At this critical juncture, hotel owners and operators must endeavour to strike a balance in terms of responding to the rising cost pressures without compromising its people, investment in the fabric, and delivery of a great hospitality experience.

UK Hotel Trading Performance Review

Research 2022

knightfrank.com/research

FORWARD

The pandemic provided an exceptional opportunity for the industry to reset, with strong growth and recovery in hotel trading performance in 2022. With reduced levels of hotel supply and future pipeline, this creates a favourable backdrop for the industry to navigate the current headwinds and macroeconomic uncertainty.

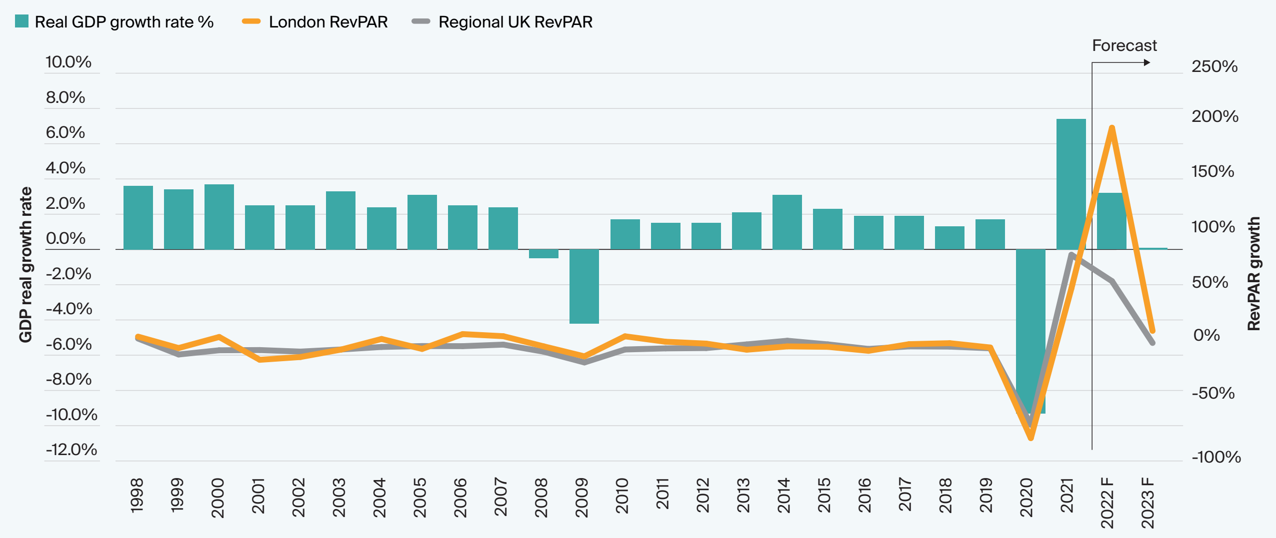
Managing uncertainty

UK economic growth for the final quarter in 2022 and 2023 looks increasingly uncertain, with a slowdown seemingly inevitable. What impact will it have on the UK Hotel sector and how will this downturn compare to previous economic cycles?

Following recent unprecedented political disharmony and at this time of heightened economic uncertainty, the challenges are profound and vast. Whilst inflation is anticipated to fall from a peak of 11% during Q3-2022, it is forecast to remain above 7% in 2023. Meanwhile, the cost of living continues to soar above wage growth, with further hikes in energy prices and interest rates anticipated. Signals are mounting towards a longer recession, with recovery in real incomes, consumption and the return to GDP growth not anticipated until 2024.

Over the past six months, the UK hotel market has continued in its recovery, delivering a strong trading performance.

London & regional UK RevPAR growth rates versus real GDP growth
1998-2023



Source: HotStats, Knight Frank Forecasts

Whilst no hotel business is immune to the effects of an economic downturn, the circumstances driving the slowdown and more importantly the current position in the cycle of the sector – one of recovery coming out of the pandemic – suggest a different outcome playing out for the UK hotel sector. Analysis of historical hotel trading performance illustrates that industry performance typically lags GDP growth by six to twelve months. Yet, more relevant at this time, rather than concerns over a dramatic meltdown, is how the speed of a sector in recovery will be impacted.

Booking windows are far shorter post-pandemic and with corporate and international demand still at considerably reduced levels, any slowdown resulting from the significant economic and external pressures, are likely to be managed timelier than compared to previous cycles. Any lag is therefore likely to occur sooner, reflecting a quicker impact of economic conditions, with the continued recovery in trading performance potentially losing momentum.

Trading review – April-September 2022

Over the past six months, as trading restrictions eased and the normalisation of travel returned once the high risk posed from the Omicron variant reduced, the UK hotel market has continued in its recovery, delivering a strong trading performance. Domestic leisure demand fuelled the early recovery, but this has been supported by robust demand for business travel as well as flexible working trends generating new sources of demand.

Regional UK now exceeds its RevPAR performance over the same six-month period in 2019 by 1.6%, but with a contraction in terms of TRevPAR of 0.6%. London's performance has rallied strongly, despite international visitor arrivals remaining at a considerably lower level than pre-Covid. London's RevPAR performance now exceeds 2019 performance by 0.6% but lags regional UK in terms of TRevPAR recovery. For the last six months London's TRevPAR is down by 2.0% compared to the same period in 2019.

In partnership with HotStats, we have produced our latest comprehensive review of the UK's hotel trading performance, which provides a unique and detailed review of hotel revenues, costs and profitability. HotStats data allows us to report to Gross Operating Profit, therefore our analysis excludes any costs relating to management fees and fixed charges, such as property tax, insurance and FF&E reserve.

Our analysis centres around a range of datasets which focuses on hotel class, market positioning and which distinguishes between London and regional UK. In addition, we have undertaken a review of the Top 12 individual regional UK markets in 2022 where HotStats hold sufficient data to report on.

Our sample of hotels, totalling over 100,000 rooms, is geographically spread across the UK, with London accounting for 35% share of the sample. The sample exhibits a strong bias towards predominantly branded hotels within the upper-midscale, upscale, upper-upscale and luxury segments and represents approximately 25% of the branded market.

UK HOTEL SUPPLY

Historically, positive RevPAR growth has underscored the resilience of the UK hotel market and helped fuel a strong pipeline of new hotels under construction. But, with the impact of higher costs, tighter credit and a shortage of labour and materials, investment in the UK hotel development pipeline is set to contract further during the next two years.

The UK currently has approximately 700,000 hotel rooms open and trading for business, with London accounting for 21% of the total supply. Our analysis shows some 19,100 hotel rooms have closed since the start of 2020, with approximately 56% of these closures taking place during 2020. The loss of independent hotels, comprising over 10,600 rooms account for over half of these hotel closures. In addition, a further 11,000 hotel rooms remain temporarily closed, with some of this supply being used to house refugees and asylum seekers.

Despite the significant adverse impact of the pandemic on the UK hotel sector, the pipeline of new hotel openings has remained buoyant. Over 31,500 new rooms have opened in the UK since the start of 2020, with regional UK accounting for 69% of this new supply. Some 30% of investment was targeted at the economy class, whilst upscale and upper-upscale hotels represented a further 41% of the new supply.

Future supply growth of hotels set to slow

Despite the volume of new openings, the pandemic resulted in only 30% of projects opening to schedule during 2020 and 2021. Since the beginning of 2020, 70% of projects either under construction or with a confirmed date of completion have now opened, whilst approximately 15% of projects, totalling over 6,000 rooms have been deferred or cancelled. Postponed hotel projects make up a further 15%, equating to around a quarter of the total UK hotel construction pipeline with a confirmed date of opening. With the increasing cost of debt and materials, this pipeline of new hotel openings is anticipated to contract further in the coming years.

Over 31,500 new hotel rooms have opened in the UK since the start of 2020. Postponed hotel projects make up a quarter of the total UK hotel construction pipeline.

Since the start of 2020, UK hotel supply increased by 6.9% in London and by 4.0% in regional UK. However, a more accurate reflection of supply growth, which includes hotels now permanently closed, forecast London supply growth at 3.3% and 1.4% in regional UK. Looking back over the past five years, compound annual supply growth has averaged 2.3% in London and 1.6% in regional UK. Looking ahead to 2025, for hotels under construction, this growth is set to slow to 2.0% in London and 1.2% in regional UK. Overall, UK hotel supply is anticipated to grow by 1.4% per annum each year between 2022 and 2025, equating to some 30,000 fewer hotel rooms, had the same trajectory of growth in the lead up to the pandemic continued.

Constrained new supply – its impact on hotel trading performance

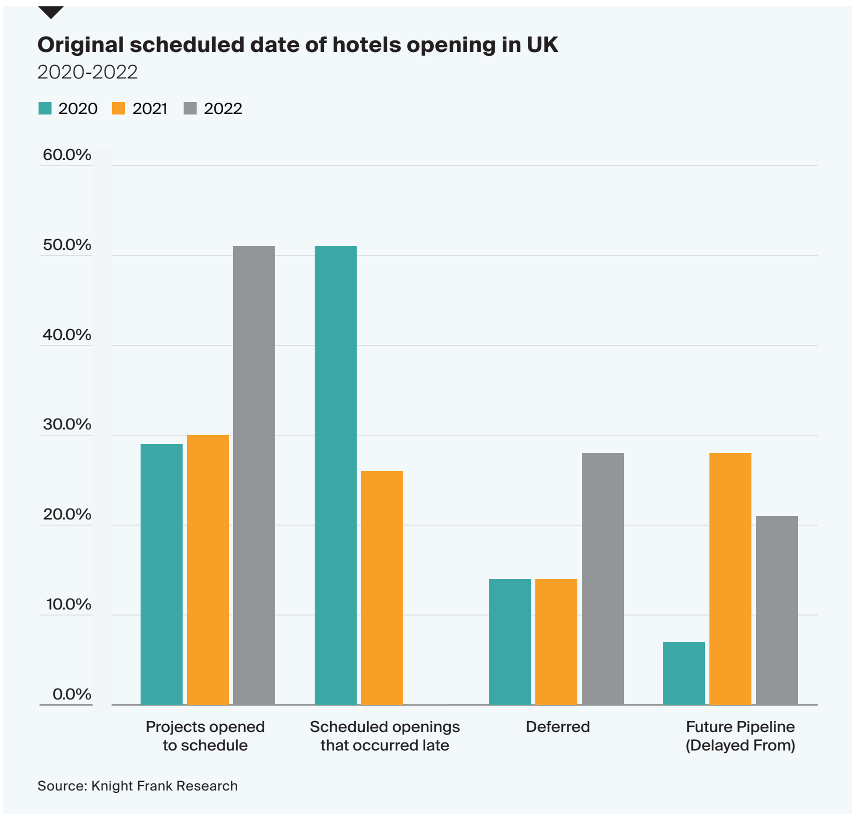
Whilst the pandemic has accelerated a wave of diversification spreading through the UK hotel sector, the devastation it caused has also placed the industry on a stronger footing. Certain mature UK hotel markets have witnessed strong growth in supply, but the pace of new supply growth has materially slowed. Combined with an increase in hotel closures, the sector is potentially better placed to cope with the uncertain times ahead.

External factors such as demand, and supply dynamics will impact the operating performance of a hotel asset. During this period of recovery, where demand is returning and strengthening across various segments, barriers of entry in terms of new supply growth, will help serve as a hedge against operational risk. As the future pipeline of hotels under construction slows in the short to medium term, this will reduce the time that would otherwise be required for a hotel to reach a stabilised trading performance. Likewise, during a period of economic slowdown, limited new supply growth will reduce the erosion of a stabilised market-wide occupancy performance and further dilution of the average room rate.

Fairmont Windsor Park, Englefield Green, Windsor, opened January 2022

Over the past five years, the UK hotel sector has continued its shift towards branded hotel supply, with a 60:40 percentage split between branded and independent hotel supply. Whilst quality independent hotels continue to open and replace obsolescent, unbranded stock, the growth in supply has come from a 20% uplift in branded hotel stock, with a focus on developing larger properties in prime, strategic locations.

With rising costs and more expensive financing, investors are likely to increasingly focus on investment projects with high value creation potential. Having a well-invested, quality product will enable a hotel to increase its market share and capture demand from the most profitable segments, to help drive strong financial returns. Furthermore, as specific hotel markets rejuvenate, the overall market-wide performance and profitability is likely to strengthen.



TOPLINE PERFORMANCE INDICATORS

Strong growth and recovery in hotel trading performance exceeded expectations for the six-month period to September 2022, reinforcing the resilience of the UK hotel market. Month-on-month growth across all top line performance indicators was recorded but faltered in August, at the height of the summer trading period. With strong underlying corporate demand and continued robust domestic leisure, there remains cautious optimism for the months ahead, despite deepening headwinds.

London

Although not fully recovered back to 2019 performance levels, the rebound of the London market is somewhat remarkable. Whilst the ADR was supported by the temporary reduction in VAT, London's occupancy averaged just 12% for the fifteen-month period to June 2021, during which time a lower RevPAR performance was achieved than compared to regional UK. The autumn months of 2021 were a turning point for London, with month-on-month demand growth boosted by an uplift in overseas visitors and the return of business travel, but the arrival of Omicron stalled a more meaningful recovery until March 2022.

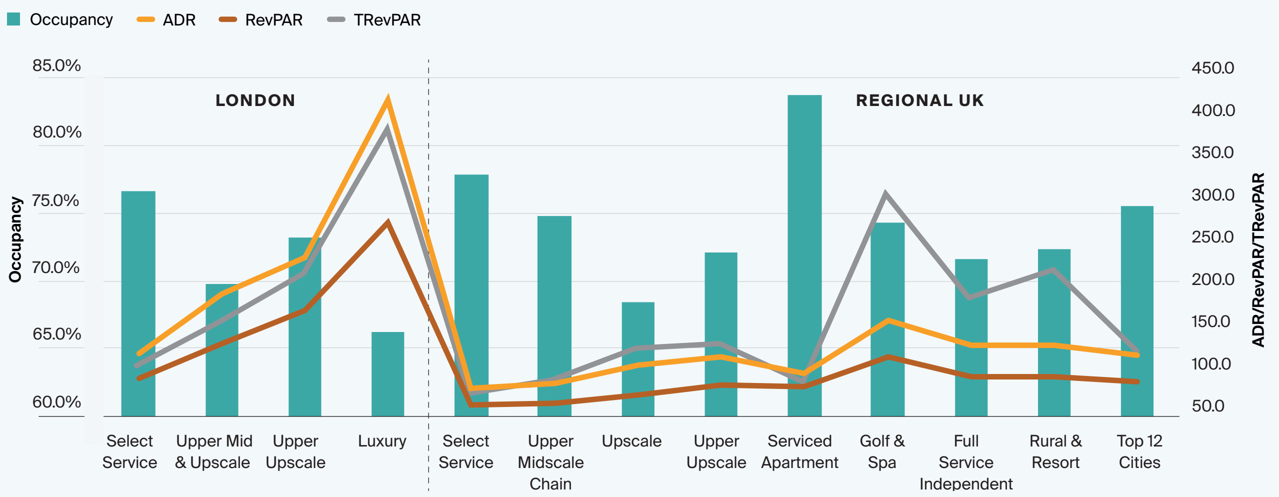
Since January 2022, London's occupancy has seen an uplift of over 48 percentage points, whilst ADR has witnessed growth of 58%. For the six-month period from April to September 2022, London has achieved an average occupancy of 70% and an average room rate of £232. The monthly rate of occupancy remains far below its historical performance, with a ten percentage-point deficit in September compared to 2019. But, fuelled by strong demand across multiple segments, the ability to drive rates within a high inflationary environment, has resulted in ADR surging ahead by 21% when compared to 2019 prices, and by 4% in real terms.

Strong demand for London's Select Service hotels has seen this hotel class outperform the London market in terms of occupancy, achieving 77% occupancy for the six-month period April to September 2022. Meanwhile, London's Luxury hotels have benefitted substantially from their less price-sensitive clientele, allowing exceptional rate growth of 12% in real terms over the last six months compared to the same period in 2019, or 29% in nominal prices. London's Upper Midscale hotels have also performed strongly in terms of ADR growth, with an uplift of 23% on 2019 prices, and by 6% in real terms.

London recorded RevPAR of £161.85 for the six-month period April to September 2022, with the strong growth in ADR contributing significantly to the recovery. For the first time in September, RevPAR for the six-month rolling period moved into positive territory, compared to the same period in 2019. London's hotel market benefitted from the passing of our late Monarch in September, boosting month-on-month RevPAR growth by 21%, but the autumnal return of a more balanced mix of demand segments equally helped contribute to the strong performance.

Key Performance Indicators

April-September 2022



Source: HotStats

Regional UK

When comparisons in performance are made between the hotel markets of London and regional UK, the variance in trading performance between different regional hotel datasets becomes obscured. The UK's city centre hotels have felt the full force of the impact of lockdowns and restrictions on travel, by contrast, more rural / resort and leisure-focused hotels have faced a very different pandemic experience. We continue to report on the regional UK hotel market, but this is very much an average, with certain datasets performing far stronger, whilst for others the trading performance reflects a far more challenging time.

Since January 2022, regional UK's occupancy has seen an uplift of 40 percentage points, whilst ADR has witnessed growth of 32%. For the six-month period from April to September 2022, the regional UK hotel market has achieved an average occupancy of 73% and an average room rate of £104. The monthly rate of occupancy remains below its historical performance, with a six percentage-point deficit in September compared to 2019. But, with the high inflationary environment allowing operators to pass on their increasing operating costs, combined with strong pricing power in the leisure market, this has resulted in ADR increasing by 13.6% when compared to 2019 prices, albeit this represents a 2% deficit in real terms.

Regional UK recorded RevPAR of £75.30 for the six-month period April to September 2022, a 59% uplift compared to the same six-month period a year ago, achieved through a 23-percentage point increase in occupancy and 9% increase in ADR. Since July 2022, once the regional UK market achieved occupancy above 75%, it has successfully outperformed it's 2019 RevPAR performance.

The Top 12 performing regional UK cities (based on 2022 YTD TRevPAR performance), shows a robust recovery during the past six months, achieving a RevPAR penetration of 122% versus the wider regional UK market, which compares to a penetration of 124% for the same period in 2019. Whilst its occupancy penetration of 104% is slightly below its historical premium of 107%, city-centre hotel demand has recovered strongly, from a low of 83% penetration for the period April to September 2020. In terms of the average room rate, the Top 12 regional UK cities have achieved a 17% premium over the regional UK average, which is marginally under its penetration achieved in 2019.

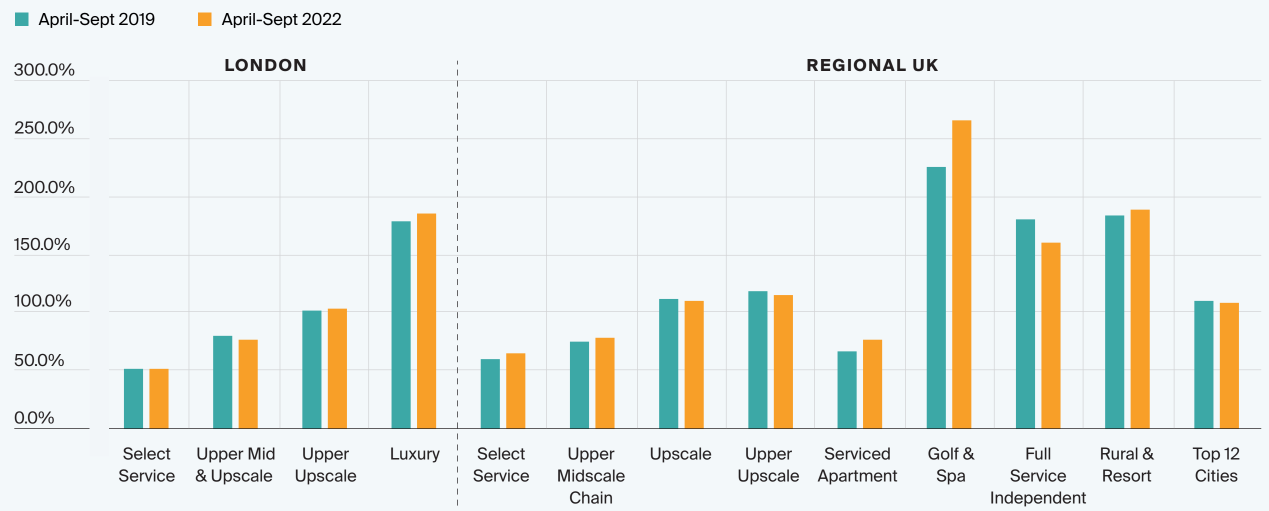
122%

RevPAR penetration of Top 12 Regional cities, aligning closer to historical performance versus the wider regional UK market.

(April-September 2022 v 2019)

TRevPAR penetration by dataset

versus their respective regional UK or London market



Source: HotStats

Regional UK Golf & Spa hotels outperformed the wider regional market throughout the pandemic, with their product offering and location showing wide appeal to the domestic market. Whilst their penetration versus the regional UK market has declined in 2022, as the regional UK market strengthened, the outperformance of this dataset versus its historical performance remains robust. Golf & Spa hotels achieved a 24% uplift in its RevPAR[1] performance , but, with only 39% of the total revenue attributed to rooms revenue, the dataset has achieved strong growth in ancillary revenues, most notably from golf income. As such, its TRevPAR penetration has increased from 226% in 2019 to 265% in 2022.

During the same period[1], the datasets for Regional UK's Select Service hotels, Upper Midscale hotels and Serviced Apartments have all increased their TRevPAR penetration versus the wider regional UK market. Meanwhile, the datasets for the regional UK's Upscale, Upper-Upscale hotels and the Top 12 Regional UK cities have fared less well, with weaker growth in food and beverage revenues impacting upon their TRevPAR penetration.

Forecasts and outlook

Looking back to this time last year, UK hotel trading performance was set to improve in 2022 as demand returned, although not expected to return to pre-pandemic levels by the end of the year. A year on and forecasting is arguably far more challenging to predict, due to yet another period of heightened uncertainty and volatility as we fast approach 2023. The ability for hoteliers to endure these rising costs, whilst maximising profit margins, will be a challenge that will require significant planning and strategy. The challenge will present itself differently depending upon the market in which a hotel operates and the class of hotel.

Our forecasts are prepared using the benchmarking data provided by HotStats[2] as well as taking into consideration other factors such as new hotel supply. For the full year 2022, our forecast for London envisages occupancy rising to 64% and ADR of £224. This represents continuing growth for the final quarter of the year, with September YTD trading data recording an occupancy of 61% and an ADR of £220. Full year occupancy will lag 2019 performance by some 17.5 percentage points, but a 22% increase in ADR will make up for a sizeable portion of the shortfall. Consequently, forecast RevPAR of £143 is deemed to be achievable, which equates to a deficit of 4.1% when compared to 2019 performance.

At 66%, full year occupancy for Regional UK in 2022 is expected to outperform the London market, yet at this level, an occupancy gap of 10.5 percentage points is anticipated versus 2019. However, respectable 16% growth in ADR is projected, with an ADR of £99 forecast, reversing the deficit endured during the pandemic, to see full year RevPAR of £66 equalling 2019 performance.

Despite the gloomy view of economists, overall, the sector remains optimistic about prospects for the final quarter of the year. The outlook for 2023 is also promising, with the cycle of recovery continuing and further growth anticipated from several segments, despite the uncertain and changing economic conditions. Our forecast for London assumes continued recovery of international travel in 2023, with an influx of tourists for the coronation of King Charles III on 6th May 2023. Should the national economic forecast improve, and GDP be revised upwards, there is potential upside to be built into these forecasts, albeit the converse is equally true.

Forecast

ANNUAL HOTEL KPIs

	LONDON OCCUPANCY	LONDON ADR (£)	LONDON REVPAR (£)	REGIONAL UK OCCUPANCY	REGIONAL UK ADR (£)	REGIONAL UK REVPAR (£)
2018	82.3%	178	147	77.3%	85	66
2019	81.3%	183	149	76.9%	86	66
2020	21.3%	144	31	29.2%	75	22
2021	29.1%	165	48	44.0%	93	41
2022 F	63.8%	224	143	66.4%	99	66
2023 F	74.8%	236	176	72.0%	100	72
2022 variance v 2019	**-17.5%**	**22.2%**	**-4.1%**	**-10.5%**	**15.7%**	**-0.1%**

* Occupancy Growth = % points of occupancy

% ANNUAL CHANGE

	LONDON OCCUPANCY (POINTS)	LONDON ADR (£)	LONDON REVPAR (£)	REGIONAL UK OCCUPANCY (POINTS)	REGIONAL UK ADR (£)	REGIONAL UK REVPAR (£)
2019	-1.0%	3%	2%	-0.4%	1%	1%
2020	-60.0%	-22%	-79%	-47.7%	-13%	-67%
2021	7.8%	14%	56%	14.8%	24%	86%
2022 F	34.7%	36%	198%	22.4%	7%	62%
2023 F	11.0%	5%	23%	5.5%	1%	9%

Source: HotStats, Knight Frank Forecasts

[1] Rolling six-month period, April to September, 2022 v 2019. [2] HotStats benchmarking data comprises a greater number of upscale midscale, upscale, upper-upscale and luxury hotels, with the majority operating under a brand. Far fewer economy hotels are included within the datasets, as such the HotStats data is skewed towards the higher echelons. For example, the London dataset shows lower market-wide occupancy levels, but higher average room rates than compared to a benchmark set with a greater focus towards limited or select-service hotels.

The Westin London City, opened November 2021

Managing volatility

Having endured and overcome the economic consequences of a lengthy pandemic and despite cashflows for many remaining depleted, hotel owners and operators are now far more prepared to withstand the challenge of an economic slowdown. As such, many hotel operators remain cautiously optimistic in their ability to ride out the current volatility and opaque trading environment.

By focusing on areas within their control, operators can remain nimble, react quickly and better predict the changing market landscape. Focused areas include:

- Revenue enhancing initiatives
- Disciplined approach to cost control
- Dynamic approach to pricing and operating a targeted, multi-channel distribution strategy
- Driving operational efficiencies through their latest technological investment
- Increase presence on social media and engaging in hotel meta search engines
- Have open communication with, and the support of, all stakeholders

Implications for travel and hotel demand

At this time of reduced economic growth, the current level of uncertainty has so far been most pronounced in the deal market. As noted earlier, continued strong levels of pent-up demand and pricing power have been driving up room rates and a recovery in occupancy. Hotel operators continue to report consumers strong inherent desires to travel for new experiences and to physically connect and interact, as well as a willingness and ability to spend. However, the impact of rising interest rates and soaring energy prices, can lead to changing market dynamics, which could see consumers trading up or down to get the experience they desire at a price point that suits their budget.

Despite greater consumer cautiousness, the structural shift placed on leisure and experiences, will most likely mean that spend on travel is among the most resilient of discretionary areas for consumers, with cutbacks in other non-essential spend taking place before deferring spending on holidays. Albeit, if budgets continue to be squeezed, the frequency of travel may be reduced, as well as lower incremental spend. Certain hotel segments are likely to be beneficiaries, such as the branded budget and upper midscale sectors attractive to consumers seeking value. Meanwhile, there will be a continued flight to quality and demand for well-invested, renovated hotels in prime locations. Trusted hotel products and brands are expected to perform strongly, with well operated groups increasing market share and proven to be significantly less volatile during a recession. Shared resources, guest loyalty programmes, driving customer centricity, digital advantage and sophisticated yield management systems all contribute to the intangible brand value.

A weak pound will further serve to drive overseas tourism to the UK, whilst staycation is likely to remain strong as overseas destinations and the cost of travel abroad become more expensive.

TOP PERFORMING REGIONAL HOTEL MARKETS OF 2022

RANKED BY TREVPAR

Using HotStats data for all hotel markets which they can report on, ranked by TRevPAR performance as at September year-to-date 2022, we have taken the Top 12 UK regional cities, and undertaken various analysis to review their recovery.

This analysis reveals a significant variation in performance, with each destination having its unique set of strengths, opportunities and challenges determining their speed of recovery.

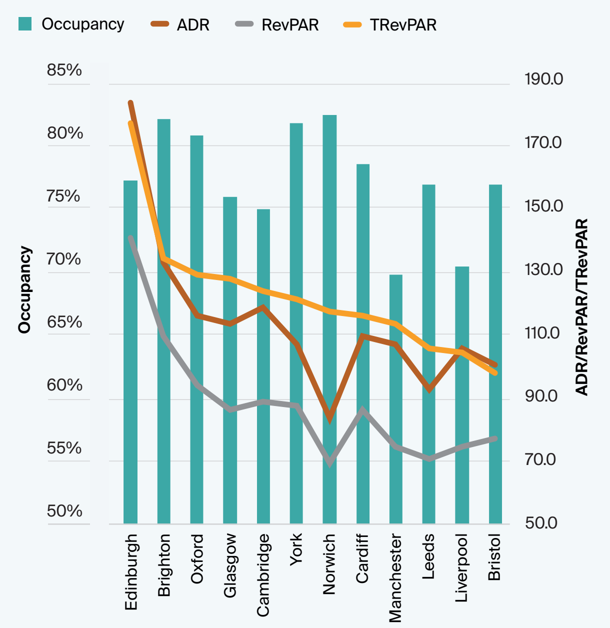
The volume of new supply opening since the start of 2020 has been a significant contributor to a market's recovery. Manchester has seen its supply grow by 18% with over 2,800 new rooms opening; supply in Glasgow has grown by 12% with 1,300 new rooms, Bristol's supply increased by 14% with over a 1,000 new rooms and Cambridge has seen supply growth of 24%, the addition of over 850 new rooms.

Stable supply growth is a key driver of strong RevPAR performance. The volume of new supply opening since the start of 2020 has been a significant contributor to a market's recovery.

Looking ahead, Glasgow, Brighton, Manchester, Liverpool and Birmingham are set to receive the greatest share of new supply by destination, with Glasgow set to grow its supply by over 5% each year between 2022 and 2025, and Manchester will see year-on-year supply growth of 4.7% per annum between 2020 and 2025.

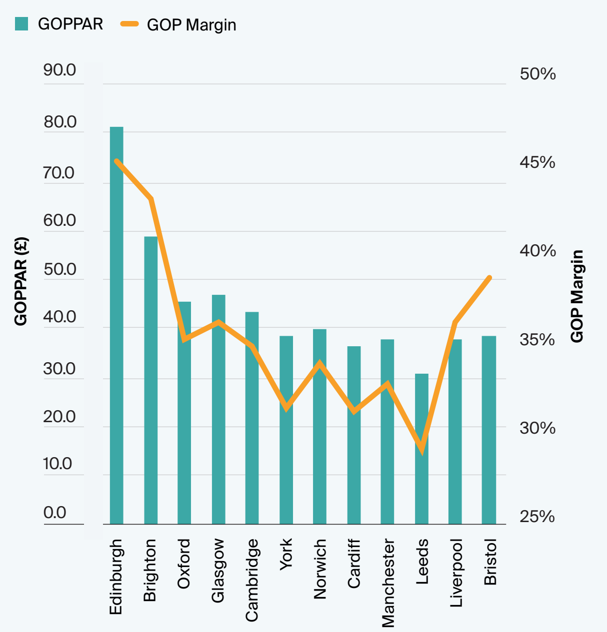
Certain cities are more focused on the conference market, others are dependent on large scale events, whilst some have established themselves as destinations driving more balanced, all-round demand, both domestic and international. 2022 has seen a strong recovery across the segments, with the return of sporting and cultural events and growth in demand for the MICE and corporate segments. However, midweek demand remains lower than pre-pandemic and some of the dependable sector corporate business has yet to return.

Key performance Indicators – Top 12 regional UK cities
April-September, 2022



Source: HotStats

GOPPAR & GOP margin – Top 12 regional UK cities
April-September, 2022



Source: HotStats

KPIs - Penetration of Performance, April-September 2022 v 2019

RevPAR

1	Brighton	117%
2	Leeds	111%
3	Norwich	108%
4	Oxford	107%
5	Cardiff	105%
6	Bristol	104%
7	Glasgow	102%
8	Liverpool	102%
9	Edinburgh	99%
10	Cambridge	97%
11	York	96%
12	Manchester	91%

TREVPAR

1	Brighton	109%
2	Leeds	106%
3	Liverpool	106%
4	Glasgow	105%
5	Bristol	104%
6	Oxford	103%
7	Norwich	103%
8	Cardiff	97%
9	Edinburgh	96%
10	Manchester	94%
11	Cambridge	94%
12	York	91%

GOPPAR

1	Liverpool	107%
2	Brighton	105%
3	Bristol	104%
4	Glasgow	103%
5	Leeds	97%
6	Oxford	95%
7	Norwich	93%
8	Edinburgh	92%
9	Cardiff	91%
10	Manchester	81%
11	York	78%
12	Cambridge	75%

COMPOUND ANNUAL AVERAGE GROWTH IN SUPPLY 2020-22

1	Cambridge	7.8%
2	Manchester	6.8%
3	Glasgow	6.0%
4	Bristol	4.4%
5	Oxford	4.2%
6	Liverpool	3.3%
7	York	2.2%
8	Cardiff	2.2%
9	Edinburgh	2.1%
10	Brighton	0.5%
11	Leeds	0.5%
12	Norwich	0.0%

PIPELINE UNDER CONSTRUCTION COMPOUND ANNUAL AV GROWTH 2022-25

1	Glasgow	5.3%
2	Brighton	3.8%
3	Manchester	3.7%
4	Liverpool	3.6%
5	Leeds	2.3%
6	Edinburgh	1.5%
7	York	1.2%
8	Oxford	1.0%
9	Cambridge	0.4%
10	Bristol	0.1%
11	Cardiff	0.0%
12	Norwich	0.0%

SUPPLY CAAG 2020-25

1	Manchester	4.7%
2	Glasgow	4.6%
3	Cambridge	3.8%
4	Liverpool	3.0%
5	Oxford	2.6%
6	Bristol	2.2%
7	Brighton	2.1%
8	York	1.7%
9	Edinburgh	1.7%
10	Leeds	1.4%
11	Cardiff	1.1%
12	Norwich	0.0%

Source: HotStats, Knight Frank Research * Hotels under construction with specified opening date

Looking ahead to 2023, city centre hotel markets will need to recover more of the transient, midweek demand to achieve higher occupancy levels. The value of the pound, if it remains low, is also expected to yield a greater number of international visitors, with key events such as the King's coronation and the Eurovision song contest driving overseas demand at key periods.

Not all UK cities were able to feature in our analysis as standalone markets, but certain destinations, such as Bath, Bournemouth, Plymouth and Exeter have recovered strongly throughout 2022, with these markets offering a wealth of leisure attractions and known for being strong staycation destinations. Our dataset of Rural and Resort hotels has performed strongly throughout the last three years and continues to outperform the regional UK market. In 2019, for the six-month period April to September, Rural & Resort hotels achieved a RevPAR penetration of 114% versus the regional UK market. For the same six months of 2022 this dataset continues to outperform, with a RevPAR penetration of 128%. Significant improvement in the bottom line is also evident with GOPPAR penetration increasing from 140% in 2019 to 168% in 2022.

Our Top 12 Regional UK cities have fully recovered their RevPAR penetration, but with still a gap to be closed in terms of TRevPAR. The decline in the F&B and ancillary revenues, together with rising costs is having an impact on the bottom line, with GOPPAR penetration also behind its 2019 position. A strong recovery has taken place in 2022 but not a full revival. Whilst regional UK city centres are likely to endure more challenging times ahead, we remain optimistic for the year ahead.

HOTEL REVENUES

Despite occupancy levels well below the historical stabilised norms, strong ADR growth has led to rooms revenue outpacing growth in other operating departments, with the volume and share of Food & Beverage revenues declining

The rapid advance of new digital technology and data sources available to hotels, is inciting new opportunities to optimise total hotel revenue streams. Hoteliers are fast learning how to use technology to create a more personalised, customised, holistic guest experience, providing guests with access to deals tailored to their specific needs and interests.

With the use of an automated digital upselling platform, the ability to create enhanced revenue generating opportunities is significant, upselling at the time of booking and throughout the stay. Increasingly, hotels are offering at the time of booking payable upgrades such as suite upgrades, a room with a view, early check-in or late check-out, or vouchers for use in their bars and restaurants.

Some hotels have begun to offer guests the option to opt out of daily cleaning in return for a free drink at the bar or offer a basic price for the room with add-on extras, such as the option for a daily clean. By offering a relevant deal to the right guest at the appropriate time, these are just some of the targeted initiatives which seek to generate enhanced revenues or support the bottom line through improved margins.

Technology allows for a much smoother and timelier check-in experience and with integrated payment systems, there is less room for human error, thereby further optimising the collection of revenues.

The Westin London City, opened November 2021

Revenue mix

- Over the past six months, on a per occupied room basis, Regional UK hotels have derived around 64% of their revenue mix from the rooms department, but where full-service hotels generate a significant part of their revenue from the MICE market, the contribution from rooms revenue can fall to around 40%.
- Across London, the revenue mix attributed to Rooms is considerably higher, due to the stronger ADRs achieved, with rooms revenue averaging 79% for the last six months.
- London's full-service upper-midscale hotels have seen rooms revenue mix increase by over three percentage points, to 81% of the revenue mix. This is largely attributed to a 23% increase in the ADR, but also changes in the segmentation mix, with a reduction in restaurant spend. As a result, total F&B revenues are 6% lower POR than compared to 2019.
- On average, rooms revenue in 2022 has seen its share of the total revenue mix increase by one percentage point in regional UK and by approximately three percentage points in London, on a POR basis. However, of greater significance, particularly for Regional UK, is the increase in miscellaneous revenue, where full-service hotels have successfully yielded higher attrition and cancellation fees.
- An increase in rental space and concession fees, as well as an increase in business interruption insurance have further contributed to a rise in the miscellaneous income, with these revenues converting directly to the bottom line.
- With strong demand for experience-led hotel stays, our dataset for Golf & Spa hotels reveals a strong increase in the ADR over the past six months. This has increased the share of Rooms Revenue to 39% of total revenue on a POR basis, reversing the trend where revenue generated from F&B is typically greater than rooms revenue.

Market segmentation

Market segmentation has become increasingly blurred, making it harder to determine the reason of travel and distinguish between business and leisure travellers. The more hotel operators know about their guests, the better they can segment them, allowing hotel marketers to create targeted promotions, attract new customers, and increase demand from existing markets. A well-defined set of market and channel segments, coupled with correct pricing per segment is the foundation for successful demand forecasting.

Segmentation helps identify the needs and preferences of different customer groups. Each market segment shows different booking behaviour and price sensitivity. Segmentation is the first step in creating a successful price discrimination strategy and if executed well, will lead to effective pricing and through the addition of customised add-ons, will help maximize revenues, increase guest satisfaction, and enhance profits.

Segmentation by booking channel also allows hotels to control distribution costs and implement strategies to shift bookings from costly Online Travel Agents to cheaper direct channels.

The share of room nights attributed to the Transient Retail and Discount segments is increasing, rising by five percentage points in London and three percentage points in regional UK, when compared to the same six-month period in 2019.

By leveraging a shift in market segmentation, this may not always seek to capture the highest room rates, but instead drive those segments that support ancillary spend. In addition, by targeting those segments with longer staying guests, this may help lower operational costs, through reduced turnover of the rooms and housekeeping, thereby increasing profit margins.

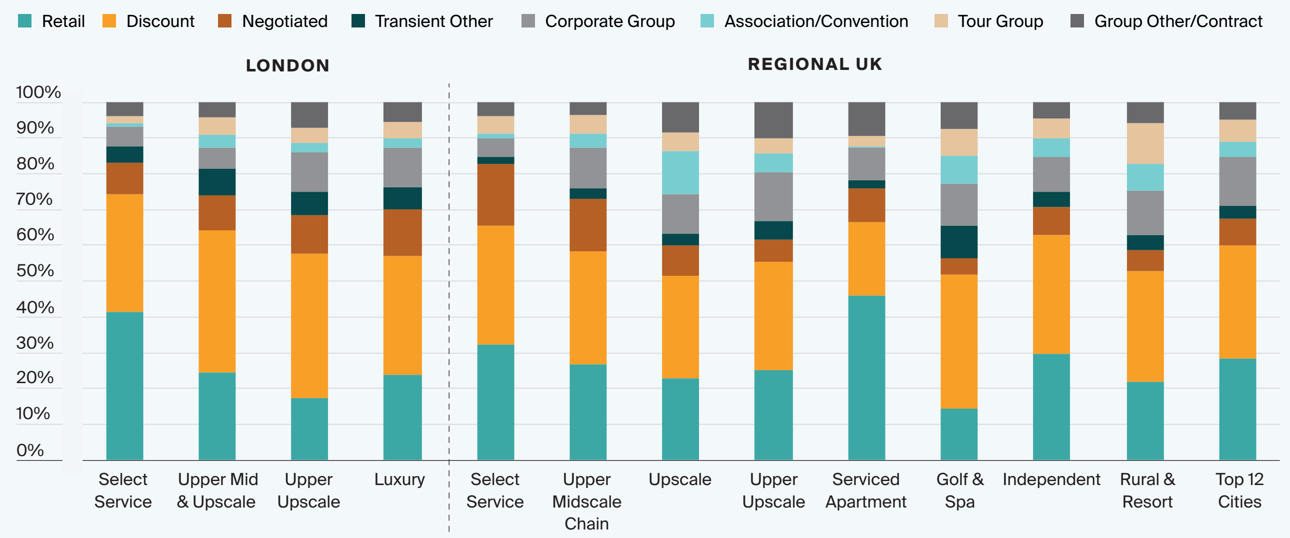
Rooms segmentation – by volume of occupied rooms

HotStats segmentation data now reports on transient, group and contract market segments, with sub-segments within each category. At this broad level, it is no longer possible to comment specifically on business or leisure segments.

Understanding of trends that have evolved out of the pandemic have now fed into pricing and promotional strategies, with flexible rate options remaining elevated. Differential and dynamic pricing strategies are not a new phenomenon to the industry, but their application has widened with the infusion of technology. Post-pandemic, there has also been an increased drive towards transparent pricing and price integrity (best rate guarantee), with greater use of fenced conditions, such as discounts applied for advance bookings, fully pre-paid, non-refundable reservations, and minimum night stays as examples.

A review of the market segments shows that Transient Retail (Best Available Rate) and Discount occupied room nights on average equate to 59% of the total rooms occupied in London and 57% in regional UK for the six-month period April to September 2022. The volume of room nights attributed to these two segments has increased when compared to the same period in 2019, rising by five percentage points in London and three percentage points in regional UK. For London's Select Service, Upper Midscale and Luxury hotels, the data shows the volume of room nights for these two market segments increasing by approximately 6% over the same period.

Market segmentation by occupied room nights
April-September, 2022



Source: HotStats

Historically, transient room nights accounted for some 96% of total room nights for the Serviced Apartment sector. With a shift towards targeting longer-staying guests, this strategy has seen a fundamental change in this dataset's market segmentation, with the share of transient room nights declining by 18%, over the last six months compared to 2019. By contrast, the share of corporate group room nights has increased by 8% and contract and other groups room nights increasing by 10%. Contract and group room nights now account for some 22% of total room nights in the Serviced Apartment sector.

With the strong rise in leisure related demand, there has been a marked decrease in the volume of Transient Negotiated room nights, with the market share of this segment falling by 5.5% in London and 4.7% in regional UK. Negotiated transient business contributed approximately 11% of occupied room nights across the UK, for the six-month period April to September 2022.

The Corporate Group segment has shown robust activity over the last six months, accounting for 9% of occupied room nights in London and 11% in regional UK. This represents more than a three-percentage point increase across London and regional UK, compared to the same period in 2019. Hotel operators are now seeing an increase in new enquiries for corporate group bookings into 2023, allowing rates to be set at higher rates than historically. Furthermore, having a base of group bookings will help offset any slowdown in transient demand, with corporate group rates leveraging respectable room rates, combined with additional incremental spend. Corporate group business also has stricter cancellation policies to control wash, with attrition revenues being an area where hotels have capitalised on over the past six months.

In terms of residential conference room nights, these are generally fewer than compared to 2019, with regional UK Upscale hotels, generating 12% of their occupied room nights from this segment, a decline of almost 2% compared to 2019.

Compensating for some of this deficit is the increase in the market segment known as SMERF, which incorporates weddings and other social engagements. A continuing trend post-pandemic is for an increased number of events to take place midweek, albeit the F&B spend is generally reduced, with fewer guests attending.

Rooms revenue mix

The revenue mix between the broad market segments have remained stable over the past three years, with transient room nights contributing 82% of the total Room Revenue in London and 75% in regional UK, for the last six-months, April to September 2022. However, compared to the same period in 2019, revenues for the transient Retail and Discount segments have increased, whilst revenues in the transient Wholesale and Qualified segments have declined.

An analysis of the composition of rooms revenue reveals that the proportion of revenue generated from the Retail and Discount segments is up by 12% in London and by 10% in regional UK on a PAR basis[1]. Certain categories of hotels have performed more strongly, with the dataset of Golf and Spa hotels generating 35% more revenue PAR from these two market segments during this same period.

Where large shifts have taken place in the volume of room nights, this is certainly reflected in the revenue mix. As an example, for the Serviced Apartment dataset, transient revenues in 2019 accounted for 93% of total rooms revenue but this has declined to 81% for the last six-months in 2022.

Hampton by Hilton Torquay, opened April 2021

[1] Rolling six-month period, April to September, 2022 v 2019.

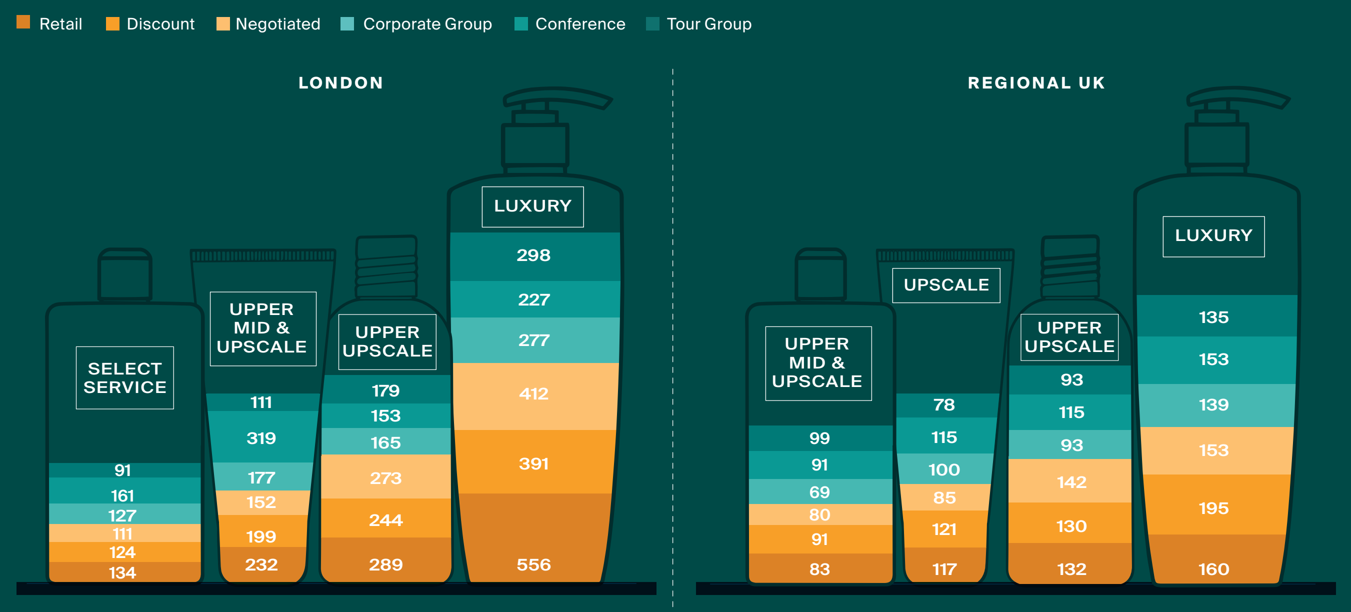
Average rate by segment

The high levels of demand in the transient Retail and Discount segments have led to strong pricing power, with London recording around a 25% increase in the ADR from both these segments1. Meanwhile, strong growth combined with the high inflationary environment provided London's Luxury hotels greater flexibility to move rates upwards, recording a 55% uplift in ADR from these segments. Across regional UK, hotels averaged a 23% uplift in the Discount segment, and 10% growth in the Retail segment. Despite demand softening in the Negotiated segment, the fall in revenues were mitigated by strong ADR growth, of 35% in London and 11% in regional UK. Transient wholesale rates increased by 15% in regional UK but remained static in London.

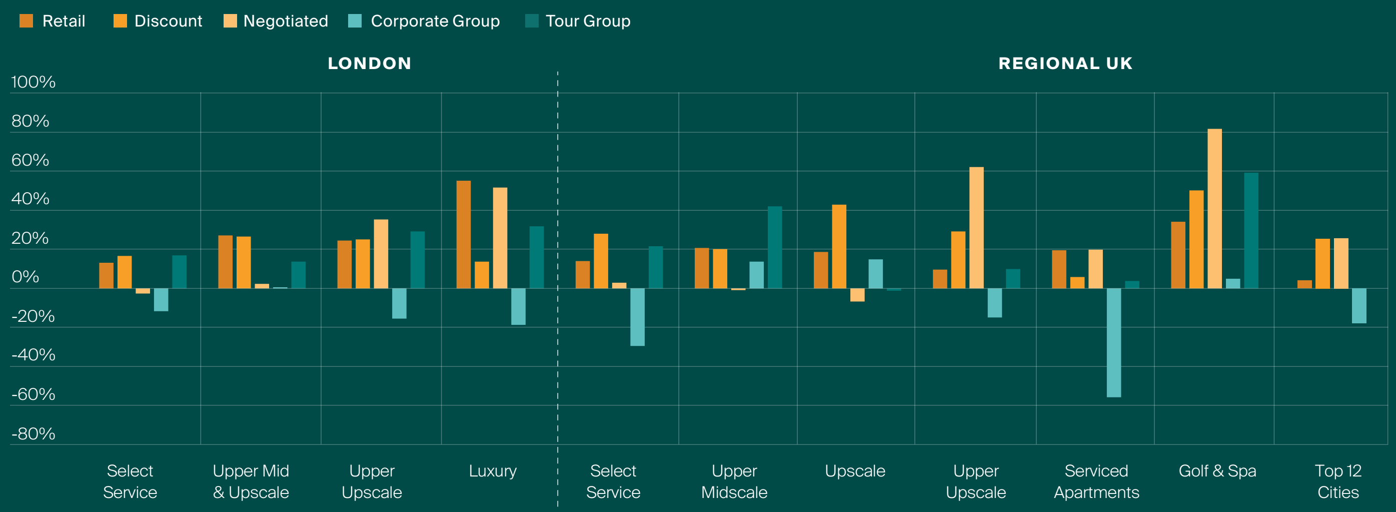
In terms of Group market segments, there was significant variation in the level of ADR growth recorded by the various sub-segments[1]. Corporate group demand returned but at a lower ADR, with London reporting a 14% decline and 7% in regional UK. Meanwhile, despite weaker demand for residential conferences, growth in ADR was achieved, rising by 9% in London and 7% in regional UK. Strong demand for social events in regional UK led to a healthy 21% uplift in its ADR. And, whilst the volume of tour and wholesale groups were yet to return to historical levels, the ADR growth was impressive, with a 40% uplift in London and 10% in regional UK.

On average, London recorded 25% growth in the ADR of its Transient segment to £252, 10% growth in Group ADR averaging £189, and Contract rates increased by 16% to £93. Across regional UK, 17% growth in ADR was recorded in the Transient segment to £109, 6% growth in the Group segment to £93, whilst Contract rates declined marginally by 1% to £85.

Average daily rate by market segment Rolling six months, April-September 2022



% Change in ADR by Market Segment April-September, 2022 v 2019



Source: HotStats

Food & beverage revenue

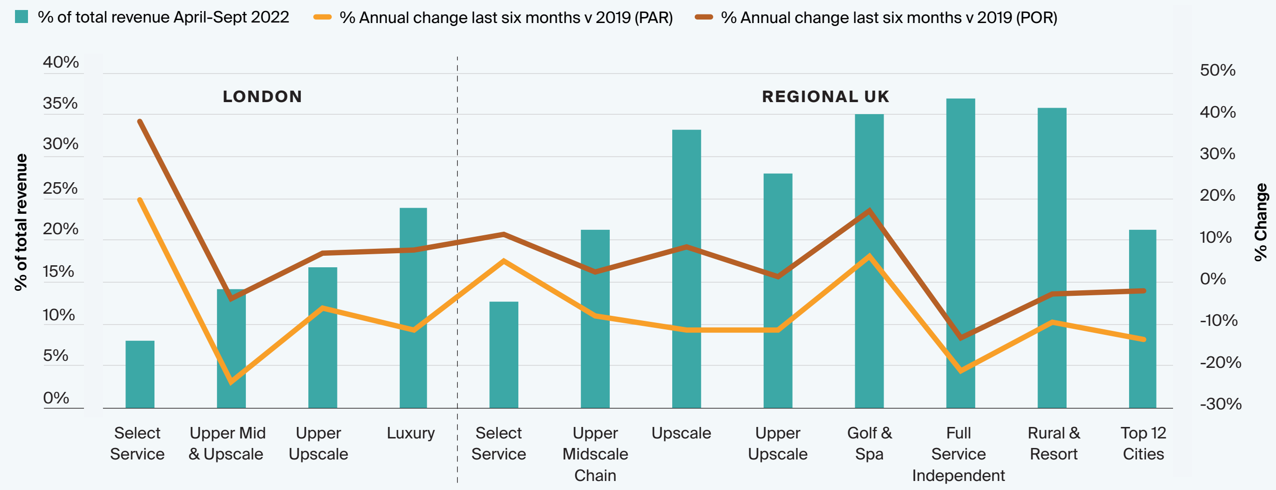
Changing behaviours throughout the pandemic have accelerated and inspired new hospitality trends, which continue to evolve. For example, the emphasis now placed on new food, beverage, workspace and socialising concepts in public areas, or greater demand for alfresco dining, has led to the reimagining of space and given rise to new revenue streams. Consumer standards and aspirations are rising, as such new concepts must constantly advance to keep up and exceed consumer expectations.

With consumers more environmentally conscious, choosing brands which advocate sustainability is no longer a passing fad. Hotel restaurants and bars are increasingly rebranding, with fresh identities of their own, in which to emphasise these new environmental trends. The provision of authentic, local dining experiences, where farm-fresh foods, organic produce, meat alternatives and increased community engagement are in hot demand, and all becoming essential revenue drivers.

Meanwhile, the provision of self-service, grab-and-go concepts continue in their popularity and have fast expanded in their product offering. Ready-made dinner kits, pre-made cocktails and liquor

Food & beverage as a % of total revenue

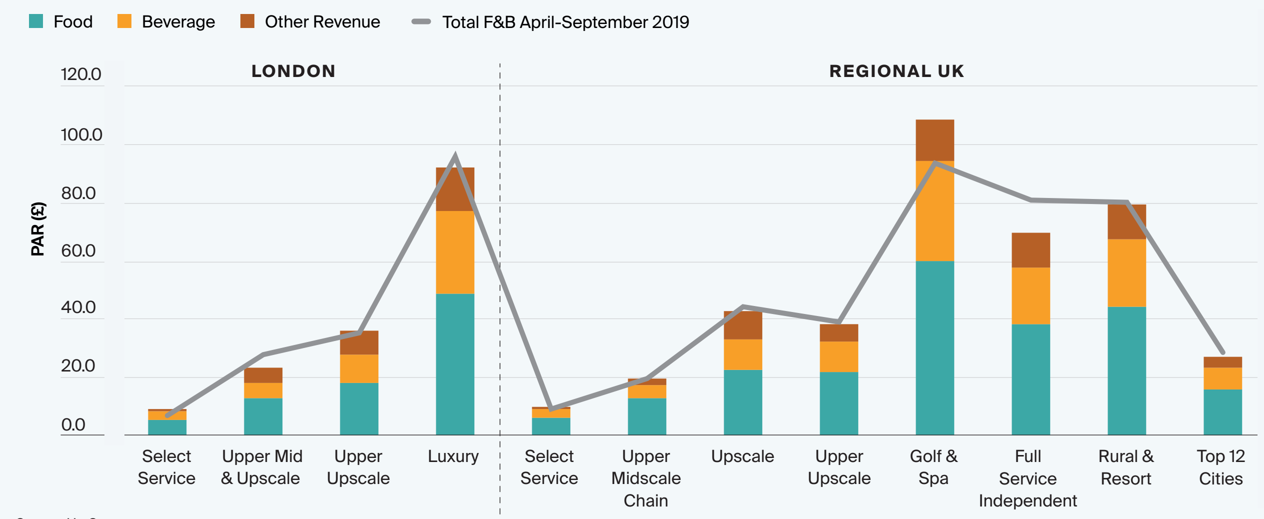
April-September 2022 and % change v 2019



Source: HotStats

Food & beverage revenue PAR

April-September, 2022



Source: HotStats

[1] Rolling six-month period, April to September, 2022 v 2019.

packages all add an alternative offering to the traditional room service and seek to compete with the mobile delivery apps. Embracing virtual or host kitchens is a further trend that evolved following the exponential growth of delivery platforms, which have driven customer spending on off-premises dining to new heights. Excess space in hotel kitchens is ideal to establish virtual restaurant brands and in doing so, operators gain market share and new revenue streams from the fast-growing mobile delivery economy.

F&B revenues made up 26% of total revenue as an average across all regional UK hotels, with the scale ranging from as little as 13% for regional Select Service hotels and rising to 35% for Golf & Spa hotels. The Top 12 regional UK cities are below the regional UK average in terms of F&B revenue generation, accounting for only 21% of its total revenue.

Ready-made dinner kits, pre-made cocktails and liquor packages all add an alternative offering to the traditional room service and seek to compete with the mobile delivery apps.

Our analysis reveals that F&B revenues as a percentage of total revenues across regional UK and the Top 12 cities have declined by 3 percentage points[1]. With lower occupancy levels over this period, F&B revenues appear to have remained relatively stable or increased on a POR basis, but this is misleading. With supply issues and a shortage of personnel, many operators have changed the operational functioning of their F&B outlets, which has potentially constrained revenue growth. On a PAR basis, F&B revenues have been on a decline, with revenues down by 10% across regional UK and by 14% across the Top 12 regional UK cities. For full-service independent hotels, the fall in revenues PAR has been far more severe, declining by 21% PAR.

A similar picture has occurred in London, with the market averaging F&B revenue of 18% of total revenue, a decline from 22% in 2019. On a PAR basis F&B revenues have declined on average by 16%[1]. Yet the picture for London's Upper midscale hotels is more severe, with revenues falling by 24%. Bucking this trend, however, is the performance of London's Select Service segment, which has seen F&B revenues grow by 20% on a PAR basis, albeit increasing from a very low base, with the increase in the sales price of breakfast contributing significantly to this increase in revenues.

The Gantry London - Curio Collection by Hilton, opened November 2021

Ancillary revenue streams

Ancillary revenues equate to approximately 9.5% of total revenue on average in regional UK, whilst in London, the contribution falls to just over 2% of total revenue. Ancillary revenues in regional UK have increased in 2022, with the contribution to total revenue rising by some 1.5 percentage points. The uplift in revenue generated from the rental of space and concessions has been the over-riding contributing factor to this growth.

Attrition fees, whereby income is derived from group bookings which fall short of a guaranteed number of room nights, have also seen a significant rise, particularly so for Upscale and Upper Upscale regional UK hotels. Meanwhile, cancellation fees have also increased despite hotels typically offering far greater flexibility on booking.

An increase in ancillary revenues is also pronounced for Regional UK Spa & Golf, with exceptional growth in experience-led activity, both in domestic and corporate demand. As a result, golf revenue has increased by 29% PAR[1], which has boosted the share of golf revenue from 13% to above 14% of total revenue.

Rooms RevPAR v Total RevPAR growth

As month-on-month RevPAR has strengthened across all datasets quite dramatically in 2022, we have seen the percentage by which TRevPAR exceeds RevPAR fall more within the normal historical range. Looking back at 2019, London's TRevPAR performance for the full year averaged 38% higher than its RevPAR performance, whilst for Regional UK, the benchmark was 64%. For the last six months of 2022, the TRevPAR uplift for both London and regional UK tracked at around 3.5 percentage points lower than in 2019, whilst the variance narrowed to 2.1 percentage points for the Top 12 regional UK cities.

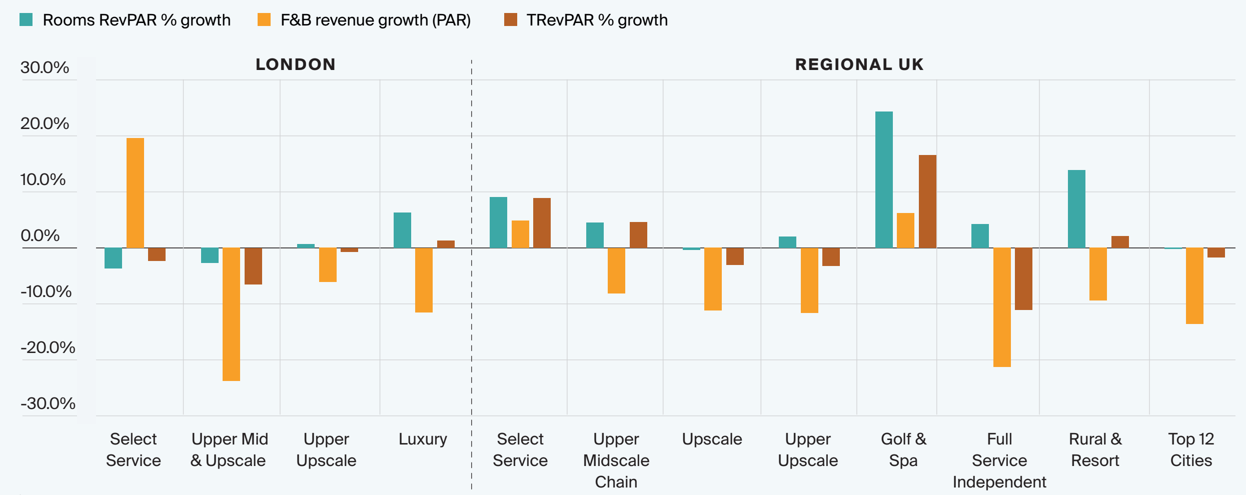
What this data shows, is that whilst the strong growth in ADR has allowed RevPAR to recover back to a broadly similar level to its 2019 performance, the revenues generated from the F&B department in particular are considerably weaker. As occupancy levels further recover towards 2019 levels this will support growth in incremental revenues, but TRevPAR is likely to continue to be impacted by reduced discretionary spending, with consumers dining out less often or reducing their spend, as the rising cost of living bites.

+31%

On a PAR basis[1], strong demand for golf experiences, drives upwards ancillary revenues for Golf & Spa Hotels.

A review of the different datasets identifies that regional UK's branded Upper Midscale and Select Service hotels in both regional UK and London appear to have either equalled or outperformed their 2019 performance. For those groups of hotels which typically generate a high percentage of their total revenue from operational departments excluding rooms, their recovery back to 2019 levels potentially could take far longer.

RevPAR v TRevPAR growth
April-September 2022 v 2019, % change



Source: Knight Frank Research

[1] Rolling six-month period, April to September, 2022 v 2019.

[1] Rolling six-month period, April to September, 2022 v 2019.

DEPARTMENTAL OPERATING COSTS

An exceptionally challenging operating environment, with supply chain disruption, a tight labour market and inflation causing operating costs to rise, but efficiencies made during the pandemic have at least mitigated some of these rising cost pressures.

Total Room Departmental Costs

Total room departmental costs, which incorporates payroll, room expenses and the cost of sales (commissions and reservation fees) have increased by 22.5% POR in regional UK and by 28% POR in London[1]. Total room costs in London account for 18.5% of total revenue, rising from 17% in 2019, whilst in regional UK the total room cost has shifted upwards by two percentage points to 20% of total revenue. For Select Service hotels, room costs are rising far higher than revenues, with total room costs averaging 24% of total revenue (20% in 2019) in London and 30% in regional UK (26% in 2019).

Payroll costs

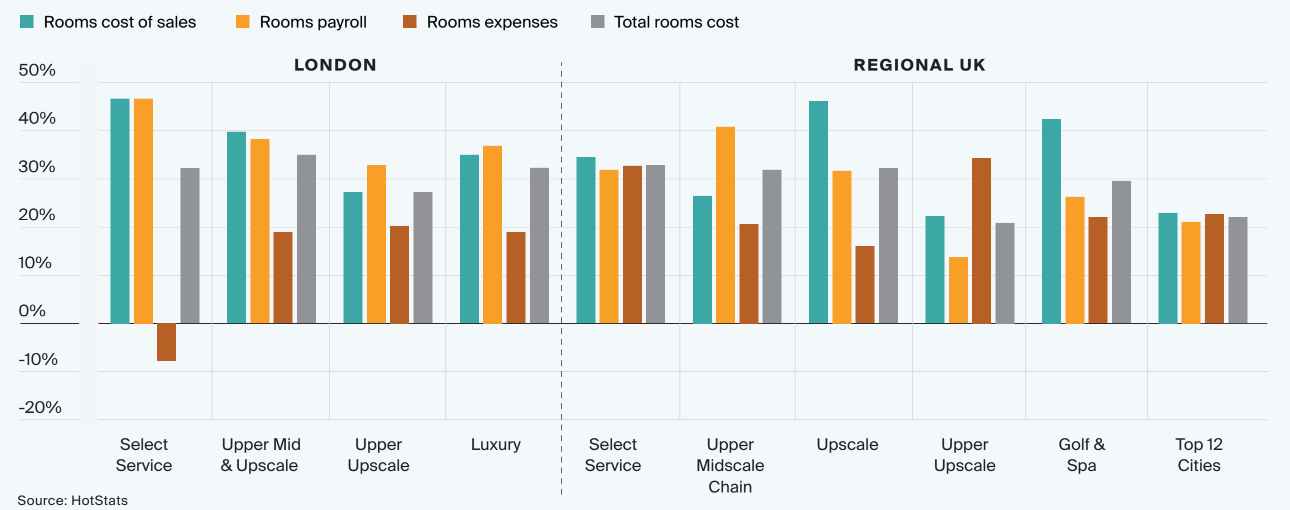
Payroll costs which account for almost 50% of the total departmental costs, have increased on average by 32% POR in London and by 21% POR in regional UK. Whilst the National Living Wage has increased by approximately 15.7% since April 2019, the rise in the cost of living, combined with wage inflation due to a tight labour market have all contributed to the rise in rooms payroll costs. Rooms payroll costs average £27 POR in London and £16 POR in regional UK, albeit for London's Luxury hotels the rooms payroll cost is double the London average.

London's Select Service Hotels, which operate lean and tight business models, have seen the greatest increase in payroll costs, increasing by 47% POR, whilst regional UK Upper-midscale chain hotels have seen payroll costs rising by 41%. By contrast, the Serviced Apartment dataset has witnessed a 3.5% reduction in payroll costs, to £11 POR, as their strategy to target cheaper to service, longer staying guests appears to be having a profound positive impact on departmental income, particularly when the Rooms Revenue accounts for 95% of its total revenue.

Cost of sales

Despite a growing emphasis on direct bookings and brands investing heavily in their loyalty programmes and Central Reservations Systems, the cost of acquisition for a hotel guest has increased significantly. In London the total cost of sales has recorded a 29% rise POR compared to 2019, and by 24% POR in regional UK. For some datasets the rise has been considerably greater, with Regional UK's Upscale hotels subject to a 46% rise POR and by 47% in London's Select Service Hotels. Serviced

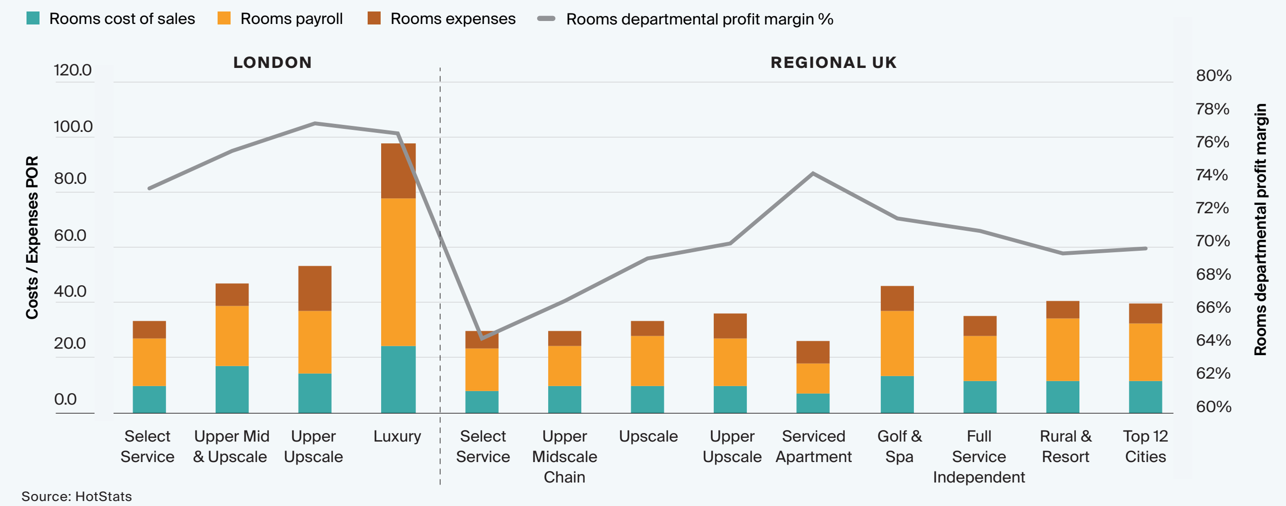
Rooms departmental costs
% change (POR), April-Sept 2022 vs 2019



Source: HotStats

[1] Rolling six-month period, April to September, 2022 v 2019.

Rooms departmental costs
% change (POR), April-Sept 2022

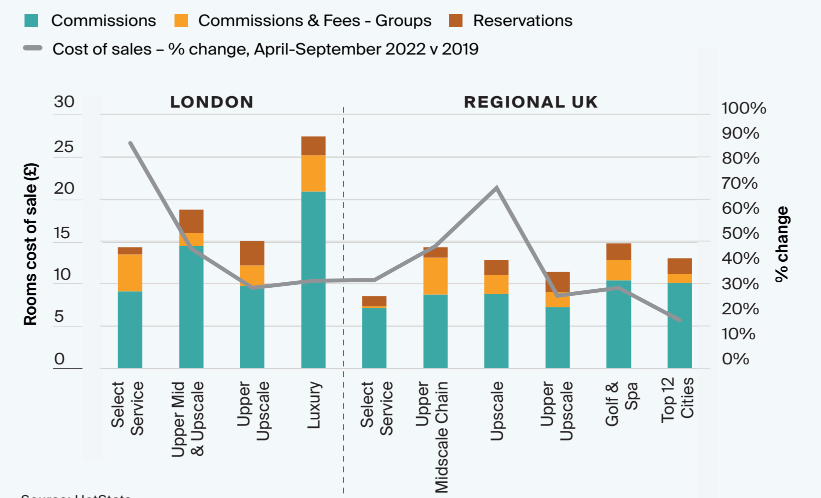


Source: HotStats

Apartments have excelled, however, with far fewer guests arriving, as such the cost of sales have reduced by 3% POR.

Room Cost of Sales across London averaged 28% of the total rooms cost, rising to 31% in regional UK. The total cost of sales equates to approximately 5.5% of the ADR in London and 9.2% in regional UK.

Rooms cost of sales (POR)
Last six months, April-Sept 2022



Source: HotStats

Food & beverage total costs

F&B revenues remain lower in 2022 than compared to 2019, but this is not totally unexpected, given the sector is in recovery and those segments which generate the greatest F&B spend are yet to return in full force. However, lower revenues combined with the intensity and speed of rising costs faced by the F&B operating department, is potentially one of the greatest challenges that the industry is having to manage.

Year-on-year, departmental F&B profits have been in decline. Looking back to 2018, for the six-month period April to September, in London F&B total expenses averaged 73% of total departmental revenue, but profit margins have been eroded ever since, with this metric rising to 83% in 2022 over the same six-month period. In regional UK the situation is not quite so acute with total F&B expenses averaging 74% of total departmental revenue in 2022, compared to 68% in 2019.

In 2022, total F&B costs have declined on a PAR basis when compared to 2019, on average by 8% in London and by 3% in regional UK. But, with F&B revenues throughout 2022 considerably lower than in 2019 on a PAR basis, profit margins have been severely impacted.

F&B payroll costs

Across regional UK, F&B payroll costs represent 56% of the total F&B departmental cost, which is equivalent to 41% of total F&B revenue and 38% of total hotel payroll. By contrast in 2019, F&B payroll costs accounted for only 45% of the departmental cost, equivalent of 38% of F&B revenue.

In London, F&B payroll costs have averaged 60% of total departmental costs, which is equal to 50% of total F&B revenue and accounts for 24% of the total hotel payroll cost. F&B Payroll costs PAR are 50% more expensive than in regional UK, yet the uplift in London's revenue compared to regional UK is only 24% greater in the last six months of 2022.

[3] For the period April to September 2022.

citizenM London Victoria Station, opened July 2022

Declining F&B profit margins

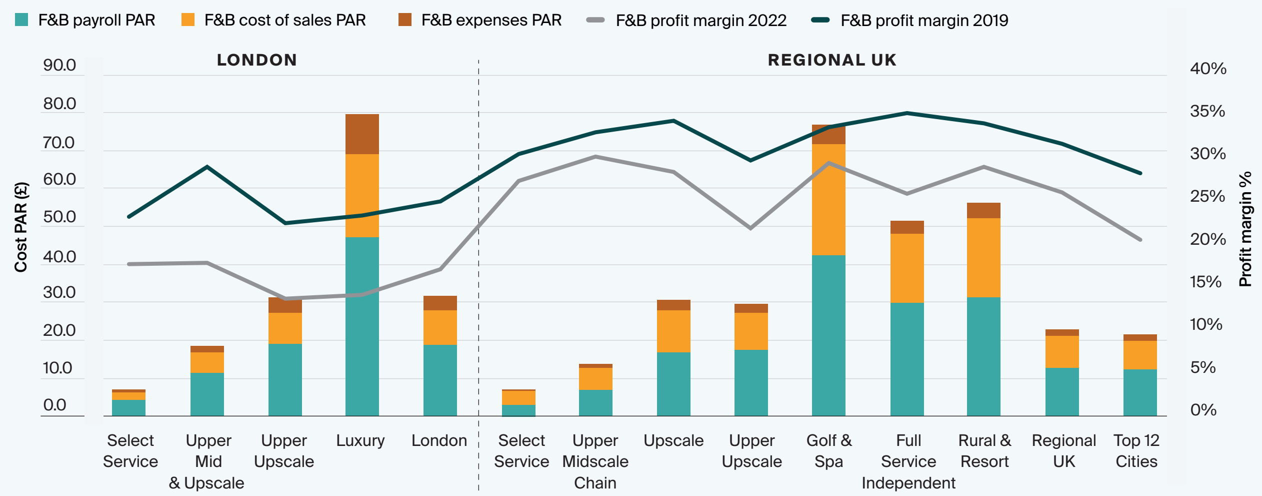
Those datasets which have seen the greatest declines in F&B revenues have typically seen the biggest declines in profit margin. For example, London's Upper Midscale hotels have seen a 24% decline in F&B RevPAR[1], but with total costs only declining by 11% PAR, the decline in profit margin is significant. Similarly, the Top 12 Regional UK cities have a F&B revenue deficit of 14% when compared to 2019, but whilst costs have only declined by 4% on a PAR basis, the dataset has suffered an eight-percentage point decline in profit margin.

Only Select Service hotels have secured growth in F&B revenues, but these gains are off a low base, which has been quickly eroded by the rising costs, as such profit margins have been hit. For example, London's Select Service hotels achieved a 20% gain in F&B RevPAR, but with costs rising by 28% PAR over the same period, the profit margin has declined by five-percentage points.

Regional UK has seen an average six percentage point fall in its profit margin to 26.2%[1], whilst the Top 12 regional UK cities and London have both witnessed an eight-percentage point decline, to 21% and 17% respectively.

Food & beverage Cost breakdown PAR

April-September, 2022

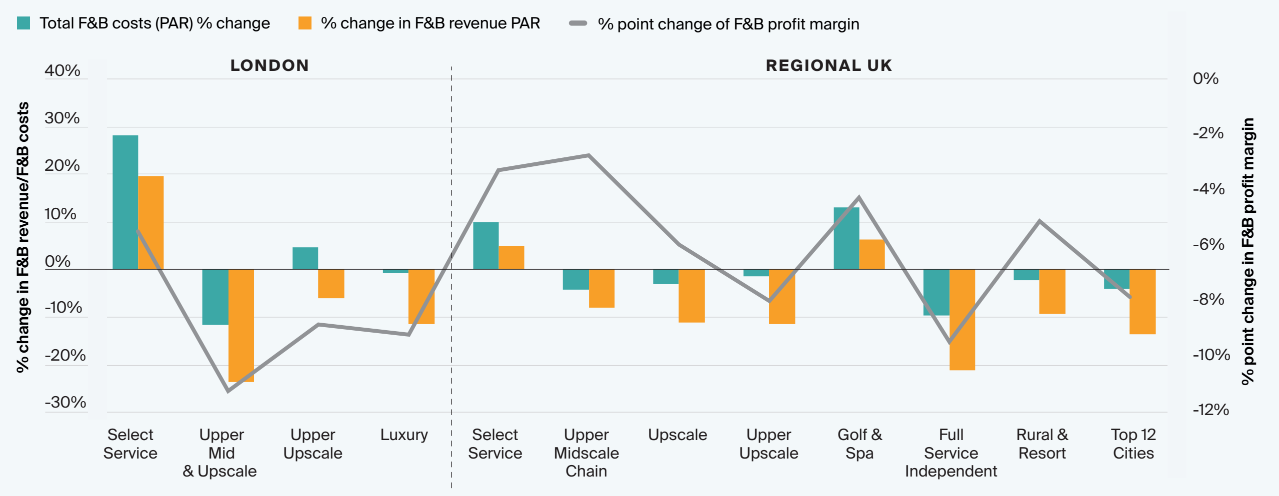


Source: HotStats

[1] Rolling six-month period, April to September, 2022 v 2019.

Total F&B Costs % Change PAR / Percentage Point Change in Profit Margin

Last six months - April - September, 2022 v 2019



Source: Knight Frank Research

Total departmental operating expenses

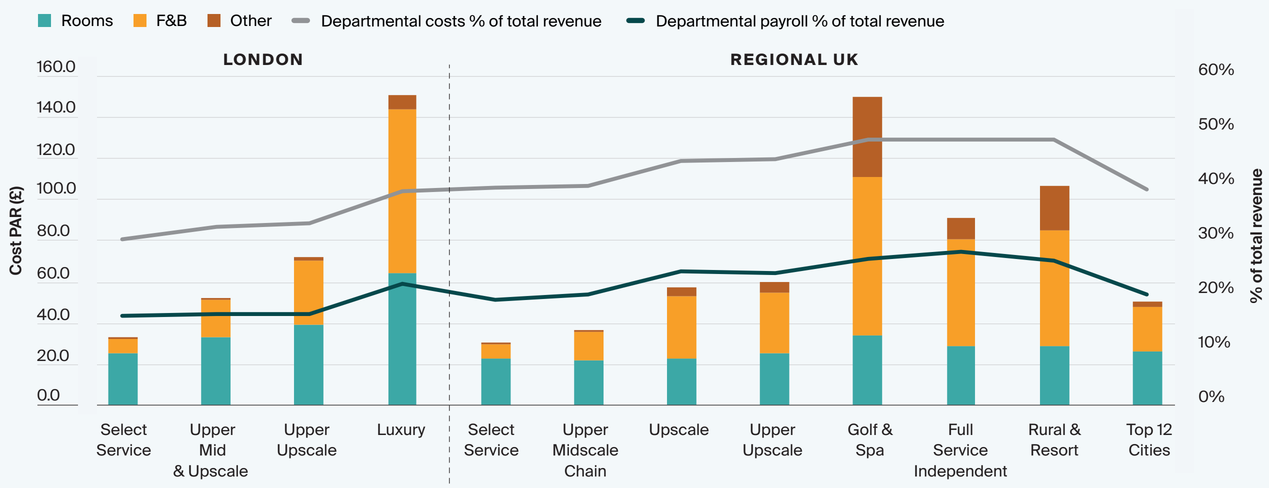
Considerable disparity exists between the various datasets, and whilst not all groupings have seen a rise in departmental costs, this is largely a function of reduced occupancy levels. On average, on a PAR basis, London's departmental costs have remained static, whilst regional UK has recorded a 1.7% rise in total departmental costs.

With the expectation that payroll costs will rise further, due to strong growth in wages to support the rising cost of living, total departmental payroll costs have increased by 2% in London and by 0.4% across regional UK on a PAR basis[1]. But, with significantly lower occupancy levels coming out of the pandemic, a greater reduction in payroll potentially should have been expected. Whilst the total cost of wages is likely to have been supported by recent investment in technology to improve efficiencies, payroll costs have increased as a percentage of total revenue and on a POR basis. Select Service hotels, with little flexibility to reduce their payroll count, have seen the greatest hike in payroll costs, increasing by 27% across regional UK and by 58% PAR in London.

On a PAR basis, total departmental expenses have averaged approximately £72 PAR for London hotels (35% of total revenue), £26.50 PAR for regional UK (43% of total revenue) and £26 PAR for the Top 12 regional UK cities (39% of total revenue).

Departmental costs PAR

Last six months April-September, 2022



Source: HotStats

[1] Rolling six-month period, April to September, 2022 v 2019.

DEPARTMENTAL OPERATING INCOME

A review of departmental operating income illustrates the impact of rising food and staffing costs and the pressure this is causing on margins. Whilst upscale, upper-upscale and luxury hotels are potentially most exposed, due to their increased provision of ancillary services and staffing requirements, their ability to drive ADR growth during a high inflationary environment is mitigating some of these pressures.

The six-month period April to September 2022 has signified a period of strong recovery following the pandemic, with robust levels of demand and facilitated by the high inflationary environment, has seen exceptional nominal ADR growth when compared to 2019. This recovery in the ADR, which has seen 4% real growth in London, has been instrumental in the recovery of RevPAR.

With London and regional UK generating 90% and 77% of their total profit from the Rooms department[3], the importance of achieving respectable RevPAR growth cannot be overstated, particularly in the current climate of rising costs.

The profit margin generated by the rooms department equated to 76% in London and 69% in regional UK[3], which reflects a fall in the rooms profit margin by 1.3 percentage points in London and by 2.3 percentage points in regional UK, when compared to 2019. For Select Service properties, where the Rooms department contributes about 95% of their total profit, they have seen the sharpest declines, with Rooms profit margins falling by over 4%, both in London and regional UK. Meanwhile, Upper Midscale hotels in regional UK have experienced a similar drop, with the profit margin declining by 3.9 percentage points.

Falling F&B revenues, as outlined previously, have seen regional UK's Golf & Spa hotels and Rural and Resort properties increase their profit contribution for the Rooms division, to 54% and 59% respectively (Up from 52% and 56% in 2019). Also, of significance in our dataset of Golf & Spa hotels, is the increased profit contribution from the Golf revenue stream, with the departmental operating profit accounting for 16% of the total hotel income, up three-percentage points and a 47% increase in the gross operating income PAR to £24.70, compared to the same six-month period in 2019.

London continues to achieve some of the strongest departmental operating margins, averaging 65% of Total Revenue, for the period April to September 2022.

Recovery of revenues, together with increasing costs have varied significantly across the various datasets, with a range of factors all influencing the hotel's ability to generate revenues and convert them to achieve a respectable departmental operating income (DOI). All datasets which successfully achieved growth in TRevPAR achieved an uplift in DOI PAR growth, apart from London's Luxury hotels where TRevPAR growth of 1.3% only allowed the dataset to equal but not exceed its 2019 DOI PAR.

Regional UK achieved a DOI PAR of £66.90[3], whilst the Top 12 UK regional cities achieved a 15% premium in its DOI, rising to £76.90 PAR. Compared to the same period in 2019, this represented a decline of 2.2% across the regional UK hotel market and a 3.7% deficit across the sample of hotels in the Top 12 regional cities.

London continues to achieve some of the strongest departmental operating margins, averaging 65% of Total Revenue, for the period April to September 2022. This, compared with 57% across regional UK and 61% for the Top 12 regional cities. The datasets of London's Upper Midscale & Upscale hotels and London's Select Service Hotels achieved the highest profit conversions at 68% and 70% respectively, but both these sets recorded the greatest declines in DOI PAR, by approximately 9% versus the same six-month period in 2019.

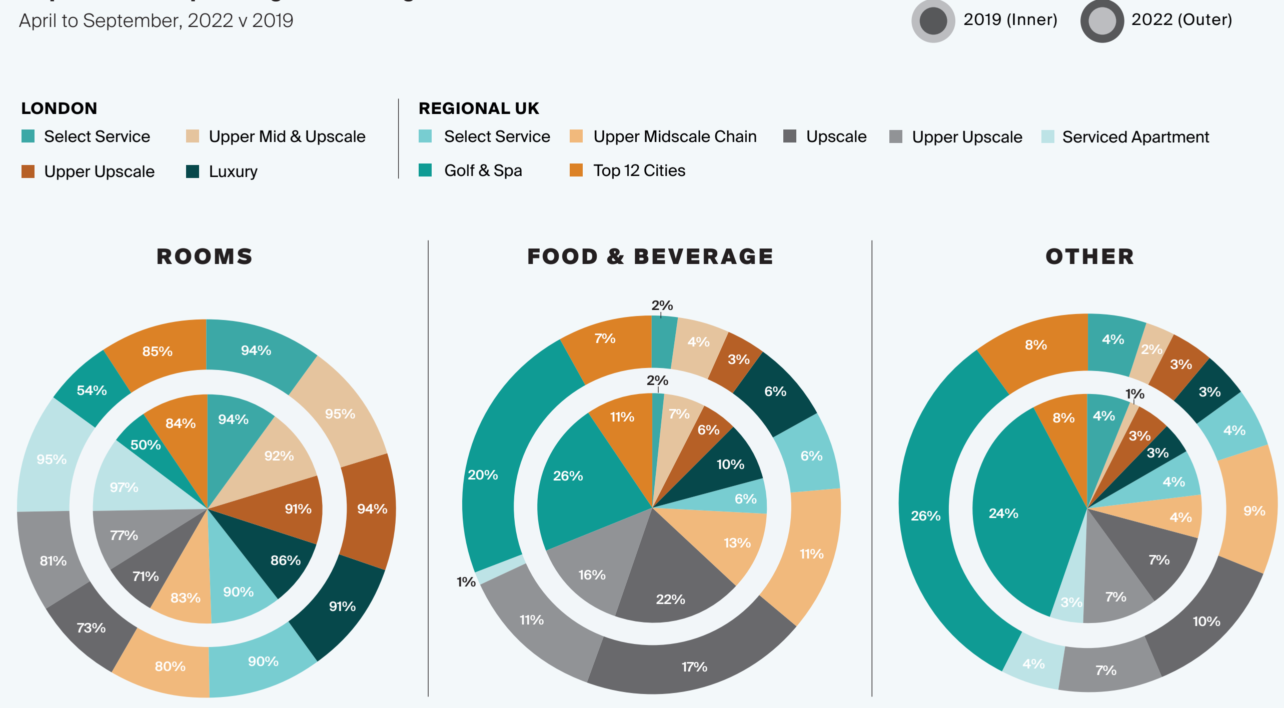
For the last six-months of 2022, the London hotel market recorded an average DOI PAR of £136.40, which represented a 2.8% decline compared to 2019. London's Luxury hotels outperformed the London market, with DOI PAR equalling its pre-pandemic performance.

[3] For the period April to September 2022.

Strong ADR growth, combined with weakening F&B revenues and rising costs, have seen significant movement in the contribution of departmental income. For the six-month period to September 2022, over 91% of the income from London's Luxury hotels was generated from the Rooms department, whilst the profit contribution from the F&B department has declined.

Departmental operating income segmentation

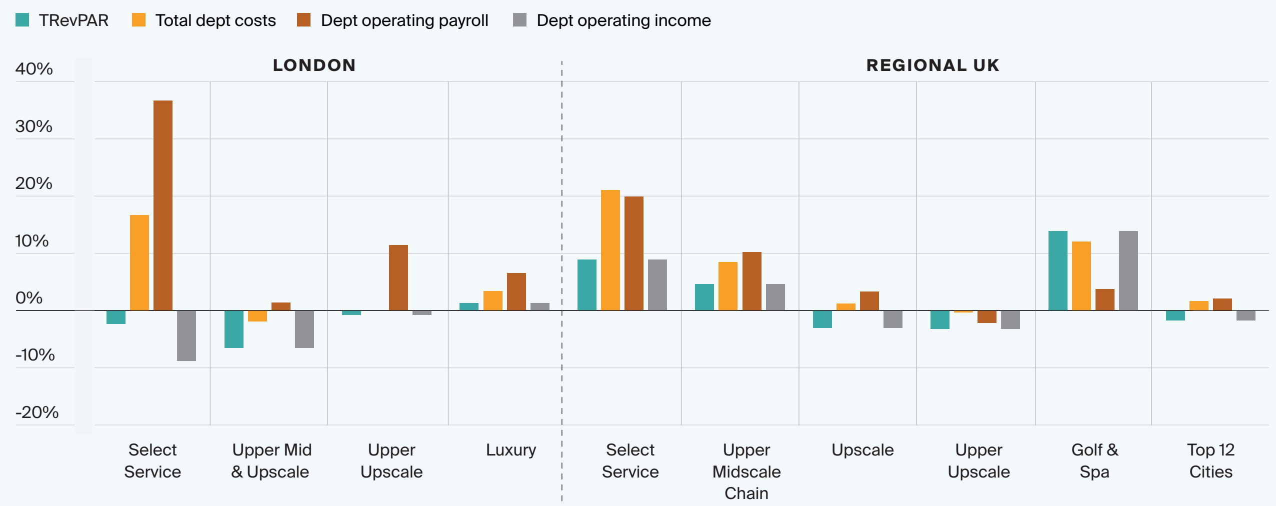
April to September, 2022 v 2019



Source: HotStats

Key performance indicators - Total operating departments - PAR

% change April to September 2022 v 2019



Source: HotStats

UNDISTRIBUTED OPERATING EXPENSES

Efficiencies made during the pandemic are helping offset some of the cost increases in undistributed operating expenses. Whilst expenses are on the rise, payroll costs across all cost centres have reduced. Yet, the surge in energy costs is compressing margins and as fixed deals end, the prospect of higher energy costs will be longer lasting, even once wholesale prices begin to fall.

Administration & general

Administration & General (A&G) expenses have decreased on average by 2.9% on a PAR basis in London[1]. The efficiencies have been driven largely through lower payroll costs, with significant cuts having been made during the pandemic. Despite increasing on a 6 -month rolling basis to September 2022, payroll costs remain at a lower level during this period of recovery than compared to 2019.

On average, total A&G expenses in London equate to around £15 PAR, with payroll costs representing 46% of the total A&G cost, rising to above 50% for London's Select Service Hotels and London's Luxury hotels. As a percentage of total revenue, total A&G expenses average between 6.2% for London's Select Service hotels and 7.7% for London's Luxury hotels.

In regional UK a similar trend has occurred, with total A&G costs 3% lower than in 2019, but this decline has stemmed largely from reductions made to A&G expenses as opposed to payroll. On average, total A&G expenses in regional UK equate to around £8.40 PAR or 7.2% as a percentage of total revenue. There is, however, huge variation between the different regional hotel datasets, with total A&G expenses averaging above £20 PAR for Regional UK Golf and Spa hotels - but at 6.6% of total revenue, this is below the regional UK average. By contrast, at £15 PAR for Full Service, Independent hotel dataset, this represents 8.1% of total revenue.

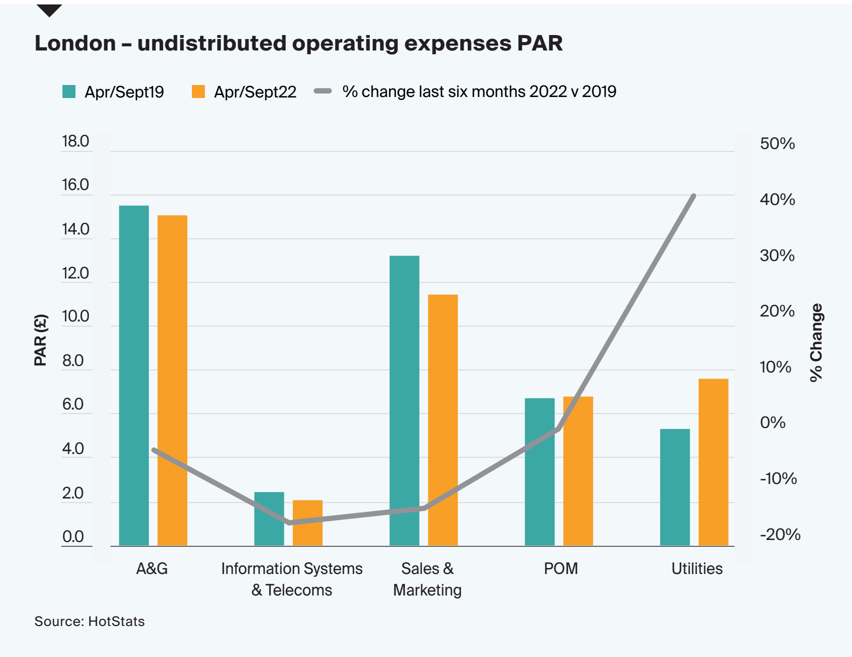
Credit card commission remains the largest single A&G expense (excluding payroll costs), averaging 33% of total A&G expenses in regional UK and 44% in London on a PAR basis. For Select Service hotels, credit card commissions make up a significantly larger proportion of the total A&G expense, averaging 58% in London and 44% in regional UK on a PAR basis.

Information systems & telecoms

Adoption of technology in hotels has been accelerated during the past couple of years, with the integration of systems and enhanced automation critical in terms of investment decision making. The focus has therefore been on tech adoption, tech upgrades, and creating an integrated tech stack, with the aim of creating greater efficiencies, improving productivity and increasing returns.

Systems expenses from operational departments include expenses related to the software licenses and maintenance, service fees, web hosting storage fees, and technical support fees. Undistributed system expenses relate to other general administrative fees, telecoms, energy management fees, as well as brand or corporate systems that provide centralized information technology.

For the last six months of 2022, expenditure related to Systems and Telecoms has decreased in the London market by 16%, to £2.05 PAR. By contrast, regional UK has seen an increase of 7.8%, to £1.50 PAR, suggesting that a greater proportion of hotels in regional UK have invested in technology, with associated tech costs and services fees rising to support these investments.



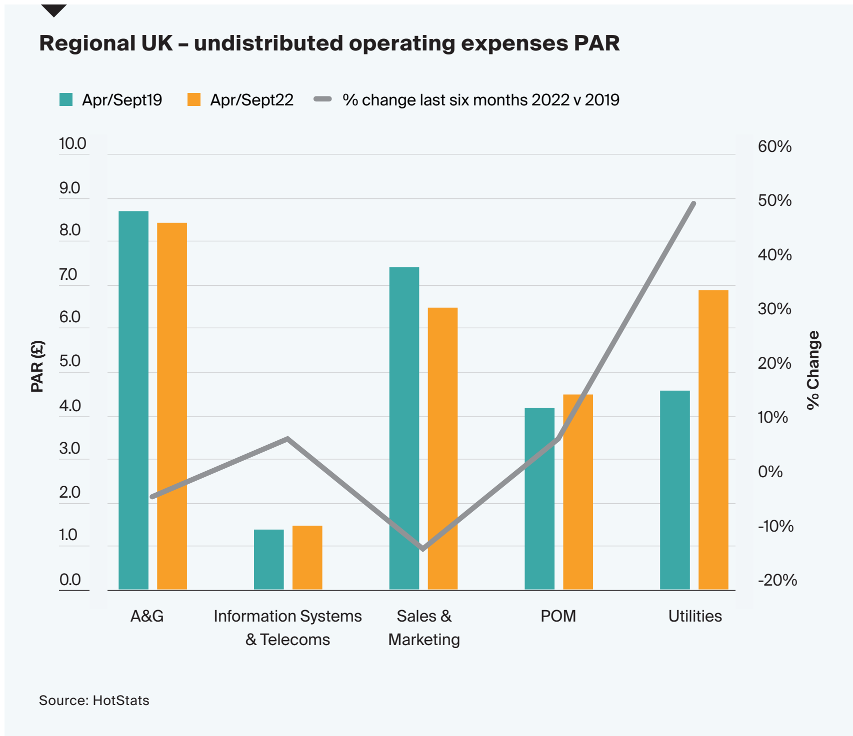
Sales & marketing

Total Sales & Marketing (S&M) expenses remain at a lower level than in 2019[1], with efficiencies continuing to be made with S&M payroll costs. Payroll costs in London are approximately 13% lower than in 2019, whilst in regional UK payroll costs have reduced by approximately 17%. During this time, S&M Payroll costs throughout the UK represent on average around 1.4% of total revenue compared to around 1.7% in 2019. One exception, however, has been an increase in payroll costs for Select Service hotels, with payroll costs PAR increasing by approximately 26% in London and 38% in regional UK.

Further savings continue to be made with S&M general expenses when compared to 2019, with these costs having reduced on a PAR basis by approximately 17% in London and by 7% in regional UK. For our London hotels dataset, these costs account for approximately 1.7% of total revenue (2.0% in 2019), whilst in regional UK these costs now represent 1.7% of total revenue (1.8% in 2019).

In contrast to the regional UK average, our dataset for the Top 12 regional UK cities is seen to be devoting more resources and personnel to the S&M function during this period of recovery, with total payroll costs only 5% less for the six-month period in 2022 versus 2019, whilst expenses have increased by 11% during this time.

The Bird, Bath



[1] Rolling six-month period, April to September, 2022 v 2019.

Included within S&M expenses is the inclusion of Franchise and Affiliation fees and costs associated with brand loyalty programs. As a large proportion of franchise fees are calculated based upon Total Rooms Revenue, those datasets that have achieved RevPAR growth are seeing these costs increase on a PAR basis when compared to 2019. As such we have seen a large variation across the different datasets for this expense line. For example, compared to 2019, London's Luxury hotels and Upper-Upscale hotels have seen franchise fees and loyalty programme costs increase by 10% and 14% respectively.

In regional UK, Golf & Spa hotels have seen a 49% increase in franchise fees PAR, with this expense now accounting for 2% of Rooms Revenue (1.6% in 2019). Select Service hotels have also seen a surge in franchise fees, increasing by 15% in Regional UK and 12% in London PAR. As a percentage of Rooms revenue, for Select Service hotels these fees represent 6.8% of Rooms Revenue in London (5.8% in 2019) and 8.2% of Rooms Revenue in Regional UK (7.7% in 2019).

As a percentage of total revenue, total S&M expenses, which includes payroll, central marketing costs and franchise and affiliation fees, represent on average 5.5% of total revenue in London, but rising to 7.8% for Select Service hotels. In regional UK, total S&M expenses represent between 5.0% and 6.0% of total revenue, rising to 7.4% for Select Service hotels. For full-service independent hotels in regional UK, where there are no franchise fees payable, total S&M expenses reduce to approximately 4.3% of total revenue.

Property, operations & maintenance

With many hotel operators delaying planned maintenance during the height of the pandemic, in line with Glenigan's forecast of a 5.8% increase in repairs and maintenance output compared to 2021, hotels POM expenditure in 2022 has increased. With such projects in general far quicker to complete, expenditure decisions can be taken at a faster pace.

POM expenditure has increased at a far higher pace in regional UK, increasing by 8% PAR[1], compared to only 2% PAR in London.

In regional UK, significant variation exists in the level of expenditure between some of the datasets. For the Top 12 Regional UK Cities, this dataset witnessed a 20% rise PAR in POM expenses, with a similar level of growth for the Select Service, Midscale and Upscale hotel datasets. Meanwhile, Upper Upscale hotels and full-service independent hotels have not seen expenditure exceed 6% PAR. Similarly in London, Select Service hotels recorded a 20% increase

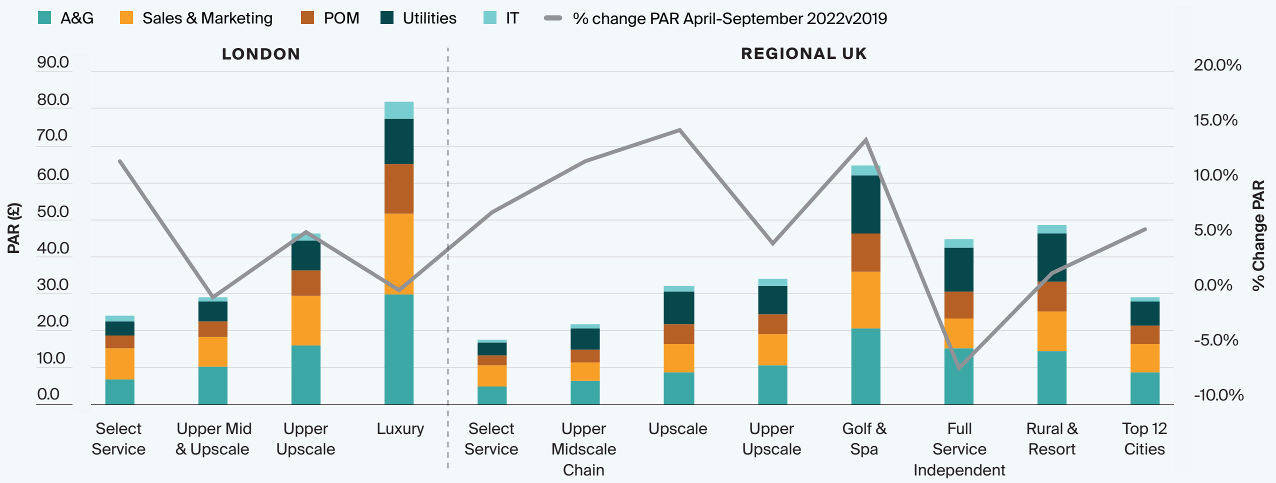
The focus on sustainability and the need to reduce one's environmental impact was brought to the fore as the world emerged from Covid.

PAR, whilst the Luxury hotel dataset recorded growth of 6% PAR.

POM payroll costs, which account for 38% of total POM expenditure in London, remained on par with 2019[1]. Across regional UK POM payroll costs averaged 32% of the total expenditure, with these costs rising by 6% PAR. Meanwhile POM Payroll costs in the Top 12 regional cities increased by 12%.

Total POM expenses[3] (including payroll) remained largely on par with 2019 expenditure for London, averaging £6.80 PAR, or 3.2% of total revenue. For the same period, regional UK recorded an increase of 7.7%, averaging £4.50 PAR, or 3.8% of total revenue. Full Service Independent hotels recorded a much higher level of expenditure at £8.00 PAR, but this is due to a much higher payroll cost PAR, double the regional UK average.

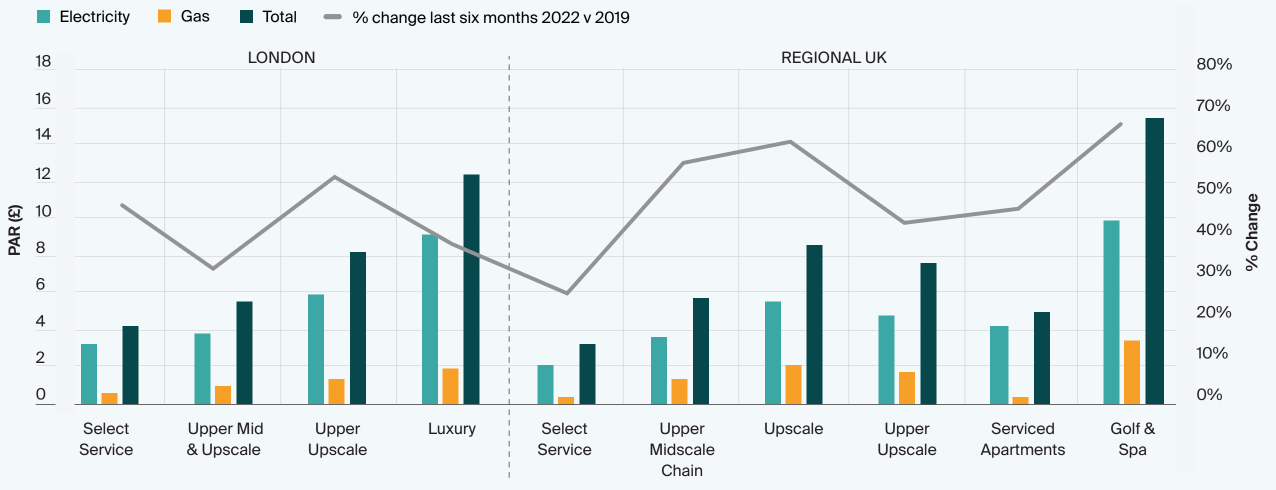
Undistributed operating expenses PAR
% change, April-September 2022 v 2019



Source: HotStats

[1] Rolling six-month period, April to September, 2022 v 2019. [3] For the period April to September 2022.

Detailed breakdown of utility costs PAR (£)
April-September 2022



Source: HotStats

Utilities

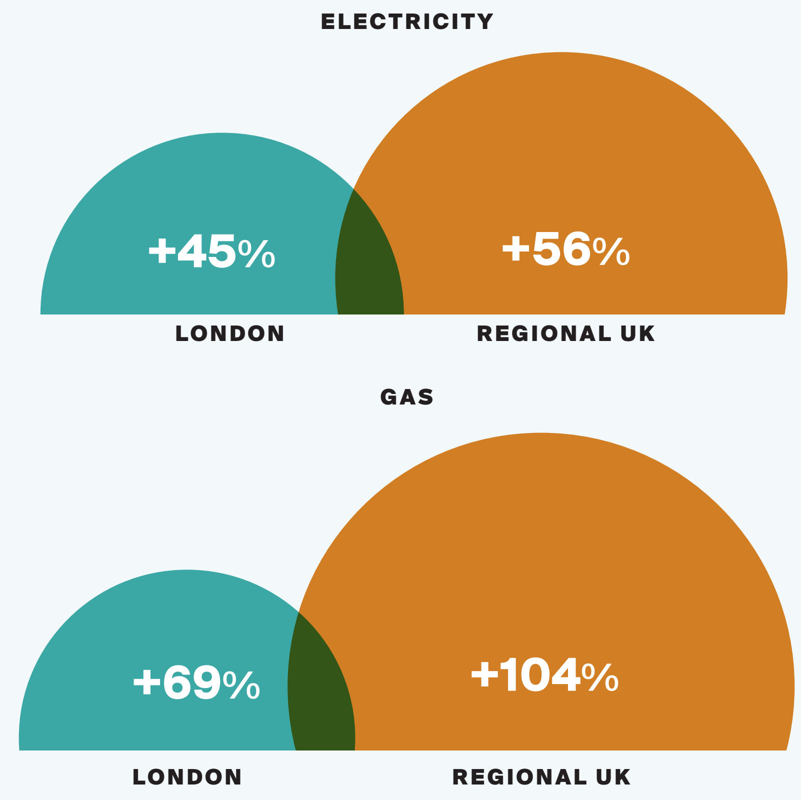
The focus on sustainability and the need to reduce one's environmental impact was brought to the fore as the world emerged from Covid. Following rising energy consumption coming out of global lockdowns; Russia's unprovoked invasion of Ukraine and the closure of Russia's two largest gas pipelines to Europe, leading to subsequent supply and storage issues across Europe – as a consequence the pressure to conserve energy has been mounting. The continuing surge in energy prices has become a nationwide problem, diluting profit margins and contributing to the increasing cost of living.

The focus to reduce energy consumption has never been greater, but with the rise of wholesale gas prices doubling since June 2021 and the average unit price for electricity increasing by 45%, such external pressures are having a profound impact on a hotel's utility costs.

A new government Energy Bill Relief Scheme operational for a six-month period from 1st October 2022 will provide some relief, but as more fixed-rate plans expire in 2022 and 2023, hotels are faced with soaring energy prices. Furthermore, with the margin between wholesale and retail energy prices soaring over the past six months, this has led UKHospitality to call for an urgent investigation into energy pricing, with the trade body demanding "clarity and certainty that energy suppliers are not profiteering from this energy crisis."

Total utility costs have been increasing month-on-month. For the last six months, when compared to the same period in 2019, the cost of energy

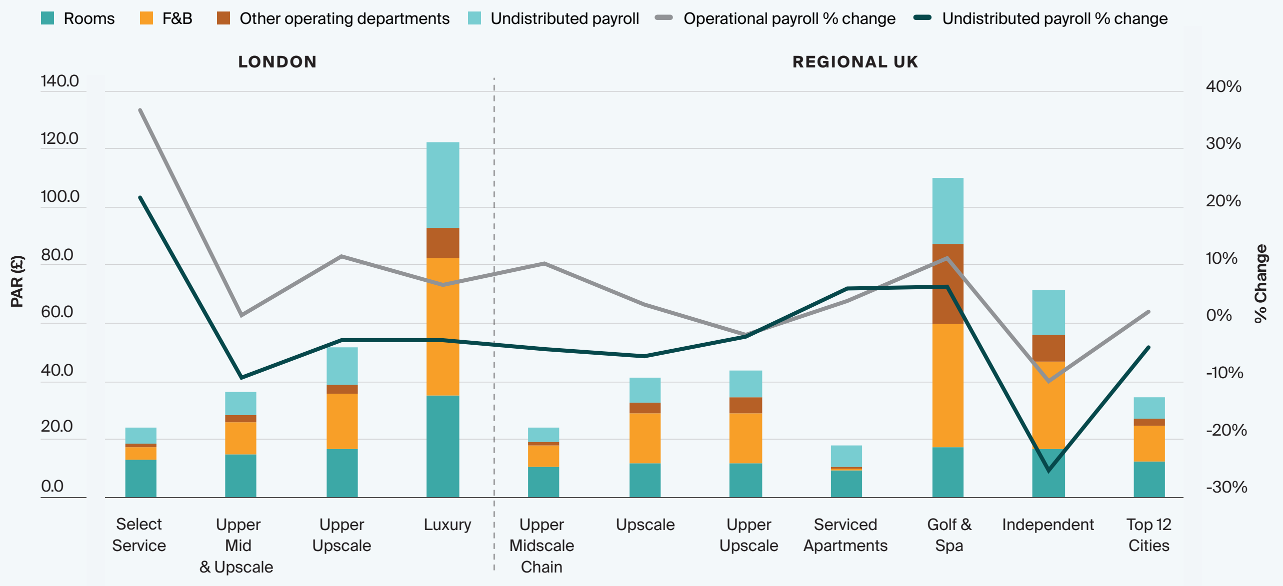
% change PAR
April-September 2022 v 2019



Source: HotStats

Breakdown of payroll costs PAR

April-September, 2022 v 2019



Source: Knight Frank Research

across London hotels has increased by approximately 42%, rising to approximately £7.60 PAR. However, with prices rising more steeply in recent months, total utility costs in September 2022 have increased by 58% compared to September 2019, with London's Upscale hotels recording a 75% increase.

Across regional UK, compared to the equivalent periods in 2019, utility costs have increased by over 51% to £6.90 PAR for the last six-months, and rising by 69% for the month of September. Total utility costs have averaged approximately 5.9% of total revenue in regional UK over the past six months, compared to 3.7% of total revenue for the same period in 2019. For London, utility costs have averaged approximately 3.6% of total revenue, up from 2.5% in 2019.

Looking at the detailed breakdown of utility costs, for regional UK the cost of gas has doubled in price PAR[1], whilst London has recorded a rise of 69% over this same period. Meanwhile rising electricity prices have seen a 56% rise PAR in regional UK and around 45% increase PAR in London.

Highlighting a couple of the datasets, the extensive facilities offered by Golf & Spa hotels and their intensive use of water and greater energy consumption, has led to a 69% hike in utility costs to over £15.50 PAR, equivalent to 5% of total revenue, up from 3.5% in 2019. Meanwhile, regional UK Upscale hotels have seen a most pronounced rise in utility costs, rising by 63% PAR, which is the equivalent of 6.8% of revenue, compared to 4.0% in 2019. As energy costs have increased month-on-month, these same datasets have recorded far higher increases, with utility costs almost doubling in September 2022 versus the same month in 2019.

Total hotel payroll costs

A tight labour market because of Brexit – a staffing shortage caused by the pandemic – strong demand for operational staff as a normalised period of trading emerged post pandemic – these are all factors that have played a significant contribution to the rising cost of labour, over and above the planned 6.6% increase in the National Living Wage last April. The high inflationary environment has led to further wage inflation as the sector battles to retain its competitiveness and look after staff as the cost-of-living crisis deepens. Some employers have gone even further and are now paying the Real Living Wage, which is an independently calculated rate that ensures workers can meet the cost of living, currently set at £10.90 per hr across the UK and £11.95 in London.

Payroll costs form a significant proportion of costs for a hotel, with total payroll costs equating to 24.8% of total revenue for London hotels and 28.7% for regional UK hotels[3]. Yet whilst there have been notable increases in operational payroll during the last six months, a significant number of hotels have reduced their fixed costs during the pandemic and continue to operate with reduced levels of staffing in non-operational departments. As such the proportion of payroll costs to total revenue and payroll costs on a PAR basis have broadly stayed the same when compared to the same six-month period in 2019, but there are exceptions.

London hotels increased their share of operational payroll to 75% of total payroll costs, rising from 73% in 2019. Operational payroll costs increased on average by 2% PAR, whilst undistributed payroll costs declined by 7% PAR, with significant reductions coming from both A&G and S&M cost centres. London's payroll costs for the last six-months average £51.70 PAR. For regional UK hotels, operational costs have remained at a similar level to 2019, but efficiencies have been made with respect to undistributed payroll costs,

[1] Rolling six-month period, April to September, 2022 v 2019. [3] For the period April to September 2022.

Payroll costs form a significant proportion of costs for a hotel, with total payroll costs equating to 24.8% of total revenue for London hotels and 28.7% for regional UK hotels[3]

with a 17% reduction in S&M payroll PAR. Hotels across regional UK have averaged payroll costs of £33.70 PAR[3].

Select Service hotels in regional UK have one of the lowest payroll costs after Serviced Apartments, with payroll costs equating to 23.8% of total revenue (approximately £18.20 PAR)[3]. But, with the 'budget' price point of this hotel class and very limited flexibility to reduce the level of operational staff, wage cost inflation has increased disproportionately to revenues. As such, Select Service hotels have seen payroll costs increase by 18.5% PAR during this period, with a 20% rise PAR in operational payroll and 13% increase in undistributed payroll.

A similar trend has emerged for London Select Service hotels, where during the past six months, payroll costs have increased by 32.7% PAR (approximately £22.90 PAR) and account for 21.4% of total revenue, compared to 15.7% of total revenue in 2019. Operational payroll costs now account for 76% of total payroll costs, compared to 73% in 2019, increasing by 37% to approximately £17.30 PAR. A strong surge in payroll costs in S&M and POM also led to a 22% rise in non-operational departments.

Other hotel datasets which have seen a rise in total payroll costs for the last six months, compared to the same period in 2019, include Golf & Spa hotels, which recorded a 10% rise to £106 PAR, of which operational payroll increased by 11% PAR. Regional UK's midscale hotels also recorded a 7% uplift in total payroll costs, with operational payroll costs rising by 10% PAR, whilst undistributed payroll costs reduced by 4% PAR, with the greatest efficiencies coming from S&M.

citizenM London Victoria Station, opened July 2022

Hilton Garden Inn Silverstone, opened September 2022.

[3] For the period April to September 2022.

GROSS OPERATING PROFIT

The pandemic brought about two full years of severely disrupted trading and a period where breaking-even and sustaining cashflow were of utmost priority. Bumps in the road continue along the journey of recovery. At this time of economic uncertainty and standing alone without government support, the sector's long-term resilience is under scrutiny - leveraging GOPPAR has never been more critical.

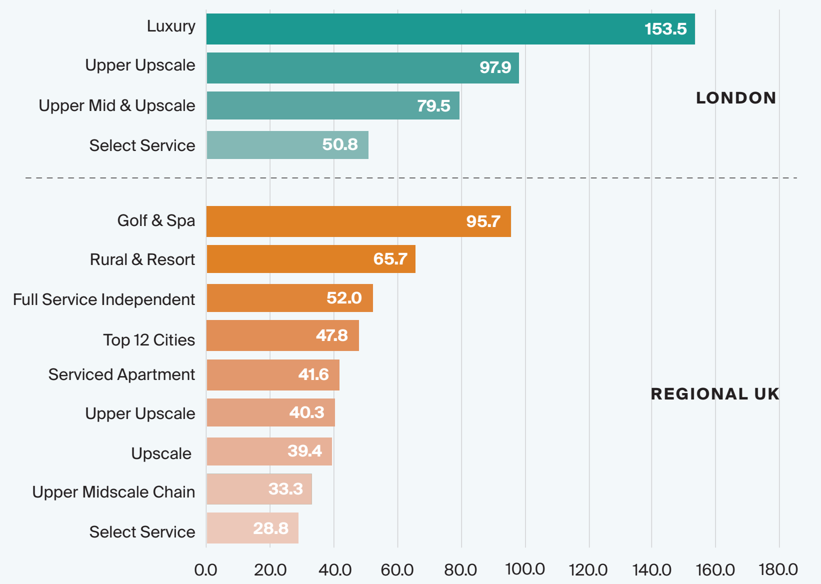
In this period of post pandemic recovery, analysts are guilty of always looking back, no more so than with the year 2019 - the last full year of normalised trading and now set as the industry benchmark. Yet, in 2019, despite a year of positive RevPAR growth, a surge in costs led to declining profit margins. The pandemic has provided an exceptional opportunity for the industry to reset and given the current challenging economic environment, both revenues and expense lines, as well as supply and pipeline, remain in very different places than compared to the period leading up to the pandemic, putting the industry on a more secure footing to navigate the future challenges.

Over the last nine months the sector's recovery has been remarkable. A look back at where the key performance indicators were positioned, provides an understanding of just how much pain was endured. As at September YTD, compared to its trading position for the same period a year earlier, London has witnessed RevPAR growth of some 313% and TRevPAR growth of 245%. For Regional UK, whereas large corporate city centre hotels suffered poignant declines, the rebound curve has been meaningful but not as steep as compared to London, with both YTD RevPAR and YTD TRevPAR growth of 88% recorded.

Faced with rising costs, increased service levels and inflation, departmental profit margins are falling, at a time when revenues are still recovering. Achieving positive GOPPAR growth is extremely challenging. London hotels have a significantly higher profit conversion, achieving a GOP of 45% of total revenue, compared to an average of 33% GOP for regional UK hotels[3]. London recorded GOPPAR of £93.50 for this period, but the city's weaker top-line performance, combined with rising costs has translated into a loss in GOPPAR of 3.7%, versus 2019. For regional UK, a similar picture is emerging, with GOPPAR of £39.10 having been recorded, representing a 7.4% loss in GOPPAR[1].

There are however plenty of exceptions, with certain groups of hotels performing strongly, achieving either respectable GOPPAR growth or at worst equalling the same level of profitability as compared to 2019. London's Luxury hotel dataset is one such example, achieving GOPPAR of £153.50 and a profit margin of 40%. This equals its historical performance, with just 1% TRevPAR growth and managing to control costs, profit margins have been preserved. Meanwhile, regional UK Select Service hotels have also equalled their 2019 GOPPAR performance for the last six months, but with 9% TRevPAR growth below 2019 performance for regional UK Upscale hotels and 12% below for Upper-Upscale hotels.

Gross operating profit PAR (£)
Last six months, April-September, 2022 v 2019



Source: HotStats

[1] Rolling six-month period, April to September, 2022 v 2019. [3] For the period April to September 2022.

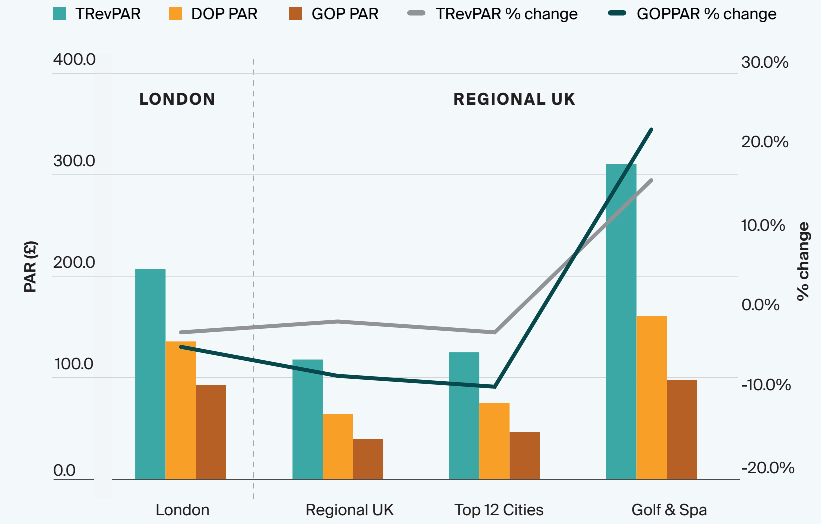
being eroded, preventing costs from spiralling out of control must be heeded.

Two datasets which have outperformed achieving robust levels of GOPPAR growth[1], are Serviced Apartments and Rural and Resort hotels. Serviced Apartments have successfully translated 14% growth in TRevPAR into GOPPAR growth of 8.7%, equating to a GOPPAR of £41.60 and a profit margin of 46.5%. The higher margins have emphasised the sector's leaner cost model and their inherent advantage and resilience during an economic downturn. Meanwhile, Golf & Spa hotels have achieved exceptionally strong GOPPAR growth of 23%, far in excess of its respectable 17% TRevPAR growth.

Those datasets of hotels which have performed less strongly, include regional UK's Upscale and Upper-Upscale hotels. These hotels have performed strongly in terms of RevPAR, either equalling or ahead of its 2019 performance, but have trailed in terms of TRevPAR, due to considerably reduced F&B revenues. Combined with rising costs, their GOPPAR recovery underperforms the wider regional UK performance, with GOPPAR some 18% below 2019 performance for regional UK Upscale hotels and 12% below for Upper-Upscale hotels.

As the UK hotel sector sustains yet another challenging operating environment, maximising revenues, appreciating how to enhance the profit contribution from each operating department, and reviewing each line of the undistributed expenses is critical to preserving profit margins and sustaining GOPPAR.

Hotel profitability - Key performance indicators
April-September 2022, % change v 2019



Source: HotStats

The Holiday Inn Express Folkestone - Channel Tunnel

[1] Rolling six-month period, April to September, 2022 v 2019.

TRADING PERFORMANCE OUTLOOK

PHILIPPA GOLDSTEIN
SENIOR ANALYST – HEAD OF HOTEL RESEARCH

Responding to the challenge when a downturn threatens

Decisive action must be taken by hotel owners and operators to mitigate against further threats and to plan for business survival. As illustrated by the pandemic, during periods of crisis or economic downturns, both challenges and new opportunities are presented. Strong businesses often establish an even greater advantage during these conditions. Certain sub-sectors, which are lean to operate, such as the budget hotel sector and the serviced apartment sector are likely to perform strongly during such times.

Weakening consumer sentiment may place downward pressure on demand and, in turn, revenues, but the high ADRs continue to provide a cushion to the current high-cost inflation. Furthermore, the flexibility that hotel operators have to change rates at any time, allows the sector to be more responsive and adaptive to the changing landscape and to take advantage of opportunities as they arise. Whilst the Bank of England forecast for inflation to fall back during 2023, it is not expected to return to 2% until late 2024. In 2023, we anticipate ADR growth to be more moderate, and at this time of writing, there is no evidence that the sector will lose the benefit of the recent strong rate growth. Thus, these higher prices are likely to become the basis of an industry reset, in doing so help prevent the dissipation of profits.

Industry fundamentals remain strong

With the downturn coming so soon after the pandemic, there are many influences that will enable the sector to ride out the storm. The pandemic has been the catalyst for many of these factors, including hotel owners and operators becoming far more savvy about their cost base; existing supply levels kept in check by the weight of hotel closures and a reduced pace of new hotel openings; and modest future supply growth forecasts – all facilitating a quicker recovery and the return to a stabilised level of performance.

The current challenging operational environment, has led to enhanced structural opportunities, with fewer independent hotels now trading. A further slowdown would accelerate this trend even more. As brands increase their market share and quality of hotel supply improves, this will elevate the wider hotel market performance further.

Despite deepening headwinds, we remain optimistic that hotels throughout the UK will steer a route to a successful recovery, emerging stronger from this latest turbulence. Whilst a tightening of disposable incomes is expected, it is not yet known by how much this will negatively impact on UK leisure demand.

As recent history has shown, any forced cutbacks in leisure travel will at the first opportunity revert quickly back to a period of robust demand growth. Facilitated by a weak pound, London, Edinburgh, and other tourist hotspots are expected to benefit from the return of international visitors, whilst UK staycation will continue to support the UK economy - with quality and value becoming essential drivers in consumer choice, selection and experience. Critical to the continued well-being of the sector, however, is having a balanced segmentation mix, generating year-round hotel demand.

Striking a balance

Although significant pressure exists to cut costs, an increasing number of operators have placed employee welfare and wellbeing high in terms of priority. Many respectable operators are providing additional pay rises on top of the National Living Wage. By offering the Real Living Wage this helps nurture talent and keeps the rate of pay competitive, at a time of national recruitment difficulties. The positive impact reaped from retention of trained staff, enhanced employee morale and improved levels of customer service will become tangible through improved trading performance. In the short-term, the cost of payroll has the potential to rise significantly, but with some of this payroll cost being ‘fixed’, as occupancy levels rise payroll costs POR are likely to reduce.

The focus on reducing energy consumption and improving efficiency is a further means of mitigating the impact of rising energy cost. With the advancement of technology, energy management systems provide the data and with it the ability to monitor and measure the performance of such energy-saving initiatives, as well as provide scope for additional efficiencies to be made. Regular servicing can help reduce energy costs, as well as further investment in larger scale projects, such as the installation of ground heat pumps.

Should this economic downturn come to fruition so soon after the pandemic, we are likely to witness increased bifurcation between the performance of well capitalised assets under strong and proactive management and hotels which remain starved of investment in all facets. At this critical juncture, hotel owners and operators must endeavour to strike a balance in terms of responding to the rising cost pressures without compromising the buffers, in terms of its people, investment in the fabric, and delivery of a great hospitality experience.

Fairmont Windsor Park, Windsor, opened Jan 2022

Please get in touch with us

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Front cover picture: The Fairmont Windsor Park, opened January 2022

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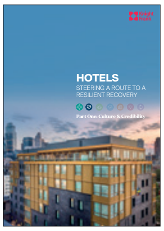

Hotels – Steering a route to recovery

UK Hotel Capital Markets - 2022

HOTSTATS
Hospitality Intelligence

We would like to express our sincere thanks to the HotStats team, our particular thanks goes to David Stephens and Leah Hewlett.

GLOSSARY

POR/PAR	POR/PAR Per Occupied Room / Per Available Room
OCCUPANCY %	The number of rooms sold as a proportion of available rooms for a specified time period.
ADR (AVERAGE DAILY RATE)	Calculated by dividing a hotel's total room revenue by the number of rooms sold for a specified time period.
REVPAR	The total Rooms Revenue divided by the total number of available rooms during the period.
TREVPAR	Total Revenue from all operating departments plus rental income divided by the total available rooms during the period.
DOI % / PAR	Departmental Operating Income – Total Revenue less total Departmental Operating Expenses; expressed as a percentage of Total Revenue or divided by the total available rooms during the period.
UNDISTRIBUTED OPERATING EXPENSES	Expenses attributable to the whole hotel, but not allocated to a specific department. These expenses are typically split between Administration & General; Sales & Marketing; Property, Operations & Maintenance; and Utilities.
GOP	Total Revenue less Operating Expenses (Departmental Expenses and Undistributed Operating Expenses).
GOPPAR	Total Gross Operating Profit across all revenue streams divided by total available rooms during the period.
PAYROLL %	Departmental Payroll (or Total Departmental Payroll) as a percentage of departmental revenue (or total revenue).

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