UK Hotel Investment

Spring 2012

SUMMARY

■ UK investment volumes held in 2011, up 0.8% to £1.5bn, with 68% of this focused on London and the South East.

■ The focus on prime means that there remains a clear preference for leased hotel investments as opposed to those on management contracts.

■ Overseas investors and UK Institutions were the only net investors in UK hotels in 2011, with the latter focusing on budget operations.

■ Average prime UK hotel yields are holding at 6.5%. The volume of product on the market, combined with a decline in wider investor confidence, is preventing any downward yield shifts.

■ However, lack of debt remains the biggest barrier to investment and is likely to remain an issue through to 2013.

■ Operational performance at the end of 2011 has raised concerns. Yet, the Olympics and Queen's Diamond Jubilee should provide a boost to performance this year, particularly in London.

"Lack of debt is more of an issue for the hotel sector, but the lure of the London trophy asset continues to attract overseas investors."
Robert Seabrook, Savills Hotels & Healthcare

2011 was a year of two markets

■ Investment volumes held in 2011 being only 0.8% up on the previous year to £1.5bn. While this did not mark a resurgence in investor activity it did buck the wider investment trend as total investment volumes in the UK saw a 7.1% fall over the same period.

■ Investors have continued their focus on prime. As a result there remained a geographical focus on the South East with it accounting for 68% (c.£1bn) of total volumes in 2011, 80% of this in London alone.

■ This focus was not just restricted to certain geographies it is also restricted to lease operated assets. Regional hotels operating under management contracts are still too far up the risk curve for those investors that have re-entered the market.

■ 2011 also saw little change in the profile of investors. UK Institutions and to a lessor extent overseas investors were the only net investors in the sector. While overseas investors reduced their investment in the sector by 39%, UK Institutions increased it by 12%.

■ However, despite both these groups being net investors, they differ markedly in their particular sub-market focus.

■ Hotel investment by overseas investors was focused on top end/trophy assets. These included the £192m purchase of the Sanderson and St Martin's Lane hotels (both five star operations) by the Middle Eastern Capital Hill Hotels and the £200m purchase of the recently completed W Hotel in Leicester Square by the Qatari conglomerate Al Faisal Holdings.

■ In contrast UK Institutions have focused their attentions on the budget sector. Of their £430m net investment in 2011, 73% of this was in budget hotels. This dominance largely reflects the expansion by budget operators, increasing the number of assets available, and the fact that these tend to be operated under leases rather than management contracts making them more pallatable to institutional investment.

■ The continued difficulties facing the Eurozone is unsurprisingly having a detrimental impact on investor confidence and this does pose a risk to investment volumes this year. As a result we expect that what activity does ocur will remain focused on London.

Yields continue to hold

■ Prime UK Hotel yields have held at 6.5% since February 2011, some 95bps above average UK Prime yields and 71bps lower than All UK property yields.

■ The stall in yield compression has, on the whole, been seen across all prime sectors as investor uncertainity re-emerged during the second half of 2011 and as the level of previous repricing was considered to be sufficient.

■ The volume of product on the market, the majority of which is on management contracts, has also restricted any further downward shifts. For example, the banks have been a

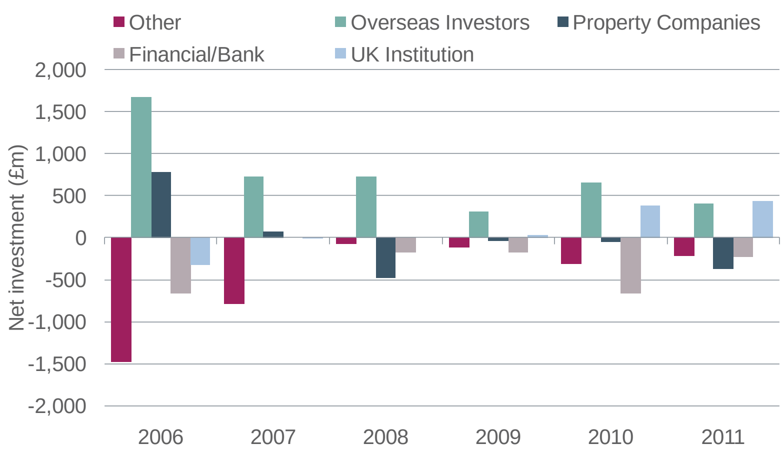
GRAPH 1

London and South East continues to dominate

Graph source: Savills; PropertyData

GRAPH 2

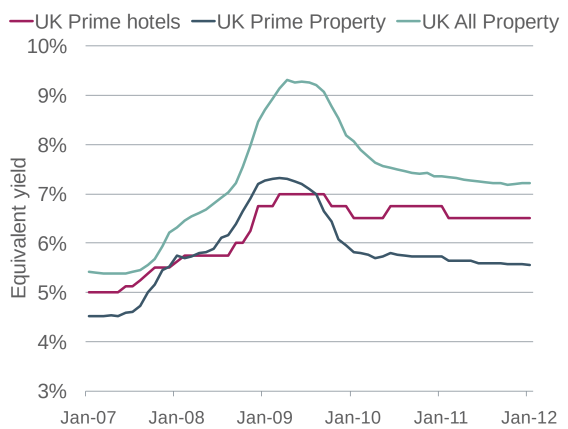
UK Institutions remain key net investors



Graph source: Savills; PropertyData

GRAPH 3

Yield compression has stabilised



Graph source: Savills; IPD

primary source of this supply bringing a number of distressed sales to the market some at significant price discounts, as seen with the Von Essen portfolio where discounts are rumoured to be as much as 50%.

■ Further yield hardening is not expected until wider economic conditions, and in turn confidence levels, improve. However, it is the lack of debt that remains the biggest barrier and this is likely to remain an issue through to 2013.

2011 saw better than expected capital growth

■ Based on Savills Valuation Index, hotel capital values in London increased by 9.8% last year, with regional hotels reporting a 3.7% fall. Unsurprisngly, considering the activity by overseas investors and their preference for 'trophy' assets, it was this sub-market that reported the greatest growth of 6.8%.

■ Savills forecast that values in London will see a further 3.9% growth this year and a more modest 1.5% in 2013. Growth in regional hotel values is not expected to return until post 2013 with an average 3.3% fall expexted this year.

Operational performance under threat

■ While wider investor confidence has had a bearing on the outlook for hotel investment, operational performance has also raised concerns.

■ Following a strong 2010 for both London and the regions, 2011 saw

GRAPH 4

Savills capital value index

Graph source: Savills

falls and/or reduced levels of growth in average occupancy and Revenues per Available Room (RevPAR). In the case of RevPAR's (chart 6), London reported a 6.1% growth down on the 10.8% reported the previous year, with the regions seeing a 1.5% increase, a third of that reported in 2010.

■ Room profits have also come under threat due to rising inflationary pressures with London reporting a 9.2% decline in year-on-year room profit in December representing the greatest monthly year-on-year drop since August 2009, according to TRI Hospitality Consultancy. The regions saw a similar monthly fall of 6.7%. The introduction of the CRC will generate further pressures on room profits.

■ The Olympics will no doubt provide a boost to London performance this year, although this may be mitigated by the increase in room supply being brought to the market ahead of the Games. The fact that a number of international operators are hoping to enter the London market such as Park Regis, Peninsula and Kosmopolito suggests that London still remains an attractive operational market.

■ However, there are some potential green shoots that may provide some support to the regional hotel market. For example, the surprise tick-up in consumer confidence seen in January, which tends to pre-empt retail spend, may mean that we see renewed domestic tourism demand bolstered by the feel good factor associated with the Olympics and the Queen's Diamond Jubilee. Yet, for those oversupplied markets this may not be enough to improve average operational performance levels.

GRAPH 5

Early pick-up in consumer confidence

Graph source: ONS; GfKNOP

GRAPH 6

Revenues per Available Room (RevPAR)

Graph source: TRI Hospitality Consulting

OUTLOOK

Until debt availability improves we are unlikely to see any significant increase in investment activity.

■ Difficulties facing the Eurozone will pose a risk to investment volumes this year as confidence levels will be subdued. We expect activity to remain focused on London.

■ Prime yields are expected to hold at current levels through 2012. However, the continued focus on leased assets means that downward pricing on those assets available on management contracts and/or vacant possession, particularly those in the regions, is likely to continue.

■ Our forecasts for capital value growth are that London values will increase by 3.9% this year with the regions seeing a further 3.3% fall. However, we may see declines in some regional markets in excess of this.

■ Recent operational performance has generated concerns. However, the Olympics should provide a boost to London performance this year. Regionally, the feel good factor associated with the Games and the Queen's Diamond Jubilee may also bolster domestic tourist demand.

Savills Hotels

Savills are market leaders, having sold and transacted more than 300 hotel and serviced apartments in the UK. Sales include trading hotels at both corporate and private levels, from tourist class to five star luxury hotels. Based throughout the UK and Europe, we provide the complete package from acquisition and development advice, through to lease, management contract or turn-key negotiations, asset management and sale of investment.

In 2011, Savills provided consultancy advice for a luxury 130 unit serviced apartment renovation in Mayfair, London. The team also completed the annual portfolio valuation for Ascott Reit and sold five Malmaison hotels on sale and leaseback.

Savills remain one of the most experienced agents and valuers in the industry. Annually we handle some €5bn worth of hotel and serviced apartment asset transactions and valuations across the UK and Europe.

Savills Research

The Savills Research team has gained a reputation for an innovative and pro-active approach, which comes from a clear philosophy of market dynamics and an understanding of our clients needs.

The team is unique in providing advice and analysis to clients across all sectors of the property market: from rural property to offices; residential to retail and leisure; in both the UK and globally.

Our established research team, with some 20 years experience, has a strong reputation for producing accurate, well informed and above all else, independent analysis and commentary.

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