



Clear skies ahead? Challenges and trends shaping the UK hotel industry in 2008

The UK hotel industry saw continued growth and rising room rates throughout many cities in 2007. But what will the new year bring? Russell Kett and Michael Schwarz of the London office of HVS have looked at five major trends and factors which are expected to influence the country's hotel industry in 2008.

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1. An industry turning green

At a time of concern about the climate and amid discussions about environmental tax impositions the country's hotel industry is likely to jump on the green bandwagon. Hence 2008 will see an increasing number of UK hoteliers respond to green trends by implementing sustainable management practices and environmental standards. Recycled and more sustainable building materials are likely to impact the development side of the business. 2008 therefore will become a year when UK hoteliers and developers start to benefit more than ever from improved operating efficiencies, cost savings and favourable PR as they incorporate sustainable business practices into their day to day operations.

2. Another year of record transactions

Low-cost debt and significant above-inflation growth in average rate and RevPAR are likely to continue to stimulate investor's appetites for UK hotel assets. Despite the fact that this momentum will continue to coincide with divestment and brand expansion strategies, where operators seek to separate their ownership and management, buyers are expected to far outnumber potential sellers. With UK property being highly sought-after the country's hotel investment market will continue to undergo globalisation and see record prices paid for trophy assets. Shortened investment horizons and continued yield compression will induce owners and investors to become more demanding in terms of return on investment. UK hoteliers will therefore be required to manage their assets more effectively.



3. Brand innovation and development

High room rates demanded in many UK cities are likely to cause corporate travel managers to seek more cost effective, alternative forms of accommodation for their travelling workforce. At the same time, consumer tastes are becoming increasingly sophisticated and accommodation choice is frequently based on unique brand experiences rather than simply location. Developers and investors will be inclined to take advantage of these new travel patterns and associated changes in purchasing behaviour.

Following the recent introduction of hotel concepts such as 'Yotel', 'easyHotel', 'GuestInvest' and 'Travelpod', the UK hotel industry is expected to see continuing brand innovation in 2008.

Comparatively low development costs as well as superior profitability ratios are likely to lead to increased activity in the extended stay and serviced apartment sectors. This segment will see the arrival of Staybridge Suites by Intercontinental Hotel Group in 2008. Other Extended Stay brands such as Hilton's Homewood Suites, and Element by Starwood, have announced ambitious international expansion strategies and should soon follow.

With significant occupancy and RevPAR gains, high levels of new hotel development are expected in London. The capital's strong development pipeline will be further fuelled by the city's successful bid for the 2012 Olympic Games. Large urban redevelopments, such the 2012 Olympic Park and the Greenwich Peninsula, are expected to house a large portion of the more than 11,000 rooms which will enter the market by 2010. Private equity owned budget giant Travelodge plans to operate over 7,000 rooms in central London by 2012. The company has announced the opening of a further 15 sites across the capital for the tourists the Games will bring. However, despite the fact that the market is expected to absorb the new capacity, it is likely that most of the new supply will hit the London market at a stage of slowdown.

4. Low-cost airlines flying high

The UK aviation industry will stay highly competitive in 2008 as oil prices remain high and the pound stays strong. Low-cost carriers are expected to strengthen their position in the market and benefit from increased popularity among business travellers as new destinations are added and flight frequencies increased. With the anticipation of new budget routes, 2008 is likely to become another year of strong inbound and outbound budget flight travel. Considering that over 70% of foreign tourists enter the UK via one of London's five international airports, the capital's tourism industry is likely to continue to benefit from any increase in aircraft movements.



5. UK REITs on the move

2007 saw the long-awaited launch of UK real estate investment trusts (REITs), a tax-effective way of owning real estate. However, the £2 billion IPO of Vector Hospitality, a 71-hotel REIT, fell flat in June owing to ambiguities over fees payable, the values of the underlying assets as well as concerns about the perception of a conflict of interest. Notwithstanding this unsuccessful start, hotel-based REITs are expected to offer attractive yields compared to other investment vehicles. The UK hotel REIT industry is therefore – despite a need for clearly outlined deal structures and income volatility associated with daily hotel room rentals – expected to further gain in popularity. Provided that investors have learnt their lessons from recent events, 2008 will see healthy growth in the country's newly born REIT industry.

So the weather's set fair then?

Not necessarily. At the time of writing (October 2007) some dark clouds are building on the horizon, threatening to blot out those clear skies. The crisis in the US sub-prime mortgage market has manifested itself most clearly in the UK with the panic surrounding the Northern Rock bank. If creditors are nervous, then they will be less willing to lend and hence the likelihood of a large volume of transactions is diminished. Marylebone Warwick Balfour, for example, has decided to delay the sale of its Malmaison and Hotel du Vin chains on account of "current uncertainties in the markets".

An additional concern is the re-emergence of foot-and-mouth disease. Although the disease is at the time of writing confined to one area of Surrey, the worry must be that the countrywide outbreak of 2001 will be repeated. Six years ago, the beaming around the world of images of the slaughter of infected animals brought visitation to the UK to a practical standstill.

Increased environmental awareness, record asset transactions, continued brand innovation, the growing REIT industry as well as a highly competitive low-cost carrier market are only a few of the factors influencing the UK hotel industry in 2008. Change won't happen overnight and the global credit crunch serves as a warning that changes might proceed more slowly than expected.

In our view 2008 is set to become another challenging, yet exciting year of growth for most hoteliers in the UK.

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About the authors

Russell Kett is Managing Director of the London Office of HVS, the leading global specialist hotel valuation, consulting and brokerage firm which was founded more than 25 years ago. HVS has more than 400 hotel specialists around the world and is renowned for (literally) having 'written the book' on how to value hotels. Russell has some thirty year's specialist hotel consultancy, investment and real estate experience and generally focuses on the provision of valuation, feasibility, shared ownership, property brokerage, investment, asset management, strategy and related consultancy services, advising hotel companies, financial institutions, developers and investors on all aspects of their hospitality industry related interests, throughout Europe, the Middle East, Africa and Asia. He is a frequent speaker and writer on the international hotel industry and on topics relating especially to the valuation of and investment in hotels, resorts and shared ownership developments, as well as on the hospitality sector generally.

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