AM:PM hotels
Hotel data and intelligence

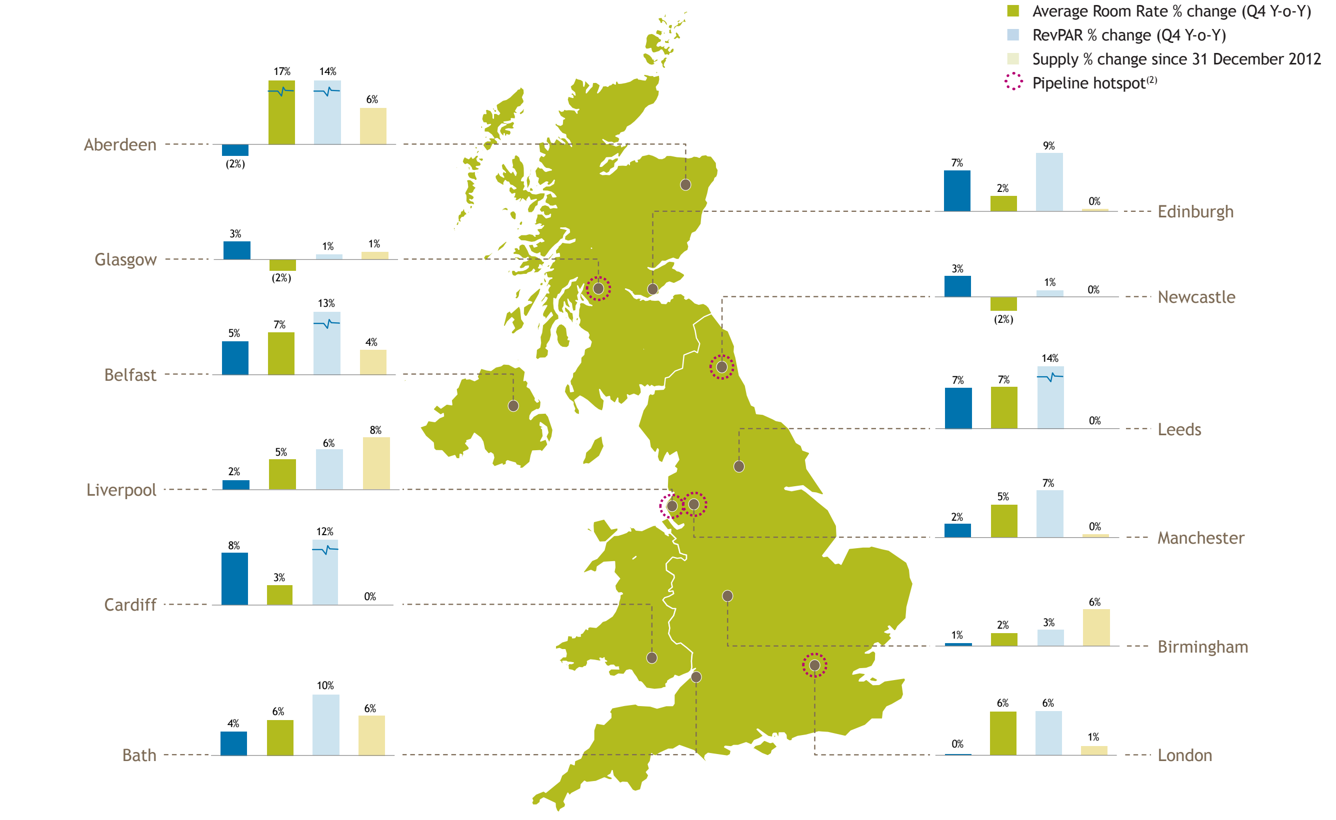
HVS

ZOLFO COOPER

Hotel Bulletin: Q4 2013

The Q4 2013 Hotel Bulletin considers 2013 as a whole and looks forward to 2014. 2013's most significant trend was the broad-based performance improvements recorded in the regions which, in contrast to previous years, are now being converted into profit. With valuations improving and investors and lenders returning to the UK hotel market, we expect an active year for the UK hotel market in 2014.

Selected UK hotel markets – demand and supply



Source: AM:PM, HotStats
Note: Q4 covers the three months to the end of December
Q4 Y-o-Y compares the average of Q4 2013 to the average of Q4 2012
Supply and pipeline analysis relate to numbers of hotel bedrooms
(1) Occupancy percentage change represents actual rather than absolute percentage change
(2) Pipeline hotspots are cities with an active pipeline greater than 10%. Active pipeline refers to hotels with an opening date in the next three years

Our key highlights of 2013

Graeme Smith
Head of Hotels at Zolfo Cooper

"For the first time since 2007, the UK hotel market appears to be in a confident mood. 2013 marked the return of the UK regions both in terms of trading and transactions, reflecting more positive economic sentiment. In the absence of external shocks the outlook for 2014 is good."

Tim Smith
Director at HVS

"At last some good news for the beleaguered hoteliers of the UK. Revenues have been rising for a number of months now and are, at last, starting to outstrip rises in expenses. This, in turn, is resulting in improved investor appetite and, therefore, values. I hope the current poor weather and damage to infrastructure does not de-rail or postpone this recovery."

Alan Gordon
Director at AM:PM

"The underlying performance of the London hotel market in 2013 was remarkable. Many were concerned of a possible hangover after the 2012 Games and a 40 year record of new supply growth in the previous 12 months, but London took both in its stride."

Demand commentary

Strong, sustained and far-reaching growth in 2013 - more to come in 2014

Q4 2013 was another positive quarter for the UK hotel sector, with all of the 12 cities reviewed experiencing RevPAR gains.

In London, Q4 2013 RevPAR increased by 6% in comparison to the previous year. The London market was always likely to be resilient to the additional pre-Olympic supply, but to return to solid growth so quickly is very impressive.

On average, the 11 regional cities reviewed recorded an 8% quarterly RevPAR increase in comparison to Q4 2012, and LTM income before fixed costs (IBFC) PAR was 4% higher than the previous year.

Notable winners in Q4 2013 include the ever-present Aberdeen and also Leeds (both recorded Q4 RevPAR increases of 14%). Demand in Leeds reached the highest level recorded in four years in November 2013 due to a number of conferences during the month. Glasgow and Newcastle recorded the lowest growth levels, however, Newcastle's return to growth after seven quarters of decline will be welcomed by the city's hoteliers.

In Q4 2012 we predicted that 2013 profit growth in London would be hard to achieve due to the strength of comparators in previous years and the absence of an event to match the 2012 Olympics. IBFC PAR in London did indeed fall over the year but only by 2%. In the final quarter profitability has increased by an average of 6% which provides excellent momentum to carry into 2014.

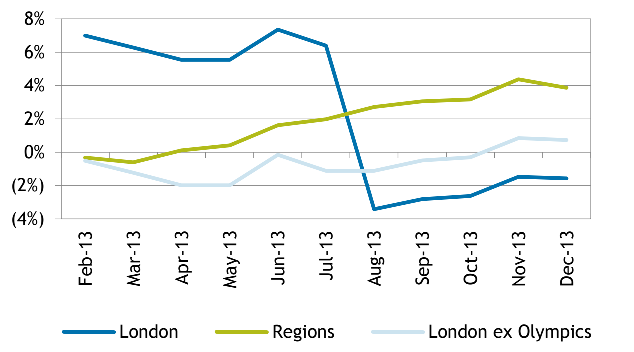
Regional hotels performed far better than expected in 2013. Historically, regional hotel performance has closely tracked GDP growth. In 2013, all but one of the 11 regional cities reviewed recorded average quarterly growth in excess of 2013 GDP growth of 2%. It should not be forgotten that this growth comes from quite a low base after a number of years of decline but it is very encouraging.

We expect performance improvement to continue across the UK in 2014.

London should benefit from increased corporate activity as the economy continues to recover and relaxation of the Chinese visa rules is likely to boost the tourist market.

Profitability in the regional market should continue to grow as corporate activity recovers. The main challenge will be for hoteliers in the regions to have the confidence to push rate in the face of rising demand after years of having to chase occupancy. Those who can achieve this will see the benefit in their bottom line.

Change in income before fixed charges PAR (LTM)(3)



Source: HVS, HotStats, Office for National Statistics

Note: (3) Graph shows rolling 12 month average of monthly year-on-year IBFC PAR (ex Olympics data assumes 0% Y-o-Y growth in August 2012 and 2013)

Supply commentary

Budget sector expansion through 2013 - Premier Inn and Travelodge likely to continue to flourish in 2014

Of the 1,766 hotel bedrooms added in Q4 2013, 78% were in the budget sector. Budget openings have recently dominated new supply, predominantly due to Premier Inn and Travelodge's presence in this sector. Both groups are completing refurbishment plans which may impact other hotels in the budget and three star spaces.

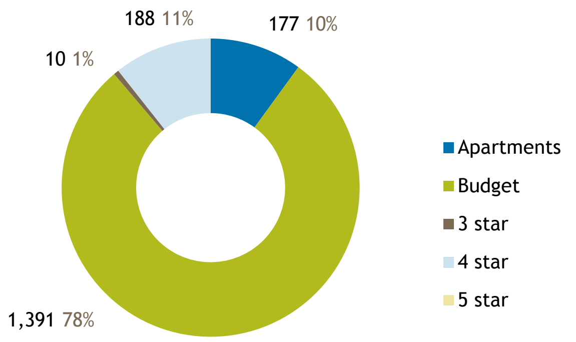
Notable openings in the fourth quarter include:

- Qbic's first opening, the 171 bedroom Qbic Hotel London City. All bedrooms in the boutique budget hotel are designed around the 'Cubi', an all-in-one living box. Qbic plans to open ten more properties across the UK over the next seven years.
- The 168 apartment Staybridge Birmingham. The aparthotel is the fourth and largest Staybridge Suites opening in the UK.

As we anticipated, new supply in 2013 was subdued in comparison with 2012 with 6,769 bedrooms opening in comparison to 18,262 bedrooms in the previous year.

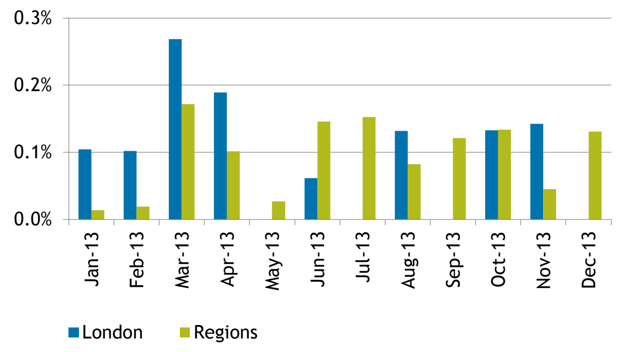
In 2014 we expect new supply levels to be closer to those of 2012, with over 14,000 bedrooms in the 2014 active pipeline. Premier Inn and Travelodge will continue to expand and Hilton is set to continue its multi-brand expansion plans with Hampton by Hilton and Doubletree by Hilton opening over 1,200 bedrooms in 2014 other brands to watch in 2014 include Motel One and Citizen M, with a combined active pipeline for 2014 of over 1,000 bedrooms.

Q4 new UK bedroom supply by offering



Source: AM:PM

Month-on-month change in supply(4)



Source: AM:PM

Note: (4) Graph shows supply compared with the previous month

In the pipeline

Three star developments continue to be avoided by investors

There are 29,263 bedrooms in the active pipeline, of which 51% are in the budget sector. There is greater pipeline activity in the four star market than in the recent new supply activity. As with the new opening trends, there appears to be limited investor appetite in the three star space.

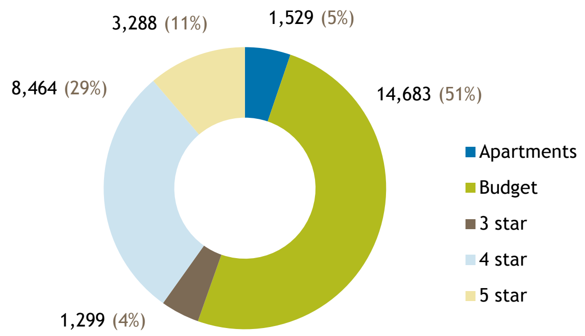
Of the cities reviewed, Glasgow (15%), Manchester (14%), Liverpool (11%), and Newcastle (11%), London (10%) all have pipeline levels above 10% of current supply. The amount of hotel bedrooms in the active pipeline has trended upwards in 2013 highlighting real-estate investors' attraction to improving performance in the UK hotel sector.

It is notable that supply growth is following demand growth. Cities such as Manchester, Liverpool and Aberdeen have been consistent performers and this is now reflected in increased pipeline levels. Glasgow pipeline has been boosted ahead of the Commonwealth Games.

Notable assets in the pipeline include:

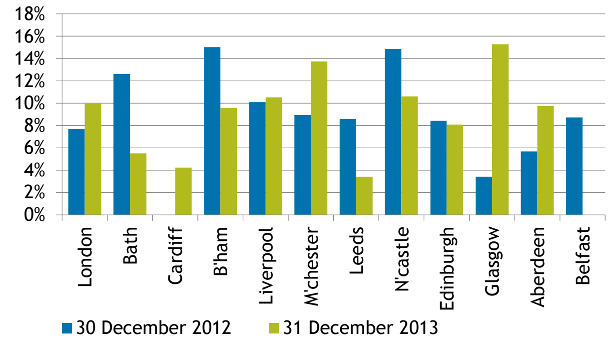
- Whitbread is set to open its first dual-branded site at Caltongate, Edinburgh with Artisan Real Estate. The group will open a 127 bedroom Premier Inn and a 131 bedroom hub by Premier Inn.
- Marriott has confirmed plans to open four UK hotels in 2015 under its new budget brand Moxy, which is being developed with IKEA's property division.

Current UK bedroom active pipeline by offering



Source: AM:PM

Active pipeline as a percentage of supply by city



Source: AM:PM

Note: The pipelines above only include developments with a confirmed opening date in the next three years

Transactions

Hotel transaction value doubles in 2013 - further transaction potential in London and regionally in 2014

Notable transactions in Q4 2013 included:

- LBG selling its Project East portfolio of loans secured against 38 regional UK hotels to Cerberus Capital Management (31 hotels) and Deutsche Bank (7 hotels).
- 12 UK regional Menzies Hotels with over 1,200 rooms were sold to Topland Group for an estimated £80 million.

During 2013, the value of UK hotel transactions topped £2.5 billion(5) – more than £1 billion higher than the value achieved in 2012 and the highest since 2007. This was bolstered by a trio of portfolio transactions at the beginning of the year, however, single asset transactions also increased in comparison to 2012.

A number of hotel management deals were also completed, as operators created large management platforms to accommodate for real estate investors who are increasingly trusting third party operating companies to run their hotels.

In 2014, London will undoubtedly remain an attractive market for investors, but stretched London prices are forcing many to consider assets outside the capital. The combination of improved performance and increased competitive tension is likely to enhance valuations and unlock transactions in 2014.

Bank funding

Sustained performance improvement encouraging lenders

Notable examples of funding in this quarter include:

- HSBC provided development funding for the new citizenM hotel in Tower Hill as well as development funding to Synergy Hotels LLP for a new Hilton hotel in Southwark.
- RBS England & Wales and NatWest Scotland are to fund THAT Group's construction of a £90 million mixed use development at Terrace Mount in Bournemouth town centre. The development will consist of a 172 bedroom Hilton hotel, a 120 bedroom Hampton by Hilton hotel, 15 luxury penthouses, 45 apartments and an underground car park.
- RBS provided debt financing to develop a full-service urban resort at 45 Curtain Road in East London's Shoreditch district.
- HSBC and RBS provided finance for a joint venture between Raag Hotels Limited and Wellcome Trust. The JV has acquired a site in the quarter with planning permission for a 130 bedroom Tune Hotels property in Canary Wharf.

There has been a major return of liquidity in the debt markets in 2013, albeit hotel financing is principally being provided on a traditional cash flow, rather than real estate basis. Lending sources to the sector have also widened far beyond the traditional high street banks with insurance companies and investments funds entering the market. Additionally, the major clearing banks are lending more, including on developments and in the regions.

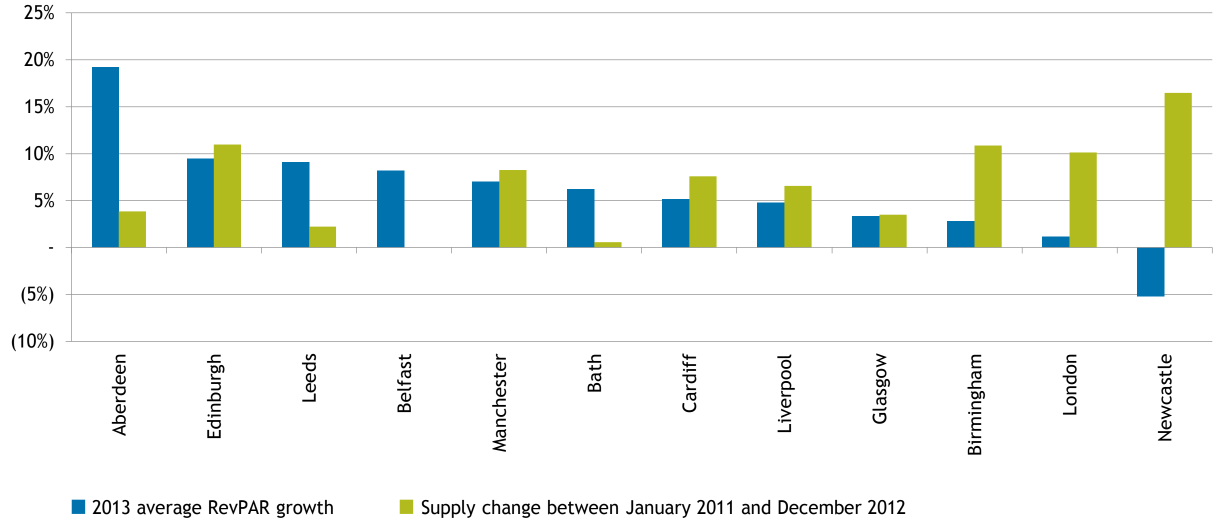
In 2014 we expect this trend to continue, especially if, as expected, trading performance continues to improve.

Source: AM:PM, HVS, press releases

Note: (5) Hotel transactions under £6 million excluded from analysis

Focus on: 2013 Winners and Losers

Selected UK hotel markets – 2013 average RevPAR growth and supply growth between January 2011 and December 2012



Source: AM:PM, HotStats

The winners – Aberdeen and Edinburgh

In 2013, Aberdeen and Edinburgh's performances have outstripped the other 10 cities reviewed in the bulletin.

Aberdeen's hotel market growth has been predominantly driven by oil and gas related demand, but limited historical supply has enabled existing hoteliers to record extraordinary RevPAR growth rates throughout 2013. Aberdeen's average RevPAR increase of 19% is especially impressive given that it is over double that of the next closest city. It must be noted that new supply is beginning to come on to the market and the city has an active pipeline slightly below 10%, however, this does not seem sufficient to temper the performance outlook for the city.

Edinburgh's RevPAR has grown by an average of 9% in the past four quarters. The city has proved better able than other cities to absorb significant supply growth (11%), however, performance improvement is set against weak comparators in 2012 partially caused by tourists avoiding the city during the 2012 Olympics. In 2014, the city is likely to indirectly benefit from the 2014 Commonwealth Games and also from increasing corporate demand.

Leeds is perhaps one of the surprise performers in 2013, with RevPAR increasing by an average of 9% due to conference related demand improvement and a relatively low level of historical new supply. Existing hoteliers will be encouraged by a low active pipeline level (3% of existing supply).

The losers - Newcastle and London?

In 2013, Newcastle, London and Birmingham RevPAR performance has been the least favourable of the cities reviewed. These cities had three of the top four increases in supply.

Newcastle has recorded a RevPAR decrease of 5%, the only city of the 12 cities reviewed to record RevPAR decline. This follows 2012 where the city recorded an average RevPAR decline of 4%. Newcastle demonstrates the sensitivity of less robust markets to supply growth - its historical supply growth was the greatest of the cities reviewed. The four star and apartment sector, both of which rely on the corporate market, appear particularly overstocked. With active pipeline levels above 11%, Newcastle hoteliers may continue to struggle in 2014.

London RevPAR increased by an average of 1% in the year which, when compared to the other cities reviewed, appears low. However, as already discussed, this is an impressive result given supply growth and the Olympic boost experienced in 2012.

Birmingham and Glasgow have recorded the next lowest growth levels out of the cities reviewed. Glasgow is likely be bolstered in 2014 by the Commonwealth Games, but Birmingham has a high active pipeline level in addition to a relatively large historic supply growth.

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