INSIGHT
UK Leisure

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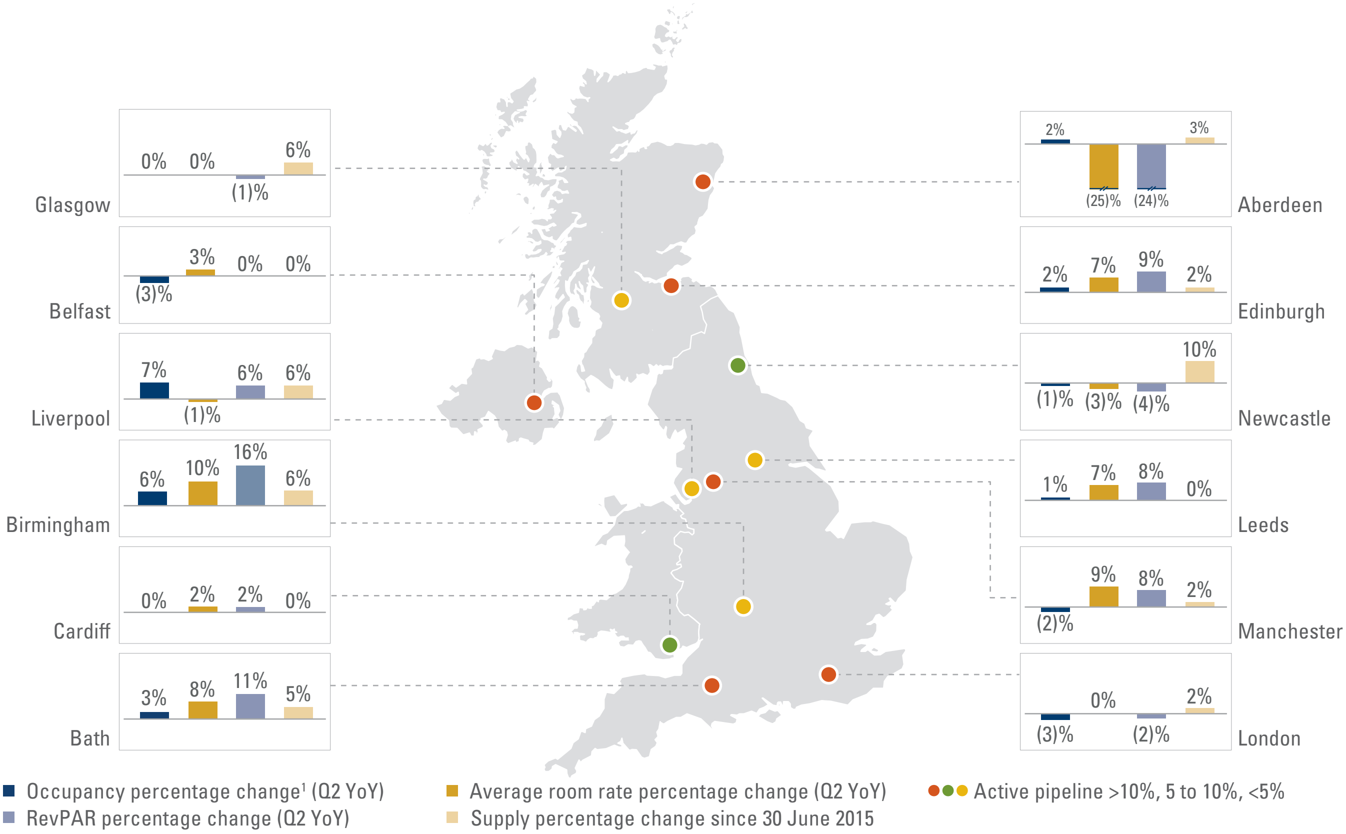
Hotel Bulletin: Q2 2016

Q2 2016 saw polarisation of performance between the 12 cities reviewed in the Hotel Bulletin. London, Newcastle, and Aberdeen underperformed cities including Birmingham and Bath, both of which benefitted from an influx of international tourists. Overall, plateauing RevPAR growth suggests that many locations may have reached the top of the market. The transaction market picked up in Q2 2016, although this was skewed by the sale of Atlas Hotels which accounted for over half of the total acquisition value. M&A activity in H1 2016 was significantly lower than H1 2015, which is more reflective of market uncertainty. In this quarter's Focus, we consider the potential implications of Brexit on the UK hotel market.

FIGURE 1: Selected UK hotel markets – demand and supply



Notes: Q2 covers the three months to the end of June | Q2 YoY compares the average of Q2 2016 to the average of Q2 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

Mixed RevPAR performance

In Q2 2016, top-line performance varied significantly across the 12 cities reviewed in this bulletin. RevPAR growth ranged from 16% for top performer Birmingham to a 24% decline for worst performer Aberdeen. Another quarter of sluggish demand growth (average RevPAR growth of 2%) provides further evidence that we may be approaching the top of the market, although this is, of course, location dependent. Seven of the 12 cities recorded RevPAR growth in Q2 2016, and as mentioned in the Q1 2016 Hotel Bulletin, a number of the cities reviewed are currently generating RevPAR below 2008 levels,[1] suggesting there is room for growth in these locations.

In Q2 2016, London's RevPAR decreased by 2% in comparison to Q2 2015. Occupancy in London has decreased for the last six quarters and, for a second consecutive quarter, average room rates did not increase. Performance in London and many other major European cities has been negatively impacted by increased global terrorist activity with declines in airline and hotel bookings reported across cities seen as being under threat.[2] In addition, as with previous US election years, the number of US tourists travelling abroad has decreased (the number of US visitors to the UK in May 2016 was 12% lower than May 2015).[3] It is worth noting that this is a relatively modest decline given the strength of the London hotel market.

Birmingham recorded the highest RevPAR growth of the cities reviewed in Q2 2016 (16%). Over 2.9 million passengers passed through the airport in Q2 2016, up 12% from the same quarter in 2015.[4] Hoteliers in the city are likely to benefit from a number of high profile events in the rest of 2016, including the third test match between England and Pakistan at Edgbaston and the BBC Sports Personality of the Year awards in December.

In Q2 2016, RevPAR in Bath increased by 11% in comparison to Q2 2015. Recently released figures show Bath moved up five places to twelfth in the VisitBritain top towns for international staying visitors between 2014 and 2015.[5] Growth may continue through the rest of 2016 due to the £5-million South West Growth Fund targeting visitors from countries including Australia and New Zealand.

Aberdeen was the worst performer for the sixth consecutive quarter (24% RevPAR decline in comparison to Q2 2015). The city's hotel market continues to struggle due to its exposure to the oil and gas industry; RevPAR is now 43% lower than the peak recorded in Q2 2014. The road to recovery is unclear for the city, with some analysts predicting further falls in oil prices due to a sustained oversupply of refined oil products.[6]

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.

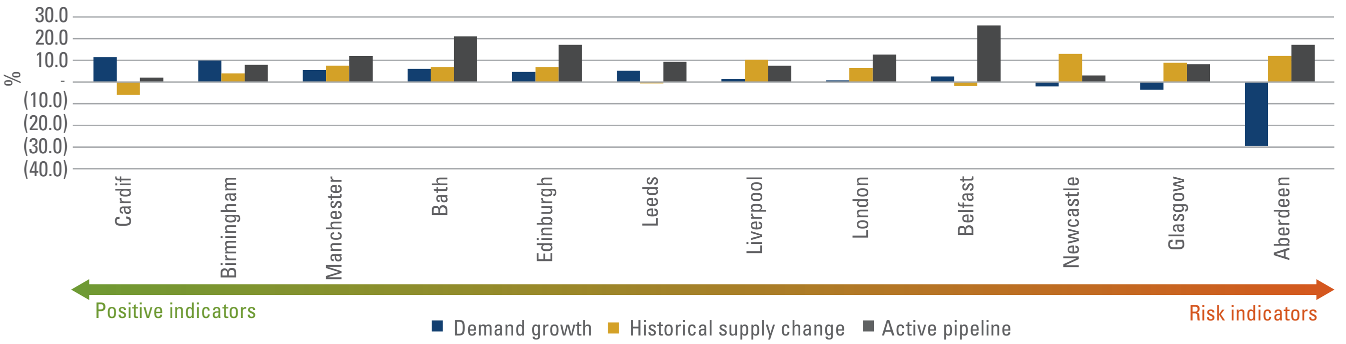
The interaction of demand growth, historical supply change and active pipeline are considered. Demand growth has been calculated as the average RevPAR growth for the last four quarters to provide an indication of recent demand trends. Historical supply change has been calculated as the increase in rooms 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 in order to illustrate the changing profile for each city over the year.

Average RevPAR growth in Manchester has dropped from 20% in Q3 2014 to 8% in Q2 2016. This deceleration is not as pronounced as other cities reviewed, despite supply increasing by 10% during this period. Although the city currently has active pipeline equivalent to 12% of current supply, investors may consider Manchester an attractive option. This is due to ongoing investment in the city, its historical ability to absorb new supply and the city being named as top city in the country for rental yields.[7]

Notes: 1. On an inflation adjusted basis
Source: 2. Wall Street Journal, 3. Visit Britain, 4. Birmingham Airport, 5. Visit Bath, 6. Morgan Stanley 7. Lendinvest

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 June 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) indicators

Supply and pipeline

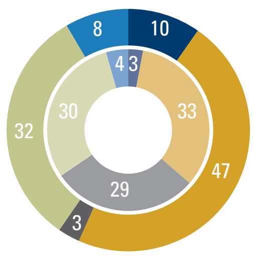
In figure 3 below we compare the proportion of current supply (inner circle) and active pipeline (outer circle) in the UK market by sector. Budget hotels continue to make up the largest portion of both supply and active pipeline. Almost half of budget bedrooms due to open in the next few years will be Premier Inn or Travelodge, as these brands continue with rapid expansion plans. Whitbread has stated its ambition to have 85,000 Premier Inn bedrooms by 2020, while Travelodge has set the shorter term goal of opening 19 new sites in 2016.

Q2 2016 was a relatively quiet quarter for hotel openings. The number of bedrooms added was over 40% lower than Q1 2016 and the lowest since Q4 2013. In contrast to this, the number of bedrooms added to the active pipeline remained in line with the average from the previous four quarters. These additions included a number of extensions and conference room conversions as hoteliers look to maximise total bedrooms in existing sites. This trend suggests that developers' appetite has not been materially impacted by recent performance metrics.

Notable new openings and developments this quarter include:

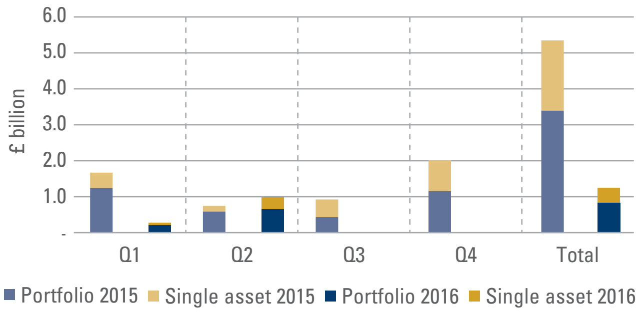
- 342 bedrooms opened in Glasgow in Q2 2016 (4% of current supply). This was more than the total bedrooms opened in the whole of the previous year. Glasgow continues to attract hotel investors following significant investment, including £700 million invested in transport infrastructure, in preparation for the Commonwealth Games in 2014.
- Hyatt opened its first UK Hyatt Place branded hotel in Heathrow/Hayes. The 170 bedroom hotel sits beside the site of the brand's proposed Hyatt House apartment offering which is currently awaiting planning permission.
- Bloc Hotels have submitted plans to develop a second apart-hotel in Birmingham. The planned 238-bedroom, 26-storey building would become one of the tallest buildings in Birmingham if planning permission is granted.

FIGURE 3: UK current bedroom supply (inner circle) and active pipeline (outer circle) 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

£964 million of transactions were completed in Q2 2016. This was 30% greater than Q2 2015. However, H1 2016's total transaction value of £1.3 billion is £1.1 billion lower than the previous year.

This year, the M&A market in the UK has been suppressed (total M&A transaction values in all sectors in H1 2016 were 34% lower than H1 2015).[8] This is largely due to a multitude of uncertainties including Brexit, economic growth in China, increased terrorism risk, and the US presidential election. The impact of Brexit on the UK hotel market is considered later in this article.

Notable transactions completed this quarter include:

- London & Regional acquired Atlas Hotels from Lone Star for a reported £575 million in May 2016. The portfolio of 46 Holiday Inn Express hotels and one Hampton by Hilton accounted for over half the total transaction value in Q2 2016.
- Hong Kong investor Magnificent Hotel Investments acquired the 408-bedroom Travelodge Royal Scot in Kings Cross from TH Real Estate for £70 million. William Cheng Kai-man, chairman of Magnificent, said: 'We are probably the first company to buy a property in London amid the Brexit overhang. The uncertainties provided the company an ideal opportunity to get into the high-demand hotel sector in London, and the falling currency has made the deal more attractive.'[9]
- Arora Hotels has agreed to buy out the remaining 50% stake in the 5 star 453-bedroom InterContinental London The O_2 from joint venture partner Queensgate Investments for a reported £100 million.
- Six regional Hilton hotels (813 bedrooms) have been sold by Oaktree Capital to individual private buyers for a total reported £40 million. Five of these hotels have been acquired free of their Hilton branding following the termination of their management agreements.

Source: 8. Bureau van Dijk, 9. The Caterer

Focus on: Brexit

With the dust now settling following the UK's decision to leave the EU, Theresa May's government is slowly preparing to initiate the formal exit process, having made clear that 'Brexit means Brexit'. What is unclear at present is what Brexit will look like as certain goals, such as control over immigration, appear to be incompatible with maintenance of current levels of access to the single market. These include, for example, financial firms being able to operate across Europe using the passport system. This lack of clarity causes uncertainty for investors considering long-term investments in the UK such as hotels.

The Bank of England's recent reduction in 2017 GDP growth forecast to 0.8% (from 2.3% in May), indicates the seismic impact of the Brexit vote. According to Governor Mark Carney, this was 'the largest revision to our GDP forecast since the MPC (Monetary Policy Committee) was formed almost two decades ago'. The pound has weakened against the euro and the US dollar since the Brexit vote, and fell again to £1.00 = €1.18 and £1.00 = $1.31 on 4 August in reaction to this news.

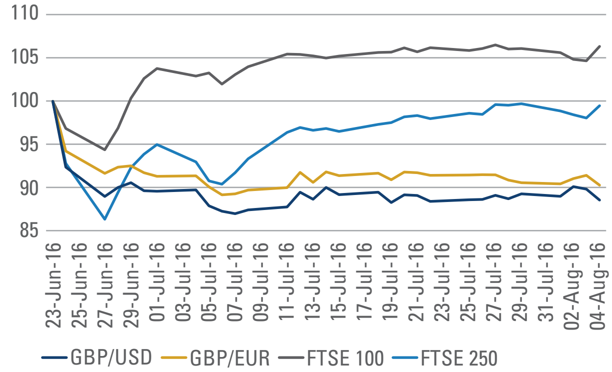
Contrasting effects have been seen in the stock markets post referendum with the more domestic weighted FTSE 250 down 2% before the Bank of England's announcement whilst the FTSE 100, which has a greater weighting to overseas revenues, was up 5% on the same date. Stock markets have initially responded positively to the Bank of England's stimulus package, which included a drop in interest rates to 0.25%, with the FTSE 100 and FTSE 250 increasing by 1.6% and 1.5% since the announcement.

The twin impacts of a weaker sterling and a reduction in expected economic growth have implications for the hotel sector.

Currency weakness is a mixture of good and bad news for the UK hotel sector. Prices for rooms and visits overall appear cheaper to those in Europe and the US, thereby potentially boosting demand from overseas visitors. In the short term, most UK holidaymakers will have made their arrangements for this summer but, in time, outbound UK travellers may also be persuaded to forego or shorten their foreign holidays (which will now be more expensive in sterling terms) and remain in the UK—the return of the 'staycation'.

From a cost perspective, the fall in sterling could lead to an increase in input prices of goods denominated in foreign currencies such as oil or other basic commodities, which are mainly denominated in US dollars. Other cost lines, for example F&B, are also likely to rise as suppliers try to pass through their inflated cost bases. Oil prices have fallen significantly in recent times so there should be some headroom for hotels to absorb some price increases.

FIGURE 5: Movement in euro and US dollar exchange rates, FTSE 100 and FTSE 250 (rebased to 100)



Source: Oanda, London Stock Exchange

In the transaction market, a weaker pound will make hotels relatively cheaper for overseas investors in their local currency. This will be a welcome effect given that the UK hotel market has become more fully valued in recent times, with many of the US funds that had been so active in the UK market redirecting their efforts to mainland Europe. The opposite side of this effect for overseas investors who already own hotels will be that the value of their assets will have taken a hit from the currency devaluation.

The focus for investors now is to assess future trading which, given the uncertainty over Brexit, could be challenging. This uncertainty could well depress hotel transaction activity.

Historically, regional hotel performance has been closely aligned to GDP growth. Given lower growth expectations, performance improvement caused by the factors mentioned above, which will impact primarily impact leisure trade, may be mitigated or even outweighed by the negative impact of subdued economic growth, which will primarily impact corporate trade.

We remain cautiously optimistic that the UK (and European) hotel sector will remain an attractive source of investment for those global investors who are interested in the medium to long-term growth perspective as well as knowledgeable intraregional investors seeking to consolidate their ownership position in markets that they know well. However, this is reliant on the UK remaining an investor-friendly market post-Brexit—if not, London as a financial centre could be badly hit, which in turn could lead to companies' relocating to Europe and jobs' being lost in the City. To avoid damaging the UK hotel sector, those negotiating the terms of Brexit need to be wary of this while also finding some way of ensuring that the UK maintains the ability to employ suitably skilled, relatively low wage staff from overseas.

Investment indicators for Q3 2015 to Q2 2016

FIGURE 6: Glasgow

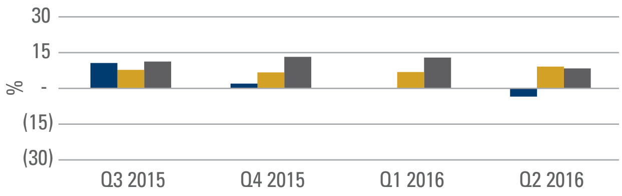


FIGURE 7: Belfast

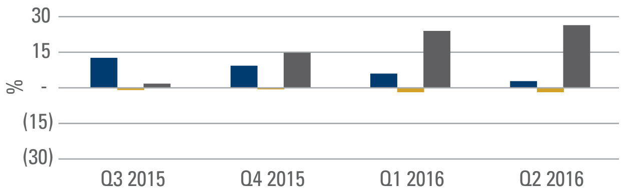


FIGURE 8: Liverpool

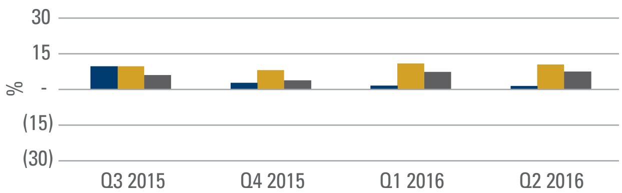


FIGURE 9: Birmingham

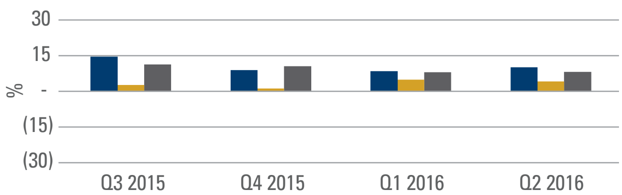


FIGURE 10: Cardiff

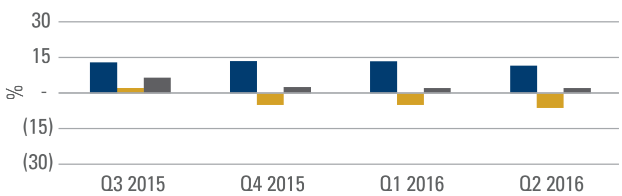


FIGURE 11: Bath

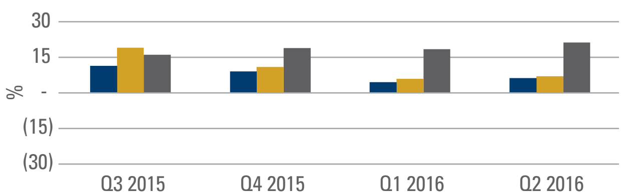


FIGURE 12: Aberdeen

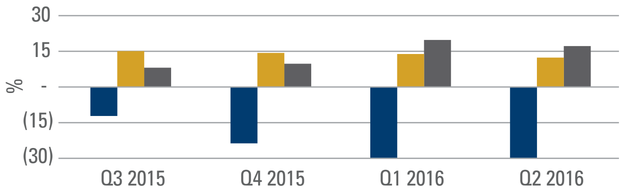


FIGURE 13: Edinburgh

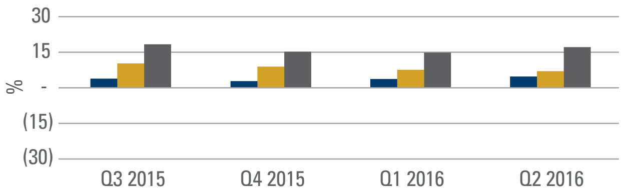


FIGURE 14: Newcastle

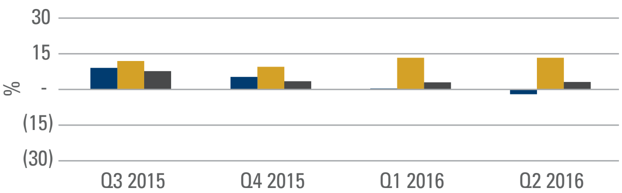


FIGURE 15: Leeds

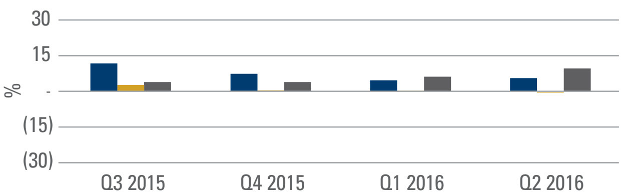


FIGURE 16: Manchester

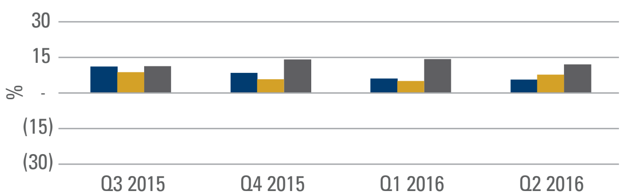
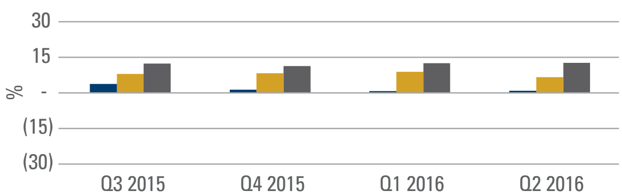


FIGURE 17: London



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 confirmed pipeline bedrooms as a percentage of current supply

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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.

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