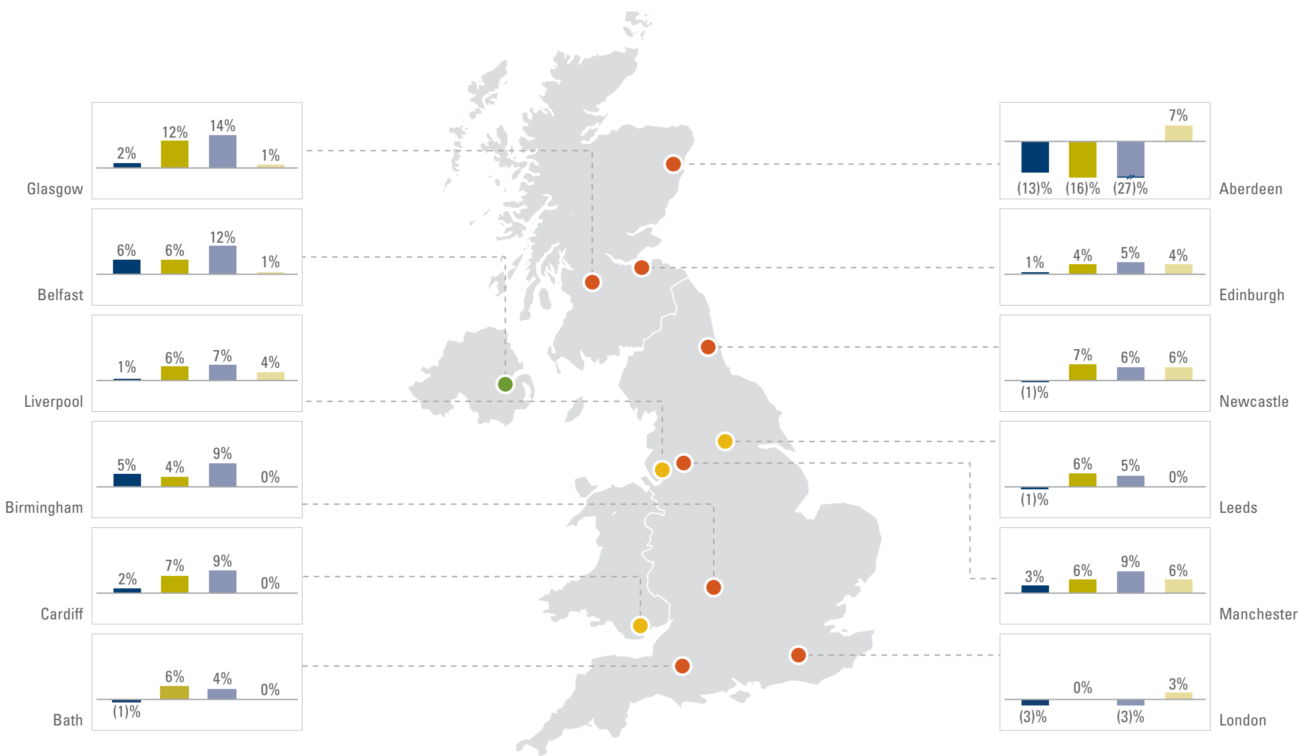
INSIGHT
Leisure

Hotel Bulletin: Q2 2015

In Q2 2015, the majority of the cities reviewed in this bulletin recorded RevPAR growth, albeit at a slower overall rate than experienced in the previous eight quarters. We have considered whether a recent contraction in London's RevPAR can be partially attributed to the weakening of the Euro and analysed Aberdeen's continuing woes. Asian and Middle Eastern investors seeking higher yields than in their home markets have been acquisitive this quarter in London and, increasingly, the regions. At the other end of the investment lifecycle, we consider whether a public market exit is achievable for US funds who have built significant UK hotel portfolios in the last few years. In this edition's Focus, we discuss the increasing foothold of serviced apartments in the UK.

FIGURE 1: Selected UK hotel markets – demand and supply



Occupancy percentage change[1] (Q2 Y-o-Y) | Average room rate percentage change (Q2 Y-o-Y) | Active pipeline >10%, 5 to 10%, <5%
RevPAR percentage change (Q2 Y-o-Y) | Supply percentage change since 30 June 2014

Notes: Q2 covers the three months to the end of June | Q2 Y-o-Y compares the average of Q2 2015 to the average of Q2 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 years

Demand

Growth deceleration throughout the UK

Ten of the 12 cities reviewed in the Hotel Bulletin recorded RevPAR growth, although average growth of 4% was the lowest recorded since Q1 2013. For the seventh consecutive quarter, hoteliers have pushed rates to bolster performance.

London's RevPAR decreased by 3% in Q2 2015. Performance trends historically lag 12 to 18 months behind supply trends and, as such, this contraction is likely to be partially due to the significant increase in supply from January 2012 to December 2013. Hoteliers have recorded flat or decreasing occupancy for the last six quarters but, unlike previously, were not able to increase rates to compensate.

Another contributor to this decline has been the recent weakening of the Euro. In H1 2015, the Euro exchange rate decreased by 8% against the USD. During this period, long-haul visitors as well as forward bookings to London decreased by 4% year-on-year, whereas visitors to major European cities have increased by up to 11%[1]. With continued uncertainty in the Eurozone, no short-term strengthening of the Euro is anticipated[2], meaning UK holidays may remain comparatively more expensive.

In Q2 2015, the 11 regional cities reviewed recorded average RevPAR growth of 5%. Growth has been bolstered by the continued resurgence of the hotel conference market. Although booking lead-up times remain shorter than before the downturn, ongoing economic recovery is leading to an increased number of events.

Signs of the market slowing identified in the previous quarter continued in Q2 2015. Average regional RevPAR growth, albeit against strong comparators, has decreased from 21% in Q3 2014 to 5% in Q2 2015. As shown on page 5, there is evidence that occupancy in a number of the cities is plateauing or declining, particularly in Newcastle, Leeds and Aberdeen. The window of opportunity for hoteliers to push rates in these cities may be narrowing.

Source: (1) ForwardKeys, (2) Goldman Sachs

The top performer in this quarter was Glasgow (14% RevPAR growth). The city's hoteliers have managed to increase rates by 12% to capitalise on buoyant occupancy harnessed from a steady flow of events at the city's arenas and increasing conference numbers. In H1 2015, Glasgow attracted £75 million of new conference business with 229 conferences to be attended by over 65,000 delegates booked between now and 2022[3].

The quarter's worst performer was Aberdeen which, for the second consecutive quarter, was the only regional city to record a RevPAR decline. As discussed in the previous bulletin, oil companies in Aberdeen have reacted to the drop in oil price by scaling back investment plans. Hoteliers' attempts to bolster occupancy by cutting rates have not been successful, with occupancy dropping by 13%. With an average Q2 2015 crude oil price of $64 per barrel, well below its 2014 peak of $110 per barrel[4], a short-term recovery of the oil and gas sector in Aberdeen appears unlikely.

Investment indicators

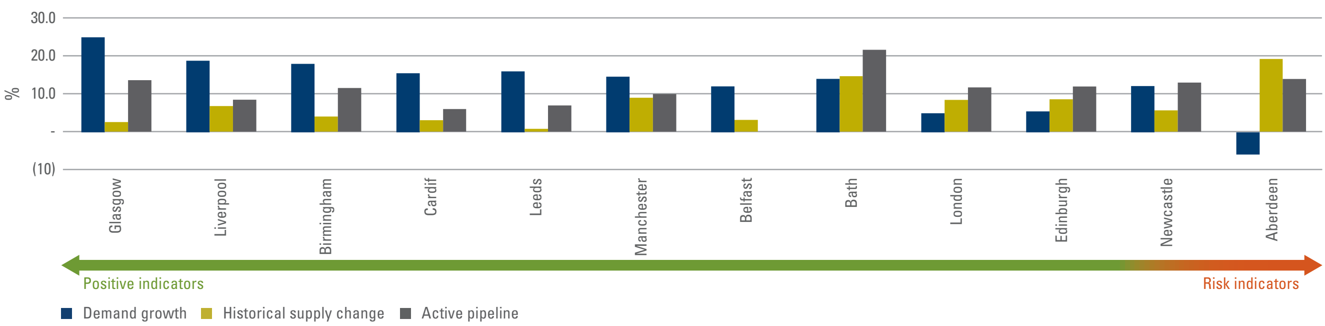
Although high-level demand and supply metrics alone will never fully inform an investment decision, the chart below is intended to highlight demand and supply data for cities that may attract, or concern, investors.

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.

Newcastle's active pipeline is currently 13% of supply. In 2012, the city's supply increased significantly which led to depressed trading until the beginning of 2014. With occupancy beginning to plateau, current hoteliers will be wary of a recurrence of this trend.

Source: (3) Herald Scotland, (4) Brent Crude spot prices

FIGURE 2: Investment indicators



Source: AM:PM, HotStats

Notes: Demand growth is calculated as the average quarterly RevPAR change for the last four quarters | Historical supply change is calculated as the change in hotel bedrooms between June 2013 and June 2015 | Active pipeline is calculated as the active pipeline as a percentage of current supply | The shading of the arrow reflects positive (green) 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 three star hotels in development has fallen further while investors increasingly focus on the budget market. This trend is largely driven by Travelodge and Premier Inn, who account for over half of the 18,000 budget rooms currently in the pipeline.

Strong competition for new sites in the UK has led companies to consider extending and enhancing existing properties. Premier Inn has had over 1,000 extension bedrooms approved in Q2 2015. Other groups adopting this approach include Splendid Hospitality Group, who are advanced in obtaining approval for a £15 million extension for the five star Grand in York[5].

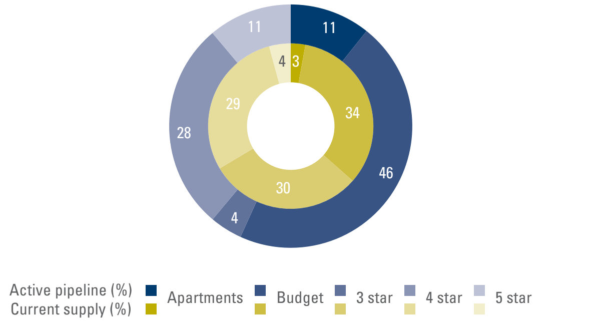
Banks struggling to deploy acquisition finance are increasingly considering development funding. Currently, however, only operators with strong track records of success are likely to be consistently considered backable.

Notable new openings and developments this quarter include:

- 608 hotel bedrooms opened in Manchester this quarter, including Bespoke Hotels' 60 bedroom five star Hotel Gotham. This represents 4% of current supply which, for a single quarter, is substantial. Manchester as a whole has historically absorbed new supply with limited impact on demand metrics. However, this may be a cause for concern for current hoteliers in the city centre.
- 331 bedrooms in coastal resorts opened in Q2 2015, including the 66 bedroom Premier Inn, Clacton-on Sea, the 82 bedroom Travelodge, Llandudno and the 120 bedroom Hampton by Hilton, Bournemouth. Certain hoteliers in these areas may have to incur significant capital expenditure to compete with these new hotels.
- Montcalm Hotels opened its fifth London hotel in April with the 269 bedroom M by Montcalm Shoreditch. This is the first luxury hotel to open in 'Tech City', a few minutes' walk from Silicon Roundabout.

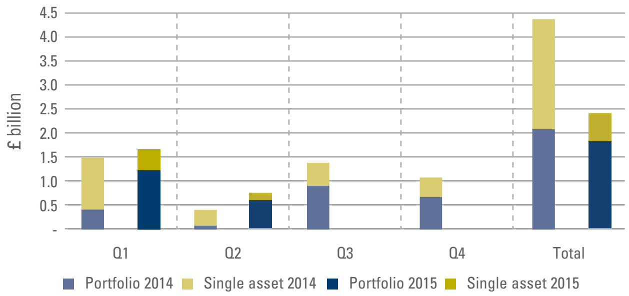
Source: (5) York Press

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

£0.7 billion of transactions completed in Q2 2015, the lowest since Q2 the previous year. £0.6 billion of this related to portfolio transactions.

Notable transactions include:

- Singapore-based Frasers Hospitality has acquired Malmaison and Hotel du Vin from KSL partners in a deal worth £363 million, over twice the reported £180 million KSL paid for the group two years ago. A large number of Asian and Middle Eastern investors are considering assets in both London and the regions, as even tight yields are beyond those achievable in their home markets.
- US fund Marathon Asset Management acquired five Hilton hotels from Blackstone in a deal reported to be worth £160 million. Marathon now has a portfolio of 3,670 hotel bedrooms in the UK following its purchase of 11 former Queens Moat House hotels in August 2011.

Considering a public market exit

In recent years the UK hotel market has seen significant investment from US based private equity capital. These investments have been made both in operating businesses such as Malmaison and Hotel du Vin and also in underlying real estate.

These funds all typically target investment returns over a three to five year time horizon so thoughts soon turn to how an exit will be achieved.

East Asian and Middle Eastern investors represent one likely exit route as evidenced by the Frasers acquisition of Malmaison and Hotel du Vin. Given the lack of European trade buyers for real estate heavy groups, it will be interesting to see whether the public equity markets will see a return of hotel company floatations. Dalata Hotel Group successfully floated on the Irish Stock Exchange in 2014. Its share price has risen by over 40% since then. We may well see others follow if current performance trends continue and cyclical companies remain in favour with the public markets.

Focus on: serviced apartments

A sector finally coming of age

Hotel industry events in the early 1990s flagged the potential of serviced apartments in the same vein as the then fledgling budget hotel sector, which has since grown to account for almost 25% of all UK hotel bedrooms. In contrast, and for numerous reasons, not least a less branded and more fragmented structure and lower investor confidence, serviced apartments have yet to fulfil this early promise and represent around 3% of room keys in the sector. The segment has gained significant momentum over the last three years and appears to finally be on the cusp of maturing from a niche segment firmly into the mainstream, not only in the eyes of consumers but the brains of investors, developers and operators.

Defining the sector key to unlocking future potential

Leading stakeholders recognise challenges remain in terms of clear and consistent industry definition, as well as better data transparency. It is crucial these issues are overcome in order to fully unlock the growth potential of the segment.

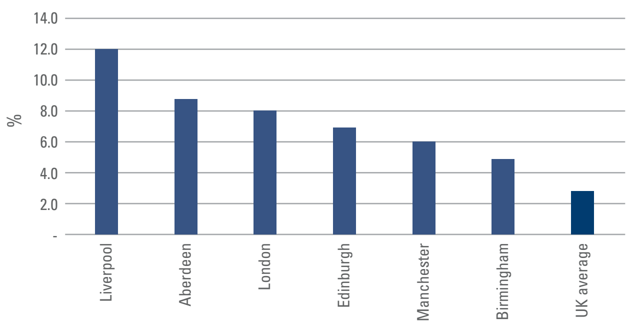
The Association of Serviced Apartment Providers (ASAP) continues to encourage a unified approach by its members and the signing of a new Industry Charter by all major operators in 2014 has been a key milestone. The charter sets out to broadly define the segment as offering either Aparthotel or Corporate Housing accommodation, with fundamental differences in corresponding services.

Due to a strong independent presence, supply often falls outside these categories and owners can be deliberately evasive about disclosure where they operate without correct planning consent or do not fully comply with health & safety, fire safety or insurance requirements. Some of these issues resonate with criticism by hoteliers of the less regulated Airbnb model.

Supply mainly in major metropolitan areas

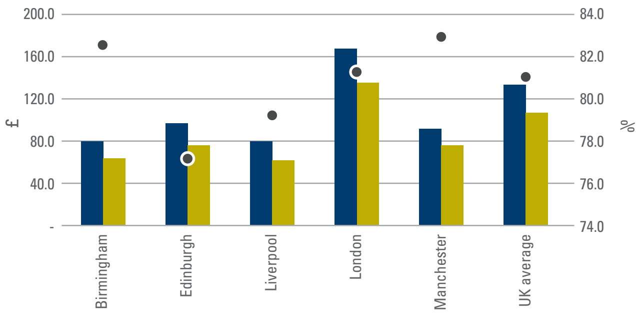
The serviced apartment model is best suited to high population metropolitan areas with a deep pool of large employers, strong public transportation links and a readily accessible range of nearby amenities and services. Unsurprisingly, London dominates the supply of serviced apartments with over 55% of the UK total (compared with 23% of total UK hotel bedrooms) but most of the

FIGURE 5: Serviced apartment supply as percentage of total bedrooms



Source: AM:PM

FIGURE 6: Serviced apartment demand H1 2015



Source: STR Global ■ ADR £ ■ RevPAR £ ● Occupancy

leading and larger cities have also proven increasingly fertile ground, particularly for supply in the aparthotel category where a mix of corporate and leisure demand can be met. Liverpool is a prime example of this and has seen strong growth in recent years.

In specific cases, markets such as Aberdeen (energy), Canary Wharf in London (financial services) and Reading (technology) have been satisfying demand for corporate housing for many years and are very well established thanks to early independent pioneers such as Skene House, Marlin Apartments and House of Fisher.

Leading players driving expansion and shaping consolidation

At a national level, no serviced apartment brand features in the top 50 UK hotel brands, with leading players such as BridgeStreet, Cheval, Citadines, Fraser Suites, Go Native, SACO, and Staycity typically operating portfolios of 500 to 1,000 units.

Several brands have a strong development pipeline with Beyonder by SACO, Roomzzz, Staycity and Urban Villa all set to open properties in multiple locations in the next few years. Leading global hotel groups are also very active in the segment with Accor (Adagio) and IHG (Staybridge Suites) both on course to reach 1,000 units in the near-term. Marriott (Residence Inn) and Starwood Hotels (Element) have more modest interests at present but ambitions to expand.

Several other well-known international operators have designs on becoming new entrants including Adina (TFE Hotels) and Quest, which agreed an investment partnership with Ascott Group last year.

Rising investor confidence and institutional interest

Investor confidence has clearly risen and institutional interest also continues to develop, attracted by strong occupancy, lower operating costs than mainstream hotels and superior profit conversion.

Major US firms such as Oaktree Capital and Starwood Capital have invested £200 million to £300 million to buy or roll-out new portfolios whilst AVIVA and LaSalle Investment Management have also let or are forward funding several new sites to established operators.

Year-on-year monthly rolling growth

FIGURE 7: Glasgow

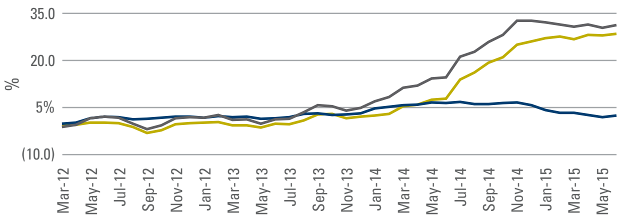


FIGURE 8: Belfast

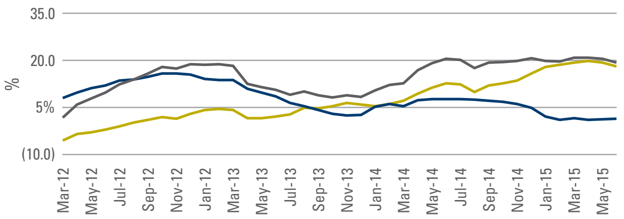


FIGURE 9: Liverpool

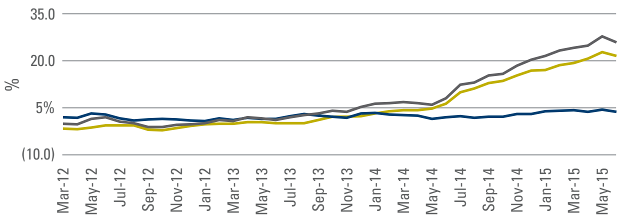


FIGURE 10: Birmingham

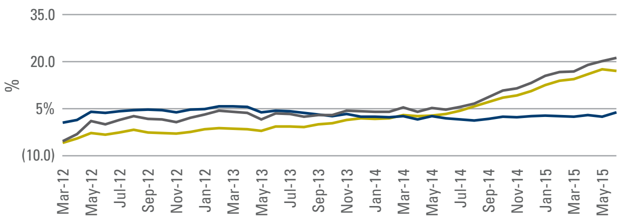


FIGURE 11: Cardiff

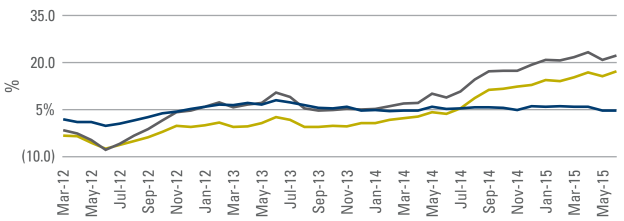


FIGURE 12: Bath

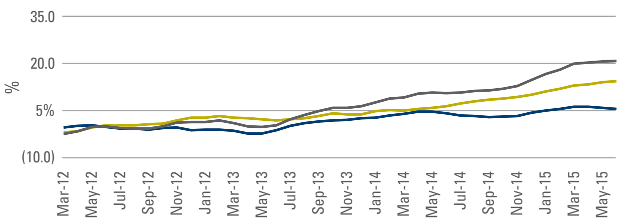


FIGURE 13: Aberdeen

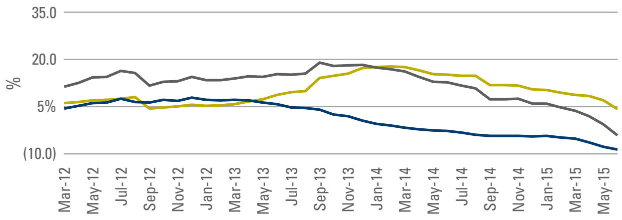


FIGURE 14: Edinburgh

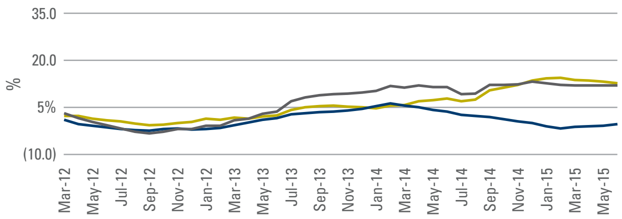


FIGURE 15: Newcastle

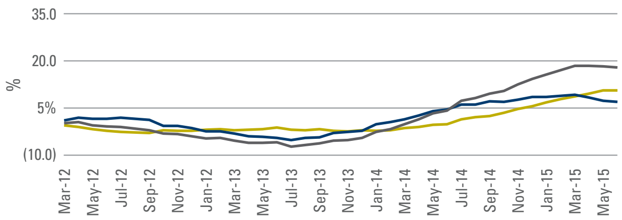


FIGURE 16: Leeds

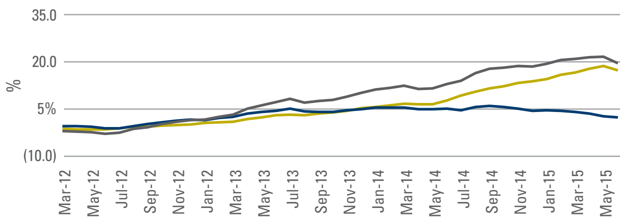


FIGURE 17: Manchester

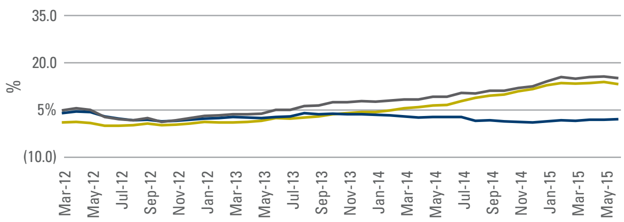
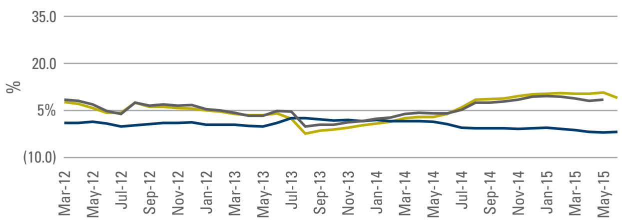


FIGURE 18: London



Key for all: — Occupancy — Rates — RevPAR

Source for all: AM:PM, HotStats

FOR MORE INFORMATION, CONTACT:

Graeme Smith
Managing Director, AlixPartners
gsmith@alixpartners.com
+44 (0) 20 7332 5115

Russell Kett
Chairman, HVS
rkett@hvs.com
+44 (0) 20 7878 7701

Alan Gordon
Director, AM:PM
alan.gordon@ampmhotels.com
+44 (0) 188 783 0430

ABOUT ALIXPARTNERS

AlixPartners is a leading global business advisory firm of results-oriented professionals who specialize in creating value and restoring performance at every stage of the business life cycle. We thrive on our ability to make a difference in high-impact situations and deliver sustainable, bottom-line results.

The firm's expertise covers a wide range of businesses and industries whether they are healthy, challenged, or distressed. Since 1981, we have taken a unique, small-team, action-oriented approach to helping corporate boards and management, law firms, investment banks, and investors respond to critical business issues. For more information, visit www.alixpartners.com.

AlixPartners. *When it really matters.*

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.

We're serious about hotels, AM:PM.

ABOUT HVS

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.

Superior results through unrivalled hospitality intelligence. Everywhere.

AlixPartners
When it really matters.