Scotland's Hotel Market Overview

Avison Young Hotels

July 2021

Introduction

The tourism and hospitality sector across Scotland has been severely impacted by the Covid-19 pandemic with international travel and large events at a standstill and hospitality closed for all but essential uses during much of the last 15 months.

With some normality returning, now is the time to reflect on the impact and look to the future as the sector starts to recover. We have looked at what we believe the shape and speed of the recovery will look like over the coming months.

Avison Young are the leading hospitality advisory team in Scotland with vast experience and a specialist team based between the Glasgow and Edinburgh offices. We have advised on many of the recent and current development projects across Scotland and are actively involved in several hotel transactions. We understand extremely well the market dynamics and, importantly, what will drive the recovery, overlaying historic market performance and projecting the new normal moving forward.

Avison Young's AVANT data platform tracks the cross-sector recovery through the "UK Cities Recovery Index" in ten cities across the UK, including Glasgow and Edinburgh, and we outline the performance (all sectors and hotels & leisure). This shows clear momentum in the recovery of the hospitality and leisure sectors since lockdown easing in May, with further significant growth expected during the summer and early autumn, driven by domestic leisure and a gradual return of business travel.

We are confident that the hotel sector will bounce back strongly from the pandemic, and that Scotland's main markets are well-placed to recover quickly once travel and events begin to return. Whilst we expect demand volumes to return to pre-pandemic levels, the type and mix of that demand will change. The midscale and economy sectors will recover first driven by domestic demand, with full service and luxury sectors lagging behind, in line with the return of international travel and large events.

Hospitality businesses will come under increasing pressure as Government support measures come to an end and the costs of supplies and staffing (limited resources and significant wage pressure) could still result in distress from less viable businesses and those that have been historically under-invested.

New supply pressure could also see revenue performance continue to be impacted even as demand returns. New, well-located hotels will often outperform older competitors, and with potential under-investment due to the pandemic, this could become more pronounced in the short term. We look at the status of some of the key pipeline schemes as one of the impacts of Covid-19 has been a severe restriction in the availability of development funding.

Whilst transaction volumes have been limited in the hotel space since the onset of Covid-19, and there certainly hasn't been the levels of distress that many predicted, a handful of Scottish hotels have changed hands in recent months. There is a large amount of private equity ready to be placed in the sector and we are aware of a number of off-market deals under discussion. However, there remains a gulf between buyer pricing and vendor aspiration in many instances. We provide further insight into the outlook for asset valuations and the transactional market as we move out of the crisis.

Please get in touch if you would like to discuss any of the points raised in this overview, or to discuss your hotel project.

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* What makes up the Recovery Index?

Sector indices include data points for:

Commercial activity: Industry, business sentiment and employment
Hotels and leisure: STR data, restaurant, pub, bar and other leisure activities
Mobility: Journeys by foot, air, train, bus and car
Residential: Residential property market activity
Retail: Footfall, shop visits and consumer confidence
Return to Office: Commuting patterns and levels of office occupancy

The sector indices are combined into an overall Recovery Index, which illustrates the evolution of urban impact and recovery over time.

Scotland's Hotel Market

Tourism and Economy Overview

UK Tourism

Visit Britain has published visitor numbers and spend for both inbound and domestic tourism in 2020 and forecast for 2021. It shows large declines in all metrics with the industry affected by the significant drop in travel.

The Visit Britain scenario from 7th May 2021 for both inbound and domestic travel takes into consideration the successful vaccine rollout. We anticipate a spike in domestic leisure travel in the second half of 2021, with international travel remaining subdued until late 2021 / early 2022.

Visit Britain 2020 and 2021 Forecast - Compared with 2019

2020	Visitors	Spend
Inbound	↓ 73.0%	↓ 78.2%
Domestic	↓ 60.0%	↓ 62.9%

2021	Visitors	Spend
Inbound	↓ 72.4%	↓ 78.0%
Domestic	↓ N/A	↓ 56.0%

Source: Visit Britain 2021

Scottish Tourism

2019 was the best year for overnight tourism to Scotland over the previous ten, with visits and expenditure increasing by around a sixth from 2018. This growth was underpinned by a strong domestic market, as well as increases in length of stay by international visitors. However, with a high dependence on events and leisure tourism, inbound tourism in Scotland has reduced disproportionately against the UK average since March 2020.

2020	Visitors	Spend
Inbound	↓ 78%	↓ 85%

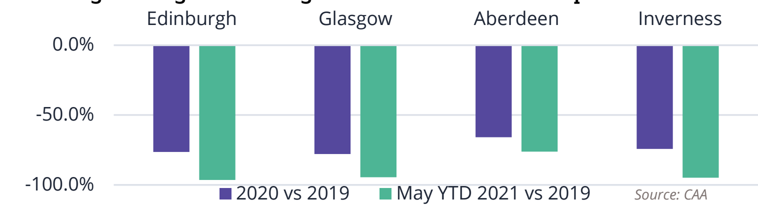
Source: Visit Britain 2021

The Visit Britain scenario forecasts domestic overnight and day visitor spending to be around 50% lower in 2021 than in 2019. However, with the easing of lockdown restrictions, staycation destinations (rural and coastal) are performing very well currently with strong occupancies and ADR. This benefit has extended to some cities, with solid increases in the volume of visitors to Edinburgh since the May reopening, and strong levels of future bookings.

Scottish Flights

Air travel has been severely affected throughout the pandemic with global travel restrictions enforced for much of 2020. This has continued into 2021 and will not begin to fully recover until the vaccine is widely available across multiple countries. The graph below shows the decline in passenger numbers (international and domestic) across Scotland's main airports. Glasgow experienced the largest decline in 2020 (-78.0%) closely followed by Edinburgh at -76.4%. However, all airports experienced improved passenger numbers in the summer months of 2020 with the easing of travel restrictions. UK-wide in June 2021, easyJet's passenger volumes stood at 17% of those in June 2019, whilst Ryanair is at 37%, highlighting the continued impact on the industry.

Percentage Change of Passenger Numbers at Scottish Airports vs 2019



Scotland's Economy

Before Covid-19, Scotland's economy was experiencing modest and steady growth, with GDP increasing by 0.2% in Q4 2019. However, the pandemic has resulted in a significant level of disruption, with national lockdowns having an unprecedented impact on the economy. KPMG estimates that Scotland's economy declined by 9.6% in 2020 with the pandemic impacting all sectors. This compares with a UK wide drop of 9.8%.

However, with the continuing successful vaccine programme and potential post-restriction consumer bounce back, it is estimated that Scotland's GDP will grow 6.4% in 2021 and 5.2% in 2022, slightly below UK-wide averages. The Fraser of Allander Institute's central scenario projects GDP levels returning to pre-crisis levels by October 2022. Industries including oil and gas are expected to see a boost from the rebound in global demand and increase in oil prices, whilst the country's tech, biotech and medical industries have continued to attract investment and grow over the last year.

Despite these signs of greens shoots there are still some uncertainties facing the Scottish economy including the potential for unemployment to rise through late 2021 as Government support measures, including the furlough scheme comes to an end.

Avison Young's "Big 9" Office Market Report

The Edinburgh and Glasgow office markets have shown a healthy level of activity during H1 2021, with sentiment in the market upbeat and a number of occupiers initiating requirements for new space which should see the market continue to improve through the rest of the year.

Total office take up for Q2 2021 was relatively robust in Edinburgh; city centre take up was only 4% down on the ten year average with the largest numbers of deals since Q4 2018. Glasgow recorded its highest level of take up since Q1 2020, 13% down on the ten year average, however a handful of notable deals are expected to complete during Q3.

While there is still some uncertainty over space requirements with occupiers wanting greater clarity on future office use needs, businesses are having to make decisions. There remains a healthy level of new requirements, particularly in city centres, although the out-of-town market is also starting to see greater activity levels.

UK Cities Recovery Index - Edinburgh

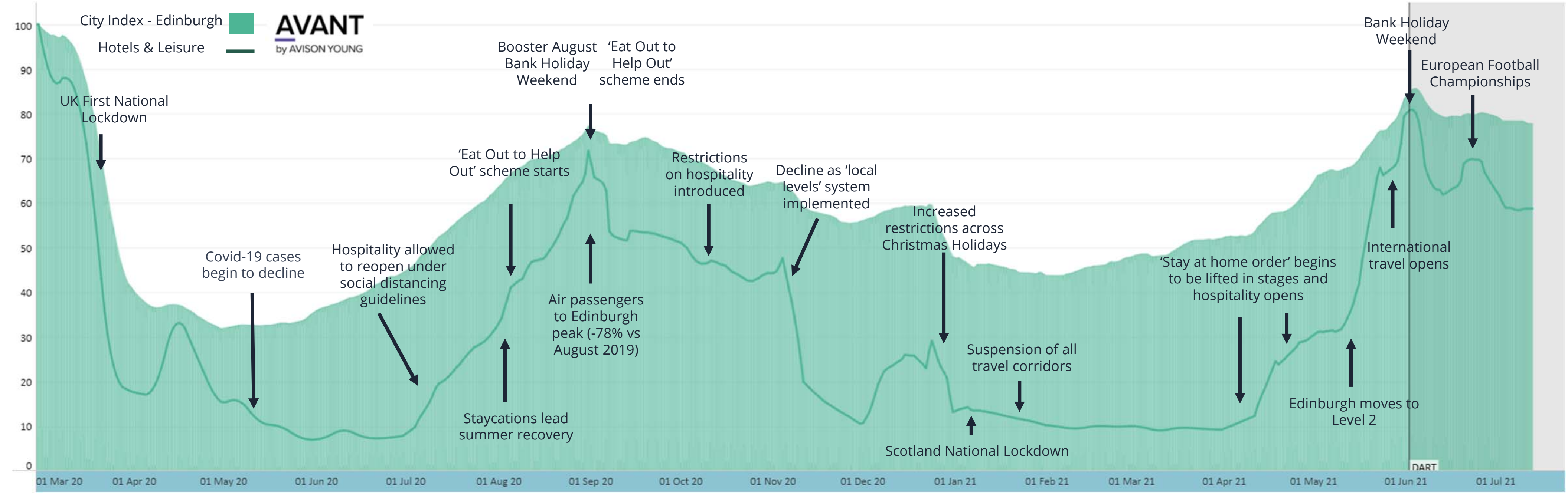
Positive trends fueled by quick recovery of hospitality on lockdown easing

Prior to the pandemic, Edinburgh's hotel sector experienced very strong growth, with occupancy reaching a peak in 2017. Whilst performance softened slightly in 2018 and 2019 due to a number of hotel openings, the market has successfully absorbed new supply over the last decade thanks to the strength of the city's commercial, conference, Government and leisure tourism sectors, making it the best performing hotel market in the UK outside London. This was aided by the exceptional growth in, and profile of, passengers at Edinburgh Airport, increasing the number of international visitors to the city, typically staying longer and spending more than domestic visitors.

Edinburgh hotels experienced one of the greatest RevPAR impacts during 2020 of any UK city due to its large reliance on international visitors, large quantum of upscale and luxury properties and the cancellation of the summer festival programme. The hotel and leisure sector index shown below (green line) highlights the significant impacts the pandemic has had on the sector's performance in Edinburgh, with successive lockdowns and restrictions on international travel. The index increased significantly in April and May as restrictions eased, reaching a new recovery peak in early June (and very close to the all-sector index, shaded area) suggesting strong levels of pent-up demand in the sector. The recovery has plateaued to early July and the hotel & leisure index remains only around 60% of 1st March 2020, below the all-sector city index of about 80%.

Avison Young UK Cities Recovery Index – Edinburgh Hotel & Leisure vs All Sectors

Hotel market underperforms the all-sector index



Source: Avant by Avison Young. Accessed via the following link for the current index https://www.avisonyoung.co.uk/en_GB/ukcitiesrecoveryindex

UK Cities Recovery Index - Glasgow

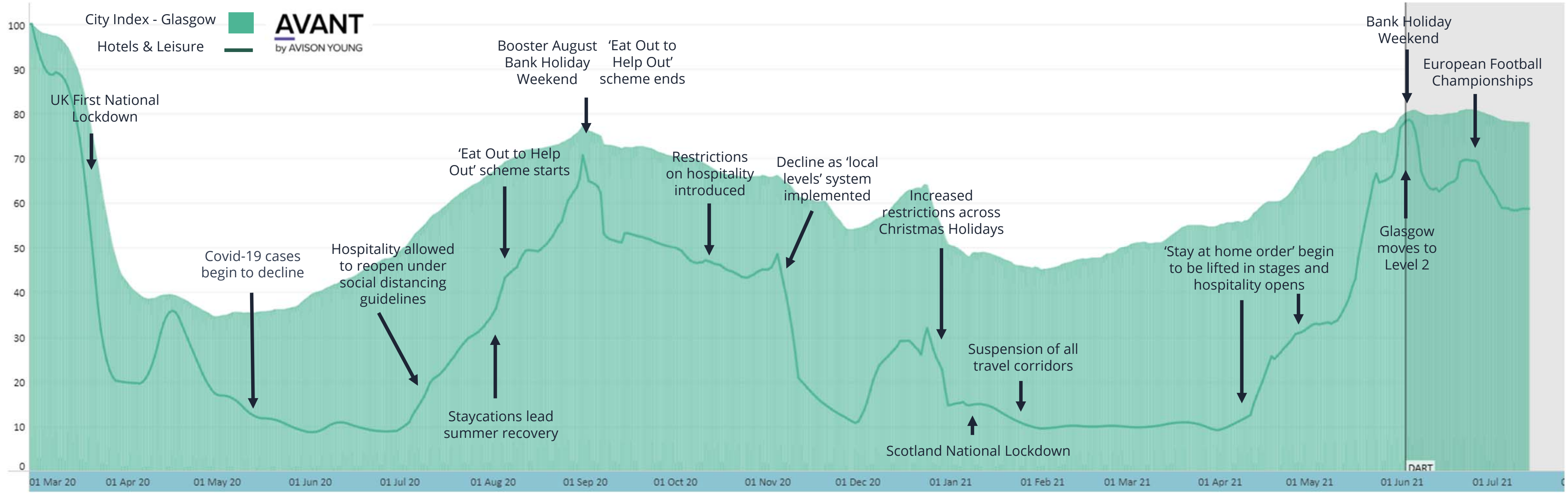
Positive trends fueled by quick recovery of hospitality on lockdown easing

Glasgow's hotel sector grew considerably in the years prior to the pandemic, notably following the 2013 opening of the SSE Hydro Arena and the major events year of 2014 (Commonwealth Games and Ryder Cup) putting the city on the map for hotel developers, operators and investors. The result of this however was a significant increase in new hotel openings in the years prior to Covid, which put both occupancy and rate pressure on the market. The subsequent impact of lockdown was strongly felt by Glasgow hotels (albeit not quite as significant as in Edinburgh), with major events such as Euro 2020 and the COP26 climate conference postponed. Despite summer growth, Glasgow entered a localised lockdown in late 2020, with indoor hospitality effectively dormant in the city until May 2021.

The Recovery Index for Glasgow has followed a similar pattern to Edinburgh over the last twelve months. The effects of more localised lockdowns in the city have not been seen within the index, with declines at similar levels as Edinburgh during these periods. Despite a later lifting of restrictions to Level 2 in June 2021, significant increases in the index have been seen with peaks similar to Edinburgh. At the end of June 2020, both the all-sector and hotel & leisure indexes are very similar to Edinburgh. Although hotel performance (Occupancy and ADR) in Edinburgh was superior in June, as an index against the same period of 2019 both cities are very similar.

Avison Young UK Cities Recovery Index – Glasgow Hotel & Leisure vs All Sectors

Hotel market underperforms the aggregated index



Source: Avant by Avison Young. Accessed via the following link for the current index https://www.avisonyoung.co.uk/en_GB/ukcitiesrecoveryindex

New Hotel Supply

Significant pipeline with a number of hotels under construction

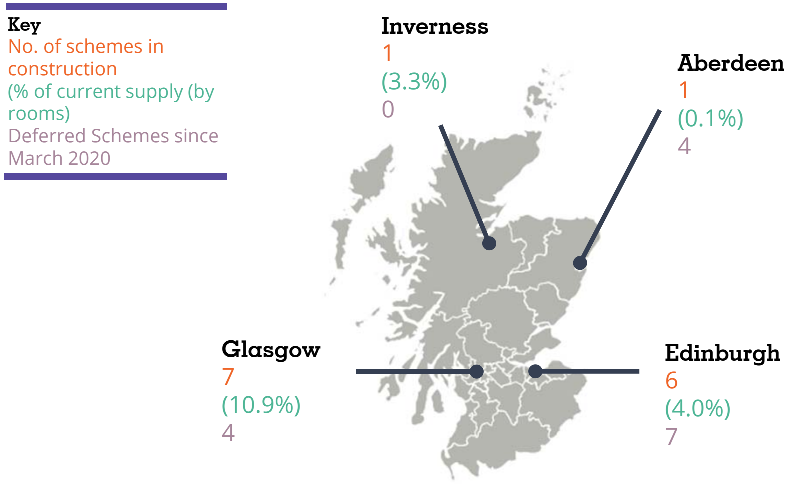
New Supply in 2021

In the four largest cities detailed below, there are 15 significant and large schemes (2,166 bedrooms) currently under construction.

Despite Covid-19, Glasgow still has a large active pipeline, with new bedrooms as a proportion of current room stock at 10.9%. Edinburgh follows this but at a significantly lower level of 4.0%. Equally a large number of pipeline schemes across the two cities have been deferred since March 2020 due to funding pressure (albeit there are now positive signs that development finance is starting to flow). Aberdeen has also experienced a significant number of deferments in the last year with the Scotsman Hotel the only active project in the city. Aberdeen has also seen the closure of three hotels in the last year; two of which have entered liquidation, the other due to be converted to residential.

Hotel Pipeline in Key Cities and 2020/21 Deferred Schemes

A large number of deferred schemes due to Covid-19



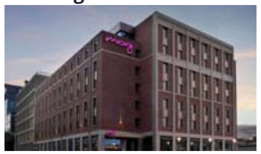
Source: STR., 2021 © CoStar Realty Information, Inc (June 2021)

Hotels Opened H1 2021

New hotel openings across Scotland were limited in H1, with some projects completed which had started pre-Covid-19. New additions include Scotland's second Voco hotel in Edinburgh's West End. Other notable openings include the Premier Inn St Enoch Square in Glasgow and Moxy Edinburgh Fountainbridge which opened in February.

Voco, Edinburgh

Moxy Fountainbridge, Edinburgh



Hotels Opening H2

Construction has continued on a number of major hotel projects across Scotland, with some of these anticipated to open in the second half of 2021. These include the new Gleneagles Townhouse in Edinburgh and the Marriott duo at Glasgow SEC. The Clayton Glasgow's opening has now pushed back into early 2022, which will also feature the opening of the Virgin Hotel Edinburgh.

Gleneagles Townhouse, Edinburgh

Moxy and Courtyard SEC, Glasgow

New Pipeline Schemes 2021

Despite Covid-19, applications for new hotel developments have continued to be submitted. These have included a number of prominent brands within the major cities including the second Virgin Hotel for Scotland in Glasgow and a new Marriott Tribute on Princes Street. In May, preparatory work started for the construction of the new 500 bedroom Student Hotel in Candleriggs, Glasgow which gained planning approval in May 2020. New hotel opportunities are also being presented to the market such as Osborne House, a 157 bedroom hotel development site close to Haymarket Station.

Broomielaw Hotel, Glasgow

Planning submitted in June 2021, for the redevelopment of Oswald House close to the River Clyde to a new upscale hotel.

Virgin Hotel, Glasgow

Virgin Hotels announced in March it will open a new 242-bedroom hotel in Glasgow in 2022 at Clyde Street.

Marriott Tribute, Edinburgh

L&G plans to redevelop the former Debenhams on Princes Street to a 210-bedroom Tribute were approved in April 2021.

Transactions and Values

Volume of transactions low, but capital available

DoubleTree Treetops, Aberdeen

August 2020, £4.25m (Conversion to residential)

The Canongate, Edinburgh

December 2020, £7.4m (£352k per key)

Bruntsfield Hotel, Edinburgh

May 2021, Undisclosed sum

Highland Coast Hotels

May 2021, Undisclosed sum

Ardoe House Hotel, Aberdeen

April 2021, Undisclosed sum

Marine Hotel, Troon

October 2020, £12.3m (£138k per key)

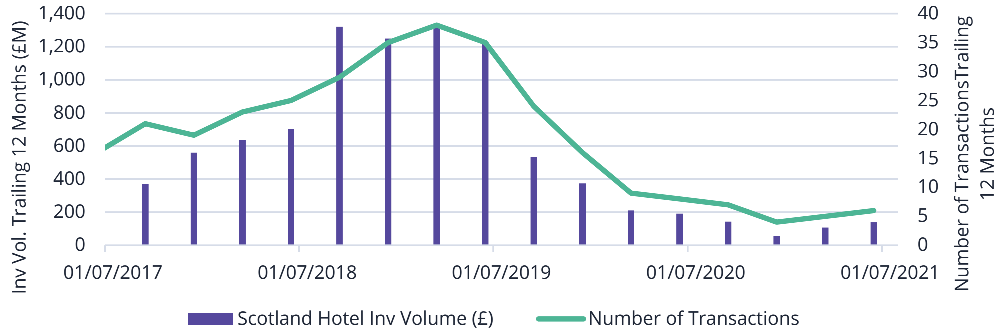
There has not been the levels of distress in the hospitality sector many anticipated as we entered the first lockdown (due to Government support measures), and transaction volumes have remained very low since, due primarily to a gulf in buyer pricing and vendor aspiration. Nevertheless, there have been a handful of transactions across Scotland in the last 12 months, and we are aware of a number of other discreet marketing processes and off-market conversations underway. There are a number of private equity funds looking to place capital into the sector, although debt funding is extremely difficult at the moment. This is likely to remain the case until later this year albeit there are positive signs that funding is starting to ease.

There have been a couple of high profile UK portfolio transactions in the first half of 2021 and Henderson Park reportedly have an exclusive position on the acquisition of a portfolio of 12 Hilton hotels (thought to be around £580m, £240k per bed) including the DoubleTree hotels in Glasgow, Edinburgh Airport and Strathclyde, and the Hilton Edinburgh Carlton. Further, we are aware that Zetland Capital is poised to acquire the Macdonald Manchester Hotel and the Macdonald Holyrood Hotel & Spa in Edinburgh in a portfolio deal at approximately £100m, £202k per bed.

Positively, under guidance from the RICS the material uncertainty clause was removed from all asset classes in May 2021. This is potentially significant as in our experience a number of lenders and funders were unable to transact on valuation reports which contained the clause.

Generally, buyers remain positive about the mid and long term prospects for most prime and secondary Scottish markets. In our experience buyers are confident in achieving or surpassing 2019 trading performance relatively quickly with exit yields remaining fairly robust (despite some softening as a result of the fragility in the debt market). In the main, pricing reductions are as a result of falls in short term income and this is reflected in a circa 5-10% discount below 2019 levels.

Scotland Hotel Investment Volumes 2017 - 2021



Source: Avison Young

The Outlook

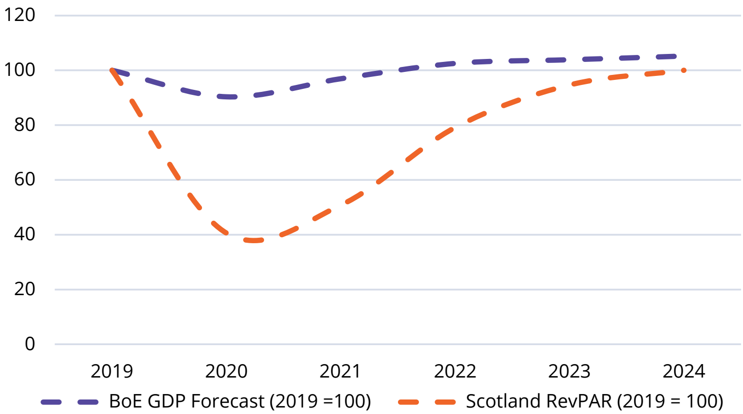
RevPAR recovery by 2024 but operating costs an additional challenge

Hotel sector to recover at a slower pace than GDP

- This is due to travel restrictions and social distancing guidelines remaining for some time and until wider international vaccine rollout. Whilst each market will vary, on average we expect that Scotland RevPAR will return to 2019 levels by 2024.
- Rural and coastal tourism has recovered quicker than the cities initially due to increased staycations. There has also been a recent return of some domestic business travel, although international travel is still extremely constrained. With pent-up demand, international leisure travel will accelerate rapidly in 2022;
- With large seasonal swings likely into 2022, profitability will remain challenging until occupancy can be sustained above c.50%, probably from Q3 2022.

Avison Young Annual RevPAR Forecast 2020-2024 Indexed against 2019 Base Case

Scotland RevPAR to reach 2019 levels by 2024



Source: Avison Young, Bank of England (May 2021)

Higher operating costs may still cause distress

- Limited service hotels, apart-hotels and self-catering accommodation (with less interaction between guests and staff) are expected to recover quicker than other accommodation types. The slower recovery of full-service and luxury sectors will see operators reviewing service standards to drive down costs and remain competitive;
- With Government support schemes coming to an end and operating costs increasing (including payroll due to labour shortages and wage pressure), it is still possible that there will be distress, potentially providing acquisition opportunities.

Positive outlook for Scotland's main cities

- Edinburgh's broad appeal as a visitor destination remains unchanged and we expect a surge of pent-up demand with the return of international travel and the lifting of restrictions on major events and festivals. Add to that a number of major developments proposed or ongoing in the city (such as the St James Quarter), which will increase hotel demand moving forward, and we believe that the city will return to pre-Covid levels of RevPAR performance by late 2023, ahead of the Scotland average;
- While slightly less impacted than Edinburgh in 2020, Glasgow has additional 'hurdles' in its road to recovery in regards to the significant amount of hotel developments under construction and the city's reliance on major international conferences. That said, we expect the demand drivers that resulted in the substantial growth in performance by Glasgow's hotel market over the last decade will recover, with a number of major commercial developments ongoing, as well as the return of major conferences and events (COP26 later this year will strengthen the city's global profile). As a result, we believe Glasgow RevPAR will come back strongly, albeit due to the supply pipeline we expect this will take slightly longer than Edinburgh and the Scotland average, most likely by early 2025.
- We anticipate operator interest in new schemes and rebrands to remain robust, notably in Edinburgh, Glasgow and Inverness.

Changing emphasis of operator agreements

- One of the most notable impacts of the pandemic was on lease agreements and rents. Travelodge entered a CVA in June 2020 to restructure its rent obligations until the end of 2021, impacting a large number of hotels and landlords in Scotland. Other operators, notably Premier Inn continued to pay rent, choosing to raise capital through share offerings;
- Moving forward and for the foreseeable future, it seems likely that many operators who previously offered fixed rent FRI leases will move towards management agreements (variable income) or hybrid arrangements with a low fixed base rent and turnover related top-up;
- Understanding the balance of risk and reward on a case by case basis will be essential moving forward.

Local authority intervention will continue to drive new developments

- There will be increased need for regeneration and place-making activity as town and city centres re-invent themselves to drive the economic recovery. Hotels and leisure will play an increasingly important role in this, often facilitated by local authority intervention;
- The findings of the 2020 Public Accounts Committee enquiry into local authority investments using PWLB (Public Works Loans Board) loans precludes local authorities from investing in property purely for yield, but not investments and developments that support the local economy and growth through regeneration.

How Can Avison Young Assist?

Avison Young Hotels and Leisure

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Avison Young Hotels team can advise and support clients in a number of ways:

Understanding the long-term impacts of Covid-19 on future development and funding of new hotels

Procurement of development partners, brands and operators

Advising on the appropriate and most relevant hotel products that fit the overall master plan of a regeneration project, matching the demand drivers

Advice around the structure of any support or financial subvention including financial performance, investment returns and risk profile;

Detailed financial projections and sensitivity analysis

Investment advice, negotiation of commercial terms and analysis of long-term returns

Avison Young Hotels Team Capabilities

- Agency and Investment
- Valuation
- Building Consultancy
- Project Management
- Planning
- Business Rates
- Consultancy Advice (Feasibility Studies, Branding, Re-Positioning, Operator Selection, Performance Monitoring, Acquisition Due Diligence)

Carried out valuations totalling £10bn+ in the last two years

£1.5bn+ of hotel developments in 2019

Advised on £350m+ of hotel transactions in the last year

UK-wide Coverage – Avison Young Offices

Should you wish to discuss the contents of the document in greater detail please do not hesitate to contact:

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