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UK Hotel Investment Outlook: Summer 2016 And Beyond

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London remains the top destination for hotel investment in Europe, according to a November survey of senior hospitality figures, beating Barcelona and Madrid into joint second place.[1] Questions are being raised about how much further values can rise but we continue to see high levels of interest from clients. The underlying metrics remain strong — room occupancy levels and revenues per room "RevPAR" rose in 2015 and PWC forecasts further growth through 2016, with average occupancy rates up to 83 percent (London) and 77 percent (regions) and RevPAR growth of 1.9 percent, rising to 2.2 percent in 2017.[2]

Outside London, regional U.K. hotel performance continues to outpace Europe, with cities such as Birmingham, Nottingham, Bristol and Liverpool performing particularly well, although some expect regional growth to be more moderate into 2017.

According to Savills, U.K. hotel investment surpassed its 2006 peak in 2015 at $11.7 billion (8.1 billion pounds), representing a 32 percent increase since 2014.[3] 2016 is expected to be another strong year. As one client has commented, they know the U.K. and that "... the money will be safe here."

Investor Trends

Investors from the Asia Pacific and Middle East dominated the central London hotel market in 2015 and there are few indications that this will change in 2016. The most high-profile recent transaction was QIA's purchase of a majority share in the iconic Claridges, Connaught and Berkeley Hotels in May 2015, and one or more of these hotels may soon be repackaged and sold on. Middle East investors' reputation for focusing on luxury and trophy assets may be deserved, but is not the only reason for the high levels of activity. Sovereign wealth funds and other cash-rich investors typically have a lower cost of capital and longer-term investment strategy, reducing sensitivity to compressed gains and yields in the current market.

Rising prices and lower returns sent many investors out into the regions in 2014-2015. Since private equity funds typically invest for a period of only three-five years and then exit, it is no surprise that U.S. private equity accounted for 65 percent of all acquisitions in the regions in 2015. Lone Star Funds' acquisition of the Jurys Inn portfolio was a notable example of the trend. Asian Pacific and Middle Eastern investors will also continue to show interest in these areas.

“Investors are not only looking for yield, but also for safety amid turbulent macroeconomic conditions,” said Sean P. Harrison, executive vice president and general counsel at Kingdom Hotel Investments which, amongst its global portfolio of luxury hotels, holds a 50 percent interest in the iconic Savoy Hotel in London. “This risk-off environment has driven capital back to developed markets, and particularly into the U.K., where market dynamics underwrite value preservation and legal frameworks enable thorough due diligence and sophisticated transaction structuring.”

Capital markets liberalization and volatility in China and other key Asia Pacific regions are also leading to increased real estate investment into the U.K. and Europe more broadly, as well as the more generous yields which can be achieved compared to some home markets.

As global capital has continued to hunt for yield, in-bound capital into Europe has become increasingly multifaceted, boosting liquidity across a greater spectrum of hotel classes and locations. The willingness to evaluate higher-yield opportunities in select secondary markets demonstrates enduring confidence in the sector.

Possible Issues for 2016 Performance

The “Brexit” referendum on whether the UK should leave the EU, scheduled for June, has certainly left clients cautious, with most taking the view that an exit will make the U.K. a less attractive market. However a weakening pound against the Euro (a 10 percent fall already in 2016) is good news for hotel owners as most overseas visitors come from within the Eurozone. Moderate growth at home has also kept corporations and consumers traveling within the U.K. and the dollar remains strong, maintaining a flow of U.S. visitors.

It remains to be seen how Europe’s geopolitical instability and the slowdown of the Chinese economy will affect the market. There are no major events such as the Olympics or European football tournaments to ensure people will visit U.K. hotels regardless.

There is also the issue of increased room supply. Approximately 38,000 rooms are in the pipeline for 2016[4] and an increasingly wide range of nonhotel accommodation has been brought to the market.

Although not a new issue, changes of taste will continue to drive changes in the market, and traditional, heavily branded hotel offerings have proved particularly vulnerable in recent years. Guests of the “millennial” generation are seeking something different, something less “homogenous.”

Trends for Summer 2016 and Beyond

Alternative

Private rented or “shared space” accommodation is gaining in sophistication, covering the full range of accommodation requirements from budget to Airbnb Inc. to Onefinestay. Forecasters are predicting that these offerings will expand and diversify in 2016, with the mid-market likely to be most affected.[5]

Rebranding

We expect to see a continuing shift away from uniform hotel brands towards “lifestyle” and boutique hotels for 2016, on both sides of the Atlantic. Well-known brands such as Starwood, Intercontinental and Marriot Hotels have each launched diffusion brands recently, with a stronger focus on areas such as lifestyle, technology, interconnectivity and locality. Those pitched correctly have performed strongly and other operators are bound to follow.

Selected or Limited-Service

Forecasters also expect a push into lower tier accommodation, to compete with the influx of private rented accommodation at a more competitive price point, perhaps by focusing on select services.[6]

Extended Stay

The serviced apartment or “extended stay” sector is also gaining in popularity and has now emerged as an identifiable, consistent subsector of the wider hotel market. In London serviced apartment operational performance has tracked and, in some cases, out-performed traditional hotels.[7] Add to this the potential for greater operational returns because of reduced servicing requirements and this is an area being watched closely 2016.

Diligence

Changing market conditions and the range of choices available are making the pre-acquisition and predevelopment diligence requirements more complex and more nuanced. Clients need to look carefully at the market and consider soft brand versus traditional franchise, upscale lifestyle hotel or pared-back millennial-focused offering, short-stay versus long-stay, or any combination of the above, together with the underlying planning and title parameters before making an investment. Those who get the branding and positioning right will be rewarded with better yields. Those that don’t will be forced to make way.

—By Elizabeth Alibhai and Simon Briggs, Dechert LLP

Elizabeth Alibhai is counsel and Simon Briggs is a partner in Dechert's London office.

[1] Parrett, D, Deloitte survey “London remains top hotel investment pick in Europe” (Nov. 4, 2015)

[2] PWC UK Hotels Forecast Update for 2016 and 2017 “Cheerful but fearful”(March 2016)

[3] Savills “UK hotel investment to surpass 2006 peak at £8.5 billion by year end” (Oct. 15, 2015)

[4] PWC UK Hotels Forecast 2016 “Growth is in the air” (Q4 2015)

[5] PWC UK Hotels Forecast 2016 “Growth is in the air” (Q4 2015)

[6] Russell, B, HVS, “The Millenial Shift in Hotel Brands” (Dec. 2015)

[7] Savills, “UK Hotel Investment” (Q4 2015)