UK hotel market overview

Avison Young Hotels

October 2022

AVISON YOUNG

Introduction

Avison Young's Hotels team are pleased to present our latest overview of the UK hotel market as it continues to recover from the significant impact of Covid-19.

During 2022, with Covid-19 restrictions now in the past, pent-up domestic demand continuing and a return of international travel and large events, hotel performance has largely continued the strong recovery seen in the second half of 2021. Recovery is being led by high average daily rates (ADR) across the UK with most markets above pre-Covid levels year to date. Though demand is still lagging behind, we expect occupancy levels to follow suit during 2023.

However, on a macro-scale, there are significant headwinds in the form of rising inflation and interest rates, and recession predicted by the Bank of England that could slow recovery.

Our market overview includes:

- A Market Snapshot of hotel performance in the UK, showing how the top 10 cities are recovering, as well as the Regional UK average. Domestic demand has remained strong in 2022 benefiting traditional coastal and countryside staycations areas while cities have benefited from the return of large-scale events and conferences. London performance is still yet to return to pre-covid levels as international travel has yet to fully return.
- An overview of Transaction Volumes to date highlighting key deals and markets of note. Whilst volumes have not returned to pre-pandemic levels, there has been good interest in hotel assets, primarily from private equity.
- Our view on how the worsening economic conditions in the UK and on a global scale, as a result of international conflict and rising energy prices, has contributed to increasing cost of finance, operating costs and construction costs as well as the challenges for new developments despite the recovery of market performance.

Avison Young is the leading hospitality advisory team in the UK with vast experience and a specialist team based between the London, Glasgow and Edinburgh offices. We have advised on many of the recent and current development projects across the UK and are actively involved in several hotel transactions.

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

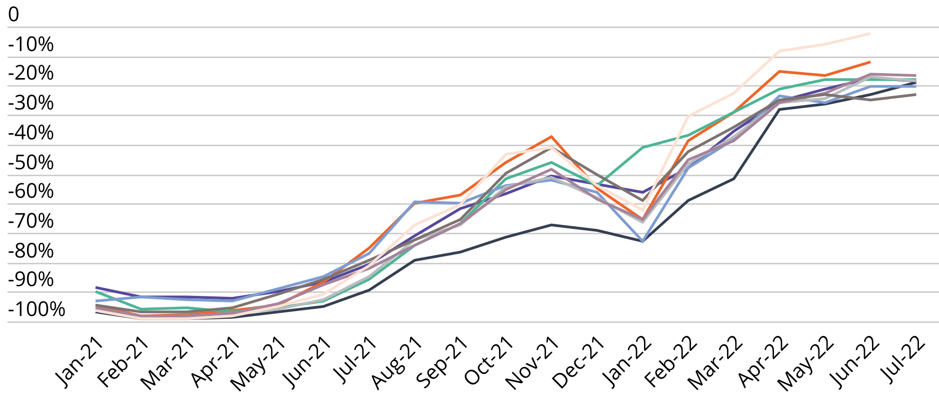
Current market conditions

Economy and Tourism

- After the UK experienced its largest fall in GDP on record in 2020, down 9.9% from 2019, 2021 returned to growth increasing by 7.5%, though still below 2019
- The ONS has estimated that Q2 2022 decreased by 0.1% compared to Q1 2022, though the level of quarterly GDP was still 0.6% above its pre covid level in Q4 2019
- Near-term inflationary pressures have slowed GDP growth across Europe reflecting the almost doubling of wholesale gas prices brought on by Russia's restrictions on its supply of gas
- This is having a sharp effect on global supply chains and the price of goods for most UK households' incomes and eroding UK companies' profit margins. UK CPI in August is at 9.9% compared to last year and the Bank of England (BoE) has forecasted that this could reach a peak of 13.6% in 2022 Q4 (as of August 2022)
- The BoE has forecast a further slow down in GDP growth in Q3 2022 with a 0.1% decline. The BoE's latest position on 2022 GDP forecast is that the UK will experience growth of 3.3% however output is expected to fall in each quarter from 2022 Q4 to 2023 Q4 as the UK is forecast to enter a recession
- Unemployment is expected to remain consistent for the next year but is forecast to gradually rise up to a peak of 6.3% by mid 2023
- Avison Young's UK Cities Recovery Index (click here) monitors the speed and trajectory of the recovery using a range of key indicators. It highlights that there was sharp decline in December 2021 and January 2022 as Omicron affected recovery, but between February and May there was a sharp rebound to November 2021 levels, which has since plateaued. The National Index is 95.2 (100 = Feb 2020) as of 5th July 2021
- Notably, metrics such as 'Mobility' and 'Retail' are 20% higher than pre-covid levels but 'Return to Office' is down 36%. 'Hotels and Leisure' has bounced between indexes of 106 and 85 since March 2022
- 2022 has seen inbound tourism recover after being heavily affected throughout the pandemic. Passenger volumes have shown strong increases up to July (most recent available data) though still approximately 30% below that of the same period in 2019
- Visit Britain has estimated that 2021 saw only 7.1m inbound visitors spending just over £6.1bn. This is significantly down from 40.9m visitors spending £28.4bn in 2019. In their August forecast, 2022 is expected to see a strong uplift from 2021 to 26.7m visitors spending £21.6bn

MONTHLY AIRPORT PASSENGER NUMBERS 2021/22 VS 2019

Source: CAA (no data in July for Stansted or Bristol)



Heathrow Gatwick Stansted Manchester Luton Birmingham

Edinburgh Glasgow Bristol

INFLATION

+9.9%

AUGUST 2022

Source: BoE (September 2022)

UK CONSUMER CONFIDENCE

-44

DOWN 25PTS FROM JAN 22

Source: GfK Consumer Confidence Barometer (September 2022) >0 = positive consumer confidence <0 = negative consumer confidence

UK UNEMPLOYMENT

3.6%

Q2 2022

Source: ONS (September 2022)

UK GDP Q2 2022

-0.1%

DOWN FROM Q1 2022

Source: ONS (August 2022)

Hotel market snapshot

2022 Hotel Performance

To present a snapshot of the UK's key hotel markets' performance, we have indexed August 2022 year to date (YTD) performance against that of August 2019 YTD. This shows that all UK cities (except for London) and the Regional UK average are performing well, with revenue per available room (RevPAR) in line or ahead of 2019. London is the only major UK city to yet to reach parity with 2019 performance.

So far in 2022, Average Daily Rate (ADR) is driving hotel performance recovery with levels well above 2019 in all markets. The staycation boom experienced in the UK during 2021 has continued into 2022 with some holidaymakers preferring not to travel abroad due to remaining restrictions and the well-publicised airport chaos. As such domestic tourists have been spending their holiday budgets in the UK driving ADR growth. The slow return of corporate travel has also impacted on ADR with the lack of business travellers (often with discounted hotel rates) not diluting the average rate.

Hotel demand is still below the pre-pandemic benchmark though trending upwards, with only Newcastle seeing occupancy above that of 2019. London is still down 25% compared to 2019 with the slow return of corporate and international travel having a material impact.

Looking forward we expect an ADR correction in 2023 driven by the return of outbound leisure tourism and stronger levels of corporate travel. The cost of living crisis, driven by inflationary pressures is likely to also dampen recovery.

New Supply in 2022 and 2023

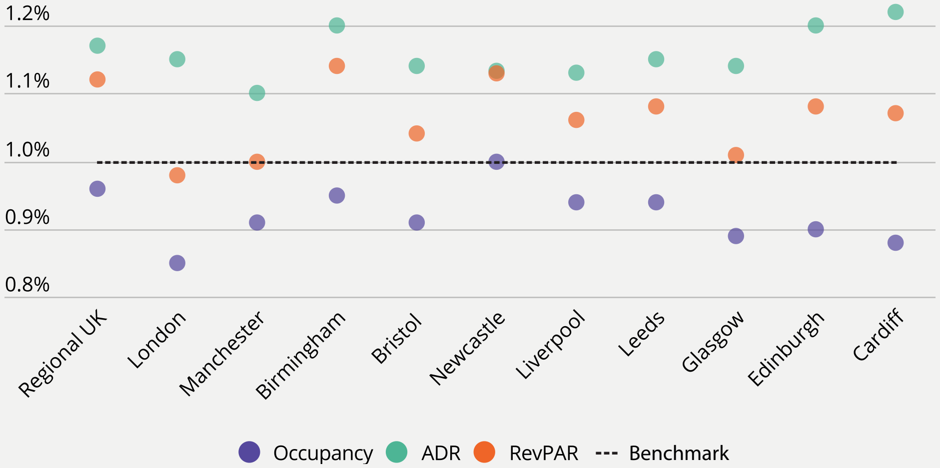
In the top ten cities detailed, there have been 33 new hotel openings (4,792 bedrooms) in 2022 up to September with a further 31 hotels planned to open in the last quarter of the year. In total this would bring the number of new hotel openings in 2022 to 64 (4,028 bedrooms), 14 more than in 2021 and 19 more than in 2019. The data is for all hotel developments over 20 bedrooms including apart-hotels.

It is likely that the high number of openings seen in 2022 were due to a large number of developments paused during construction throughout 2020 as well as improved funding conditions. 2023 is expected to be down on 2022 with high construction cost inflation and increasing cost of finance affecting new developments.

Liverpool and Glasgow have the highest percentage of new bedrooms as a proportion of their current room stock, 16% and 12% respectively. While Newcastle, Leeds and Cardiff currently have no pipeline developments expected until after 2023.

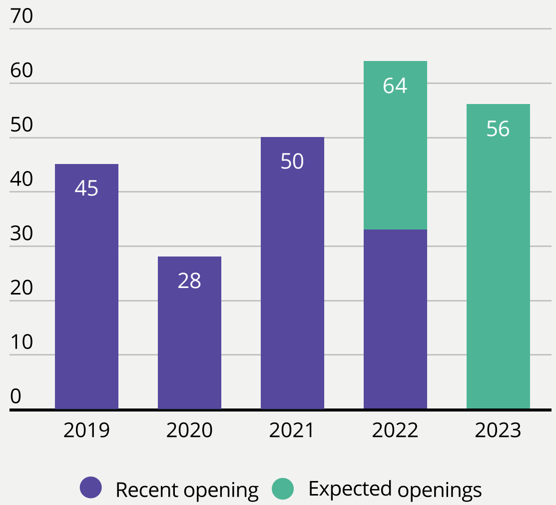
UK CITIES HOTEL PERFORMANCE – AUG 2022 YTD INDEXED AGAINST AUG 2019 YTD

Source: Avison Young/ STR., 2022 © CoStar Realty Information, Inc



RECENT AND EXPECTED HOTEL OPENINGS 2019-2023

Source: Avison Young/ STR., 2022 © CoStar Realty Information, Inc



EXPECTED OPENINGS PER CITY

	Q4 2022	2023
London	17	36
Manchester	4	5
Birmingham	0	1
Bristol	1	1
Newcastle	0	0
Liverpool	2	8
Leeds	0	0
Glasgow	4	4
Edinburgh	3	1
Cardiff	0	0
TOTAL	**31**	**56**

Cost pressures

Operating Costs

Whilst the increased ADR across the UK has supported RevPAR recovery, there are both positive and negative sides to this.

Firstly ADR growth converts better to gross operating profit (GOP), so higher ADR in the current cost inflationary environment is very positive and is likely to offset some of the higher costs in utilities, labour and supplies.

Lower occupancy and fewer guests could, however have an impact on food and beverage and other incremental revenues. Whilst this is a negative impact in terms of revenue generation, given increasing operating costs and the challenges of attracting and retaining staff, lower food and beverage activity in the short term may not be such a bad thing for operators and owners.

The main cost pressures currently are coming in two key areas; energy and labour.

Energy costs for most hotel companies is unlikely to impact profitability until later this year or early next year. This is because most hotel companies pre-buy their utilities at reduced rates over an extended period cushioning the blow, but only for a short period.

There are increasing pressures around labour availability and pay rates. The demand for staff is currently outweighing supply and as a result the labour market is highly competitive. Companies that can move quicker are benefitting from a sleeker recruitment process, but salary expectations are much higher than even a few months ago.

Development Costs

The hotel market has not been immune to the current "perfect storm" that has raged through the construction industry here in the UK. A combination of Covid-19, Brexit and more recently the war in Ukraine, triggering hikes in energy pricing has made forecasting tenders almost impossible, resulting in contractors pricing in risk for fixed price tenders that in many cases make development unviable.

The main issues in terms of materials revolve around steel, concrete and timber due to a reduction in manufacturing capability that is exacerbated by global constraints on shipping since Covid, energy costs and importation, where bizarrely, the ensuing volume of delays has caused a reactive measure of bulk buying that has then resulted in price hikes due to the shortage of materials and availability.

The new immigration rules together with the Government's furlough scheme resulted in an exodus of Eastern Europeans who were the mainstay of the labour force in construction. However, hopefully over time we will see the return of the labour force in line with an increase in "home grown" labour for the industry to reduce the reliance on foreign workers.

Avison Young do not expect any negative inflation for the foreseeable future but we do not expect to see a return of the spikes witnessed in the last two years, rather a flattening out of the inflation cycle as labour returns post the furlough scheme and manufacturing of core materials rises again.

Along with other major QS firms, Avison Young tracks inflation and whilst over the last two years we have all had to increase our predictions sharply upward on a quarterly basis due to the volatility of the market, we are seeing forecasting being more consistent between us for the next three years with compounded figures of between 6-8%.

OPERATORS PERSPECTIVE

INTERSTATE HOTELS | RESORTS

> "Due to the pandemic, there has been a lot of pent-up demand in the social event space and our hotels have some excellent facilities to capitalise through this continued demand
>
> **DAVID ANDERSON**

RBH HOSPITALITY MANAGEMENT

> "Across the UK new hotel developments have slowed due to increased construction costs and this dip in supply will be welcome for most hotels to support the continued recovery
>
> **ANDREW ROBB**

Hotel transactions

2022 Transactions

UK hotel transaction activity in 2022 has continued from the strong finish last year with a total £2.4bn investment year to date. This sees the transaction volumes for the last 12 months exceeding £4.2bn.

London remains the core driving submarket in investment, with £900m this year. Notable deals include Crimson Hotels' £130m acquisition of the Trafalgar Square Hotel in August. Also, Frogmore Capital bought Hilton Kensington Olympia for £130m in April. This 405-room acquisition equated to just under £322,000/room. The Marriott Hotel, Blackfriars Road was purchased for £104m (£646,000/room) by Vertiq Captial Partners.

One of the year's standout deals was the purchase of the 39-room L'Oscar Hotel which was bought for £60m in March. This equated to a £1.5m price per room, the highest in 2022 and was acquired by Michel Reybier Hospitality.

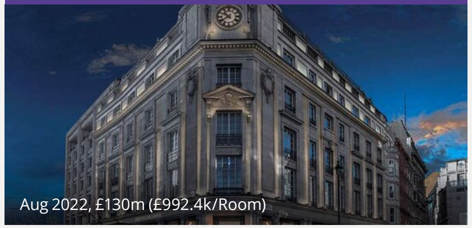
Outside of London, there has also been strong transactional activity. The Hyatt Hotel in Leeds was sold in May for £62.7m to the UK Commercial Property Finance LTD. It is a 305-room hotel that is currently under-construction to be completed in 2024.

Birmingham and Manchester are the second and third-placed submarkets by sales volumes in the last 12 months with £183.5m and £114.7m transacted respectively. Sales of the Hotel Indigo for £12.5m in Birmingham and Brooklyn Hotel for £22.8m in Manchester emphasise the recovery in demand from an investment standpoint for regional UK cities.

Portfolio investment was also present with Tristan Capital Partners acquiring a £420m share in Raag Hotels, owner of the Point A hotel group this April. Further confidence for transactions was seen from KSL Capital Partners' £35m investment into operator Pig Hotels.

Current market conditions, with interest hikes and inflationary pressures, may impact transactional volumes for the remaining months of 2022 as well as into 2023. This may also cause owners to retain assets to 'weather out the storm' until the economy is more appetising. On the other hand, it is likely that there will be an increase in distressed or underperforming assets as rising operating and financial costs squeeze bottom lines and push owners to sell at a discount.

The Trafalgar, London

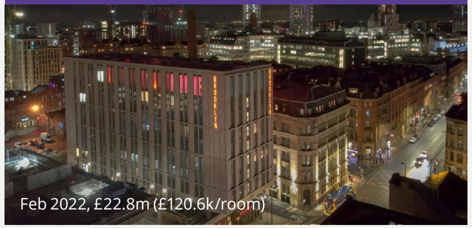


Aug 2022, £130m (£992.4k/Room)

Hyatt Place, Leeds

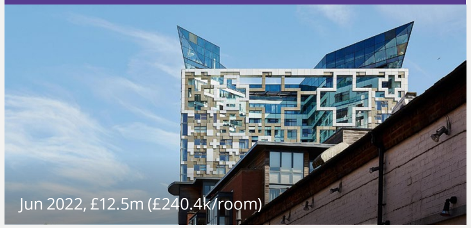
May 2022, £62.7m (£205.6k/room)

Brooklyn Hotel, Manchester



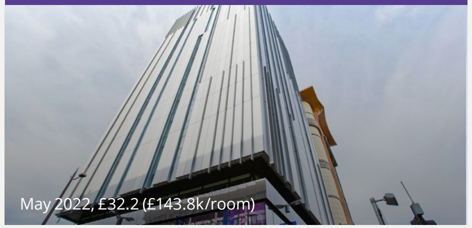
Feb 2022, £22.8m (£120.6k/room)

Hotel Indigo, Birmingham



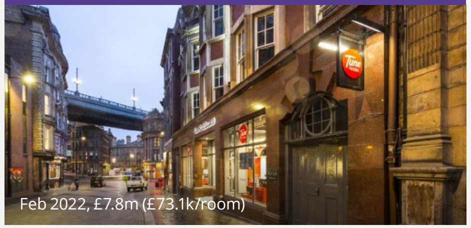
Jun 2022, £12.5m (£240.4k/room)

St Andrews House, Glasgow



May 2022, £32.2 (£143.8k/room)

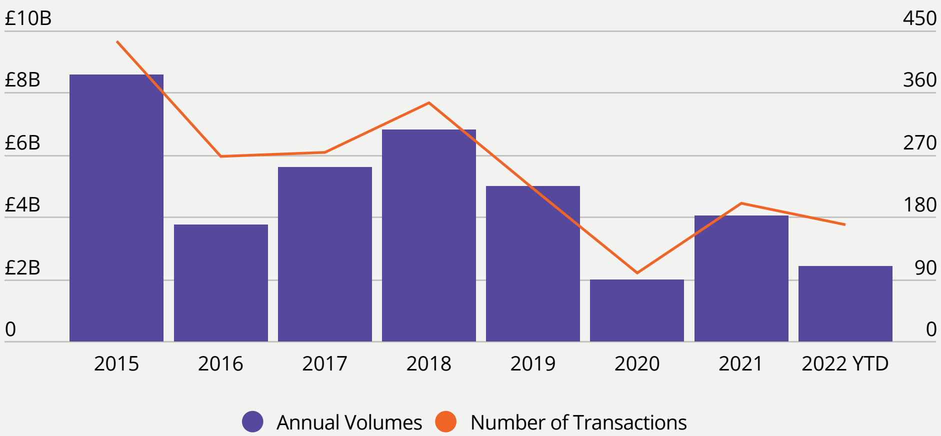
Proctor House, Newcastle



Feb 2022, £7.8m (£73.1k/room)

UK HOTEL INVESTMENT VOLUMES 2015 – 2022 (SEPTEMBER YTD)

Source: Avison Young



How can
Avison Young assist

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

Detailed financial projections and sensitivity analysis

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

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

AVISON YOUNG HOTELS TEAM CAPABILITIES

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

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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