UK hotel market overview

Avison Young Hotels

May 2023

AVISON YOUNG

Introduction

Avison Young's Hotels team are pleased to present our latest overview of the UK hotel market as it navigates through an economy with increasing cost pressures and consumer uncertainty with the backdrop of Covid-19 recovery illustrated by impressive performance.

It can be said that 2022 was epitomised by significant macro-scale headwinds that have created an environment of high inflation and interest rate hikes.

UK hotel performance however, went against the grain and ended the year with a strong recovery in revenues. This was buoyed by ADR growth as a result of pent-up domestic demand, increased international travel and the return of MICE events. Many hotels, notably those in London and in popular leisure destinations, achieved or exceeded 2019 levels of performance.

Inflationary pressures and bank rate hikes increasing the cost of finance continue to hit consumer confidence; slowing down development, investment and transactions in the industry.

Looking forward to the remainder of 2023, both inflation and interest rate movements are predicted to stabilise and their remains significant 'dry powder' for opportunities, with the biggest log jam for transactions being the disconnect between vendor and buyer expectations.

RevPAR is likely to stablise following the exceptional year in 2022 due to lower consumer purchasing power and a squeeze on corporate budgets.

Our market overview includes:

- A Market Snapshot of hotel performance in the UK, demonstrating how the top 10 cities are recovering, as well as the Regional UK average.
- Domestic demand has remained strong so far in 2023, with the boost from staycations continuing to lead demand aided by a return in MICE events. The reopening of key airline routes to North America and Asia has improved international travel and has benefitted performance in London.
- An overview of Transaction Volumes to date highlighting key deals and markets of note. There has been a subdued start to transaction volumes in 2023 contrasting the strong recovery of trading performance. Rising interest rates has resulted in a softening of investment yields and higher costs of borrowing leading to a hesitancy from investors. Investors have become more selective in their capital allocation favouring high quality, well located assets as well as value-add opportunities.
- Our view on the key market trends that hoteliers, investors and developers should be aware of to navigate the current economic conditions.

Avison Young has a leading specialist Hotels team with vast experience. We are actively involved in several hotel transactions and have advised on many of the recent development projects across the UK.

Please get in touch if you would like to discuss any of the points raised in this overview, or to find out how we can help you.

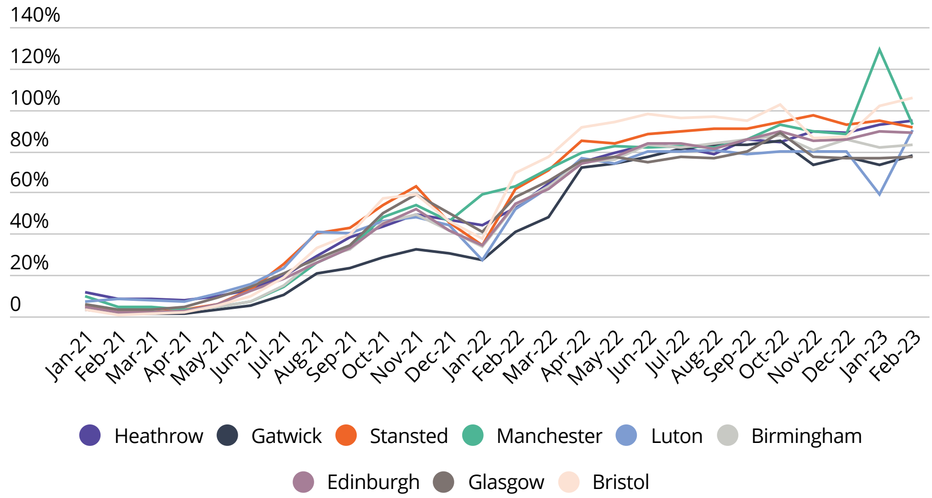
Current market conditions

Economy and Tourism

- The short-term outlook for the UK and global economies has become clouded by a series of bank failures and rescues in the USA and Europe. Regulators appear confident the crisis will be limited to a small number of banks, although financial markets have become volatile, and the situation is fast moving.
- Recent months have seen the economy move into a 'stop, go' pattern, where GDP has alternated between growth and contraction on a month-on-month basis. GDP growth slowed to 0.1% in November, turned negative by -0.5% in December, then rebounded to 0.4% in January and then flatlined in February 2023.
- In May, the UK base rate was increased to 4.5% as a means to control inflation which is expected to average 6.5% in 2023. Despite the base rate rise as well as the inflation rate being 10.1% (March 2023) the GfK's consumer confidence index stood at –30 in April and –36 in March.
- The unemployment rate is low in historic standards and indicates a tight labour market.
- Oxford Economics is currently predicting 0.0% GDP growth in 2023, then 1.5% in 2024 and 2.5% in 2025. It should be noted that most economists have been revising upwards their forecasts for the UK economy in 2023. This reflects a run of economic indicators for the UK proving to be better-than-expected.
- Industrial action has become much more common in the last year, with the lost working hours and disruption dampening growth. Other headwinds facing the economy include sticky core inflation, volatile financial markets and ongoing geo-political risks. A sharp escalation of one or more of these risks could prompt renewed speculation on a recession occurring.
- There are more factors that could dampen the pace of a future economic recovery, such as labour shortages in key industries and higher taxation. The UK will face a general election next year, which will increase political uncertainty. Consequently, we view the risks as being on the downside.
- The Pret Index gives a good indication that people are back working in offices in London post-pandemic as London city worker data shows transaction volume has nearly reached the pre-pandemic level. Regional Stations have the lowest transactional volume, while London airports currently have the highest transactional volume.
- In February 2023 London airport passenger numbers show that they were very close to pre-pandemic figures, with Heathrow only having 5.1% fewer passengers.
- Visit Britain's provisional results for 2022 show that there were 30.5m annual inbound visitors to the UK and spent £25.7bn. In 2023, Visit Britain are forecasting 35.1m visits (18% higher than 2022) and £29.5bn spend up 4% from 2019 levels.
- The UK is predicted to avoid a technical recession this year. In general, many recent economic indicators, while clearly subdued, have exceeded forecasts. Although it does not mean living standards will improve this year, which may cause softer demand patterns from a leisure perspective.
- A weak currency is expected to increase the quantity of travel nearer to home, which is positively impacting UK destinations. It will also entice more international visitors to come, such as people from the US, Asia and the Middle East.

MONTHLY AIRPORT PASSENGER NUMBERS 2021/23 VS 2019

Source: CAA



INFLATION

+10.1%

MARCH 2023

Source: ONS (May 2023)

UK CONSUMER CONFIDENCE

-30

UP FROM 8PTS FROM APRIL 23

Source: GfK Consumer Confidence Barometer (May 2023) >0 = positive consumer confidence <0 = negative consumer confidence

UK UNEMPLOYMENT

3.8%

DEC – FEB 2022

Source: ONS (May 2023)

UK GDP Q1 2023

+0.1%

UP FROM Q4 2022

Source: ONS (May 2023)

Hotel market snapshot

2023 Hotel Performance

To present a snapshot of the UK's key hotel markets' performance, we have indexed March 2023 year to date (YTD) performance against that of March 2019 YTD. This shows that all UK cities and the Regional UK average are performing exceptionally well, as revenue per available room (RevPAR) is either in line or ahead of 2019 performance.

The boosted staycation trend has continued into 2023, pushing the Average Daily Rate (ADR) well above 2019 in all markets. Current influences for the domestic demand includes higher flight prices combined with greater financial pressure on household budgets. The cost of travel overseas is likely to maintain a positive level of domestic demand but not at the levels seen in 2021 and 2022. It is expected however that the weaker currency will also entice in international travel, further increasing the ADR. The slower return of corporate travel, which often have discounted rates, has further helped through not diluting the average rate.

Despite still being below pre-pandemic levels, occupancy remains trending upwards with now Birmingham, Edinburgh, Leeds, Manchester and Newcastle seeing occupancy above that of 2019. The regional UK average is still down 3% compared to 2019 with the slow return of corporate and international travel having a material impact.

ADR has remained a key driver in the recovery of hotel performance throughout 2023 so far, as we see greater outbound leisure tourism as well as corporate travel. However, it must be noted that the cost-push inflationary pressure has slowed the recovery of ADR.

New Supply in 2022 and 2023

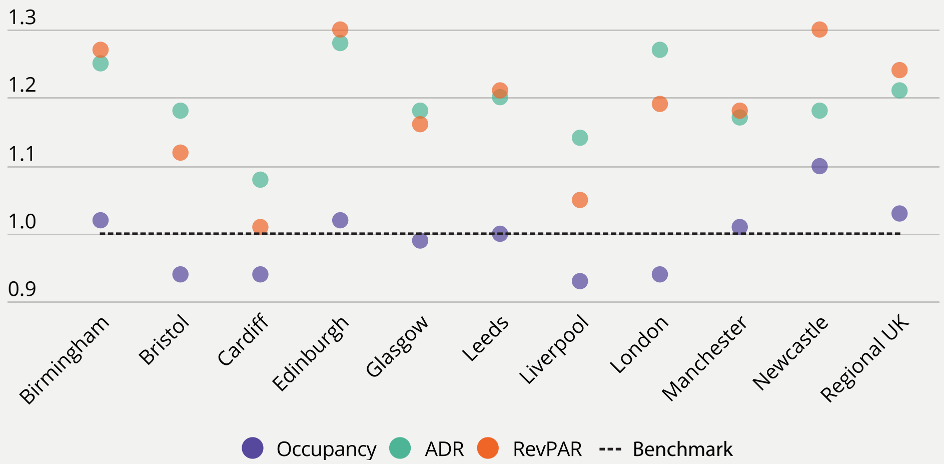
According to CoStar, there are expected to be 76 new hotel openings in 2023 across the ten cities detailed that will bring a total of 9,781 bedrooms, of which eight hotels containing 944 bedrooms have already opened YTD 2023.

There is a significant increase in the number of hotel openings in 2023 compared to previous years and only 26 expected to open in 2024. The largest number of openings was in 2021, partly due to developments having to postpone their completions as a result of the Covid-19 pandemic. This knock- on affect is continuing and a reason behind the high number of hotel openings for 2023. It is however likely that some of the hotels in construction in 2023 will move to opening in 2024. The large supply of hotels for 2023 indicates that demand for new hotels still exists despite a confluence of factors including rising building material costs, energy costs and cost of finance impacting new developments and labour shortages.

The largest number of hotels in the pipeline for 2024 are in London, with fifteen hotels expected comprising of 2,677 bedrooms. Bristol has four hotels opening (360 bedrooms), the second highest number of new hotels out of the top cities. Currently Newcastle and Cardiff have no pipeline developments expected in 2024.

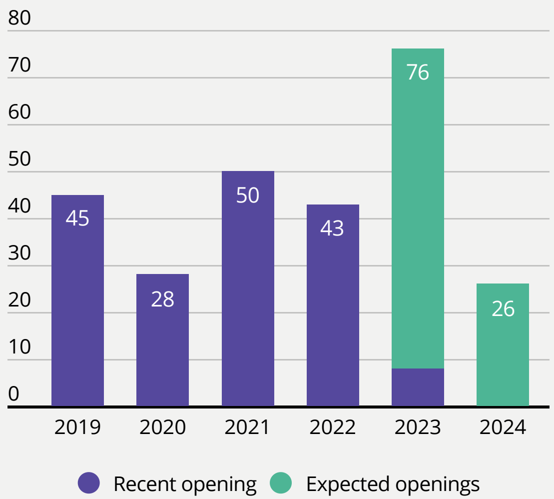
UK CITIES HOTEL PERFORMANCE – MAR 2023 YTD INDEXED AGAINST MAR 2019 YTD

Source: Avison Young/ STR., 2023 © CoStar Realty Information, Inc



RECENT AND EXPECTED HOTEL OPENINGS 2019-2024

Source: Avison Young/ STR., 2023 © CoStar Realty Information, Inc



EXPECTED OPENINGS PER CITY

	2023	2024
London	51	15
Manchester	6	1
Birmingham	2	1
Bristol	1	4
Newcastle	0	0
Liverpool	5	1
Leeds	1	1
Glasgow	5	2
Edinburgh	4	1
Cardiff	1	0
TOTAL	**76**	**26**

Market trends and issues

OPERATING COST PRESSURES

- Sharp increase in inflationary pressure across the sector and the wider economy affecting all aspects of the supply chain.
- Utility costs are expected to increase as current contracts at lower rates expire.
- Stronger ADR is helping to offset the rising costs.

COST OF LIVING

- Likely to be a cut back in leisure and corporate spend as rising costs impact consumer spending and corporate budgets.
- Consumer-facing real estate such as Hotels will experience a tighter market in 2023, but it could become an area of opportunity in 2024 and 2025.

INCREASED STAFFING COSTS AND AVAILABILITY ISSUES

- Demand for staff is currently outweighing supply and as a result the labour market is highly competitive.
- Salary expectations continue to increase.
- Companies that can move quicker are benefitting from a sleeker recruitment process.

RISING DEVELOPMENT COSTS

- Price hikes in raw materials due to reduced availability, supply chain issues, rising energy costs and labour shortages.
- It is expected that there will be no negative inflation for the foreseeable future, but a return of the spikes witnessed in the last two years is unlikely.

INCREASED COST OF FINANCE

- Rising interest rates has led to more expensive debt, loan-to-value ratios have compressed and investment yields have softened.
- A significant amount of the opportunity fund money that was raised during the Covid pandemic has not yet been deployed, providing a waiting pool of 'dry powder' when economic conditions start to improve.

ESG

- The low carbon agenda is one of the most important issues for businesses and individuals.
- It is now at the forefront of the minds of investors, developers and occupiers to ensure a sustainable business in the long run and to meet market demands.
- Markets are moving towards integrating ESG into underwriting.

Hotel transactions

2023 Transactions

UK hotel transactional activity in 2023 has slowed down following interest rate increases in response to high inflation and the increasing cost of debt that began in Q4 2022. Transactional volumes had a relatively strong finish last year with a total of £2.9bn, however 2023 quarter one figures were 33% down on the previous year.

Despite the slow down of the hotel investment market, the start of 2023 has seen a strong demand for regional asset sales. Pandox acquired the 232-room Queens Hotel in Leeds for approximately £53 million (£228,000 per room) from Aprirose. The Group announced that the acquisition was being financed via existing funds and credit facilities, providing an advantage in an extremely difficult debt market.

Fattal Hotel Group purchased the 201-room Grand Hotel Brighton for an undisclosed sum, reported to be up to £60 million, having previously been sold in 2014 for around £50 million to Wittington Investments.

Investors are becoming increasingly selective, however high quality, well located assets in leisure-led locations remain attractive whilst value-add investors are seeing an increase in opportunities. Both The Queens Hotel Leeds and Grand Hotel in Brighton sit in locations that have benefitted from the increase in demand for domestic leisure following the pandemic, while the assets are also key landmarks within their destinations, offering potential value upside for both domestic leisure and corporate markets.

London remains the core driving submarket in hotel investment, with the most notable deals including Firmdale Hotels acquiring the Covent Garden Hotel for around £55 million (£948,000 per key) from CBRE Investment Management, a hotel it has managed since 1996. The price per key for the property was the highest to date and reinforces the strength of the luxury boutique hotel sector. This sector benefits from the incoming tourism from overseas visitors taking advantage of a weaker GBP and more favourable exchange rate.

Dalata Hotel Group acquired the recent delivery of a 192-room hotel in Finsbury Park. The acquisition amounted to approximately £44.3 million (£230,000 per room) with the group reporting that an additional £2 million capex will be invested into the asset, to meet Maldron brand standards.

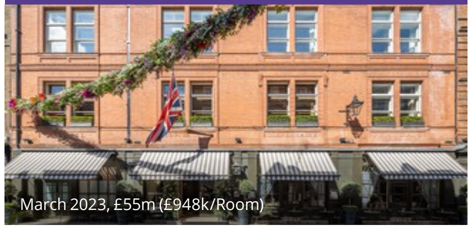
The 75-unit Native Bankside aparthotel, which sold for approximately £41 million (£533,000 per room) to JaStar Capital, is expected to create further value by folding the lease and the tenant, Native Places, continuing to operate under a new long-term management agreement.

Portfolio Investment is also present with Landsec closing on a £400m+ deal to sell 21 long-held hotels to Ares Management. The collection, which is operated under the Novotel and Ibis brands, is let to AccorInvest on a lease expiring in 2091 and the agreed price is expected to reflect an initial yield of around 6.5%. The most valuable assets in the 3,766-room portfolio are the Novotel London West in Hammersmith and the Novotel London Tower Bridge.

The difficult current economic conditions are likely to have an impact on transactional volumes for the remainder of 2023. CPI inflation for Q1 2023 averaged 10.2%, which was ahead of the Bank of England's estimate of 9.73%. As a result the BOE has raised interest rates further in May. This may cause owners to retain assets until the economy is more appetising. It's a waiting game at the moment with vendors holding out for markets to stabilise. At present there has been a significant shift in pricing for long fixed income investments mirroring the moving out of gilt interest rates. In general, hotel fixed income leases have seen a 50 to around 100 basis point increase.

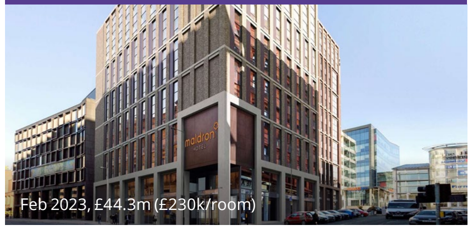
That said, it is almost inevitable that time will run out for some operators and opportunistic cash buyers are circling in the hope that they may at last be able to secure distressed or underperforming assets at a discount. It will be interesting to see whether improved operational performance can offset the impact of rising operating and financial costs, however now, more than ever, some will be left with no option but to sell or consolidate their portfolio and it remains to be seen whether this will lead to a fall in prices, however, such is the quantum of dry powder that discounted prices are likely to be limited to poorer quality stock.

Firmdale The Covent Garden Hotel



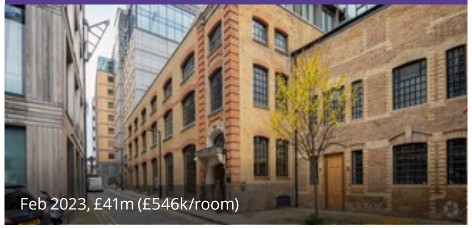
March 2023, £55m (£948k/Room)

Maldron Hotel, Finsbury Park



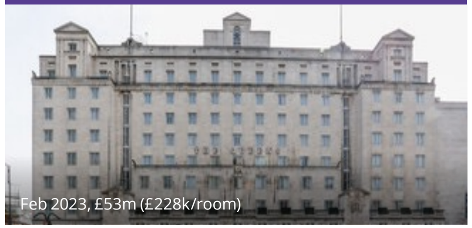
Feb 2023, £44.3m (£230k/room)

Native Bankside



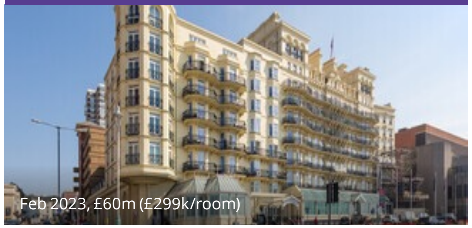
Feb 2023, £41m (£546k/room)

The Queens Hotel, Leeds



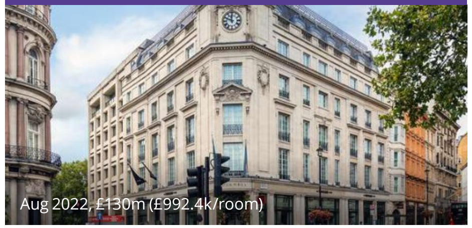
Feb 2023, £53m (£228k/room)

The Grand Brighton



Feb 2023, £60m (£299k/room)

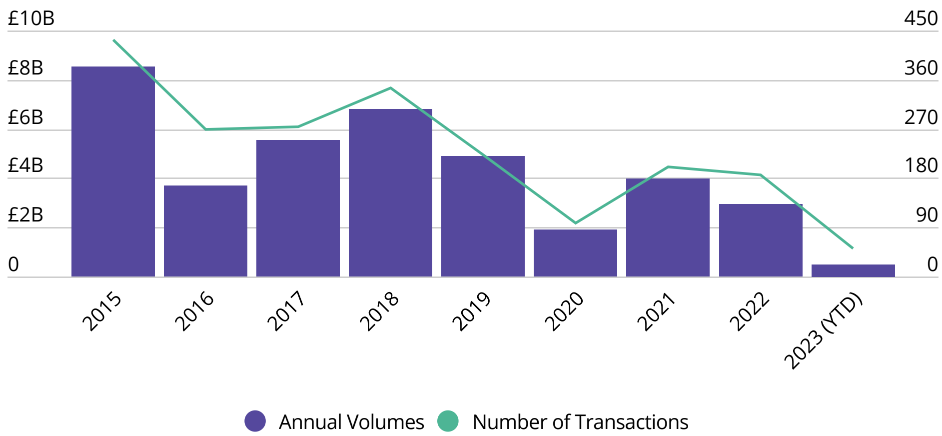
The Trafalgar, London



Aug 2022, £130m (£992.4k/room)

UK HOTEL INVESTMENT VOLUMES 2015 – 2023 YTD

Source: Avison Young / Real Capital Analytics



How can Avison Young assist

AVISON YOUNG HOTELS TEAM CAN ADVISE AND SUPPORT CLIENTS IN A NUMBER OF WAYS:

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

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

We are panel valuers for the major UK clearing banks and lending institution

Provide rating technical expert advice leveraging our strong relationships and experience to identify and maximise the opportunities for business rates mitigation

AVISON YOUNG HOTELS TEAM CAPABILITIES

- Agency and Investment
- Acquisition Due Diligence
- Brand and Operator Selection
- Building Consultancy
- Business Rates
- Planning
- Project Management
- Valuation

Carried out valuations totalling £5bn in the last two years

Advised on £310m+ of hotel transactions in the last year

UK-WIDE COVERAGE – AVISON YOUNG OFFICES

Should you wish to discuss any details within this update please get in touch

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