



JUNE 2014 | PRICE £350

IN FOCUS: LONDON LUXURY HOTELS

CAN THE MARKET RISE FOREVER?

Christof Bertschi
Associate

Luisa Pott
Senior Associate





London's luxury hotels are amongst the most prestigious in the world and are the darlings of the hotel investment community. Market performance has gone from strength to strength over recent years. London continues to benefit from steady demand from leisure and business guests alike. It has been placed in the spotlight even more since hosting the Olympics in 2012. However, with the various proposed additions to London's luxury segment, will the market be able to absorb and continue to grow at the same pace? HVS presents a study of the London luxury hotel market and answers the question by examining its hotel demand and supply characteristics, as well as investment market.

Highlights

- London's luxury hotels benefit from a continuous high demand due to strong market fundamentals and their high quality offerings;
- The hotels record a strong performance (albeit with a small decrease in rate after the record Olympics year) with room rates amongst the highest in the world;
- Development interest is robust and projects are moving further east and south due to a lack of available sites in traditional luxury areas;
- Finding the right location is essential in order to compete with top-performing hotels. Due to a booming real estate market, hotel development requires deep pockets;
- Investment appetite for luxury hotels remains strong with investors staying focused long-term, owing to high acquisition and/or development costs;
- The overall outlook for the luxury market is positive although there are a large number of new hotel openings which could have a negative effect on performance.

Hotel Demand Patterns

City overview

London is one of the main global gateway cities and its status as one of the most important cultural and economic capitals in Europe remains unchallenged. A large part of London's economy is driven by the strong financial industry ("the City") but tourism has historically been an important contribution to the country's GDP. London is particularly popular with its numerous leisure activities and world-famous shopping experiences. The UK's capital has seen continuous growth in tourism arrivals over the years. The Olympic Games put the city into the spotlight again during 2012 and are expected to have a long-term positive impact. A strong transport system with continuing investment and easy accessibility make London attractive for both leisure and business tourists. The UK ranks tenth in the World Bank's Ease of Doing Business Index and London is home to the headquarters of numerous international companies.

The UK's economy has recovered well from the impacts of the global financial crisis. London's financial services, which were impacted, have regained momentum and the London Stock Exchange has recently seen several large scale Initial Public Offerings. The UK's outlook remains positive; the Economic Intelligence Unit has forecast the country's real GDP to grow by 3.1% in 2014, 2.5% in 2015 and around 2% in the years after.

CHART 1: REAL GDP GROWTH, INFLATION, EXCHANGE RATE COMPARISON, UK

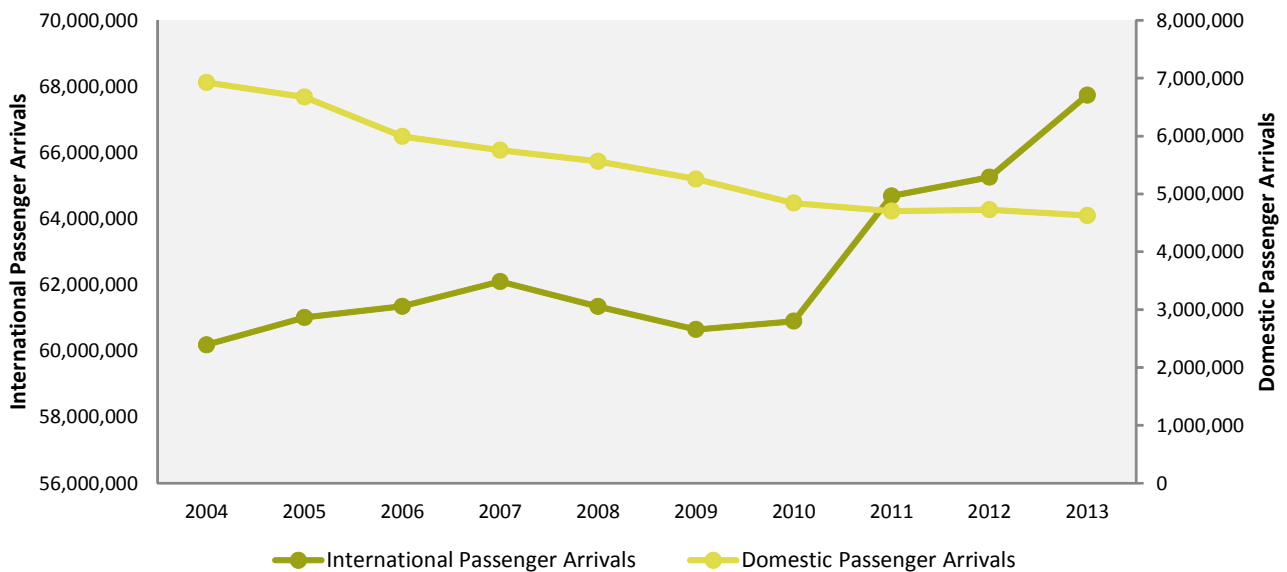
	Actual					Forecast				
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP growth (%)	(5.0)	1.4	0.8	0.3	1.7	3.1	2.5	1.7	2.0	2.1
Consumer price inflation (av %)	2.2	3.3	4.5	2.8	2.6	1.8	2.1	2.3	2.3	2.2
Exchange rate GBP:US\$	1.60	1.55	1.61	1.59	1.56	1.65	1.61	1.60	1.58	1.57
Exchange rate GBP:€	1.10	1.20	1.15	1.23	1.18	1.23	1.27	1.27	1.24	1.25

Source: Economist Intelligence Unit, June 2014

Airport Demand

Airport arrivals have been increasing at a good pace over the years. London’s airports have all demonstrated growth. However, the uncertainties about the airlift strategy pose a severe threat to the city’s accessibility. Heathrow operates at 98% capacity but no plans for an expansion have been approved at this stage nor have concrete alternatives been presented. Several options are being discussed, such as, an expansion/additional runways at Heathrow; an expansion of Gatwick airport and Mayor Boris Johnson’s plan of Thames Estuary Airport, a completely new development which faces opposition from various players. A real solution is not likely to be found before the final report by the Airports Commission in the summer of 2015.

CHART 2: ARRIVALS HEATHROW INTERNATIONAL AIRPORT, 2004 -2013



Source: Heathrow International Airport

Tourism Demand

London’s tourist arrivals have been steadily growing. The city benefits from a strong leisure, as well as, a corporate demand base. London is a popular meetings and events destination and is positioned sixth in the ICCA’s 2013 worldwide ranking of number of meetings per city. The luxury sector has seen the return of the ‘incentive traveller’, especially from the USA. Furthermore, general meeting and event performance is well on the way to recovering from the economic downturn.

Tourism demand remains high and reached a new visitation record of almost 16 million international visitors in 2013 and has allegedly overtaken Paris. International visitation has grown at an annual compound growth rate of 3.2% over the last ten years. The average length of stay varies between approximately 2.3 nights for domestic visitors and 6.1 nights for international visitors. Large scale transportation projects such as Crossrail and the HS2 are expected additionally to foster domestic demand growth.

Seasonality

London is both a leisure and business destination, meaning that the city is less impacted by seasonality, as leisure demand compensates for periods when business demand is quieter and vice versa. Leisure demand is greatest at weekends and during the summer months and is mainly concentrated around the West End of London where most of the cultural and historic sites are located, including museums, theatres, and famous shopping streets such as Regent Street and Oxford Street. However, as other areas of the city are undergoing major regeneration, these parts are also starting to benefit greatly. Traditionally, the low season in London is the months of December and January, albeit that these months are boosted by Christmas and New Year celebrations and the January sales. The summer months are peak months, with holidays in the main source countries coinciding. The Middle Eastern market, which is a very important segment for the luxury market, advances each year, depending on the incidence of Ramadan.

Luxury Hotel Overview

Market Characteristics

Main source countries for the luxury hotels continue to be the UK and USA, which in some hotels make up to 70% of total bookings, closely followed by other European countries. Chinese travellers have experienced a great facilitation in travelling to Europe, owing to easier access to visas and the introduction of Unionpay terminals at the luxury hotels. Overall Chinese arrivals to London have increased by a compound annual growth rate of approximately 9% between 2002 and 2012. As a nation with high net worth individuals, Brazil has been branded as the country to watch for increases in luxury travel. However, this trend has not materialised in the luxury London hotel scene as yet.

The Middle Eastern market continues to strengthen, with a trend of bookings now also being made outside of the classic 'Arab Season'. In terms of the highest propensity to spend, the highest rated suite bookings and average length of stay, the Middle Eastern market is still leading the trend.

In regards to booking channels, the luxury sector benefits from a high percentage of direct bookings. These are not only done online as the clientele also like to have a direct conversation via the telephone. In some cases, some 50% of bookings are made through telephone calls. However, the hotels with lower performance levels tend to rely more heavily on costly third-party booking channels. The luxury market further benefits from a high level of repeat business, more so than in lower standard hotels.

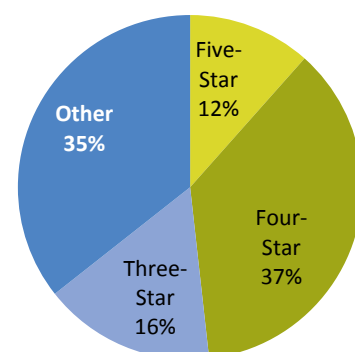
Current Supply

London's luxury hotels tend to be concentrated in the following areas: Knightsbridge, Park Lane, Mayfair, and to a certain extent Piccadilly, Trafalgar Square and the Strand.

Luxury hotels account for around 12% of total room supply in London (approximately 14,900 out of 129,000 rooms). Most major brands are present in London or are actively seeking development opportunities. The London luxury hotel market has recently seen an addition of several new hotels, amongst them are the following:

- The 45 Park Lane, a sister hotel of the Dorchester and located opposite it, 45 rooms, opened in 2011;
- The Corinthia Hotel, 294 rooms, opened in April 2011 at Trafalgar Square;
- The Bulgari Hotel, 85 rooms, opened in May 2012 in Knightsbridge;
- The Café Royal, 160 rooms, opened in December 2012 near Piccadilly Circus;

CHART 3: HOTEL ROOM SUPPLY IN LONDON



Source: HVS Research

- The London EDITION (Marriott’s lifestyle brand), 173 rooms, opened in September 2013 in north Oxford Street;
- The Rosewood, 306 rooms, opened in October 2013 in Holborn;
- Shangri-La, 202 rooms, opened partially in May at the Shard in Southwark.

Additionally, two established luxury hotels recently reopened after extensive renovation: the Savoy Hotel at the end of 2010 and the Four Seasons Park Lane in early 2011.

CHART 4: SELECTED TOP LUXURY HOTELS AND FACILITIES IN LONDON

Property	Number of Rooms	Number of Suites	Suite Ratio	Year Opened	Meeting Space (m ²)	Area
Bulgari	85	23	27%	2012	387	Knightsbridge
Mandarin Oriental London	194	56	29%	1875	428	Knightsbridge
The Berkeley	214	61	29%	1972	506	Knightsbridge
The Lanesborough	94	42	45%	1991	498	Knightsbridge
Jumeirah Carlton Tower	216	58	27%	1961	770	Knightsbridge
The Connaught	121	34	28%	1897	319	Mayfair and Park Lane
Claridge's	203	62	31%	1898	814	Mayfair and Park Lane
The Ritz	134	44	33%	1906	377	Mayfair and Park Lane
Browns Hotel (Rocco Forte)	117	29	25%	1837	250	Mayfair and Park Lane
The Dorchester	250	49	20%	1931	1,582	Mayfair and Park Lane
45 Park Lane	46	28	61%	2011	—	Mayfair and Park Lane
Four Seasons Park Lane	193	46	24%	1970	796	Mayfair and Park Lane
Stafford London by Kempinski	105	38	36%	1912	181	St. James's and Strand
The Savoy	268	78	29%	1889	1,688	St. James's and Strand
Corinthia	294	47	16%	2011	582	St. James's and Strand
Sofitel St. James	183	17	9%	1923	540	St. James's and Strand

Source: HVS Research

Development Opportunities

London has experienced a considerable increase in new supply over recent years. However, the market has shown to be resilient and even during the economic downturn luxury hotels managed to achieve high-rated business.

London is in strong demand from developers and every luxury hotel operator aims to have a presence in the capital. The majority of the international luxury hotel companies have managed to establish their brands in the city, however, there are still companies searching for opportunities. Particular interest was observed in recent years from two Asian luxury brands Shangri-La and Peninsula. Both have now managed to secure properties for their brands; Shangri-La at the Shard finally opened its doors in May and in a joint-venture Peninsula is developing a hotel and residences at 1-5 Grosvenor Place but with no communicated opening date yet.

Development opportunities are having to move away from Knightsbridge, Mayfair and Park Lane as most prime sites are already occupied. No available sites, high real estate prices and sharp yields from commercial and residential properties in these areas are high barriers to entry and make hotel conversions very expensive.

However, the northern part of Park Lane has some potential for upgrading existing upper-upscale hotels into luxury ones. Several projects in central London (Soho, Mayfair and Marylebone) focus on smaller, more boutique, but still prestige driven developments. Amongst them are, the Admiralty Arch, the Beaumont Hotel, Andre Balazs’ Chiltern Firehouse and Firmdale’s latest project, the Ham Yard Hotel which opens this month. Some potential extensions of established hotels such as The Ritz, Claridge’s, Brown’s or the Berkeley are currently of a more speculative nature.

There is increased activity south of the River Thames with developments, such as, One Nine Elms in Vauxhall by Dalian Wanda, the recent opening of the Shangri-La at the Shard and Morgan’s latest venture, Mondrian, located at 20 Upper Ground. Moving eastwards there are also some new openings, including the Rosewood in Holborn and Reignwood’s 10 Trinity Square project in the City adjacent to Tower Bridge. These hotel developments are expected

to put south and east London on the map for luxury visitors. It is a challenge, though, whether these hotels will reach rates similar their competitors in Park Lane or Knightsbridge.

CHART 5: PROPOSED UPPER-UPSCALE AND LUXURY HOTEL DEVELOPMENTS IN LONDON

Hotel Name	Brand/Operator	Bedrooms	Location	Planned Opening
Chiltern Firehouse	Independent by Andre Balazs	26	Baker Street	2014
Beaumont	Preferred Hotel Group	73	Bond Street	2014
Firmdale Ham Yard	Firmdale Hotels	91	Piccadilly Circus	2014
Shangri-La at The Shard	Shangri-La	202	London Bridge	Recently opened
InterContinental London The O2	InterContinental	452	North Greenwich	2015
Hilton London Bankside	Hilton	281	Southwark	2015
One Blackfriars Tower	Independent	152	Southwark	2015
10 Trinity Square	Independent/Reignwood	98	Tower Hill	2015
Bow Street Magistrates Court	Independent	99	Covent Garden	2016
Great Scotland Yard	Independent	234	Embankment	2016
One Nine Elms (West Tower)	Wanda Hotels & Resorts	187	Vauxhall	2016
Admiralty Arch	Independent	100	Trafalgar Square	Speculative - 2016
Peninsula London	Peninsula Hotels	Not disclosed	Hyde Park Corner	Speculative - 2018
Claridge's (extension)	Independent	40	Bond Street	Speculative
The Ritz (extension)	Independent ¹	46	Piccadilly	Speculative
Sanderson London (extension)	Morgans Hotel Group	4	Berners Street	Speculative
Browns (extension)	Rocco Forte Hotels	5	Green Park	Speculative
Berkeley (extension)	Independent	27	Hyde Park Corner	Speculative
London Marriott Hotel Park Lane (extension)	Marriott	12	Marble Arch	Speculative
Mandarin Oriental Hyde Park (extension)	Mandarin Oriental	2	Knightsbridge	Speculative
Four Seasons London at Heron Plaza	Four Seasons	192	Liverpool Street	On hold
¹ Affiliation with Ritz-Carlton				

Source: HVS Research

Hotel Performance

Despite the vast increase in supply that London has experienced in the recent years and its strong pipeline, the city appears to be still under-supplied in good quality hotels which is illustrated by the strong marketwide performance.

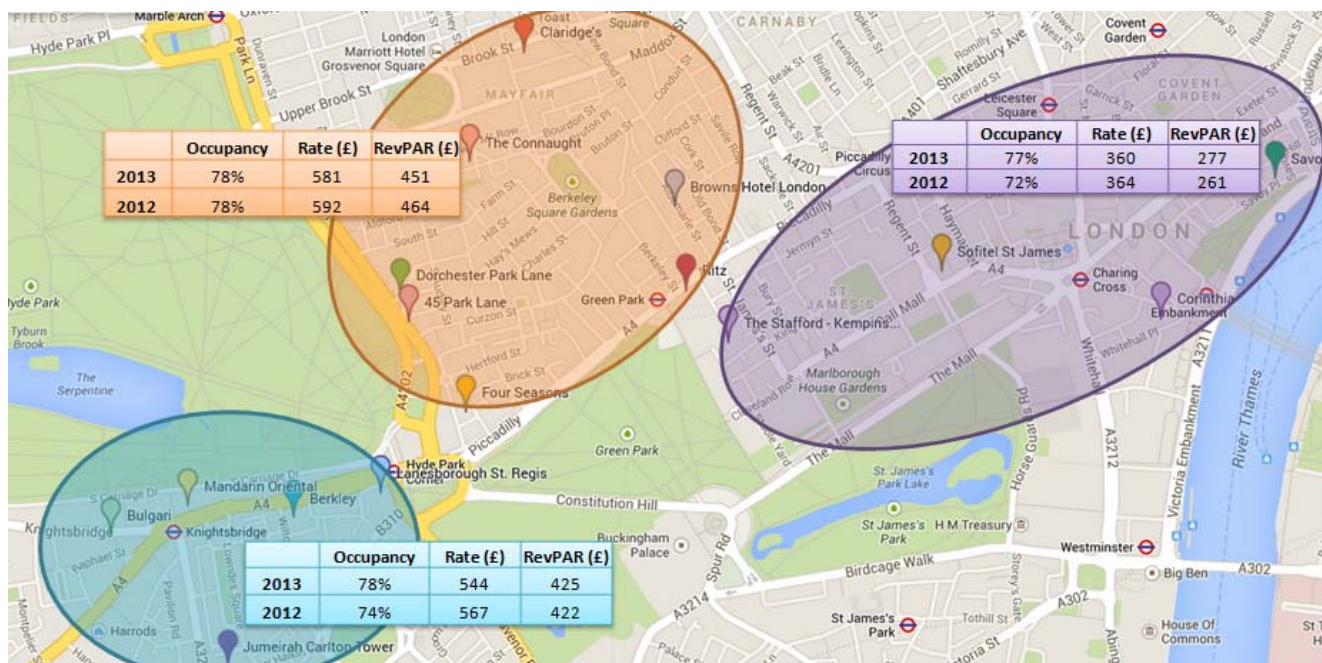
CHART 6: LUXURY HOTEL PERFORMANCE IN LONDON 2012-13

Performance Comparison	2013				2012		
	Hotel Rooms	Occupancy	Average Rate (£)	RevPAR (£)	Occupancy	Average Rate (£)	RevPAR (£)
Knightsbridge	797	78%	544	425	74%	567	422
Mayfair and Park Lane	1,064	78%	566	440	78%	592	464
St. James's and Strand	851	77%	360	277	72%	364	261
Total Luxury	2,712	78%	496	385	75%	511	383

Source: HVS Research

Overall performance in the luxury segment has seen a decline in rate as most hotels reached records in 2012 during the period of the Olympic Games. The outlook for 2014 remains positive as year-to-date numbers are promising albeit there are a number of new hotels due to open which could have a negative impact on performance.

CHART 7: HOTEL PERFORMANCE BY AREA



In a comparison of the luxury hotels in the different areas of central London, the following can be observed:

- Luxury hotels' average rates are very much driven by the quality and performance of their suites. The optimal mix of room inventory is therefore crucial to the success of the hotel. Global trends indicate that more and more luxury brands are adding additional suites to their hotels as guests desire more privacy, space and exclusivity. On average, luxury hotels in London tend to have a suite ratio between 25-30% of total room inventory which is similar to luxury hotels in Paris. In other parts of the world, where luxury hotels tend to be larger, (especially Asia and the Middle East) suite ratios are lower due to the overall higher room count;
- The Knightsbridge, Park Lane and Mayfair areas all have a long-standing tradition and reputation for luxury retail, residences and top-end hotels. Due to the high barriers to entry, these markets might appear to be rather mature and stable. However, the Bulgari hotel is a good example that with the right location and brand even established markets can be penetrated. The newly opened hotel has managed to achieve high rates and capture strong market share. (It should be noted, however, that the lower room count enables the hotel to yield more aggressively than larger properties.) Having been operational for less than two years a further growth in rate as part of its build-up period is anticipated. The Dorchester's sister property at 45 Park Lane, with its exclusive room and suite product has also been successful capturing demand from high-paying guests;
- Renovations, closings and reopenings keep the luxury market dynamic. The latest example is the Lanesborough Hotel by St.Regis which closed in December 2013 and is undergoing a complete renovation with an anticipated reopening date in the last quarter of 2014;
- Luxury hotels in the Strand and Trafalgar Square (namely the Corinthia and the Savoy) area are still in a build-up period following their recent (re)opening. A further growth in this part of London is therefore to be expected in future. As both properties have a large number of suites, much of the rate growth will depend on the ability to market their suite product. Should guests' and consumers' interests for high-end shopping and entertainment shift away from Knightsbridge, Mayfair and the West End and move towards the Strand, these two hotels would be ideally positioned as their suite product is in excellent condition;
- Luxury hotels in other parts of the city, such as the various boutique hotels in Soho or the Four Seasons Canary Wharf, that have not been included as these hotels achieve generally lower average rates than Mayfair, Park Lane or Knightsbridge properties.

The Importance of Food and Beverage

Getting the restaurants, bars and banqueting concepts and positioning right are essential in the luxury category. Hotels have different approaches to food and beverage, as for some, the department is a strong revenue contributor and can account for almost half of total revenues. Generally speaking, most luxury hotels do not focus strongly on large meetings and events and therefore do not have extensive banqueting facilities (with the exception of the Dorchester and the Savoy). However, outlets and lounges can be very profitable and high profile restaurants and famous chefs can add value to the profile of the hotel. Traditional afternoon tea, which is available in all hotels, remains popular and generally very profitable.

Profitability

A comparison of London's luxury hotels' gross operating profit (GOP) margins indicates that profitability ranges typically between 40-45% for a stabilised operation. It should be noted that the hotels with high food and beverage contribution generally have a lower GOP margin due to the lower profitability of the food and beverage operations. Naturally, profitability for hotels that have recently opened and are still in a build-up phase tends to be lower. Essential for strong profitability are high room rates which are mainly driven by the suite performance. It should be noted that due to their prestigious (and expensive) locations, the ability to generate strong annual cash flows is expected from luxury hotels in order to justify the high acquisition cost, annual loan or lease payments.

International Comparison with Paris and New York

London's hotel market remains amongst the best performing international gateway cities. A comparison between the performance of London's top five luxury hotels and its counterparts in Paris and New York shows that London hotels achieved a higher occupancy than both. However, it should also be noted that the top five hotels in London are slightly smaller in room count than the ones in Paris and New York (as the top five London hotels have a combined room count of 777 rooms compared to 883 in Paris and 1,340 in New York). On the other hand, Parisian Palace Hotels achieve a higher rate than the best performing hotels in London and New York as well as the best RevPAR.

CHART 8: TOP FIVE LUXURY HOTELS' PERFORMANCE, 2013 (US\$)

Top Luxury Performance Comparison 2013				
	Hotel Rooms	Occupancy	Rate (US\$)	RevPAR (US\$)
London	777	78%	1,060	825
Paris	883	69%	1,403	970
New York	1,340	72%	917	661

Source: HVS Research, based on exchange rates of 1 USD = 0.598 GBP = 0.735 euro

Hotel Investment

Given the resilience of London's hotel performance, as well as a generally strong appetite for real estate in the city, London remains one of the most desirable hotel investment markets in the world with strong interest from a cross-section of buyers including private equity funds, REITs, institutional investors, private investors, Sovereign Wealth Funds and hotel operators. Between 2007 and 2013, total hotel investment volume in London was €10.4 billion, which was the second highest globally after New York.

A notable feature of the London hotel investment market has been the growth in the proportion of overseas investors, which increased from 46% in 2011 to 54% in 2013. Increasingly, there is interest from Chinese and other Asian investors as evidenced by the recent acquisition of the Marriott Grosvenor Square by Joint Treasure International Limited. With the Chinese economy cooling and the increasingly positive outlook for the UK economy, the number of Asian investors seeking to enter London is expected to continue to grow.

Against the strong investor appetite for high-end London assets, the stock coming to market is very limited and it is not unusual for high-end assets to transact at sub-5% yields, with investors focusing on capital preservation. The limited stock has also led to investors looking beyond established hotels in traditional upmarket areas, such as Mayfair, towards development opportunities in regeneration areas such as One Nine Elms, as mentioned earlier, where Dalian Wanda is developing a £700 million mixed-use scheme that includes a five-star hotel to be operated under its Vista brand.

CHART 9: UPPER-UPSCALE AND LUXURY HOTEL TRANSACTIONS (GBP)

Transaction Date	Hotel	Rooms	Transaction Price (£)	Transaction Price (£) per Room	Buyer	Seller
Sep-08	Café Royal	160	90,000,000	563,000	Alrov	Crown Estate
Sep-09	The Stafford Hotel	105	77,500,000	738,000	Britannia Hospitality	Daniel Thwaites
Dec-09	Marconi House (Former Silken)	173	110,000,000	636,000	BBVA (Subsidiary)	PwC as administrators
Nov-10	St James Hotel & Club	60	60,000,000	1,000,000	Mansha Family	Mountain Capital
Dec-10	10 Trinity Square	100	70,000,000	700,000	KOP Group	Thomas Enterprises
Dec-10	Grosvenor House Hotel	494	470,000,000	951,000	Sahara India Pariwar	RBS
Jul-11	Park Lane Mews Hotel ¹	72	44,500,000	618,000	Genting UK	Chelsfield Partners
Sep-11	W London	192	200,000,000	1,042,000	Al Rayan Tourism & Investment Company	McAleer & Rushe
Feb-12	Number 11 Cadogan Gardens	60	32,500,000	542,000	Cadogan Estate	Paul Davies
Jul-12	The Cavendish	230	158,800,000	690,000	Ascott	Ellerman Investments
Oct-12	Admiralty Arch	100	60,000,000	600,000	Rafael Serrano	UK Government
Feb-12	InterContinental Westminster	256	confidential	confidential	Sojourn Hotel Group	Splendid Hotel Group
Jan-13	The Hempel Hotel	46	30,000,000	652,000	Amazon Properties Ltd	P. Murtagh
Mar-13	InterContinental London Park Lane	447	400,000,000	895,000	Constellation Hotels Holding Ltd	Leasehold IHG, Freehold Crowne Estate
Mar-13	Parkes Hotel	33	35,000,000	1,061,000	HNWI	CBG Worldwide
Jul-13	Grosvenor Place - Proposed Peninsula	n/a	132,500,000 ²	n/a	The Hongkong & Shanghai Hotels Ltd	Derwent London
Jan-14	London EDITION	173	confidential	confidential	Abu Dhabi Investment Authority	Marriott International
Apr-14	Marriott Grosvenor Square	237	125,100,000	528,000	Joint Treasure International Ltd	Strategic Hotel Capital

Source: HVS Research

¹ 58 year leasehold

² 50% interest in 1-5 Grosvenor Place only, excluding development cost



About HVS

HVS is the world's leading consulting and services organisation focused on 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, 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 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. www.hvs.com

With offices in London since 1990, **HVS London** serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised some 4,000 hotels or projects in 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuation and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks, which finance hotels and portfolios.

**Superior Results through Unrivalled Hospitality Intelligence.
Everywhere.**

About the Authors



Christof Bertschi is an Associate with HVS London. He joined the company in 2012 after completing his Bachelor of Science in International Hospitality Management at the École hôtelière de Lausanne, Switzerland. Prior to HVS, Christof had worked in Switzerland and the UAE. Since joining the London office, he has worked on valuations, feasibility studies and consulting mandates in the UK, France, Germany, Switzerland, the Czech Republic, Poland, Belgium, Croatia and Burundi.



Luisa Pott is a Senior Associate in the London office of HVS. She joined the company in 2011 after completing her Bachelor of Science in International Hospitality Management at École hôtelière de Lausanne, Switzerland. Since joining HVS, Luisa has conducted various valuations and feasibility studies throughout Europe and Africa, and has written several market and industry related articles.

For further information, please contact:

Christof Bertschi – Associate, HVS
cbertschi@hvs.com
+44 20 7878 7724

Luisa Pott – Senior Associate, HVS
lpott@hvs.com
+44 20 7878 7753