Knight Frank

SPRING
MARKET OVERVIEW

UK HOTEL & LEISURE
PROPERTY 2018

EXECUTIVE SUMMARY

JULIAN EVANS FRICS
Head of Healthcare,
Hotels & Leisure

2017 has proven to be another positive year of revenue and profit performance for hotels in the UK, with GOPPAR growth driven through advances in the average room rate. This is a remarkable achievement and testament of the resilience of the UK hotel market, given the challenging and uncertain trading environment surrounding a Brexit deal, the unforgivable terrorist attacks and the volume of new supply entering the market.

A stronger than expected tourism boost, driven by the weak pound has resulted in record numbers of overseas visitors arriving in the UK, with London in particular benefitting from growth in the long-haul markets. Meanwhile, with the cost to travel abroad more expensive, regional UK hotels have profited from strong demand in the short break and staycation markets.

This year has seen a substantial uplift in investment activity, as strong fundamentals underpinning the sector continue to make hotels an attractive investment proposition. Key trends for 2017 have included a strong surge in portfolio activity, portfolio breakups, resulting in larger single assets coming to market and significant appetite by overseas investors with over £2.5 billion of investment. Meanwhile, further shaping the market has been the wide availability and diverse sources of capital providing senior and mezzanine hotel debt finance, on a flexible basis with the ability to execute large loans. With an increasing pool of institutional lenders, we envisage the debt market will remain highly competitive in the year ahead.

A further trend set to continue into 2018, is the growing demand by institutional investors seeking to invest in long-term, fixed-leased hotel assets, which provide secure, index-linked cashflows, backed by a strong covenant. The recent acquisition by LGIM Real Assets (Legal & General) acquiring the newly opened Hampton by Hilton at Stansted Airport illustrates the current demand in the investment market for prime, internationally branded, quality assets with significant growth potential. The compression of fixed income capitalisation rates is further proof of the investment appetite, with net initial yields currently at their lowest level on record.

Whilst we continue to see strong interest from overseas buyers who perceive value in the sector and have taken advantage of the weaker pound, we consider that in the regional UK market, 2017 is ending with more caution as buyers are paying fuller prices. The continued uncertainty over Brexit has been a contributing factor in the pool of potential buyers narrowing and with buyers becoming more vigilant, taking greater time to complete their due diligence. Opportunities are there for the taking and looking after a potential purchaser will be instrumental to the deal flow in the year ahead.

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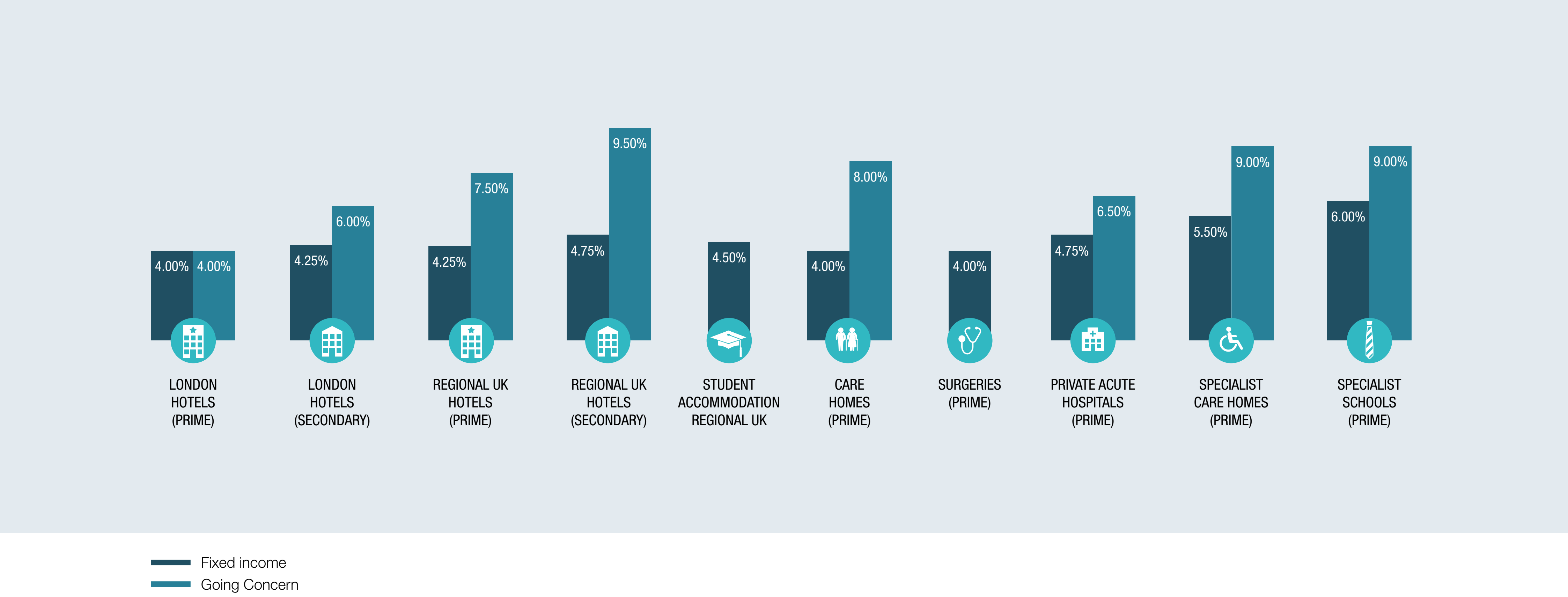
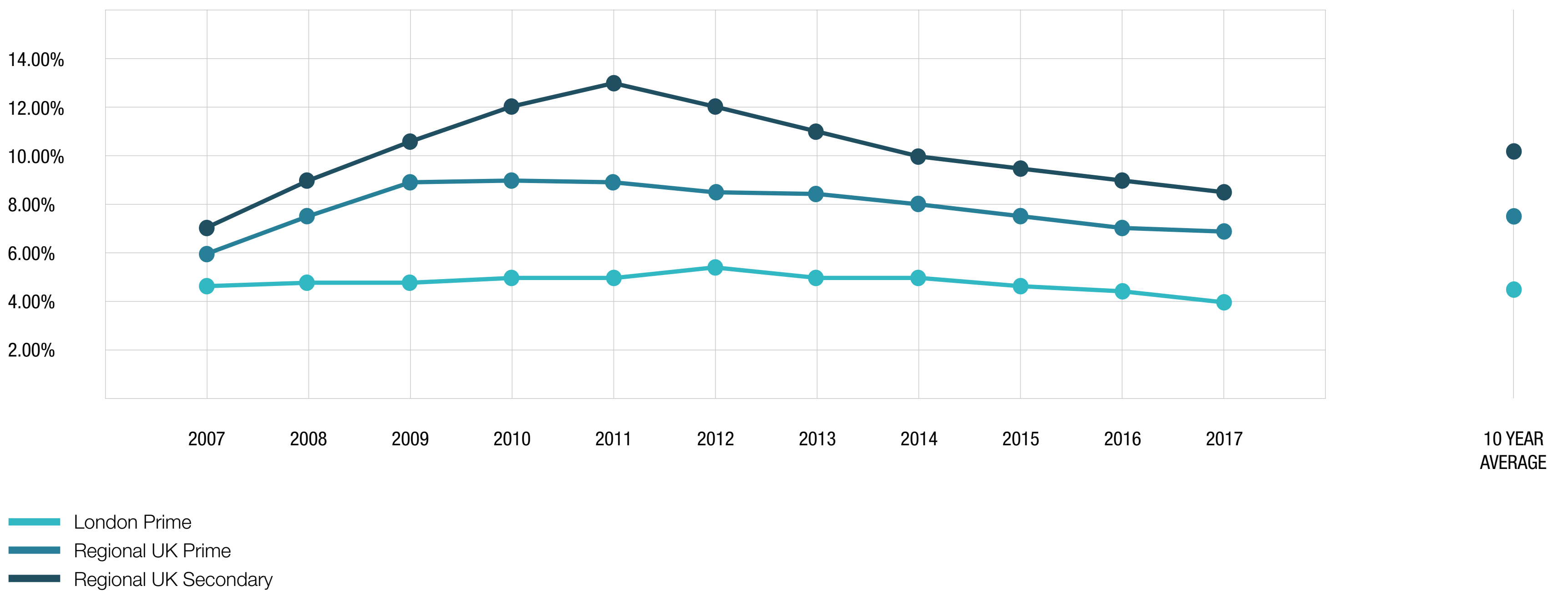
HOTEL YIELDS V OTHER SPECIALIST SECTORS – Q4 2017

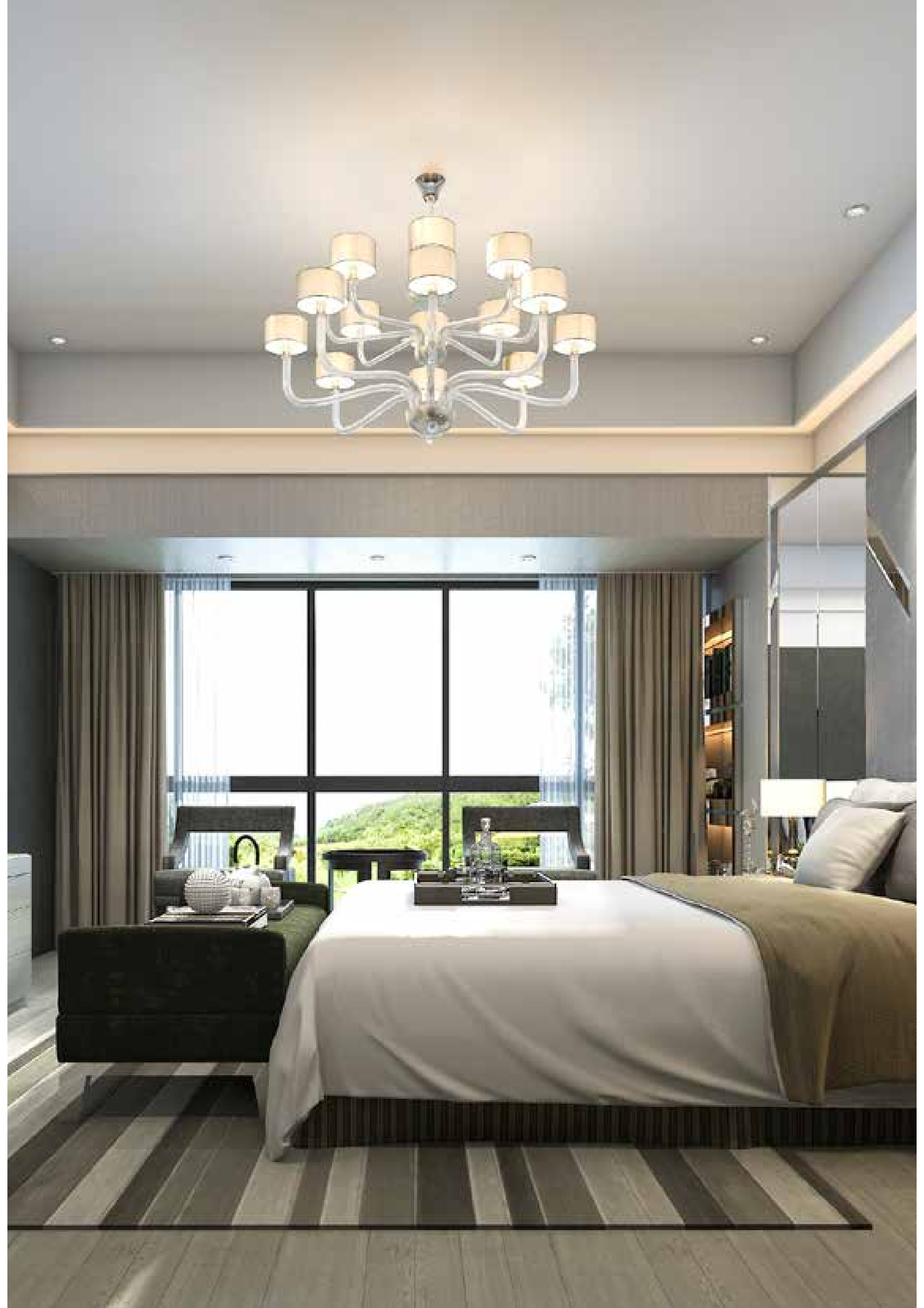


SOURCE: Knight Frank Research

HISTORICAL HOTEL YIELDS (GOING CONCERN) 2007-2017



SOURCE: Knight Frank Research



HOTEL TRADING PERFORMANCE ROLLING 12 MONTHS (DECEMBER - NOVEMBER 2016/17)

LONDON

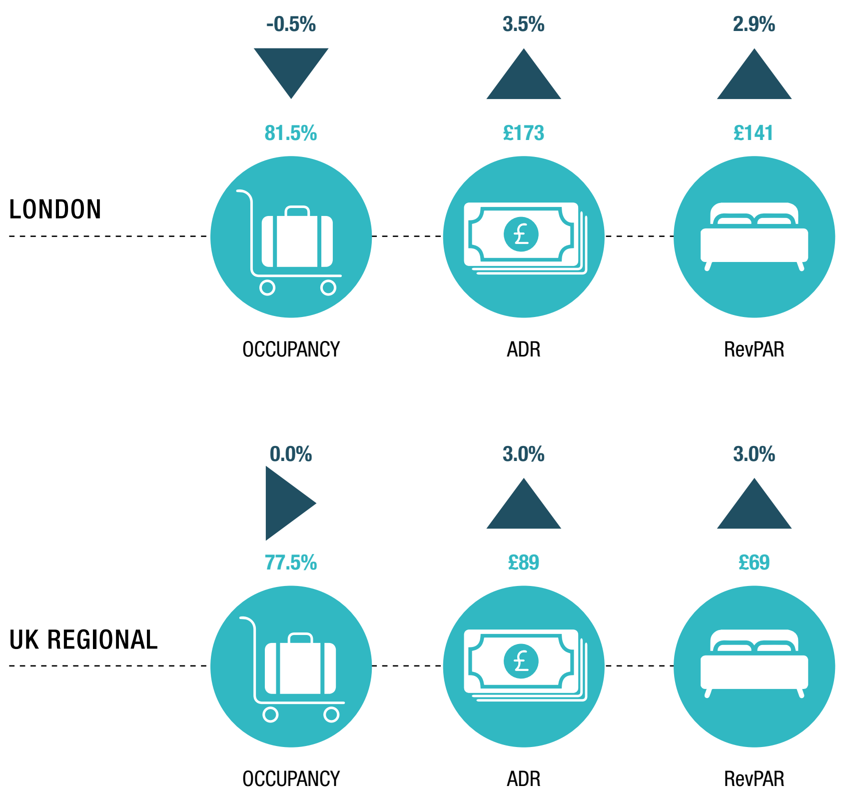
	RevPAR	TRevPAR	GOPPAR	Payroll % of total Revenue
Change	7.0%	5.3%	6.6%	6.3%
Value	£134	£185	£84	25%

UK REGIONAL

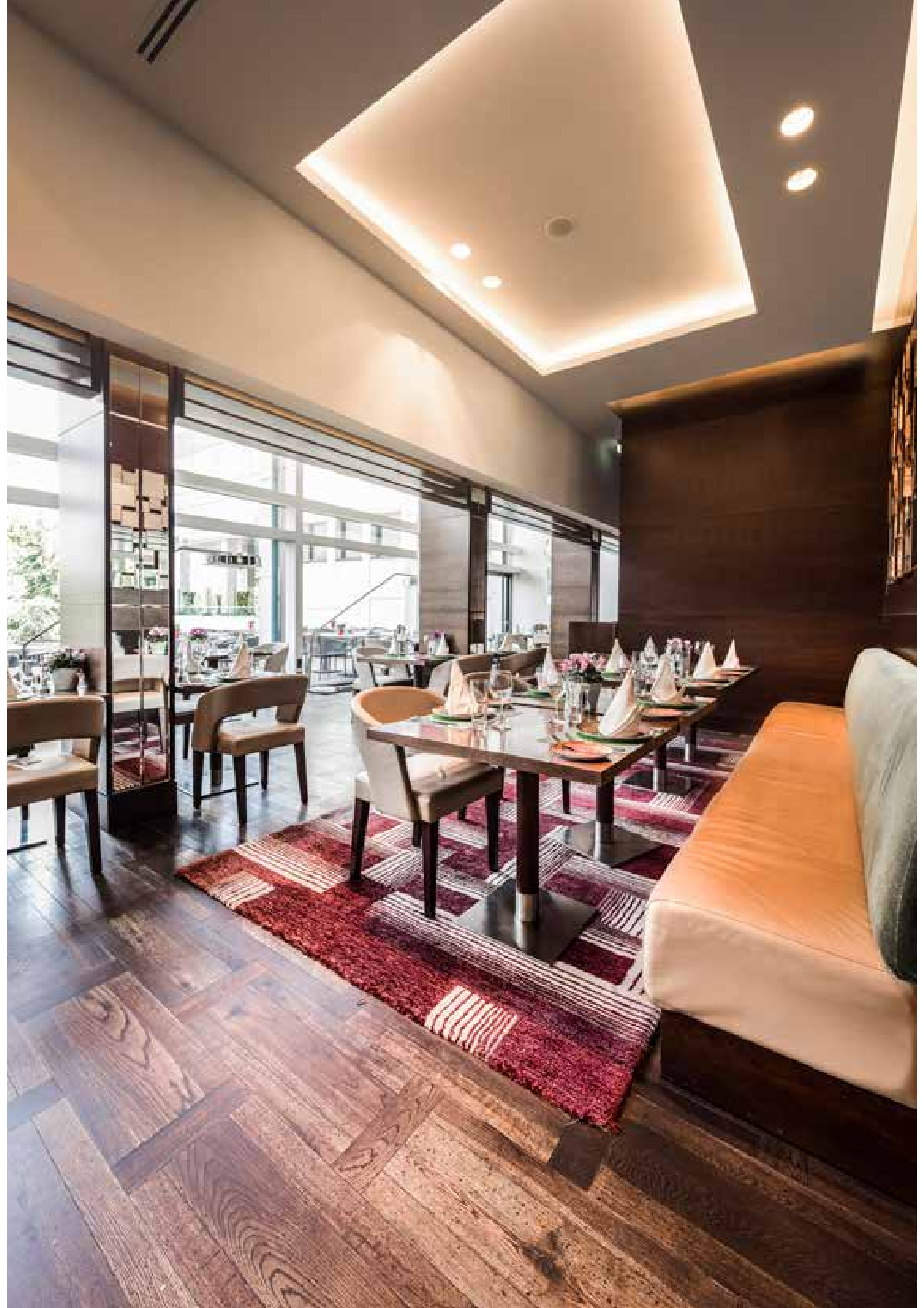
	RevPAR	TRevPAR	GOPPAR	Payroll % of total Revenue
Change	5.1%	3.6%	4.3%	3.3%
Value	£65	£112	£36	30%

SOURCE: HotStats

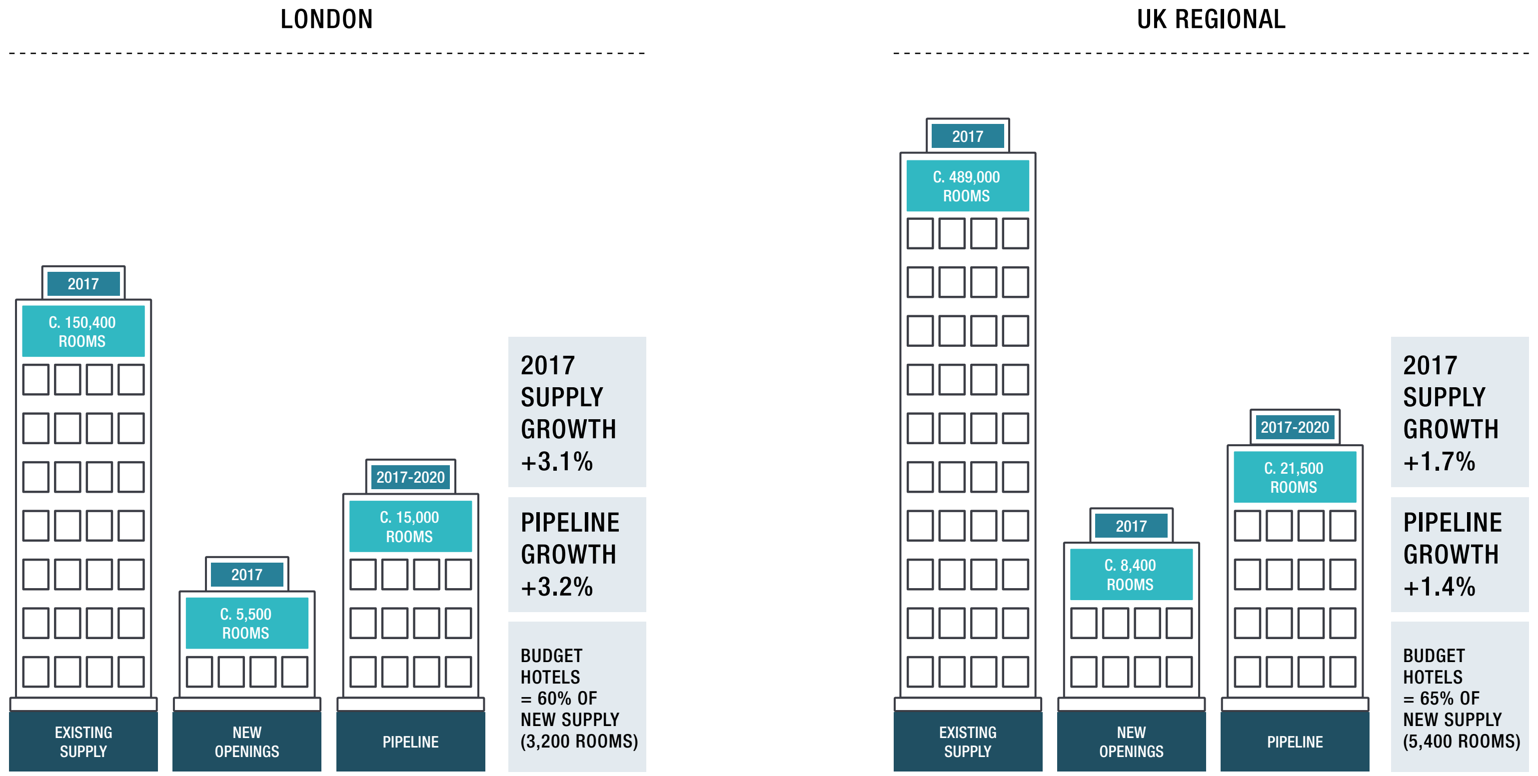
KNIGHT FRANK FORECAST 2018



SOURCE: Knight Frank Research



HOTEL SUPPLY GROWTH 2017



SOURCE: STR, Knight Frank Research

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HOTEL ANALYTICS

HOTEL PERFORMANCE

Modest growth in key trading performance indicators is expected in 2018, albeit at a slower rate than in 2017. Nevertheless, the headwinds of rising costs in operational expenses, payroll and business rates highlight the challenges ahead for the industry, at a time of heightened concern with Brexit casting a shadow over the future of the economy and the free movement of labour; consumer confidence softening and competition intensifying. Whilst top line indicators are a good measure of hotel performance, a proper and thorough understanding of the factors impacting upon GOP will become far more critical in the year ahead.

TOURISM

Despite major terrorism and security concerns, hotel performance is expected to be bolstered by continued strong growth in tourism, with the weak pound continuing to make the UK an attractive destination for overseas visitors. A record 27.1m visits was recorded for the 8-month period to August 2017, an increase of 8% on the previous year, combined with 10% growth in spend of £16.4 billion. With strong inbound tourism growth set to continue in 2018, combined with resilience in the domestic “staycation” market, strong tourism demand should provide further growth potential for the UK hotel market in the year ahead.

TECHNOLOGY

Technology will continue to have a substantial impact on the UK hotel industry, with the need to invest fast becoming a necessity. Increased competition more intense cost control pressures, cyber security, more stringent data protection regulations and social media are some of the major challenges that the industry has to embrace, combined with the adoption of mobile technology altering consumer expectations. As such, the growing need for hotels to adapt their services to provide their guests with advanced digital interaction cannot be ignored. Industry players that embrace technological change, with the use of customer-centric, next generation technology, through the use of artificial intelligence and Cloud technology are likely to become industry leaders and innovators of the future.

CAPITALISATION RATES

Investor appetite in key primary gateway cities will continue to put pressure on capitalisation rates, especially where limited pipeline and a resilient trading performance allows for income growth to be built into valuations. Fixed income margins are likely to compress further, especially where stock is limited and long-term, secure income streams are offered with a strong covenant. Where income growth is impacted as a result of rising costs, values may soften slightly in the year ahead.

TRANSACTION VOLUME

Despite the uncertainty over Brexit, full year hotel investment of above £5 billion is set to be recorded in 2017. This represents a 35% rise in investment volume compared to the previous year, with a plethora of investors and a surge in portfolio activity. Overseas investors with long-term aspirations continue to view London and key regional UK cities as an attractive investment destination. Long dated, secure income streams with strong covenants and internationally recognised brands will remain important investment considerations for the future.

UK HOTEL & LEISURE PROPERTY 2018 — **MARKET OVERVIEW**

OUR PEOPLE

Knight Frank's dedicated and highly experienced team provides a discreet and efficient consultancy service advising on the full spectrum of hotel and leisure assets. In taking time to understand the needs and objectives of our clients, we continue to provide uncomplicated property advice and solutions that add value at every stage.

HEAD OF HEALTHCARE, HOTELS & LEISURE

JULIAN EVANS, FRICS
+44 20 7861 1147
julian.evans@knightfrank.com

ALYSSIA CLARE
PA to Julian Evans
+44 20 7862 2253
alyssia.clare@knightfrank.com

RESEARCH

PHILIPPA GOLDSTEIN
Hotel Analyst
+44 20 3826 0600
philippa.goldstein@knightfrank.com

HOTEL VALUATIONS

IAN ELLIOTT, MRICS
Partner, Head of Hotel Valuations
+44 20 7861 1082
ian.elliott@knightfrank.com

JESSICA HIND
Office Manager
+44 20 3909 6827
jessica.hind@knightfrank.com

KAREN CALLAHAN, MRICS
Partner
+44 20 7861 1086
karen.callahan@knightfrank.com

JONATHAN CRITCHLEY, MRICS
Partner
+44 20 7861 5172
jonathan.critchley@knightfrank.com

ALEX BRADBEER, MRICS
Senior Surveyor
+44 20 7861 1442
alex.bradbeer@knightfrank.com

MIKE KELSEY
Associate
+44 20 7861 1081
mike.kelsey@knightfrank.com

LILIANA IELACQUA, MRICS
Associate
+44 20 7861 1084
liliana.Ielacqua@knightfrank.com

HECTOR AHERN
Graduate
+44 20 3826 0600
hector.ahern@knightfrank.com

HOTEL AGENCY & DEVELOPMENT

ALEX STURGESS, MRICS
Partner, Head of Hotel Agency
+44 20 7861 1164
alex.sturgess@knightfrank.com

HENRY JACKSON, MRICS
Partner, Hotel Agency – Regional UK
+44 20 7861 1085
henry.jackson@knightfrank.com

TOM OAKDEN, MRICS
Partner
+44 20 3826 0607
tom.oakden@knightfrank.com

KIT ABRAM, MRICS
Surveyor
+44 20 7861 1249
kit.abram@knightfrank.com

ALEX MACAULAY
Graduate
+44 20 3826 0690
alex.macaulay@knightfrank.com

GEORGINA MCCULLOCH
Team Secretary
+44 20 7861 5262
georgina.mcculloch@knightfrank.com

KNIGHT FRANK FINANCE

LISA ATTENBOROUGH
Partner
+44 20 3909 6846
lisa.attenborough@knightfrank.com

knightfrank.co.uk/commercial/hotels