

UK Hotel Investment

Q3 2014



SUMMARY

■ The UK received a record number of international tourists last year, helping to boost operational performance in the regions.

■ London's rising prominence as a global tourist destination has attracted an increasing number of new international brands.

■ Development constraints along with the arrival of these new hotel operators has seen upscale hotel supply in London spread beyond the traditional West End core.

■ 2014 has seen the rise of the 'distressed' buyer as investors increasingly look beyond London for opportunities as stock issues intensify.

■ Yields compressed further over the first half of this year. Additional compression is forecast as supply constraints continue.

■ Opportunistic divestment, as owners take advantage of the better trading conditions, may provide some boost to transaction volumes over the next 18 months.

■ Transaction volumes currently total £2.0 billion with forecasts for the year end suggesting volumes will reach £3.1 billion.

→ International visitors to UK hit new high

■ International visitors to the UK reached an all time high during 2013, reaching 32.8 million and surpassing the previous 2007 peak.

■ This increase was largely driven by the improving attraction of London. The city reported an 8.6% growth in numbers making it the most visited city in the world by international tourists, outperforming Paris the previous holder of the title.

■ European visitors continue to dominate with improving economic conditions in the Eurozone helping to boost numbers by 5.7%. However, the UK's widening international appeal meant that it was visitor numbers from outside Europe and North America that reported the greatest increases.

■ Visitor numbers from the wider Asia Pacific and Central & South American regions have grown by 8.5% and 14.0% per annum respectively since 2009. China and Brazil have been stand out countries reporting an average growth per annum of 16.1% and 14.2% respectively.

■ With UK visitor numbers for the first five months of 2014 already 5.8% higher than the same period last year, 2014 is likely to see another new high in international visitors.

Regional performance continues to improve

■ The improvement in overseas visitors to the UK corresponded with a

pick up in regional hotel performance last year following several years of relatively lack lustre performance.

■ According to BDO's Hotel Britain Report, both occupancy and average room rates saw growth of 1.5 percentage points and 1.4% respectively. This resulted in a 3.5% increase in Revenues Per Available Room (RevPAR) over three times greater than the 0.9% reported for the previous year. More reassuring was the greater number of UK cities and towns reporting RevPAR improvements increasing to 29 markets up from 20 the previous year.

■ Aberdeen reported the highest growth in RevPAR across the whole of the UK over 2013 of 16.7% driven by the continued expansion of the city's oil industry. Leeds, Oxford, Liverpool and Edinburgh all reported double digit growth in RevPAR over the same period with Oxford being the highest yielding market behind London with an average RevPAR of just under £89. Liverpool's strong growth in RevPAR (11.1%), driven by a 10.1% in average rates, marked a significant reversal of fortunes after reporting one of the largest declines in RevPAR the previous year.

■ The resurgence in the regional hotel market has continued into 2014 with a number of UK cities reporting RevPAR growth over the first six months of the year. Again, Aberdeen has been one of the strongest performers with a further 10.5% uplift in RevPAR over the first four months of 2014 according to HotStats.

the US this year with the opening of Chiltern Firehouse in Marylebone. The Mondrian, part of the Morgan Hotel Group, will open its first European hotel on London's Southbank later this year and Gansevoort Hotel & Resorts will open in Shoreditch in 2015.

■ The growth in Chinese tourism and streamlining of the visa system for Chinese Nationals, which is expected to boost visitor numbers, has also coincided with the arrival of new hotel brands from Hong Kong and mainland China.

■ Shangri-La Hotels & Resorts opened their 202-bed London hotel in The Shard in May. Peninsula Hotels secured a site on Hyde Park corner last year and Dorsett Hospitality International will operate two hotels in the Capital by 2016 with their first hotel opening in Shepherd's Bush this summer. Wanda Group's mixed use development at Nine Elms is proposed to be home to the UK's first mainland Chinese hotel brand. Further details on the potential impact Chinese tourism growth will have on the UK hotel market can be found in the box on page three.

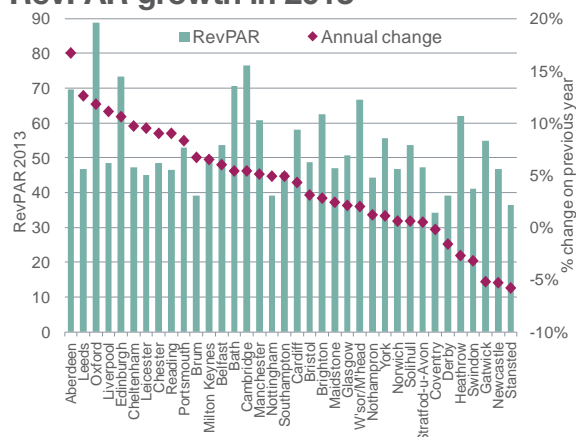
■ The arrival of these new brands, combined with development opportunity constraints in London, has opened up new hotel sub markets and facilitated the spread of upscale hotel brands beyond the traditional West End. For example, the Southbank and Old Street/Shoreditch areas will see a 79.9% and 225.6% increase respectively in upscale provision over the next four years.

The rise of the distressed buyer

■ Improving operational performance and investor sentiment is fuelling appetite for hotel assets. In contrast to the past two years, which were dominated by distressed sellers, we are now seeing the rise of the 'distressed buyer' who is increasingly eager to spend their allocated funds. This combined with a lack of stock and competition for prime assets is leading many investors to look beyond London.

■ This movement of investors beyond the Capital is apparent in the regional share of total transactions and the profile of buyers. Regional 2014 volumes to date account for 62% of

GRAPH 1
More regional markets reported RevPAR growth in 2013



Graph source: BDO Hotel Britain 2014

Arrival of new brands opens up new hotel markets

■ London's rise as one of the key tourist destinations in the world has attracted an increasing number of new international brands looking to capitalise on this expanding demand base. The diversity of London's international tourists also means that it offers operators the opportunity to market their brand to a greater variety of new consumers.

■ A number of US brands have made the jump across the pond to open their first European outpost in London. Andre Balazs, who owns The Standard hotel group amongst other boutique hotels, launched his first hotel outside

TABLE 1
Typical yields by operational structure

Structure	2013 yield	2014 yield
Franchise	8% to 12%	6.5% to 10%
Turnover leases	7% to 8%	7% to 8%
Fixed lease (strong covenant)	5.3% (50 basis point discount on similar product outside London)	4.75% to 5.25% (50 basis point discount on similar product outside London)
Fixed lease (unproven covenant)	6.5% to 10% depending on rent cover	6% to 8% depending on rent cover

Table source: Savills

total UK transactions whereas in 2013 its share was 44%. Also, institutional investors have become more acquisitive in the regions this year with transaction volumes up 135.0% on the same period in 2013.

■ However, despite the increasing willingness of investors to look beyond London sourcing stock remains an issue. It was expected that more single assets would be sold out of last year's portfolio deals, but this did not materialise. As a result total UK transaction volumes to date for 2014 are 11.5% down on the same period last year totaling £2.0 billion.

■ Stock issues have also been exacerbated by the decline in receivership assets coming to the market, partly helped by the improvement in operational conditions. This has resulted in an 87% fall in sales

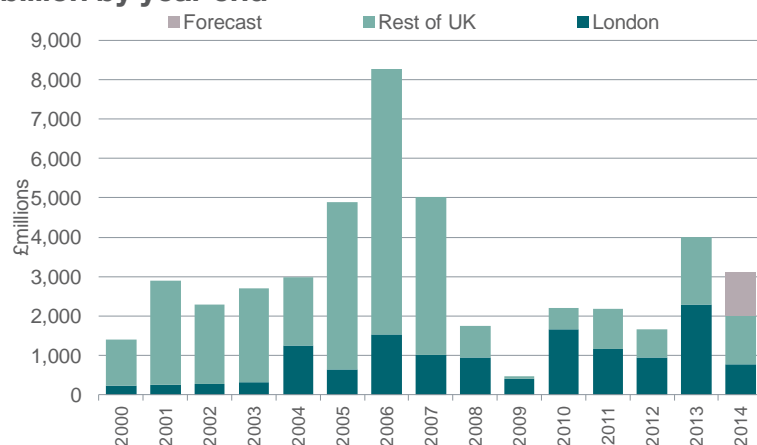
volumes by banks/receivers compared to full year 2013.

■ This lack of stock combined with improved investor demand and confidence in the sector has meant that yields have compressed over the first half of the year. Continued constraints in pipeline may apply additional yield pressure going forward.

Outlook for 2014 and into 2015

■ Looking to the remainder of 2014 and into 2015 we expect some boost to sales volumes by the opportunistic divestments of owners taking advantage of improved trading, yield compression and the weight of purchaser's capital. However, as the frequency of bank-led disposals weaken, we expect sales volumes to reach £3.1 billion by the end of the year. ■

GRAPH 2
UK hotel transaction volumes forecast to total £3.1 billion by year end



Graph source: Savills; PropertyData

Chinese tourism

Chinese visitor growth to drive brand and asset acquisition by Asia Pacific investors in the UK

■ China is now the biggest source market for outbound tourism with estimates that Chinese outbound overnight visits hit 97.3 million last year. While the wider Asia Pacific region welcomes the majority of these visitors an increasing number are coming to Europe and the UK.

■ The UK currently lags France in terms of Chinese visitors attracting only 233,000 last year as opposed to the 1.4 million who visited France. This is largely attributed to the difficulty of obtaining a UK visa. However, Theresa May's announcement in June that the visa system will be streamlined this summer could mean that visitor numbers could reach 650,000 by 2020.

■ The importance of reputation and branding combined with the anticipated increase in Chinese visitors to the UK has buoyed confidence amongst upscale Hong Kong and Chinese hoteliers. As a result the number of Hong Kong and mainland Chinese hotel brands will more than double over the next three years with London being the primary focus.

■ Given the accelerated growth forecast in independent travellers from the country and their focus on price, there may be opportunities for mid-market and budget brands from China to enter the UK market. This, however, is unlikely to happen on any significant scale as the number of Chinese visitors may not be at a level to underpin demand for a brand with little or no exposure outside their home market.

■ Rather than expand existing brands into new markets our expectation is that brand acquisition and direct asset purchases by Hong Kong and Chinese investors will be more prevalent. Prime examples of this include New World Hospitality's acquisition of the US Rosewood Hotel brand in 2011 and the recent purchase of the Paris Marriott Champs-Elysees by Kai Yuan Holdings for US\$468 million.

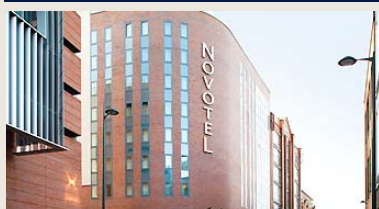
■ We expect this growing appetite for hotel assets could mean that transaction volumes by Asia Pacific investors in the UK could reach £500 million per annum by 2015.

■ This level of activity would make this group significant purchasers of UK hotels. Over the longer term it may even offer opportunities for new brands and concepts from the region to enter the UK market.

Savills Hotels Team

Recent transactions

Hotel Novotel Liverpool City Centre



Selling agent

July 2014 - £13.1m

The Pelham Hotel & The Gore Hotel, London



Selling agent

July 2014 - c£43.0m

Park Inn Hotel & Conference Centre, London Heathrow



Selling agent

June 2014 - £72.0m

Holiday Inn Express Edinburgh & Dunfermline



Selling agent

May 2014 - £11.9m

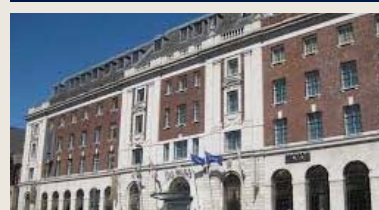
Aldgate Place Hotel Site



Selling agent

March 2014 - £11.7m

Radisson Blu Hotel, Leeds



Lease Regear

February 2014

Radisson Blu, Durham



Selling agent

January 2014 - £17.0m

Premier Inn, Croydon Town Centre



Buying agent

January 2014 - £15.5m

Hilton London Tower Bridge Hotel



Buying agent

December 2013 - in excess of £100.0m

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