

COAST & COUNTRY

THE STAYCATION-DRIVEN
HOTEL MARKET RECOVERY



RESILIENT HOTELS

A staycation-driven surge in occupancy over the summer has boosted hotels looking to make up for time and income lost during the pandemic. While new operational challenges have emerged, hotel businesses have opportunities to take advantage of pent-up consumer demand.



STAYCATION-DRIVEN RECOVERY

After being subject to a series of lockdowns and trading restrictions since the start of the pandemic, hotels in all parts of the UK were allowed to reopen in time for the 2021 summer season.

Prior to reopening, hotels were only able to accommodate guests for essential, legally permitted reasons and, as a result, occupancy rates dipped down to 25-35% in most UK markets during the early 2021 lockdown. An immediate bounce-back in occupancy rates was seen after hotels were able to reopen, and strong demand for staycations pushed nationwide occupancy to above 70% in August.

Over the summer, occupancy rates were highest in markets driven by domestic tourism and leisure such as Brighton, Bournemouth and York. Each of these saw occupancy rise above 80%, while average daily rates and RevPAR were well in excess of pre-COVID norms.

Larger city markets more reliant on international and business travel continued to lag behind. Occupancy levels in Manchester and Birmingham were below the national average in August, and London had the lowest occupancy rate of any major UK market, at 56%.

BROADENING DEMAND

However, even in these larger cities, occupancy rates and ADR were much higher in summer 2021 than in the corresponding months of 2020, indicating that the recovery in hotel demand has been more broadly based this year.

Corporate demand has started to return, as offices reopen and companies organise more in-person meetings, events and conferences. This part of the market should continue its recovery, and some London hotels are now reporting that bookings for meetings and events in 2022 are currently running at a similar level to pre-pandemic years.

Another key source of pent-up demand is weddings. According to the UK Weddings Taskforce, over 264,000 weddings were postponed in 2020, and at least 550,000 weddings are in the post-pandemic pipeline. This has created huge demand for hotel wedding venues, many of which are now fully booked up until at least 2022/23.

INTERNATIONAL DEMAND RECOVERING SLOWLY

It will take longer for international demand to fully rebound. While travel restrictions to the UK have eased considerably, flights into and out of the country's airports were still more than 40% down on pre-COVID levels in September 2021. VisitBritain forecasts that inbound tourism in 2021 will be 7.4 million visits, only 18% of 2019's level. Many industry analysts anticipate that international travel volumes will not return to normal until 2023/24.

The slow recovery of international demand may continue to drag on overall trading performance and cause London to lag regional markets in 2022. According to PwC's latest UK Hotels Forecast, hotel trading is not expected to hit pre-pandemic levels by the end of next year. Using three different forecast scenarios, PwC predicts

that occupancy rates will reach between 62% and 96% of pre-pandemic levels in London, and between 73% and 105% outside the capital, by Q4 2022.

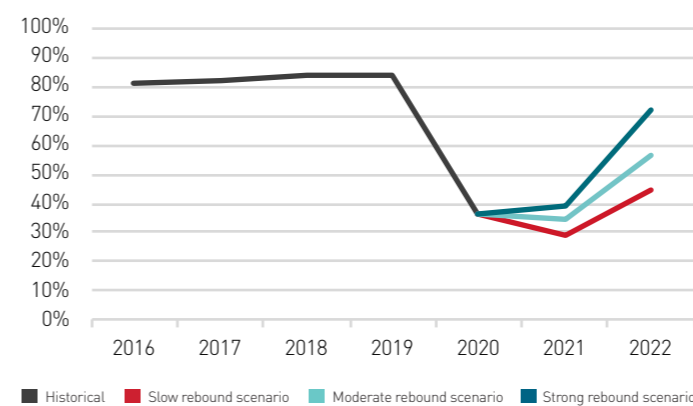
GOVERNMENT SUPPORT SCALED BACK

Hotel businesses will be keenly hoping that COVID restrictions are now a thing of the past, as their impact on hotel operations has been huge. Whitbread, the UK's largest hotel operator, reported that accommodation sales were down by 70.4% in the 2020/21 financial year. Across the wider hospitality sector, the industry body UKHospitality estimates that over £100bn in sales were lost over the course of the pandemic.

Nonetheless, government support has helped to cushion the blow of the pandemic and prevented a large wave of hotel business failures. Although some smaller chains and independent hotels have gone out of business citing COVID-related difficulties, registered company insolvencies in the accommodation and food services sector actually fell by 26% in 2020 compared with 2019, and dropped to a decade-low in H1 2021.

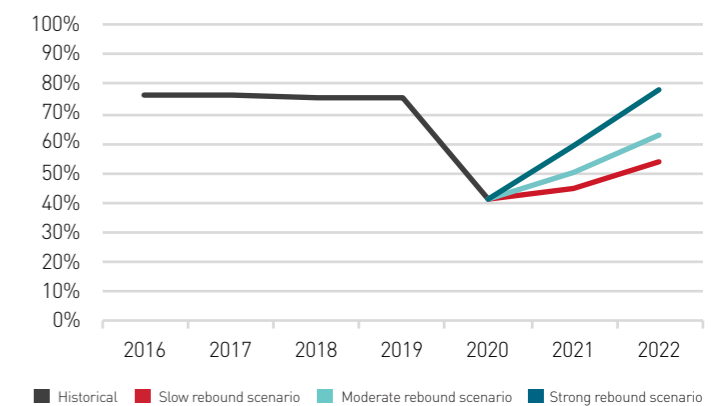
However, government support measures are now in the process of being scaled back. The Coronavirus Job Retention Scheme (CJRS), which has protected jobs in the sector, closed on 30th September. The 100% business rates holiday for retail, hospitality and leisure businesses ended on 30th June, with 66% relief applying until 31st March 2022. A new 50% discount on business rates for the 2022/23 tax year was announced in October's Autumn Budget.

LONDON HOTEL OCCUPANCY RATES (FORECAST, %)



Source: PwC

UK REGIONS HOTEL OCCUPANCY RATES (FORECAST, %)



Source: PwC

The temporary VAT cut for hospitality and tourism businesses, from 20% to 5%, finished on 30th September; with an interim rate of 12.5% applying until March next year. While many in the hospitality industry have campaigned for the maintenance of a lower rate of VAT beyond next March, this was not included in the Autumn Budget.

It remains a crunch period for many hospitality businesses and further government support may be needed to ensure that measures taken throughout the pandemic have provided them with more than just a stay of execution.

RISING COSTS AND LABOUR SHORTAGES

The challenges facing reopened hotels have been exacerbated by the emergence of a range of operational issues that have added to their costs. Recruitment has become a particularly acute issue across

the hospitality sector, with businesses struggling to fill positions. According to the Office for National Statistics, job vacancies in accommodation and food services reached a record 137,000 in the three months to August.

The labour shortage has partly resulted from workers moving to jobs in sectors less severely impacted by lockdowns over the last 18 months, such as supermarkets and logistics. Meanwhile, a significant number of overseas workers, particularly from the EU, have left the UK altogether.

At the height of the labour shortage in August, some hotels were forced to either cap occupancy or reduce services, with food and beverage operations being most heavily impacted. Many hotels have also needed to increase wages by 10-20% in order to attract staff.

While the ending of the CJRS will have brought some furloughed hospitality

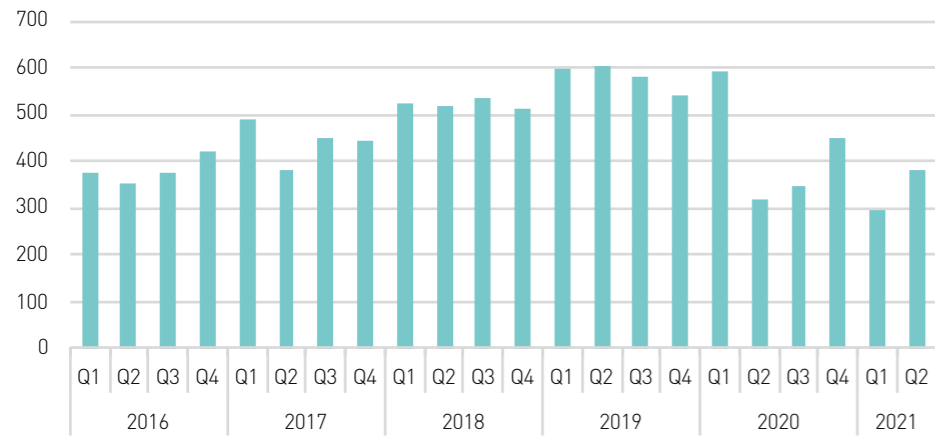
workers back into the labour pool, this alone will not be enough to ease staff shortages. Attracting and retaining staff will remain both an immediate and a long-term challenge for the sector.

In recent months, hotels' operational costs have also been impacted by sharply rising energy and utility prices; while supply chain issues have impacted their ability to source products, particularly for F&B operations. The needs to overcome operational challenges, manage rising costs and plan how to pay back any debt taken on during the crisis will give hotel businesses much to navigate in the months ahead.

POST-PANDEMIC GROWTH

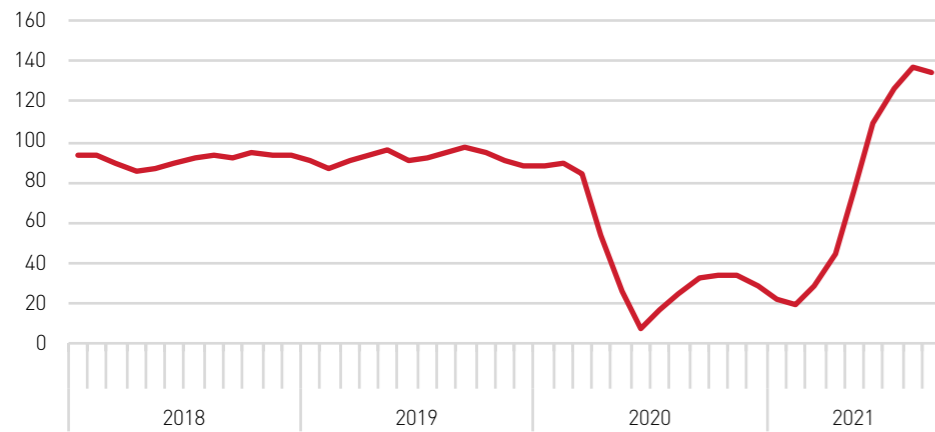
The pandemic appears to have accelerated ongoing changes in hotel demand, with some of the strongest-performing accommodation types over the last 18 months being those that were already

REGISTERED COMPANY INSOLVENCIES - ACCOMMODATION & FOOD SERVICES



Source: Insolvency Service

JOB VACANCIES - ACCOMMODATION AND FOOD SERVICES (000S)



Source: Office for National Statistics

growing their market shares. This includes aparthotels and serviced apartments, which have been well suited to guests seeking to maintain privacy and social distancing, and these may continue to appeal to post-pandemic demand.

Limited service hotels have also performed relatively strongly over the last 18 months, and could be another future growth area. By offering a reduced food and beverage service, these hotels have operating models that may help businesses to keep costs down and circumnavigate staffing challenges.

Hybrid hotels combining conventional hotel rooms with serviced apartments and flexible workspaces could also become more commonplace. These provide hotel owners with opportunities to both diversify revenue streams and to cater to changing work-life patterns.

The implementation of technologies that remove the need for contact between guests and staff, such as mobile apps and digital keys, may also have been accelerated by both the pandemic and the growing need to control staff costs.

OPPORTUNITIES AND CHALLENGES AHEAD

The hotel sector has proven its resilience over the course of the pandemic, and trading performance should continue to improve in 2022. However, in some areas, there may not be a full recovery in demand; and businesses are likely to face ongoing increases in operational costs, with profitability being further impacted by the rise in the hospitality VAT rate next April.

Well-managed hotel businesses that are able to strategically plan ahead and manage costs will be best placed to tackle the emerging challenges. Those that are able to adapt quickly to changes in guest expectations and new patterns of demand will have opportunities to flourish.



HOTEL HOTSPOTS

York tops LSH's Hotel Hotspot Ranking for 2021

The ranking assesses the strength of 30 key UK markets as locations for hotel investment and development.

This year's ranking has been refreshed to incorporate data gauging the potential for markets to benefit from changes in demand that have been triggered by the pandemic.

The ranking includes 12 data indicators, which are split into four sub-rankings:

Hospitality market strength assesses the relative size and strength of each city's hospitality sector. It includes measures of *Hospitality GVA per capita*, *Hospitality GVA growth rates* and *Hospitality employment growth rates*.

Hotel market performance measures how well the markets have fared over the last twelve months, as indicated by *Occupancy rates*, *Average daily rates* and *RevPAR growth rates*.

Development opportunity assesses markets' potential for new hotel development, primarily by measuring supply/demand dynamics. This sub-ranking includes *Tourist visits per hotel room*, *Active pipeline/current supply ratio* and *Build costs*.

COVID resilience identifies markets with demand profiles that will enable them to be robust to behavioural changes caused by the pandemic. The best-ranked cities are those where *Domestic visits as a percentage of total visits* and *Holidays as a percentage of total visits* are high, but *Reliance on corporate events & business travel* is low.

The overall results are radically different from our pre-COVID hotspots rankings. Markets that derive most of their demand from domestic leisure and tourism have risen up the rankings on the back of their relatively resilient performance since the start of the pandemic. In contrast, larger city markets more dependent on business and international travel have slipped down.



1 YORK

York is the top ranked city, based on a strong all round performance across all of the sub-rankings. It is a perennially popular tourist destination which draws most of its visitors from within the UK, and hotel occupancy reached 88% in August. York has a relatively small hotel supply relative to visitor numbers, and there are barriers to new city centre development, which supports existing hotel operations.



2 NORWICH

Norwich's high place in the ranking reflects the extremely robust performance of its hotel market in 2021, with occupancy soaring to more than 90% over the summer, surpassing pre-COVID levels. Norwich is a popular staycation destination, due both to the city's own attractions and its access to The Broads and the Norfolk coast.



3 BRIGHTON

Leisure and tourism are key drivers of Brighton's economy, with around 12 million people visiting the city in a typical year. Holidaymakers seeking seaside staycations flocked to Brighton over the summer, enabling hotels to achieve record average daily rates in August. The hotel development pipeline is very thin, which should support continued high occupancy rates.



4 BATH

Bath achieved the highest average daily rates of any city in the ranking over the summer, due to strong demand and a relatively small supply of hotel rooms, which is skewed towards the luxury end of the market. Bath's tourist economy has received a boost from sightseers visiting locations used by the hit Netflix series *Bridgerton*, much of which was filmed in the city.



5 CHESTER

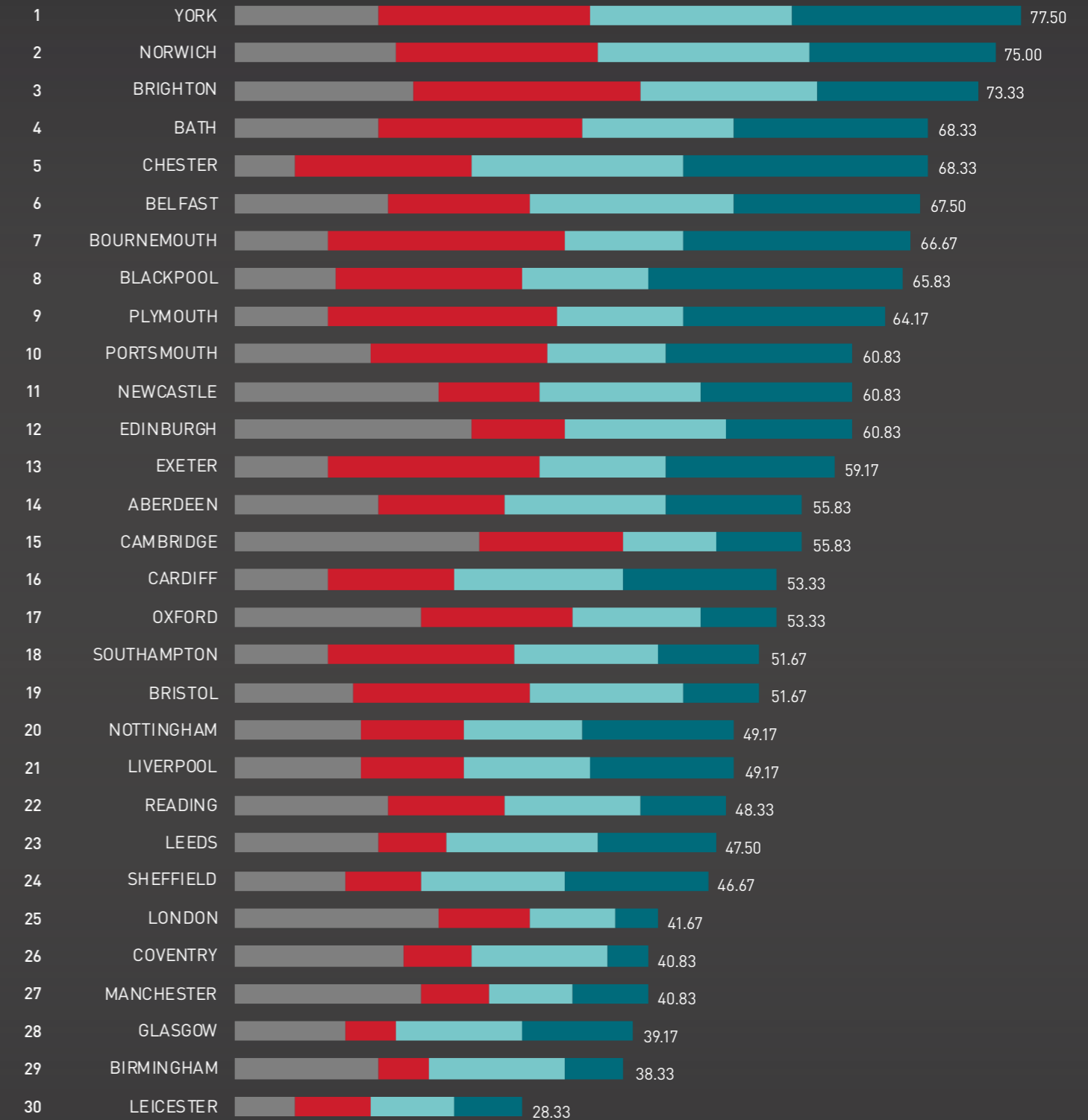
Chester is one of the top cities in the COVID resilience sub-ranking, as a location that draws the majority of its visits from domestic leisure trips. It was named City of the Year by the 2021 UK Staycation Awards, with its medieval rows and Roman walls praised as a distinctive setting for city breaks. Hotel occupancy rates rose well above 80% in August, matching pre-COVID levels.



6 BELFAST

Northern Ireland's tourism industry had been growing rapidly prior to the pandemic. While the hotel sector was badly hit by COVID, occupancy rates in Belfast bounced back to close to 80% over the summer following the easing of travel restrictions. New hotel development has stalled, but there are several proposed projects that could commence construction as the market recovers further.

LSH HOTEL HOTSPOT RANKING 2021



■ Hospitality industry strength ■ Hotel market performance ■ Development opportunity ■ COVID resilience

Total scores are out of 100
Sources: STR, ONS, VisitBritain, Experian, BCIS, NISRA, LSH Research

INVESTORS READY TO ACT

Hotel investment activity has rebounded this year, after a pandemic-induced slump in 2020. While the much-anticipated wave of distressed transactions has not materialised, the sector currently offers a wide range of opportunities, particularly for income-focused and value-add investors.

RECOVERY UNDERWAY

Hotel investment activity slumped at the start of the pandemic. While 2020's investment volume reached £1.8bn, more than £1.5bn of this was transacted in Q1, which was boosted by the c.£700m sale of The Ritz in London. Each of the following three quarters saw only a trickle of deals, and large-scale transactions were entirely absent from the market.

Hotel investment has picked up significantly in 2021, with £1.5bn transacted across the first three quarters. International and institutional investors have returned to the market, and larger-scale deals have started to come through.

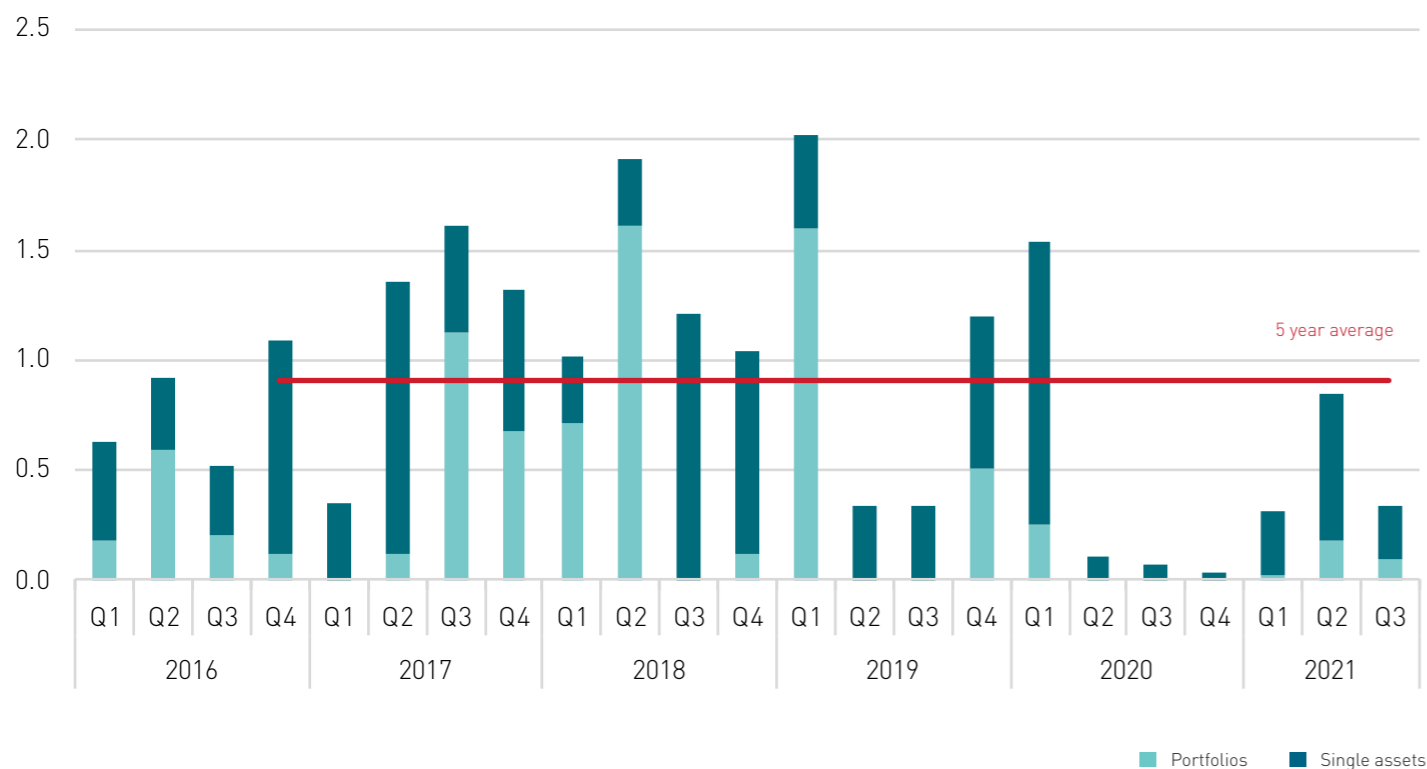
Several high-profile London assets have changed hands in 2021. Major deals have included Cerberus Capital Management and Highgate's purchase of the Dorsett City London for £115m; and Legal & General's acquisition of the YOTEL London Clerkenwell for £70m.

Relatively few portfolio deals have been completed this year, although one notable exception saw MCAP Global Finance, an affiliate of US investment manager Marathon Asset Management, acquire 17 IHG-branded hotels from Cerberus. The portfolio comprises 15 Holiday Inns and two Crowne Plazas, all in UK regional markets, and was bought for an undisclosed sum believed to be close to £180m.

Another major portfolio is expected to change hands by the end of Q4, as Henderson Park has exchanged contracts on a deal to acquire 12 Hilton-branded hotels in the UK and Ireland from Aroundtown. The portfolio was reportedly valued at £555m and, when completed, this will be comfortably the largest hotel deal since the start of the pandemic.

While corporate transactions are not included in our investment volumes, strong appetite for hotel and leisure assets was also demonstrated by Blackstone's acquisition of a majority stake in Bourne Leisure, owners of Butlin's, Haven and Warner Leisure Hotels, in a deal reported to value the business at c. £3bn.

HOTEL INVESTMENT VOLUMES (£BN)



SHIFTS IN DEMAND

Although investment activity has improved, the transaction volume for the first three quarters of 2021 was still less than half the five-year average. There is no shortage of capital targeting the hotel sector, but volumes have been constrained by a lack of available product.

At the start of the pandemic, there were expectations that it would trigger a large wave of distressed assets coming to the market, as was the case after the global financial crisis of 2007/08. However, government support measures have largely prevented this, and there has not been a significant spike in distressed sales.

Opportunistic investors will continue to monitor the market for distress. An increased volume of assets may start to come through in 2022 as government support is wound down and banks, which have been broadly supportive throughout the pandemic, begin to take a harder stance on lending to struggling businesses. However, there is unlikely to be a huge flood of distressed hotels hitting the market.

Value-add opportunities will arise from the pandemic, particularly for investors able to take on underperforming assets and reposition them so that they meet future demand. The value-add investor Castleforge has been notably active in recent months, acquiring the Crowne Plaza Royal Terrace and Best Western Plus Bruntsfield Hotel in Edinburgh, and the Hilton Hotel in Cardiff.

Investors are also showing an appetite for accommodation types that have the potential to be post-pandemic growth areas, such as aparthotels and serviced apartments, and are increasingly looking to add these to diversified hotel portfolios.

These styles of accommodation are also likely to form a growing part of the development pipeline, alongside hotels in 'coast and country' locations that benefit from staycation demand. Hotel development activity has been robust in 2021, with STR data showing that new completions returned to pre-pandemic levels in the first nine months of the year, after dropping by around a third in 2020. However, with some new development starts being put on hold during the pandemic, the pipeline appears to thin out going into 2022/23.

RESILIENT PRICING

Uncertainty over pricing has been an inhibitor of investment activity over the last 18 months, as many potential vendors and buyers adopted 'wait and see' attitudes while they monitored the impact of the pandemic on hotel values.

However, there has only been a relatively small correction. According to MSCI data, there was a peak-to-trough fall in capital values of 7.6% during 2020, but values started to pick up around the turn of the year. By September 2021, MSCI's hotel capital values had recovered to within 3% of their peak.

Pricing evidence from transactions has been limited, but it would suggest that

prime hotel values have held up throughout the pandemic, with significant discounts only really evident for lower quality product and sales that involved an element of distress.

London hotel values have been supported by international investors' unabated strong appetite for assets in the capital. Prime yields for leased hotels in London remained stable throughout the pandemic at c. 3.50%.

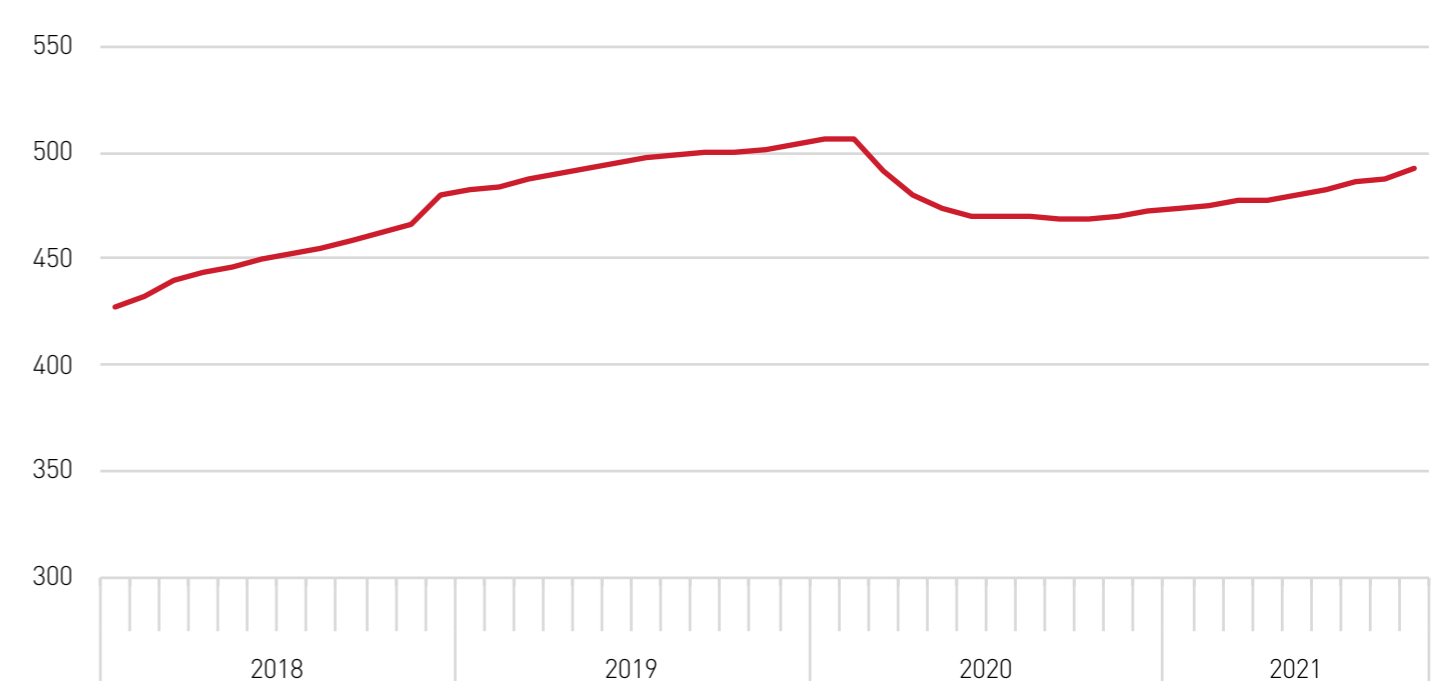
While there was some softening of regional yields in 2020, prime yields for leased hotels have come back in towards 4.50% this year, and are expected to return to the pre-pandemic level of 4.25% in the coming quarters. This reflects strong demand for leased hotels across the UK, with many investors focused on assets offering long-term fixed-income leases with strong covenants.

INVESTMENT TO RISE

With greater clarity emerging on hotel pricing, an increased number of vendors and portfolios up for sale, either on or off market. Several sizeable hotels have already been traded in the early part of Q4, and some larger deals, including Henderson Park's portfolio acquisition, are anticipated to be completed by the year-end.

As a result, Q4 has the potential to be a very strong quarter for transaction volumes. Investment activity should further improve in 2022 as an increased number of assets come to market.

HOTEL CAPITAL VALUES (INDEX, 100=JAN 2001)



Source: Source: MSCI

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HOTELS

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