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

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

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

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

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

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

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

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

Also of significance is the importance of the HNW Family Office investment, UK institutional investors and Overseas Hotel Development deals where investment accounted for 53% of total regional UK investment high achieved in 2015. The uplift in transaction volume can be largely credited to the scale of portfolio activity, which accounted for 53% of total regional investment, of approximately £2.1 billion, compared to £1.5 billion during 2017. Major portfolios transacting in 2018 included the disposal by Starwood Capital of the 12-strong Principal Hotel Group, including one De Vere hotel asset, for £800 million* to the hotel focused investment firm LRC Group for £650 million; Apollo Global Management’s disposal of its 20-strong Holiday Inn and Crowne Plaza portfolio to the Israeli HNW Dayan Family, netting some £742 million and Brookfield’s £430 million acquisition of the SACO Group, the largest serviced apartment deal in the UK to date. On a consolidated basis, the average price per room sold in a portfolio transaction in 2018 equated to £147,000 per room, which was 10% lower than the previous year, but was partially a function of the large number of Travelodge rooms transacting as part of a portfolio transaction. Single asset investments, in regional UK, fared less well in 2018 compared to the previous year, but was partially a function of the number of Travelodge rooms transacting as part of a portfolio transaction. Single asset investments, in regional UK, fared less well in 2018 compared to the previous year, but was partially a function of the large number of Travelodge rooms transacting as part of a portfolio transaction. Single asset investments, in regional UK, fared less well in 2018 compared to the previous year, but was partially a function of the large number of Travelodge rooms transacting as part of a portfolio transaction.
active in pursuit of 3-star properties, accounting for 78% of the transaction volume, with the 3-star market increasing its share of single asset transactions to 35% (compared to 27% in 2017), at an average price per room sold of £97,000 per key, a rise of 48% compared to the previous year.

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

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

London hotel market buoyed by strong investment market

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

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

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

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

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

Total investment in London climbed to £3.3 billion when including hotel developments. The acquisition of hotel sites and the forward funding of hotel projects equated to 21% of total investment in London, with the conversion of office or retail space deemed a viable option to overcome barriers to entry, particularly for full service upper-upscale and luxury hotel developments. Examples include the £30 million acquisition of an existing office block at 5 Strand, by the Indian-based developer, Abil Group, with planning consent to build a 200-bedroom luxury hotel; and Ireland’s Dalata group’s £91 million acquisition of the long-leasehold interest for a 212-bedroom, Clayton Hotel, currently under development at Aldgate East Station.

Overseas corporate investors ranked as top UK buyer

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

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

In London, international investment was the primary driver of the capital’s hotel market. Overseas Corporate Investors ranked as the highest spending investor by transaction volume, with a 25% share, closely followed by Overseas Institutional Investors with a 21% share of the total volume. Together, the two groups invested £1.1 billion of capital into the London hotel sector, involving 11 separate deals.
London assets exchanging hands to overseas investors included: four separate Travelodge investment transactions totalling over £130 million, with an average price of £193,000 per key; Cola Holdings acquisition of the Hilton London Kensington for £280 million (£431,000 per key); Katara Hospitality, the hotels division of Qatar Investment Authority acquiring Grosvenor Hospital, the hotels division of Qatar for £260 million (£431,000 per key); Katara acquisition of the Hilton London Kensington totalling over £130 million, with an average overseas investors included: four separate London assets exchanging hands to Hilton Belfast (198 Rooms) – Starwood Global Opportunity Fund XI, an affiliate of Starwood Capital Group acquired a portfolio of seven Hilton hotels from Park Hotels & Resorts for £135 million (£101,000 per room).

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

In an environment of geopolitical uncertainty and rising interest rates, strong demand exists for secure, long-term fixed income, thereby managing the downside risk during the late property cycle. In 2018, approximately £178 million of institutional investment targeted fixed lease income transactions, which equates to around 36% of total institutional investment, of which 56% of the institutional capital was focused towards regional UK. Adding value through development has also become increasingly common, with 24% of institutional investment specifically targeted towards funding a hotel development site in 2018, resulting in institutional development financing increasing by 23% year-on-year. The proportion of capital allocated to specialist property is on the rise and with the full deployment of recent capital raises and funds reaching their required quota of a particular asset class, new vehicles are constantly on the horizon. Diversification and the opportunity for greater returns have enabled hotel property to garner a greater share of investor capital in 2018. In particular, institutional capital from overseas investors has increased considerably, representing 14% of total investment volume in 2018 (compared to only 4% the previous year) and equating to 47% of total institutional capital.

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

The UK ground lease market continues to evolve

Record yields as low as 2.3% have been achieved in the market for ground lease investments during 2018, albeit whilst demand for such opportunities continued in 2018, the transaction volume was some 30% lower than during 2017 at approximately £213 million. Investment volume is of course dependent upon the ability to create suitable ground rents which appeal to both the investor and the operator. In 2018, a total of nine ground lease transactions were executed, involving 14 individual hotel assets, of which 95% of institutional capital inflows and institutional investment in the UK hotel market is expected to continue to remain buoyant, as the strategic importance of investing in alternative, specialist sector real estate intensifies.

Even after the outcome of Brexit, overseas institutional investors still represent 14% of total investment in the UK hotel market. The ability to satisfy the demand with suitable investment grade product, which offers a predictable level of income and sustainable cashflows, is one factor that may slow the growth of fixed income institutional investment going forward. However, as institutional investors’ knowledge and understanding of the hotel sector evolves, there is growing evidence that investors will focus increasingly on investment into operating assets, particularly where the yield arbitrage is attractive. Whilst the operational risk premium over a fixed lease structure provides a greater return to savvy institutional investors, there will be further opportunity to take advantage of favourable macro-trends (such as increased tourism demand) and the chance to drive enhanced levels of performance through careful asset management strategies.

The UK ground lease market continues to evolve

Record yields as low as 2.3% have been achieved in the market for ground lease investments during 2018, albeit whilst demand for such opportunities continued in 2018, the transaction volume was some 30% lower than during 2017 at approximately £213 million. Investment volume is of course dependent upon the ability to create suitable ground rents which appeal to both the investor and the operator. In 2018, a total of nine ground lease transactions were executed, involving 14 individual hotel assets, of which 95% of institutional capital inflows and institutional investment in the UK hotel market is expected to continue to remain buoyant, as the strategic importance of investing in alternative, specialist sector real estate intensifies.

Even after the outcome of Brexit, overseas institutional investors still represent 14% of total investment in the UK hotel market. The ability to satisfy the demand with suitable investment grade product, which offers a predictable level of income and sustainable cashflows, is one factor that may slow the growth of fixed income institutional investment going forward. However, as institutional investors’ knowledge and understanding of the hotel sector evolves, there is growing evidence that investors will focus increasingly on investment into operating assets, particularly where the yield arbitrage is attractive. Whilst the operational risk premium over a fixed lease structure provides a greater return to savvy institutional investors, there will be further opportunity to take advantage of favourable macro-trends (such as increased tourism demand) and the chance to drive enhanced levels of performance through careful asset management strategies.
Investment targeted regional UK. Institutional investors dominated the ground lease market, with 96% share of the total investment, with ground lease transactions representing 9% of total institutional investment.

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

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

The ground rent structures are in essence financially engineered structures, designed as an innovative means of providing an additional source of funds to help finance the acquisition or to release equity from an existing property, and which then serve to provide long-term, low risk cash flows with additional security.

Nevertheless, it is important to realise that ground rented structures are not favoured by all investors or lenders in the hotel real estate arena. The greatest concern is in regards to the growth of the rent and the future relationship to EBITDA. Whilst at the outset of the lease, rents are typically in region of 15% of EBITDA or less, this percentage has the potential to increase over time if trading performance does not keep pace with inflation.

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

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

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

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

Despite a strong rise in the volume of hotel transactions in London in 2018, the composition of hotels transacting resulted in a 13% decline in the average price per room to £332,000 (excluding developments). In 2017, in London a total six of upper mid to upscale category, the average price per room sold, of franchised / managed assets represented 37% of this franchised hotel stock.

Transactions collectively equated to a 38% share of London’s investment market. In contrast, in 2018, some 2,300 more rooms have transacted than in 2017, with a 35% uplift of the number of rooms transacting under a franchise or management agreement. With the increase in rooms transacting in London predominantly as a result of various portfolio acquisitions in the mid to upscale category, the average price per room sold, of franchised / managed assets declined to £168,000 per room, and represented just 21% of London’s hotel market.

Number of rooms transacting in the UK, some 13,000 rooms, equating to a 31% market share.

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

Despite changes to the composition of this franchised hotel stock.

Quality, branded hotel stock offered for sale via a portfolio transaction, contributed 50% of this franchised hotel stock.

Quality, branded hotel stock offered for sale via a portfolio transaction, contributed 50% of this franchised hotel stock.

Quality, branded hotel stock offered for sale via a portfolio transaction, contributed 50% of this franchised hotel stock.

Quality, branded hotel stock offered for sale via a portfolio transaction, contributed 50% of this franchised hotel stock.

Quality, branded hotel stock offered for sale via a portfolio transaction, contributed 50% of this franchised hotel stock.
UK HOTEL CAPITAL MARKETS 2019

EU Investors seek refuge in UK hotel market

In 2018, whilst the UK witnessed a number of large lot sized deals in the form of portfolio transactions, the total deal count actually declined. As such, portfolio activity has somewhat overstated the geographical distribution we have split the UK into the accepted regions and in Scotland, analysed as the most attractive region for hotel investment, with transactions totalling around £2 billion, representing 27% of the total transaction volume, compared to a 2% share the previous year. The French investor Covivio and LRC Europe, together contributed 81% of total European investment. 

UK HOTEL INVESTMENT – INVESTOR ORIGIN 2018

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

When analysing how the investment volume is distributed we have split the UK into the accepted regions and in Scotland, analysed as the most attractive region for hotel investment, with transactions totalling around £1.2 billion, approximately £0.7 billion. Despite some 50 hotels transacting, representing some 6,000 rooms, the region was responsible for some of the smaller lot sizes, with an average selling price of £112,000 per room.

The North West region recorded total transactions of around £280 million, securing the position of the 3rd most active UK region for hotel investment, with an average price per room sold of £143,000 per room. The city of Manchester recorded investment of over £90 million, which accounted for 52% of the region’s investment volume and 8% share of the total regional UK hotel market. This level of activity secured Manchester’s position as the second most popular regional UK city in which to invest, with some six hotels transacting at an average selling price of £235,000 per room.

The city of Liverpool recorded investment totalling around £160 million and represented 25% of the investment volume in the North West of England. Liverpool was the 4th most active regional hotel market, with five hotels changing ownership, averaging £163,000 per room sold. Meanwhile, Cumbria, also located within the North-West region witnessed nine hotels transacting, with an average selling price of £120,000 per room. Whilst Cumbria only accounted for 5% of hotel transactions volume in the North-West region, 90% of which took place, involved an overseas buyer. These acquisitions therefore highlighted the increased liquidity of the Lake District and the growing appeal of this region to international investors, following its award of UNESCO World Heritage Status during the summer of 2017.
Investment opportunities 2019

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

Two significant portfolio transactions have been completed, both of which have been sold to investment vehicles understood to be owned by the same investor, The Dayan Family, a HNW Family Office from Israel.

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

The appetite for development has also been strong early in 2019, with approximately £250 million of transactions undertaken in the month of January alone, and, significantly, all acquisitions having been made by institutional investors. One significant development involves investment manager M&G’s £200 million acquisition of a site in Paddington, acquiring the long-leasehold for a dual hotel scheme involving a 373-bedroom Premier Inn hotel and a 247 Wils depart hotel by Staycity, both to open under a 30-year, fixed lease upon opening in 2021.

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

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

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

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

LEADING UK HOTEL TRANSACTIONS BY INVESTMENT STRUCTURE
Important Notice
© Knight Frank LLP 2019 — This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank LLP for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of Knight Frank LLP to the form and content within which it appears. Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members’ names.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

UK Hotel Trading Performance 2018
UK Hotel Development Opportunities – 2018
Luxury Hotels & Retail 2019
Global Outlook – 2019

Knight Frank Research Reports are available at KnightFrank.com/Research