



THE UK PROVINCIAL HOTEL MARKET REVIEW
SEPTEMBER 2016

UK OVERVIEW

In 2016 the performance of the UK provincial hotel market has mirrored the underlying strength in the UK economy, showing strong resilience and positive momentum for the first half of 2016 and emerging relatively unaffected to date from the aftermath of the EU Referendum.

Whilst UK provincial hotels have continued to enjoy RevPAR growth, albeit at a slower pace than in 2015, London has endured a much more challenging environment. On a global basis London continues to attract strong occupancy levels (averaging over 80% on an annual basis) and achieve high average room rates and benefits from a strong mix of corporate and leisure demand, however, RevPAR growth leading up to and immediately post the EU Referendum has declined.

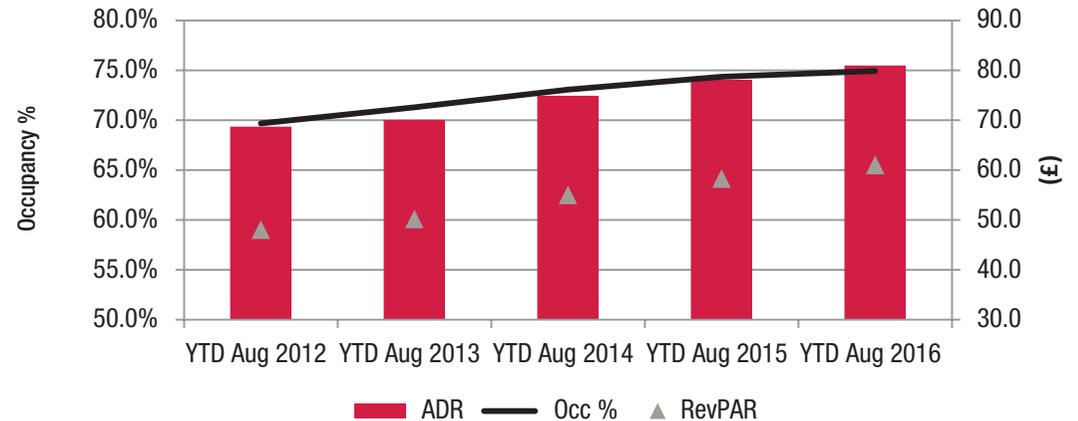
Global issues such as the increased threat of terrorism in major cities, an economic slowdown in China, the US Presidential Elections, uncertainty leading up to Brexit resulting in reduced corporate travel expenditure, have all sought to dampen demand for London hotels. Furthermore, with over 2,400 new hotel rooms entering the London market during the first half of 2016, coupled with a fall in demand for both leisure and corporate business, RevPAR

for the first 6 months to June declined by 2.5%, according to data published by Hotstats.

In contrast, regional hotel performance remains relatively detached from global concerns and instead much more aligned and impacted by domestic issues and events. As such, the fundamental UK drivers, such as historic low interest rates, a strong labour market and rising real incomes, which were strong leading up to the EU Referendum, have all contributed to the robustness of the UK regional hotel market. This momentum has continued post the Referendum and has been further boosted by positive seasonal factors, such as a warm British summer and UK Olympic and Paralympic success.

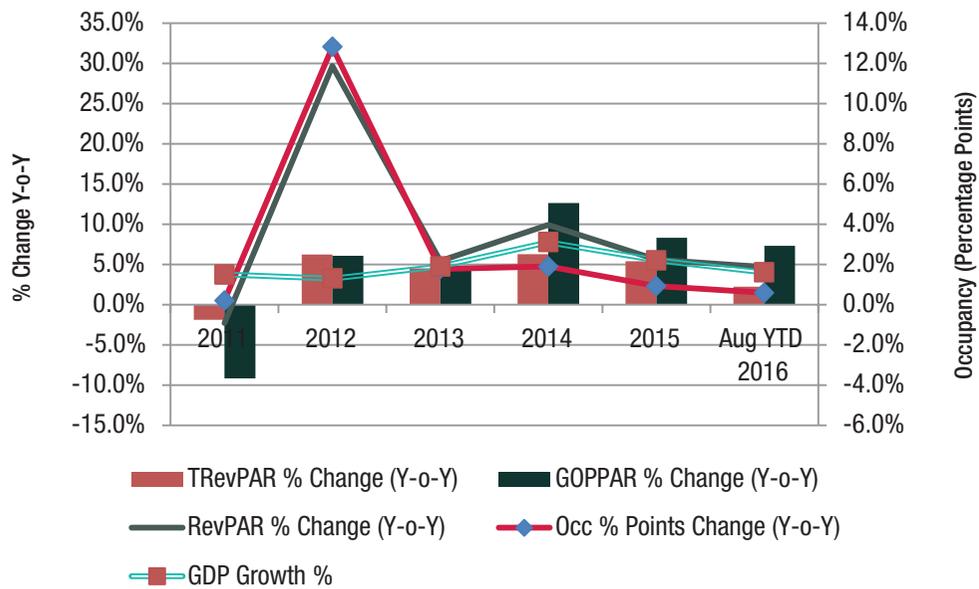
For the first eight months of the year to August, according to data published by HotStats, the UK provincial markets have reported a 3.3% increase in RevPAR, albeit that in a handful of cities with new hotel openings, occupancy levels have fallen. Nevertheless with YTD occupancy levels above 75%, provincial hotels are able to increase their rates during periods of high demand. Indeed this is the impetus behind the positive trading results, with the average daily rate, up 2.9% on the same period last year.

Regional UK Hotel Performance YTD August 2012-16



Source: HotStats

Regional UK Hotel Trading Performance % Change Year-on-Year



Source: HotStats

A revival in London's hotel performance was staged during the summer months, with a strong peak in RevPAR, up by 7.4% in July. This exceptional performance was due in part to the staging of the bi-annual Farnborough International Air Show, together with the fall in Sterling, making the UK a cheaper destination for overseas visitors. Those regional cities acting as principal international gateways, such as Edinburgh, Birmingham and Manchester have all performed strongly in 2016, achieving RevPAR growth of 6%, 9.5% and 6.6% for YTD-August.

SUPPLY

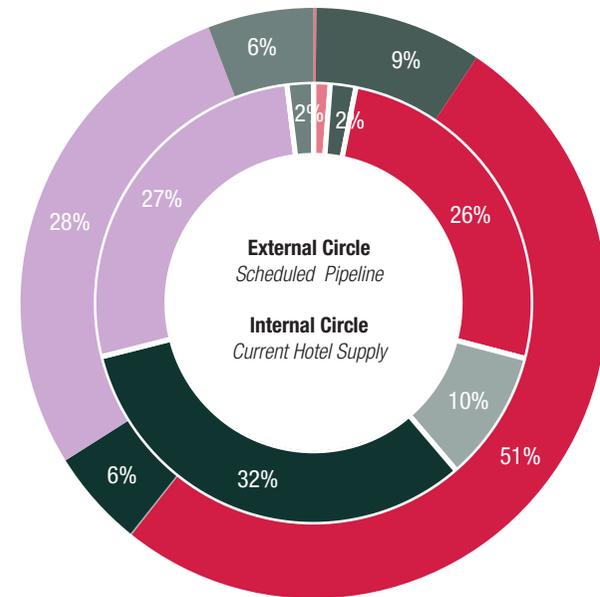
In the first nine months of 2016 a total of 124 new hotels have opened in the UK, totalling over 8,100 rooms, of which 34% of supply, some 2,700 bedrooms opened in London. The top 10 Regional UK cities with the most new supply entering the market included Birmingham, Manchester, Edinburgh, Glasgow, Liverpool, Bristol, Cambridge, York, Newcastle and Sunderland, totalling approximately 3,000 hotel rooms. 63% of the new supply within the UK provinces entered into the budget sector, with 20% of supply falling within the 4-star category, meanwhile, the third largest growth sector comprised that of serviced apartments, equating to 10% of the new bedroom stock. In contrast, approximately 50% of new hotel supply opening in London fell into the budget sector, 35% in the four-star or five-star sector and 10% of new supply opened as serviced apartments.

The growth of new budget hotels entering the market within the UK provinces is evidence of a structural change taking place and an underlying shift towards greater branding and the hotel market becoming less fragmented. This important change is resulting in market-wide improvements in terms of product offering and standards,

thereby contributing in part to the overall increase in UK regional RevPAR performance.

Supply is set to increase by a further 3,000 bedrooms in London before the year-end and a further 2,500 hotel rooms in the provinces, with planned openings in Bristol, Cheltenham, Edinburgh, Aberdeen, and Dundee. With the forecast new hotel supply, London's hotel market is set to increase by 4% in 2016 and 5% in 2017; whilst the UK regions are expected to grow at a more modest rate of round 1%. A slow absorption of new hotel supply, particularly in London, is likely to impact upon trading in 2017.

UK Regional Hotel Supply by Grading – Current Hotel Supply v Scheduled Pipeline



■ Hostel ■ Apartment ■ Budget ■ 2-star ■ 3-star ■ 4-star ■ 5-star

Source: AM:PM Hotel Data & Intelligence, September 2016

Proposed Supply Pipeline by UK City (New Hotels & Extensions) – Top 15 Cities

City	Number of Proposed Hotels				Number of Proposed Rooms				Proposed Rooms by Grading (%)				
	Due 2016	Due 2017	Due 2018	Speculative	Due 2016	Due 2017	Due 2018	Speculative	Budget	3-star	4-star	5-star	Apartments
London	25	50	26	250	3,005	7,241	4,764	18,839	33%	15%	31%	11%	10%
Manchester	1	10	1	31	28	1,631	150	4,075	20%	28%	35%	7%	10%
Birmingham	3	3	2	13	73	504	332	1,075	25%	19%	46%	0%	10%
Edinburgh	1	11	5	40	240	1,382	718	4,288	25%	43%	11%	6%	16%
Heathrow	0	3	4	7	-	1,198	1,373	1,132	42%	18%	27%	9%	4%
Blackpool	0	1	1	5	-	150	130	348	54%	28%	6%	12%	0%
Glasgow	1	2	0	29	-	550	-	3,813	35%	29%	29%	0%	7%
Liverpool	2	3	2	31	8	387	269	1,563	19%	7%	26%	6%	42%
Gatwick	0	0	0	6	10	-	-	286	93%	2%	0%	0%	5%
Aberdeen	2	3	1	22	324	454	96	2,100	36%	18%	26%	9%	10%
Leeds	0	4	0	9	-	569	-	781	46%	26%	12%	9%	7%
Bournemouth	0	0	0	3	9	-	-	398	15%	31%	54%	0%	0%
Bristol	2	1	0	17	252	168	-	1,480	47%	21%	26%	4%	2%
Newcastle	1	1	2	13	-	120	325	735	26%	40%	20%	2%	12%
Brighton	0	2	0	6	-	138	-	-	0%	14%	79%	0%	7%

Source: AM:PM Hotel Data & Intelligence, September 2016

OUTLOOK

The outlook for the UK for the final quarter of 2016 and 2017 is one of caution and blurred vision, masked by the uncertainty of Brexit and the impact the future negotiations will have on business investment and consumer confidence.

UK GDP growth is forecast to grow at a lower rate than in 2016, impacting on businesses, in particular reduced meetings & conference demand and corporate travel. Despite an increase in overseas tourism to London and international gateway cities in the UK, as a result of the weakened pound, this increase in leisure demand is unlikely to compensate for the anticipated reduction in higher-rated corporate demand.

In 2016 the performance of the UK provincial hotel market has proven to be robust, with the true impact of Brexit on the UK provinces only likely to take full effect once the UK has exited the EU and the true impact known. The full year forecast for the Provinces in 2016 remains positive, with respectable RevPAR growth in excess of 3% considered to be a realistic target. In 2017, whilst the pace of growth is likely to reduce, occupancy levels are likely to remain strong with an increase in leisure demand brought about by a

combination of increased overseas visitors and a resurgence in domestic-stay holidays as foreign travel becomes more expensive.

CHALLENGES AHEAD

One of the significant challenges faced by the UK-wide Hospitality sector during 2016, has been the introduction in April 2016 of a new mandatory National Living Wage (NLW) for all workers aged 25 and above. The rate currently set at £7.20 (which constitutes a rise of 50p relative to the former National Minimum Wage) is set to move towards £9 per hour by 2020. With so many hotel workers benefitting from this change in legislation, staff costs have increased throughout UK hotels since April, with a direct impact on profitability. The full impact of the NLW will continue to impact on hotel profitability throughout 2017 and beyond.

The effect on inward migration following Brexit will further weigh on the future of the UK Hotel industry, thereby affecting the industry's ability to employ and retain suitably skilled staff at an affordable salary level. With a potential shortage in labour, this is likely to cause inflation in staff wages, as such the growth of the budget and apart-hotel sectors with fewer staffing

overheads is set to continue as hotel operators seek to maximise bottom line performance.

The rise of the sharing economy has evolved through the rise of technology and the birth of social media, which have facilitated the task of renting and sharing. Increasingly the model is becoming more sophisticated, more diverse, more inclusive and more innovative, thereby becoming an increasing threat to hotels and in particular hotels with a non-differentiated product. The threat that the sharing economy is having on the profitability of the hotel sector cannot be ignored, especially with third parties such as corporate travel agents adding further weight and credibility to the sector. The acquisition by Accor Hotels of Onefinestay, a leading brand in the luxury segment of the serviced home sector for £117 million, is further evidence of the potential threat the sharing economy is having on the hotel sector. Whilst the peer-to-peer sector is likely to have the greatest impact on London hotels, equally primary regional hotel markets must evaluate the threat of this growth sector.





TRANSACTION OVERVIEW

The hotel transaction market in 2016 has witnessed a significant slowdown compared to a record year of hotel transactions in 2015, when circa £12 billion of assets were sold in the UK. Due in part to a lack of portfolios available, to date only £2 billion of assets have exchanged hands in 2016, with investment stagnating significantly in the lead up to the EU Referendum, due to the economic uncertainty surrounding the UK.

The majority of investment activity taking place in 2016 has stemmed from assets trading hands in the UK provinces, with domestic buyers having the greatest appetite for investment. Nevertheless, a key theme in 2015 was the resurgence of the UK regional hotel market as an international investment destination and this remains the case, particularly with the attractive exchange rate, with overseas investors targeting quality branded assets with stable and steady income streams. Examples of which include the sale of the Hyatt Regency Birmingham for £38.6 million to UAE owner Bin Otaiba Investment Group; 147-room Holiday Inn Express Manchester for £17.3 million to the Singaporean joint venture company Prospere Hotels; the Crowne Plaza Edinburgh – Royal Terrace sold to ARG Hotels Ltd, a UAE-based hotel investor

for £16 million; meanwhile, Thailand's Fico Group acquired a portfolio of three branded provincial hotels off a guide price of £12 million.

In 2016 the majority of domestic buyers have come from independent owner operators and investors with private wealth and family offices. Significant transactions taking place in the UK provinces have included: the sale of six regional UK Hilton hotels (totalling 813 rooms), sold on behalf of Oaktree Capital Management to individual buyers for approximately £40 million; the £14 million sale of The Lygon Arms to The Livingstone Brothers (London & Regional), from The Hotel Collection; the 208-room Inside Manchester for £34.4 million to Pickering Properties, the 135-room Holiday Inn Express and 186-room Premier Inn Albert Dock in Liverpool for a combined price of £42.7 million to Aberdeen Asset Management; the 62-room Formby Hall Golf Resort & Spa to CS Hotels off a guide price of £20 million and Brocket Hall, sold off a guide price of £10 million (£217,000 per room) to an independent buyer. Meanwhile, The International Hotel Group has been active, acquiring the 192-room Hampton by Hilton London Gatwick for

£22 million and two Holiday Inn Express hotels in Redditch and Southampton for £26 million.

The largest portfolio transaction to date comprised Lone Star's sale to London & Regional of the 47-strong regional portfolio, Atlas Hotels, comprising some 5,575 hotel rooms for £575 million. Whilst in September 2016, Secured Income REIT announced it was in exclusivity to acquire a portfolio of 55 fixed lease Travelodge hotels from Golden Tree, Avenue Capital and

Goldman Sachs private equity consortium for £196.2 million. Fixed income assets are likely to command strong interest from investors going forward into 2017 as investors seek guarantees and assets with strong hotel covenants, at a time of potential increased operational uncertainty.

Hotel Transactions 2016 - UK Provinces

Date	Hotel Name	City	Star Rating	Rooms	Transaction Price (£)	Price per Room	Buyer	Buyer Origin
Q1	Mercure Bristol Brigstow Hotel	Bristol	4-Star	116	£13,500,000	£116,000	Splendid Hospitality Group	UK
Q1	Lygon Arms	Broadway	4-Star	78	£14,000,000	£179,000	London & Regional, Livingstone Brothers	UK
Q1	Ringwood Hall Hotel	Chesterfield	3-Star	74	£7,500,000	£101,000	Lyric Hotels Ltd	UK
Q1	Leasehold Interest acquired of 4 Hotels	Dublin, Croydon, Cork, Limerick	4-Star	819	£38,900,000	£47,000	Dalata Hotel Group	Irish
Q1	Crowne Plaza Edinburgh - Royal Terrace	Edinburgh	4-Star	100	£16,000,000	£160,000	ARG Hotels Ltd	UAE
Q1	Formby Hall Golf Resort & Spa	Liverpool	4-Star	62	£20,000,000	£323,000	CS Hotels	UK
Q1	Hampton by Hilton London Gatwick	Gatwick, Crawley	Budget	192	£22,000,000	£115,000	International Hotel Group Ltd	UK
Q1	Travelodge Harrogate Park	Harrogate	Budget	70	£7,000,000	£100,000	CBRE Global Investors	UK
Q1	Holiday Inn Express & Premier Inn - Albert Dock	Liverpool	Budget	321	£42,752,000	£133,000	Aberdeen Asset Management	UK
Q1	Holiday Inn Express Manchester City Centre	Manchester	Budget	147	£17,300,000	£118,000	Prospere Hotels (Heaton Holdings / KSH Holdings / Lian Beng)	Singapore
Q1	INNSIDE Manchester	Manchester	4-Star	208	£30,450,000	£146,000	Pickering Properties Ltd	UK
Q1	Hawkwell House Hotel	Oxford	3-Star	77	£8,000,000	£104,000	Legacy Group / Singpathom family	Thailand
Q1	Oxford Castle - Malmeson Hotel (Mixed Use Site)	Oxford	4-Star	95	£47,270,000	£498,000	Westgate Oxford Alliance	UK
Q1	Travelodge Slough	Slough	Budget	156	£12,700,000	£81,000	International Hotel Group Ltd	UK
Q1	Travelodge Sunbury-on-Thames	Sunbury-on-Thames	Budget	131	£12,960,000	£99,000	Monaco Family Office	Monaco
Q1	Travelodge Teddington	Teddington	Budget	113	£13,700,000	£121,000	CBRE Global Investors	UK
Q1	Brocket Hall	Welwyn Garden City	5-Star	46	£10,000,000	£217,000	Brocket Hall Trustees / Brocket Hall (UK)	UK
Q1	Premier Inn West Bromwich Central	West Bromwich	Budget	85	£8,000,000	£94,000	Real Estate Investors Plc	UK
Q2	Shire Hall	Durham	4-Star	81	£15,000,000	£185,000	Maven Capital Partners	UK
Q2	Columba Hotel	Inverness	4-Star	82	£7,000,000	£85,000	Compass Hospitality / Seacare Hospitality (Singapore)	Singapore
Q2	Holiday Inn Express Leeds City Centre Armouries	Leeds	Budget	130	£8,000,000	£62,000	Starboard Hotels	UK
Q2	Holiday Inn Express Redditch	Redditch	Budget	100	£7,000,000	£70,000	International Hotel Group Ltd	UK
Q2	Holiday Inn Express Southampton M27 Jnc 7	Southampton	Budget	176	£19,000,000	£108,000	International Hotel Group Ltd	UK
Q2	4 Travelodge Hotels	Various	Budget	218	£19,760,000	£91,000	Riverside Capital	UK
Q2	Hilton Portfolio	Various	4-Star	813	£40,000,000	£49,000	Individual undisclosed buyers	UK
Q2	Atlas Hotels	Various	Budget	5575	£575,000,000	£103,000	London & Regional	UK
Q3	Hyatt Regency Birmingham	Birmingham	4-Star	319	£38,600,000	£121,000	Bin Otaiba Investment Group	UAE
Q3	Mercure Newcastle Hotel	Newcastle	4-Star	114	£12,000,000	£105,000	Gainford Hotels	UK
Q3	St Michael's Manor Hotel	St Albans	4-Star	30	£7,000,000	£233,000	St Michael's Manor Ltd	UK
Q3	Mercure St Albans Noke Hotel	St Albans	4-Star	110	£7,250,000	£66,000	Hotel Collection	UK
Q3	Dominus Group - UK Regional Portfolio of 3 Hotels	Darlington, Dumfries & Sheffield Parkway	4-Star	229	£12,000,000	£52,000	Fico Corporation	Thailand
Q3	Best Western Plus Epping Forest Hotel	Woodford Green	3-Star	99	£8,000,000	£81,000	Openview Properties Ltd	UK



CONCLUSION

Despite a number of threats with potential to cause significant turmoil to the hotel industry, the regional UK hotel market remains in a position of strength, with a respectable level of RevPAR growth forecast for 2017. The uncertainty brought about by Brexit has led to UK GDP growth forecast to grow at a lower rate than in 2016, which ultimately has potential to influence corporate confidence, thereby impacting on corporate travel expenditure and meetings and conference business. Nevertheless, with a strong labour market, low interest rates and continued stability in disposable incomes, the UK leisure market is expected to remain strong. Going forward, the outlook for the UK provincial hotel market is a picture of resilience & strength during uncertain times.

Whilst 2016 has witnessed a reduced level of investment activity compared to recent years, opportunities do exist, despite transactions anticipated to remain subdued until such a time that greater transparency exists over the shape of the UK in a post Brexit era. With the operational performance of regional UK hotels continuing to perform well, combined with only limited supply growth, assets with steady income streams and

leased assets with performance guarantees and strong covenants are expected to draw significant appeal from opportunistic investors, both domestic and from overseas.

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