RESEARCH

Knight Frank

UK HOTEL
CAPITAL MARKETS INVESTMENT REVIEW **2019**

HIGHLIGHTS

UK Hotel investment totalled £7.4 billion in 2018, with overseas investors representing 78% of total investment.

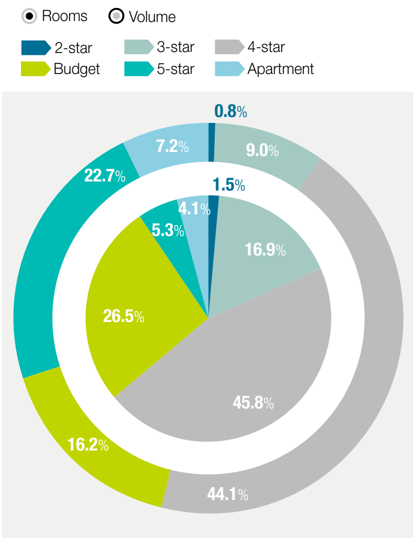
Institutional investment, grew by 42%, equating to over £2.1 billion investment in hotel property.

European investors seek refuge in the UK hotel market, with £2 billion investment, equating to 27% of the UK transaction volume.

TRANSACTION OVERVIEW

A phenomenal year of investment activity in the UK hotel market, due to an exceptional level of portfolio hotel transactions, combined with resilient trading performance, has propelled full year 2018 total investment volume to £7.4 billion.

FIGURE 1
UK Hotel investment 2018 by grade – volume v rooms



Source: Knight Frank Research

This equates to a £1.7 billion increase in hotel transaction activity, compared to the previous year, equivalent of a 29% year-on-year rise in investment and 102% above the 12-year average of annual hotel investment activity of £3.7 billion. Despite the uncertainty of Brexit, growing confidence and strong demand from overseas investors, has outpriced domestic buyers, with overseas investors representing 78% of total investment activity (excluding developments) and 85% of all hotel portfolio activity exchanging hands with an overseas buyer.

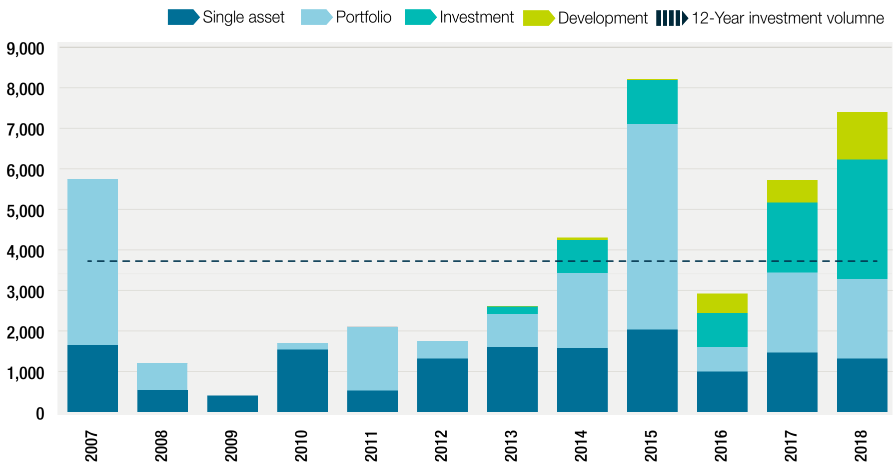
In 2018, UK hotel transaction activity represented 37% of total investment volumes in the UK Specialist Property sector (which includes Student Property, Private Rented Sector, Healthcare and Automotive), a significant 3% increase in market share compared to the previous year. Given the structural and technological changes that are affecting offices and retail in particular, this has led to positive momentum and record amounts of capital targeting the hotel sector. Robust levels of hotel investment by institutional investors, rising by 42% in 2018, reinforces the amount of capital being allocated to alternative income assets in order to seek greater diversification and to target stronger risk-adjusted returns.

In addition, increasing levels of data and detailed analytics is bringing increased investor confidence and a greater understanding of the fundamentals of hotels as a specialist sector. This is particularly noticeable across forward funded development deals where investment doubled in 2018 compared to the previous year, with over £1.1 billion of funds invested in sites deemed for hotel development or forward funding of future hotel projects.

The first half of 2018 saw the greatest share of deal volume, with £4.3 billion of deals (59% of total transaction volume) completing during the first six months. This was driven by corporate portfolio activity with 90% of the total £3.1 billion of portfolio transactions completing during the first six months of 2018. Despite fewer portfolios transacting during the second half of 2018, hotel investment remained robust, (particularly so in the final quarter of 2018), with the second half of 2018 recording 73% of all single asset deals completing (both investment and going concern), equating to over £2.2 billion.

Also of significance is the importance of the HNW Family Office investment, UK institutional investors and Overseas Hotel Focused Investment Groups, which have the highest net capital inflows of all investor types, each with approximately £1 billion of investment. In contrast, the flow of capital from Private Equity investors was in negative territory, recording £3.2 billion of capital transferring out of the sector.

FIGURE 2
UK total hotel investment volumes 2007-2018



Source: Knight Frank Research

Doubletree by Hilton Coventry, acquired by LRC Europe from Oaktree Capital Management, as part of a portfolio of 7 hotels under franchise to Hilton and to be operated by Amaris Hospitality.

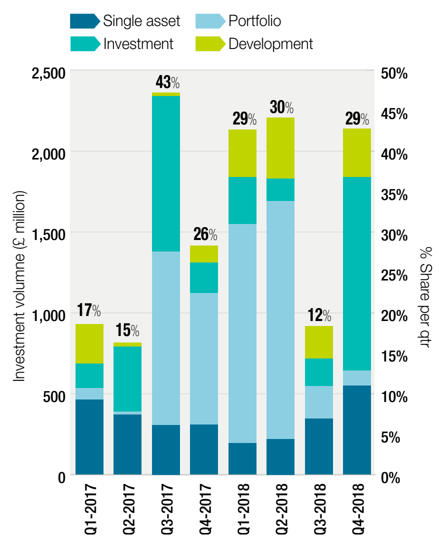
Portfolio transactions drive regional UK sales

In 2018, despite the share of regional UK's transaction volume declining by one percentage point to 56%, total investment increased by some 27%, rising to over £4.1 billion of investment and approaching the regional UK investment high achieved in 2015. The uplift in transaction volume can be largely credited to the scale of portfolio activity, which accounted for 53% of total regional investment, of approximately £2.1 billion, compared to £1.5 billion during 2017.

Major portfolios transactions completing in 2018 included the disposal by Starwood Capital of the 12-strong Principal Hotel Group, including one De Vere hotel asset, for £800 million* to the hotel focused investment company Covivio (formerly Foncière des Régions); Lone Star's remaining Amaris hotel portfolio and operating platform to the privately held investment firm LRC Group for £600 million; Apollo Global Management's disposal of its 20-strong Holiday Inn and Crowne Plaza portfolio to the Israeli HNW Dayan Family, netting some £742 million and Brookfield's £430 million acquisition of the SACO Group, the largest serviced apartment deal in the UK to date. On a consolidated basis, the average price per room sold in a portfolio transaction in 2018 equated to £147,000 per room, which was 10% lower than the previous year, but was partially a function of the large number of Travelodge rooms transacting as part of a portfolio transaction.

Single asset investments, in regional UK, fared less well in 2018 compared to the previous year. Despite only recording a 6% decline in investment of over £830 million, the number of deals declined by 45% and the number of rooms exchanging hands fell by 36%. Our more detailed review of the regional UK single asset transactions has identified that UK domestic buyers, were particularly

FIGURE 3
UK hotel investment volume per quarter 2017-2018



Source: Knight Frank Research

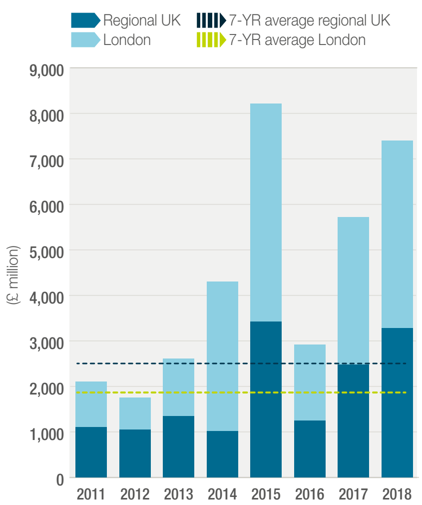
*Acquisition price of the Principal Hotel Group adjusted to reflect the sale of the portfolio in two tranches, with 12 assets (including two developments) sold in 2018 and the sale of the remaining two hotel assets completing in 2019.

active in pursuit of 3-star properties, accounting for 78% of the transaction volume, with the 3-star market increasing its share of single asset transactions to 35% (compared to 27% in 2017), at an average price per room sold of £97,000 per key, a rise of 48% compared to the previous year.

Our analysis of single asset, four-star hotels transacting revealed a decline in volume, with its share falling to 42% (53% in 2017), yet recorded a 34% rise in the average price per room sold to £146,000. The five-star market, however, enjoyed an increase in its market share, rising to 12% (compared to 7% in 2017) and a 19% rise in the average price per room sold of £310,000. Much of this growth in the average price room, in both the four-star and five-star markets, can be attributed to hotels being in strong pursuit by overseas investors, accounting for 63% of the regional UK four-star market (compared to 46% in 2017), in terms of investment volume.

In summary, the regional UK hotel market has seen no shortage of capital investing in quality stock, as growing demand from the varied investor groups, diverse sources of capital available and a resilient trading performance all contributed to a surge in the average price per room sold. Across all regional UK hotels (excluding developments), the transaction price per room increased by 11%, to approximately £119,000 per room.

FIGURE 4
UK Hotel transactional activity London v Regional UK
2011-2018



Source: Knight Frank Research

London hotel market buoyed by strong investment market

Despite the prolonged Brexit negotiations and the uncertainty surrounding how the UK will make its exit from the EU, London continues to remain attractive to hotel investors, with opportunistic investors stimulated by the uncertainty created by the UK's decision to leave the EU and attractive levels of growth prospects over the long-term. The continued strength of the global economy at the start of 2018, the liquidity of the UK property market and the competitive value of the pound are all factors that have helped attract safe haven capital flows to the UK and, in particular, London, as a leading global city.

Investment in the London hotel market during 2018 was buoyed by a strong year in portfolio sales, leading to a respectable rise in investment volume of 23% (excluding developments), with transactions totalling over £2.5 billion, albeit the composition of transactions was materially different when compared to the previous year.

For the second year running limited single asset hotel stock was brought to market, as hotel owners decided to reap the benefits of a robust trading environment, with London's upper-upscale and luxury hotels achieving RevPAR growth of 5% or more for the full-year 2018. A total of 14 single asset hotels transacted in London in 2018, the same number as the previous year, but considerably smaller in size, with the number of bedrooms declining by 33%.

Meanwhile, total sales volume of single asset hotels declined by 16% to around £475 million. As such, single asset hotels accounted for only 15% of London's transaction market (compared to 23% the previous year). Nevertheless, with strong demand from domestic and overseas buyers, sellers' price expectations were generally maximised, with the average price per room sold of single asset hotels in London rising by 21% to £387,000. However, overall, including both single asset and portfolio transactions (but excluding developments), the average price per room sold declined by 13%, to £320,000 per room.

On the rise in London during 2018, was the volume of investment deals, rising by 33% and totalling approximately £1.5 billion. Driving this growth was the number of fixed lease deals taking place, with investment volume rising by 166%, to over £530 million and the average price per room sold rising by 16% to £243,000 per room.

Total investment in London climbed to £3.3 billion when including hotel developments. The acquisition of hotel sites and the forward funding of hotel projects equated to 21% of total investment in London, with the conversion of office or retail space deemed a viable option to overcome barriers to entry, particularly for full service upper-upscale and luxury hotel developments. Examples include the £90 million acquisition of an existing office block at 5 Strand, by the Indian-based developer, Abil Group, with planning consent to build a 200-bedroom luxury hotel; and Ireland's Dalata group's £91 million acquisition of the long-leasehold interest for a 212-bedroom, Clayton Hotel, currently under development at Aldgate East Station.

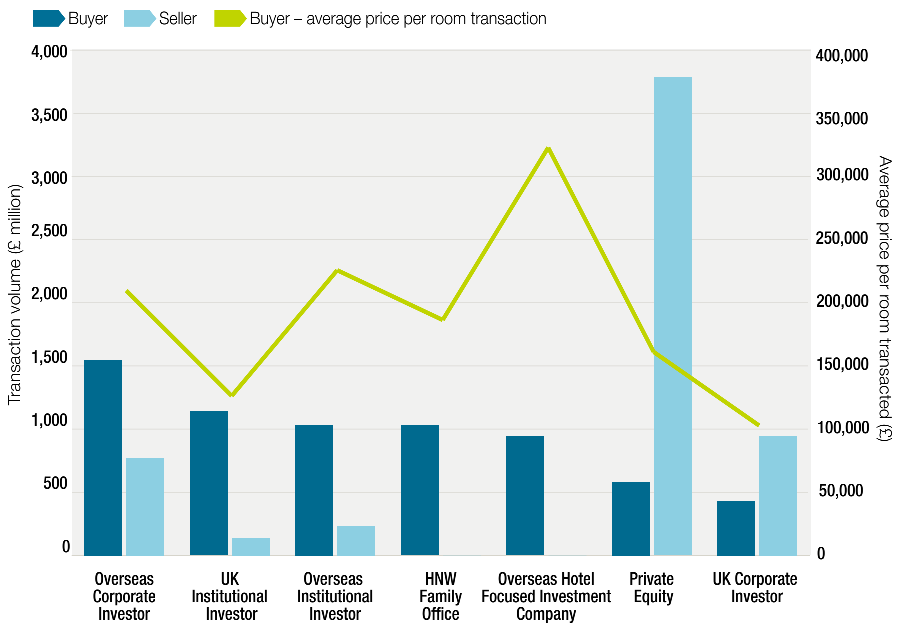
Overseas corporate investors ranked as top UK buyer

In 2018, overseas buyers invested approximately £4.9 billion into the UK hotel market, more than doubling their investment compared to the previous year, with an even 50% split of the capital invested between London and regional UK. In pursuit of scale, 85% of overseas capital invested in regional UK was directed at portfolio acquisitions; whilst in London, 53% of overseas capital focused on investment deals.

Overseas Corporate Investors were ranked overall as the top investor type into the UK hotel property sector in 2018, with investment totalling £1.5 billion. The top player, LRC Group, with the acquisition of Lonestar's Amaris Hospitality platform and owned assets, accounted for 50% of the total investment by overseas corporate investors, adding approximately over 4,700 rooms to its portfolio, with an average price of £164,000 per room.

In London, international investment was the primary driver of the capital's hotel market. Overseas Corporate Investors ranked as the highest spending investor by transaction volume, with a 25% share, closely followed by Overseas Institutional Investors with a 21% share of the total volume. Together, the two groups invested £1.5 billion of capital into the London hotel sector, involving 11 separate deals.

FIGURE 5
Total UK hotel investment volume 2018 – by investor profile (buyers v sellers)



Source: Knight Frank Research

Knight Frank advised on the sale of The Abbey Hotel, Bath for approximately £15 million, UK buyer.

Hilton Belfast (198 Rooms) – Starwood Global Opportunity Fund XI, an affiliate of Starwood Capital Group acquired a portfolio of seven Hilton hotels from Park Hotels & Resorts for £135 million (£101,000 per room).

London assets exchanging hands to overseas investors included: four separate Travelodge investment transactions totalling over £130 million, with an average price of £193,000 per key; Cola Holdings acquisition of the Hilton London Kensington for £260 million (£431,000 per key); Katara Hospitality, the hotels division of Qatar Investment Authority acquiring Grosvenor House, a JW Marriott hotel; and AXA Investment Management completing on its forward funding commitment of 250 City Road, a £90 million deal with an agreement in place with NH Hotels to operate the new 190-room nhow Hotel in Shoreditch. In total, international capital accounted for 75% of the total hotel investment in London.

In regional UK, no single investor group dominated the transaction market, albeit UK institutional investors were most active, with a 19% share of the market. Overseas Hotel Focused Investment Companies and Overseas Corporate Investors each held a 17% share of the market and together accounted for over 60% of overseas investment in regional UK. The top 6 regional UK buyer types accounted for 83% of the regional UK investment volume, equating to £3.4 billion of investment and adding over 25,000 rooms to their collection. Noticeably down on investment volume were UK corporate hoteliers and UK corporate investors, with less than half a billion transactions between them.

In Regional UK, a total of £2.4 billion of investment was made by overseas investors, accounting for 58% of total regional investment, whilst 75% of the overseas investment was deployed in eight portfolio transactions. Covivio's £800m acquisition of the Principal Hotel Group, which resulted in the appointment of IHG to manage the portfolio and the debut of the Kimpton brand to the UK, helped propel the Overseas Hotel Focused investment group into second place, representing 30% of total overseas capital invested. Swedish investor Pandox was the other significant investor in this group, contributing over £140 million. In doing so, it acquired the 312-room Midland Hotel in Manchester for £327,000 per key, (in partnership with the Fattal Hotel Group who will operate the hotel under a 35-year revenue based lease agreement), the 247-room Radisson Blu Glasgow for £158,000 per room and has entered into a forward purchase agreement to acquire a 275-room hotel near Manchester Piccadilly Station, due to open by 2021.

Structural changes by institutional investors favour the UK hotel market

As forecast, the strong growth of institutional investment into the UK hotel market continued in 2018, with a 42% increase year-on-year, equating to over £2.1 billion of investment. Whilst this represents a significant percentage change for one asset class, this represents only a minor movement overall in consolidated institutional investment volumes. Nevertheless, the growing trend for the inclusion of hotel real estate in the institutional funds is an important structural shift, with demand in the alternative property sector, particularly in hotel and student accommodation, benefitting from the growing requirement to ensure well diversified, multi-sector portfolios, designed to protect and minimise risk.

In an environment of geopolitical uncertainty and rising interest rates, strong demand exists for secure, long-term fixed income, thereby managing the downside risk during the late property cycle. In 2018, approximately £780 million of institutional investment targeted fixed lease income transactions, which equates to around 36% of total institutional investment, of which 56% of the institutional capital was focused towards regional UK. Adding value through development has also become increasingly common, with 24% of institutional investment specifically targeted towards funding a hotel development site in 2018, resulting in institutional development financing increasing by 23% year-on-year.

The proportion of capital allocated to specialist property is on the rise and with the full deployment of recent capital raises and funds reaching their required quota of a particular asset class, new vehicles are constantly on the horizon. Diversification and the opportunity for greater returns have enabled hotel property to garner a greater share of investor capital in 2018. In particular, institutional capital from overseas investors has increased considerably, representing 14% of total investment volume in 2018 (compared to only 4% the previous year) and equating to 47% of total institutional capital.

The ability to satisfy the demand with suitable investment grade product, which offers a predictable level of income and sustainable cashflows, is one factor that may slow the growth of fixed income institutional investment going forward. However, as institutional investors' knowledge and understanding of the sector evolves, there is growing evidence that investors will focus increasingly on investment into operating assets, particularly where the yield arbitrage is attractive. Whilst the operational risk premium over a fixed lease structure provides a greater return to savvy institutional investors, there will be further opportunity to take advantage of favourable macro trends (such as increased tourism demand) and the chance to drive enhanced levels of performance through careful asset management strategies.

The UK ground lease market continues to evolve

Record yields as low as 2.3% have been achieved in the market for ground lease investments during 2018, albeit whilst demand for such opportunities continued in 2018, the transaction volume was some 20% lower than during 2017 at approximately £213million. Investment volume is of course dependent upon the ability to create suitable ground rents which appeal to both the investor and the operator.

In 2018, a total of nine ground lease transactions were executed, involving 14 individual hotel assets, of which 95% of

> **Even after the outcome of Brexit, overseas capital inflows and institutional investment in the UK hotel market is expected to continue to remain buoyant, as the strategic importance of investing in alternative, specialist sector real estate intensifies.**
>
> **HENRY JACKSON,** KNIGHT FRANK, HEAD OF HOTEL AGENCY.

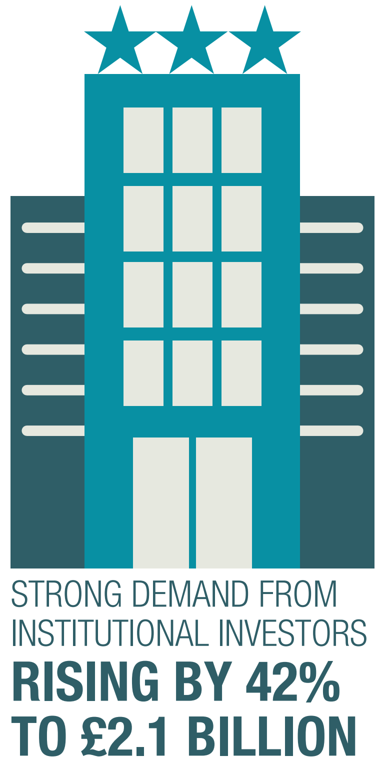
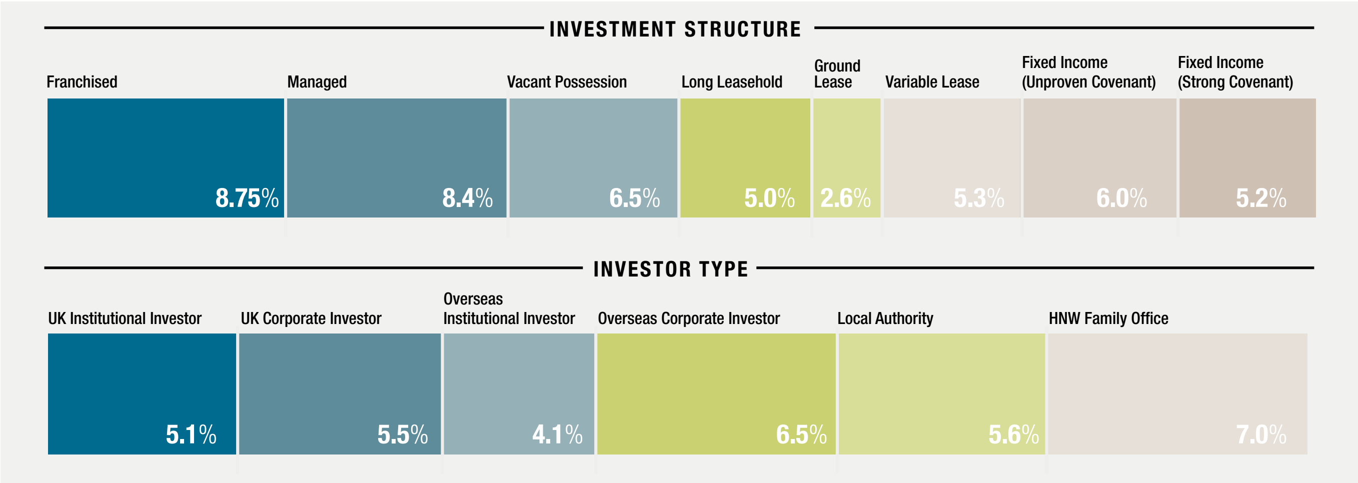


FIGURE 6

UK Hotel Investment 2018 – average net initial yield (%) – by investment structure and investor type



Source: Knight Frank Research

investment targeted regional UK. Institutional investors dominated the ground lease market, with 96% share of the total investment, with ground lease transactions representing 9% of total institutional investment.

For the second year running, in 2018, PGIM Real Estate secured the top spot in terms of the largest ground rent deal. The deal involved Starwood Capital unlocking the value of its real estate, by relinquishing the freehold of 6 De Vere Hotel assets, for a consideration of £161.7 million, totalling some 1,719 rooms, whilst maintaining operational control of the assets.

The capital sum the vendor receives in consideration of the sale of a ground lease is by no means insignificant. The ground rents being set are typically in the region of 15% of EBITDA and when combined with the record low yields, such deals can often achieve as much as 47% of the freehold value. Overall, across the market the average net initial yield moved in during 2018 to 2.6% compared to 2.8% in 2017.

The ground rent structures are in essence financially engineered structures, designed as an innovative means of providing an additional source of funds to help finance the acquisition or to release equity from an existing property, and which then serve to provide long-term, low risk cash flows with additional security. Nevertheless, it is important to realise that ground rented structures are not favoured by all investors or lenders in the hotel real estate arena. The greatest concern is in regards to the growth of the rent and the future relationship to EBITDA. Whilst at the outset of the lease, rents are typically in region of 15% of EBITDA or less, this percentage has the potential to increase over time if trading performance does not keep pace with inflation.

Other concerns have arisen over how tradable the residual (leasehold) interest will be in a post ground rented investment, however, with growing evidence of the liquidity of these assets and with the weight of institutional investment in the hotel sector growing, this concern is likely to be overcome.

Snapshot: Record levels of public sector investment in hotel real estate

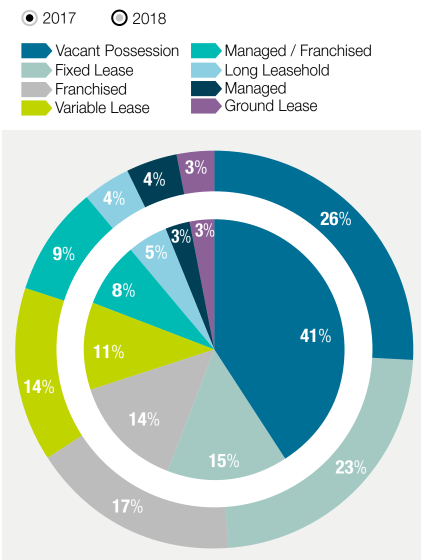
In 2018, a further trend which has developed is the increasing appetite for local authorities to capitalise on low-interest central government loans to purchase commercial property. In 2018, local councils invested a record £93 million in the hotel sector, and whilst this represented only 1% share of total UK hotel investment, it equates to an increase of 182% on 2017 (£33 million). Local councils are increasingly turning to hotel investment as an effective, innovative and forward-thinking way to boost their own income and cover budget shortfalls following central government cut backs to funding local services.

Local councils are typically replicating the acquisition strategy of institutional investors, acquiring freeholds, predominantly subject to an operating lease, with well-known brands such as Travelodge and Premier Inn. The rent provides a secure, long-term income stream, which is either fixed or inflation linked, whilst the council will further benefit from the increase in the underlying property's value over an extended period of time.

Six out of the seven local authority hotel deals in 2018 involved the acquisition of either a Travelodge or Premier Inn Hotel, transacting at an average price of £99,000 per room, with a yield spread between 4.25% and 6%. The Travelodge Scarborough (acquired for £100,000 per room) and the Travelodge Plymouth (acquired for £152,000 per room) are two examples of local councils acquiring hotel assets within their jurisdictions. As councils look to grow their investment in hotel real estate, we anticipate the trend to widen their geographical target area beyond a council's administration will become increasingly common.

FIGURE 7

Investment structure – total UK 2018 v 2017



Source: Knight Frank Research

Local councils are also increasingly involved in development schemes, with financial investment in the form of: helping secure land (combined with the security of a local government covenant); the provision of gap funding; sourcing and access to LEP grants; and entering into joint ventures agreements with developers, in order to ultimately retain the freehold interest of a trading asset. Hilton is one of the most active hotel operators known to be working with at least six different local authorities including Woking, Stoke-on-Trent, Aberdeen and Peterborough and has recently opened the 130-room Hampton by Hilton Aberdeen and the 128-room Hampton by Hilton Stockton on Tees, both in conjunction with local authority partners.

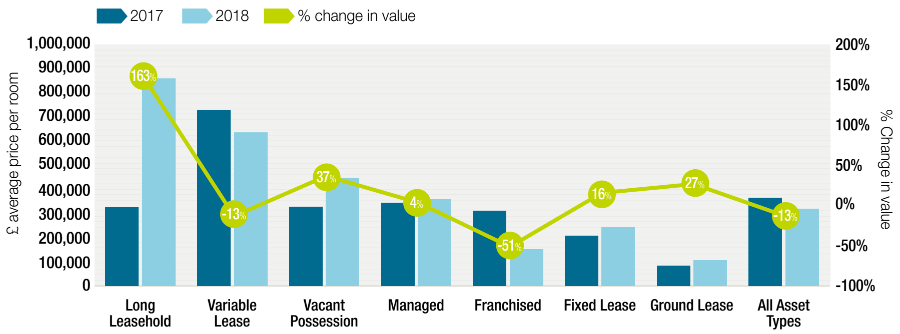
Surge in fixed lease and franchised transactions, result in huge gains in market share in 2018

Hotels that sold with vacant possession represented the largest group of hotels in the UK changing hands in 2018, with a total value of £1.6 billion, however, the market share of this asset group significantly declined from 41% in 2017 to just 26% in 2018. Significant variation existed between regional UK and London, with only 16% of the transaction volume in London selling with the benefit of vacant possession, compared to 32% in Regional UK. Nevertheless, in 2018 a greater proportion of hotels transacted in London with the benefit of vacant possession than compared to the previous year (10% in 2017); whilst in regional UK the quantum of assets which sold subject to vacant possession substantially declined.

In 2018, fixed lease hotel transactions leap frogged into second place, achieving a 12 percentage point gain in market share, with over £1.4 billion of investment, resulting in a net increase of £870 million. Much of this growth has arisen as a result of the clear trend of increasing allocations by institutional investors into alternative real estate. Equally, the growth in the supply of branded, institutional-grade property, has further contributed to the overall rise in fixed income hotel assets, combined with the increased probability of such assets coming on to the market. As such, a number of investment portfolio deals completed during 2018, which has helped contribute over £650 million to the total fixed lease transaction pool and were a major catalyst in the asset class achieving the largest

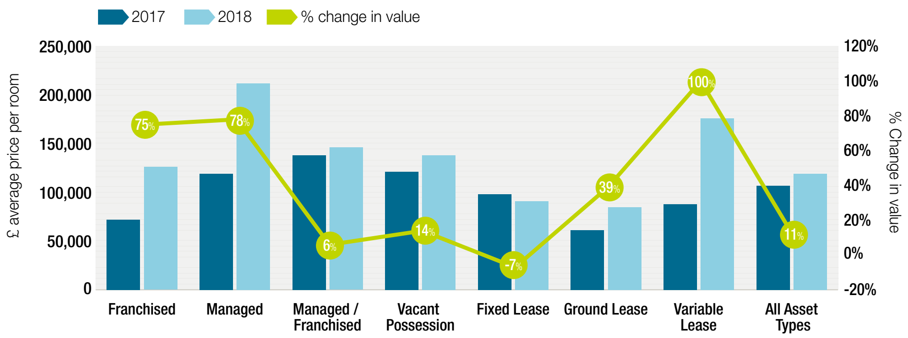
Ibis Styles Birmingham NEC (166 Rooms) – Knight Frank advised on the sale of 4 Ibis Styles Hotels to Starboard Hotels, off a guide price of £30 million.

FIGURE 8
Average price per room transacted 2018 v 2017 by investment structure – London (£)



Source: Knight Frank Research

FIGURE 9
Average price per room transacted 2018 v 2017 by investment structure – regional UK (£)



Source: Knight Frank Research

number of rooms transacting in the UK, some 12,000 rooms, equating to a 31% market share.

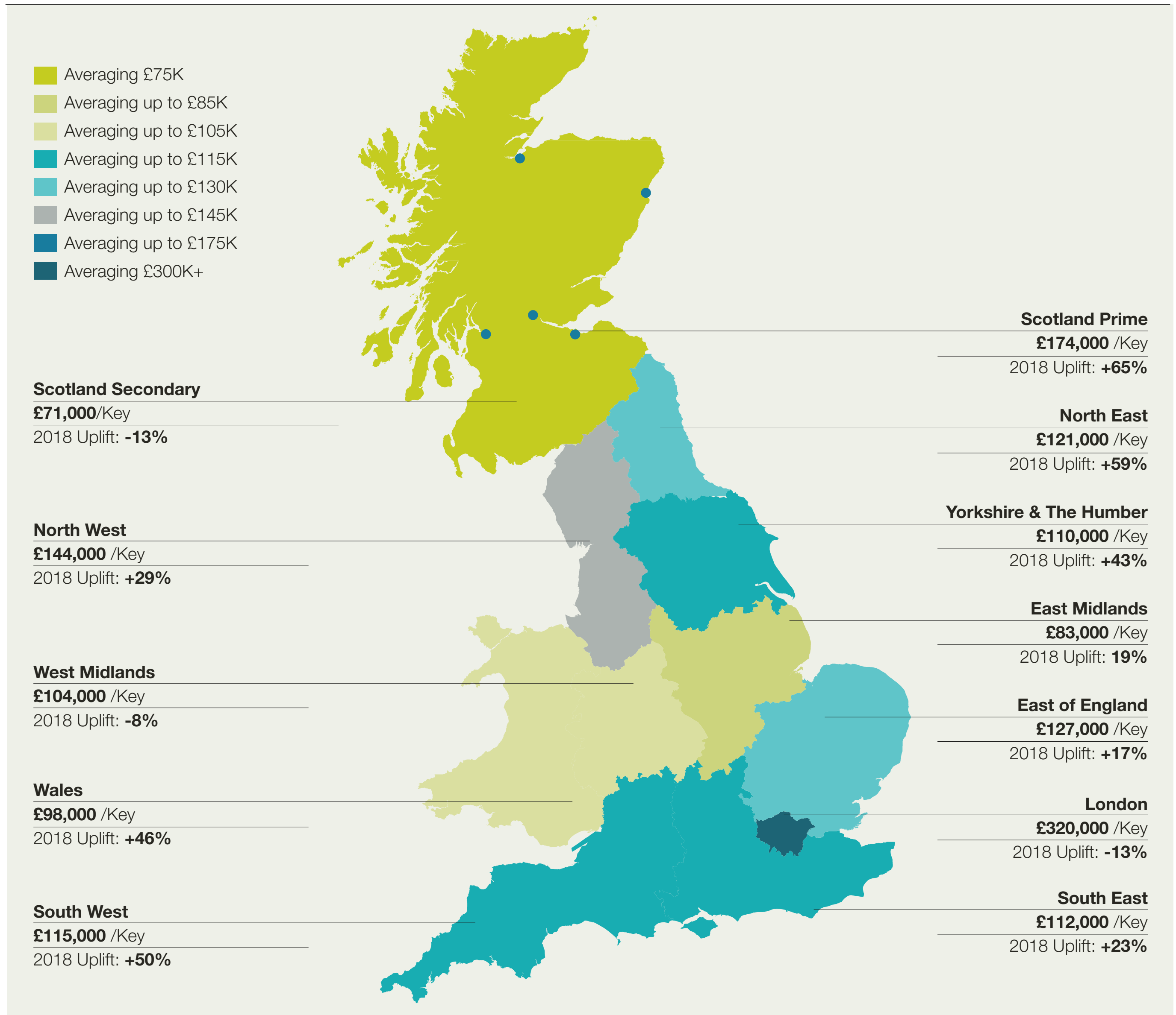
Other asset classes where significant growth in investment was observed, related to the sale of properties subject to a franchise agreement, (combining both third-party managed or owner operated, but subject to a franchise agreement), with £1.6 billion in asset sales and the market share rising by 15 percentage points, to 26% share of the total investment volume. Quality, branded hotel stock offered for sale via a portfolio transaction, contributed 50% of this franchised hotel stock.

Changes to the composition of hotels transacting leads to a fall in London's average price per room sold

Despite a strong rise in the volume of hotel transactions in London in 2018, the composition of hotels transacting resulted in a 13% decline in the average price per room to £320,000 (excluding developments). In 2017, in London a total six of upper upscale hotels exchanged hands subject to franchise or management agreement, equating to some 2,400 rooms, resulting in an average price per room of £332,000. At a time when investment in London's hotel market was relatively subdued, the

Park Inn Telford (153 rooms) – Knight Frank advised on the sale of 6 Park Inn hotels to Proark Group, off a guide price of £42 million.

FIGURE 10
Average price per key sold (£)



Source: Knight Frank Research

transactions collectively equated to a 38% share of London's investment market. In contrast, in 2018, some 2,300 more rooms have transacted than in 2017, with a 35% uplift of the number of rooms transacting under a franchise or management agreement. With the increase in rooms transacting in London predominantly as a result of various portfolio acquisitions in the mid to upscale category, the average price per room sold, of franchised / managed assets declined to £166,000 per room and represented just 21% of London's transaction volume.

Despite changes to the composition of hotels transacting, as the over-riding catalyst to a fall in London's average price per room sold, impacting in particular hotels operating under a management or franchise agreement, other investment structures, such as hotels sold with vacant possession witnessed a 37% growth in the price per room, and investment volume doubling. Meanwhile, fixed lease hotels selling in London achieved growth of 16% in the average price per room and an 11% rise in its market share. Other noticeable gains compared to 2017, were for long-leasehold assets, with the sale of the 73-bedroom Beaumont Hotel at £1,918,000 per room and the sale of the Curtain Hotel and Private Members Club for £750,000 per room. Both hotels contributed significantly to the surge in the average price per room sold for long leasehold assets, rising to £860,000 per room.

In regional UK, the heightened demand for quality branded hotel product was instrumental to the 11% rise in the average price per room sold to £119,000 (excluding developments). Franchised and managed assets made a significant contribution to this growth, with the number of rooms in this investment structure doubling to some 9,500 rooms and the average price per room sold, rising by some 30% to £139,000. As a result, the contribution of franchised and managed assets represented 37% of the regional UK's total investment volume, compared to only 14% the previous year.

Meanwhile, hotels which sold subject to vacant possession in regional UK also witnessed a strong rise in the price per room sold, rising by 14% to £138,000 per room. Whilst this figure has been impacted by various portfolio deals selling with vacant possession, it emphasises that demand is strong for hotel assets which are well located, have a balanced demand base, a strong cashflow and has potential for conversion to a specific brand. With resilient trading performance in regional UK, quality assets sold with vacant possession have been in short supply, with over a 40% decline in the number of deals transacting. Despite a rise in the average price per room sold, the total volume of vacant possession asset sales has also declined, resulting in the share of vacant possession sales in regional UK, in terms of investment volume, declining from 63% in 2017 to 32% in 2018.

EU Investors seek refuge in UK hotel market

In 2018, whilst the UK witnessed a number of large lot sized deals in the form of portfolio transactions, the total deal count actually declined. As such, portfolio activity has somewhat overstated the geographical intensity of certain inbound markets.

Nevertheless, in 2018, inbound investment from Europe increased phenomenally, with investment exceeding £2 billion, representing 27% of the total transaction volume, compared to a 2% share the previous year. The French investor Covivio and LRC Europe, together contributed 81% of total European investment. Israeli investment was also significant, representing 11% of total investment volume, largely due to the HNW Dayan Family acquiring the Apollo portfolio.

However investors from Abu Dhabi and Saudi Arabia, were also hot in pursuit of strongly performing assets, with income growth potential, acquiring The Caledonian Waldorf Astoria in Edinburgh and Travelodge London Heathrow Terminal 5, resulting in the market share of Middle Eastern countries (not including Israel) to rise to nearly 3%. Meanwhile, inbound capital from the USA increased by 77% to £1.5 billion in 2018, as a result of significant institutional interest which accounted for 75% of US investment. Brookfield's £457 million acquisition of the SACO portfolio helped drive total US investment to 21% of the total UK investment volume.

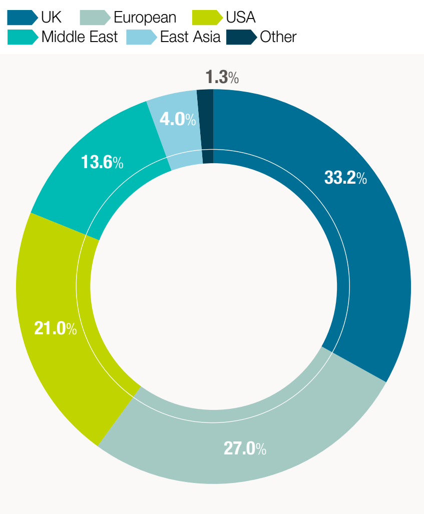
Private Equity check out of hotels

For the second successive year, Private Equity has been the largest investor group to divest of its hotel stock. Following robust acquisition strategies, private equity vehicles are often established to acquire under-performing assets with a view to driving operational improvement and an upgraded level of quality, which once achieved the focus is on securing an exit with a respectable return for investors. As such, the life cycle of an investment held by a private equity investor is one of the shortest and in 2018, this investor type accounted for 56% of the total UK assets divested, representing some 22,000 rooms and totalling some £3.8 billion of asset sales. Starwood Capital, Apollo Global, Oaktree Capital Management and Lonestar represented over 78% of the disposals by private equity vehicles.

The second largest group to divest of hotel property was the UK Corporate Investor group, accounting for 14% of UK hotel stock changing hands, with approximately £950 million of asset sales. In contrast to Private Equity divestment, the largest investor in this group represented only 15% of the group's divestment, therefore highlighting the large volume of smaller lot sized deals within this investor group. The largest sale by a UK Corporate investor involved the sale of the long leasehold interest of the 73-bedroom Beaumont Group for £140 million, equivalent of £1,918,000 per room.

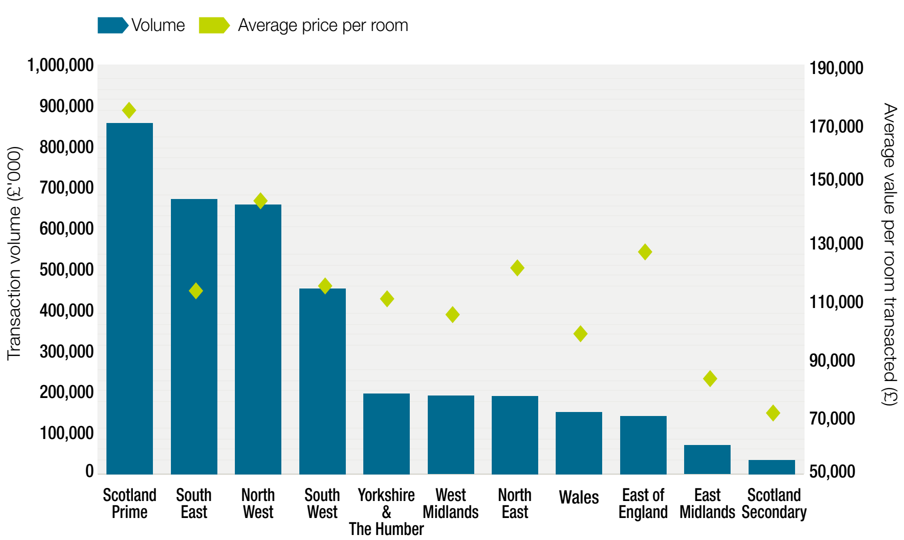
Overseas corporate investors represented the third largest group to dispose of UK hotels assets, accounting for a further 11% of asset sales, totalling some £770 million of assets divested.

FIGURE 11
UK hotel investment – investor origin 2018



Source: Knight Frank Research

FIGURE 12
Regional UK Hotel transactions 2018 by UK region



Source: Knight Frank Research

Sprowston Manor (94 Rooms) – Acquired as part of a portfolio of 5 Marriott Hotels sold with vacant possession to Britannia Hotels for £35 million.

Prime Scottish Cities ranked as the most attractive region for hotel investment in 2018

When analysing how the investment volume is distributed we have split the UK into the accepted regions and in Scotland, analysed the major Prime Cities (Edinburgh, Glasgow, Aberdeen and Inverness) as a region versus the rest of Scotland which we have termed 'Scotland Secondary'.

Prime cities in Scotland, were ranked as the most liquid region in the UK in 2018, after London, recording over £850 million of transactions, from some 31 deals. The city of Edinburgh which accounted for over 60% of the investment in prime Scotland, with transactions totalling around £525 million and a 13% share of the UK regional investment market, is ranked as the most attractive regional UK city for hotel investment in 2018. Edinburgh also achieved the highest price per room sold for regional UK, with an average selling price of £239,000 per room. The sale of the Principal Hotel Group was largely responsible for propelling Scotland into the leading position, with four out of the 12 assets located in Scotland, totalling some 795 bedrooms, with an average price per room sold of around £350,000 per room.

Also contributing to Scotland's prime cities 1st place regional ranking, was the city of Glasgow, which was ranked as the 3rd most active regional UK hotel market, with some 12 assets transacting, totalling around £275 million, approximately £143,000 per room.

The South East of England was ranked as the UK's second most fluid region for hotel investment, with transactions totalling approximately £675 million. Despite some 50 hotels transacting, representing some 6,000 rooms, the region was responsible for some of the smaller lot sizes, with an average selling price of £112,000 per room.

The North West region recorded total transactions of around £630 million, securing the position of the 3rd most active UK region for hotel investment, with an average price per room sold of £143,000 per room. The city of Manchester recorded investment of over £325 million, which accounted for 52% of the region's investment volume and 8% share of the total regional UK hotel market. This level of activity secured Manchester's position as the second most popular regional UK city in which to invest, with some six hotels transacting at an average selling price of £235,000 per room.

The city of Liverpool recorded investment totalling around £160 million and represented 25% of the investment volume in the North West of England. Liverpool was the 4th most active regional hotel market, with five hotels changing ownership, averaging £163,000 per room sold. Meanwhile, Cumbria, also located within the North-West region witnessed nine hotels transacting, with an average selling price of £120,000 per room. Whilst Cumbria only accounted for 5% of transaction volume in the North-West region, 90% of the transactions which took place, involved an overseas buyer. These acquisitions therefore highlight the increased liquidity of the Lake District and the growing appeal of the region to international investors, following its award of Unesco World Heritage Status during the summer of 2017.

TOP 10 REGIONAL UK CITIES FOR HOTEL INVESTMENT 2018

Edinburgh
Volume: **£530 million**
Rooms: **2,200**
Av price per room: **£239,000**

Manchester
Volume: **£330 million**
Rooms: **1,400**
Av price per room: **£235,000**

Glasgow
Volume: **£280 million**
Rooms: **1,900**
Av price per room: **£143,000**

Liverpool
Volume: **£160 million**
Rooms: **1,000**
Av price per room: **£163,000**

Cardiff
Volume: **£130 million**
Rooms: **1,200**
Av price per room: **£111,000**

York
Volume: **£120 million**
Rooms: **700**
Av price per room: **£166,000**

Birmingham
Volume: **£110 million**
Rooms: **800**
Av price per room: **£141,000**

Bath
Volume: **£100 million**
Rooms: **600**
Av price per room: **£163,000**

Bristol
Volume: **£90 million**
Rooms: **700**
Av price per room: **£133,000**

Windsor
Volume: **£80 million**
Rooms: **600**
Av price per room: **£136,000**

Investment opportunities 2019

Continuing the strong end to 2018, with 29% of the annual investment activity taking place in the final quarter, the pace of investment for the first eight weeks of 2019 has been strong, with approximately £1 billion of investment to date.

Two significant portfolio transactions have completed, both of which have been sold to investment vehicles understood to be owned by the same investor, The Dayan Family, a HNW Family Office from Israel. The first portfolio transaction involved Topland Group's disposal of the Hallmark Hotel portfolio for £250 million. The Topland Group had become a major player in the UK hotel market, having acquired and further invested in three separate portfolios, (Menzies, Hallmark and the Feathers Group) to merge and trade under the Hallmark Hotel brand. The 26-strong portfolio has now been sold to a private Israeli investment fund working with LGH Hotels Management (controlled by the Dayan Family), which also owns and operates the former Apollo portfolio of Holiday Inn and Crowne Plaza franchised properties. Meanwhile, a portfolio of nine regional, leased Hilton hotels, known as Project Zinc, have been sold out of administration to Vivion Investments for £246 million, which is also known to be controlled by the Dayan Family.

	Private Equity	HNW Family Office	Overseas Corporate Investor	Overseas Institutional Investor	UK Institutional Investor	Overseas Hotel Focused Investment Company
Leading Investor 2018	Brookfield Asset Management	Vivion Capital Partners (Dayan Family)	LRC Europe Group	Qatar Investment Authority Katara Hospitality	Secure Income REIT	Covivio
Total Investment	£420 million (£198,000/room)	£742 million (£153,000/room)	£774 million (£164,000/room)	£550 million (£1,109,000/room)	£245.5 million (£74,000/room)	£800 million (£303,000/room)

LEADING UK HOTEL TRANSACTIONS BY INVESTMENT STRUCTURE

	Largest Portfolio Transaction	Largest Single Asset Transaction London	Largest Single Asset Transaction Regional UK	Largest Fixed Lease Transaction London	Largest Fixed Lease Portfolio - Regional UK	Largest Development Transaction
Acquisition	Principal Hotel Portfolio	The Beaumont Hotel	Midland Hotel Manchester	Doubletree by Hilton Hotel, London Islington	Travelodge Portfolio (59 hotels)	Wanda Vista Hotel London
Investor	Covivio	Barclay Brothers	Pandox	LRC Europe Group	Secure Income REIT PLC	Guangzhou R&F Properties
Investment	£800 million (£303,000/room)	£140 million (£1,918,000/room)	£102 million (£327,000/room)	£136 million (£366,000/room)	£212 million (approx £80,000 per room)	£195 million (£1,038,000/room)

The appetite for development has also been strong early in 2019, with approximately £250 million of transactions undertaken in the month of January alone, and, significantly all acquisitions having been made by institutional investors. One significant development involves investment manager M&G's £203 million acquisition of a site in Paddington, acquiring the long-leasehold for a dual hotel scheme involving a 373-bedroom Premier Inn hotel and a 247 Wilde apart-hotel by Staycity, both to operate under a 30-year, fixed lease upon opening in 2021.

Despite the uncertainty surrounding Brexit, the varied investor base with different risk / return profiles, has helped contribute to the stability of the UK hotel market. Should sterling weaken further following the UK's exit from the EU at the end of March, we envisage further inbound investment into the UK hotel market. Even if there is little or no currency movement as a result of Brexit, overseas capital inflows and institutional investment is expected to continue to remain buoyant as greater strategic importance is placed on the growth of investing in alternative specialist sector businesses, such as hotels. Whilst investment levels are expected to be somewhat weaker than in 2018, we anticipate investment in the UK hotel market to be considerably stronger during the second half of the year (than compared to H1 2019) and into 2020.

Doubletree by Hilton Islington acquired by LRC Europe for £140 million from Lonestar (£375,000 per room).

KNIGHT FRANK VIEW

Despite the significant net outflow of capital in 2018 by private equity investors, this investor group is likely to resurge as private equity and institutional funds are growing in size, with record breaking fund raises. Moreover, they are anticipated to grow their cross border investment in search of larger value assets, portfolios or entire real estate businesses. The acquisition in 2018 by Schroders to acquire Alonquin, a specialist pan-European hotel and management business, with assets under management of £1.8 billion, is an example of this.

Similarly, private equity investor, Aprirose Real Estate, having garnered a wealth of knowledge and experience through expanding its asset base within the sector, has taken the next step in the evolution of their investment, by launching their own hotel operating platform through a partnership with third-party operator Kew Green Hotels. Such types of vertical integration are likely to become a more regular occurrence as private equity and institutional investors seek greater diversification, with a strategy to grow their presence in the hotel sector and with it, the opportunity for greater returns, whilst at the same time manage their exposure to operational risk.

Meanwhile, London's position as one of the world's most liquid and transparent real estate markets will remain alluring for global and domestic investors alike. Knight Frank's global research reveals that London has retained its title as the world's top destination for investment in commercial real estate, cementing its reputation as a safe haven for investment, despite continued Brexit uncertainty.

Nevertheless, the importance of sustainable cashflows and making the right investment decisions is critical to the longevity of institutional investment in the UK hotel sector. Income creation will become the driving force as yield compression stagnates, as such acquiring assets in core locations, with a sustainable income and adding value through development has become increasingly common in 2018 and is a trend set to continue going forward.

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Front Cover Picture:
Travelodge London Euston (150 Rooms) sold for £40 million. Buyer La Salle Investment Management

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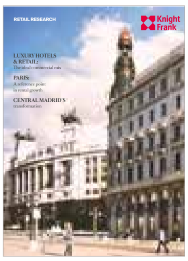

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