



PKF

str

MIPIM U.K. Hospitality White Paper 2018

Real Estate Game Changers

September 2018



We are very pleased to collaborate with STR and PKF hotelexperts to present this research at MIPIM UK which reveals the data behind the buoyant hospitality sector.

Digital and social transformations have put people firmly at the centre of property, the end user is now king and in this fast-paced world, standing still means falling behind. So how is the U.K. real estate market adapting to this change? Who are the game changers setting new parameters for the real estate market? How are they making a difference? These are some key questions which will be addressed at MIPIM UK, Britain's leading real estate event.

Among the participants, investors are analyzing all asset classes. A recent survey explained that hotels were the second most popular niche sectors being considered in 2018. Serviced apartments or private rented residential were also highly ranked. Indeed, if the hotel and tourism sector puts considerable importance on the customer experience to further growth, the real estate dimension remains essential. It's also been revealed that the U.K. remains the first destination in Europe in terms of investment in the hospitality sector.

So after a strong experience at MIPIM in Cannes and having this survey in mind, we decided to create a dedicated programme focusing on hospitality at MIPIM UK. We asked PKF, our historic partner, to be part of the show and to co-develop a hospitality lounge with us, as well as provide two panel discussions and a series of project showcases and pitching sessions. This will give the opportunity for hotels, hostels, service apartments and private rental companies to network with the rest of the real estate community which includes investors, developers, political leaders and architects on 17-18 October at Olympia London.

MIPIM UK wants to generate as much networking and deal making as possible for attendees.

Ronan VASPART
MIPIM Director

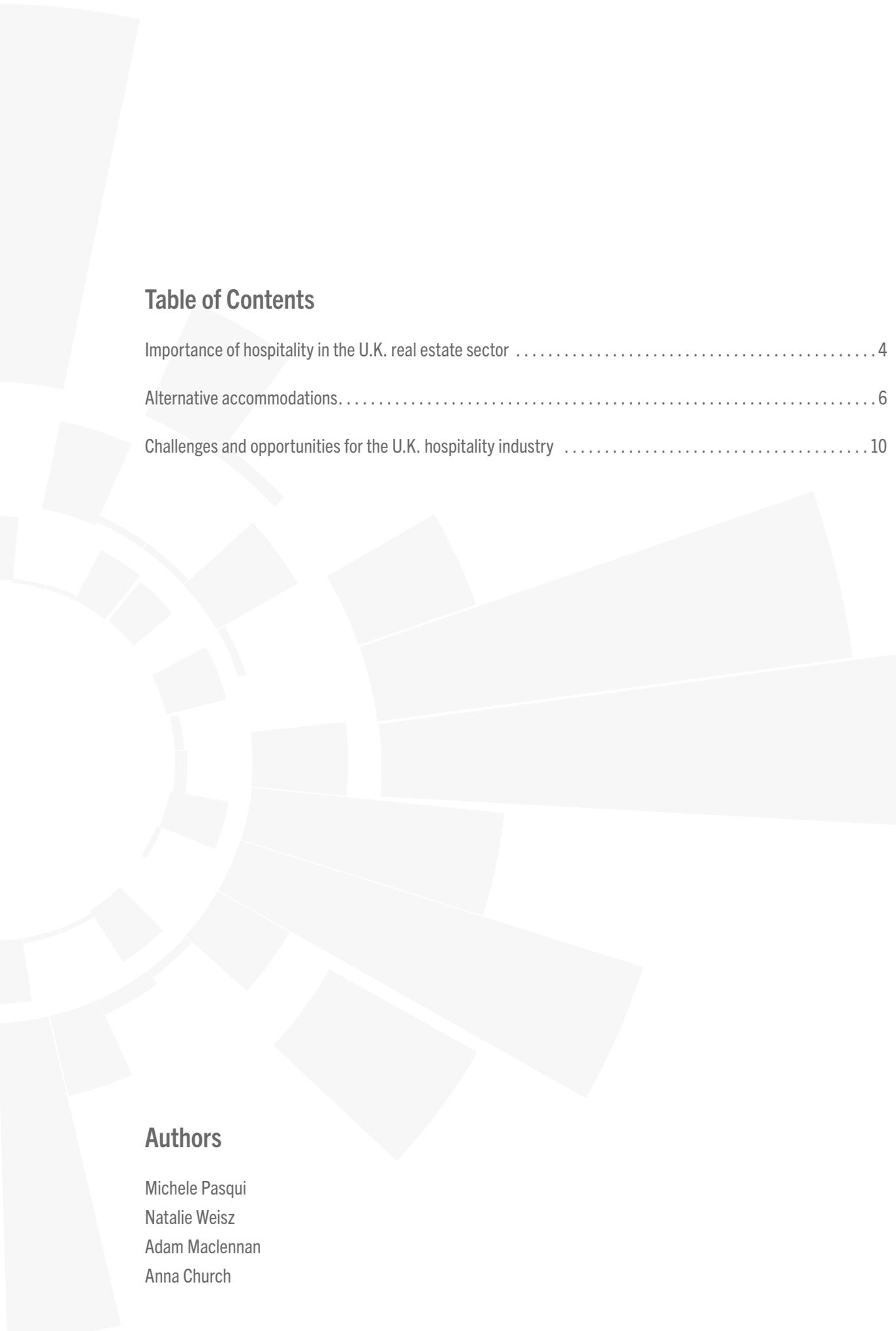


Table of Contents

Importance of hospitality in the U.K. real estate sector 4

Alternative accommodations..... 6

Challenges and opportunities for the U.K. hospitality industry 10

Authors

- Michele Pasqui
- Natalie Weisz
- Adam Maclennan
- Anna Church

Technological advancements and changing consumer habits have converged, transforming traditional industries and creating entirely new sectors. Game changers are evident across all spectrums of real estate development and investment, will be the focus of this year's MIPIM UK conference, to be held 17-18 October at Olympia, London. With hotel-asset yields experiencing strong growth in recent years, developers and investors are increasingly

viewing the industry as an important portfolio diversifier. Moreover, experienced hotel developers are finding new opportunities in hybrid hospitality concepts which cater to the ever-changing needs of increasingly globalized travellers. This white paper from STR and PKF will discuss industry game changers and the potential challenges and opportunities faced by hospitality real estate developers with an interest in the U.K.

Importance of hospitality in the U.K. real estate sector analysed by STR

Hotels in the U.K. have enjoyed a buoyant decade, with an average of over 4% annual growth in revenue per available room (RevPAR) since 2010. This has mostly been the result of strong increases in demand, which grew 2.6% on average from 2010 through the July 2018 year-to-date time period. Supply, on the other hand, has been subdued, averaging 1.2% growth during the same period.

This mix has driven occupancy rates up, pushing the metric to all-time highs above the 77% mark each

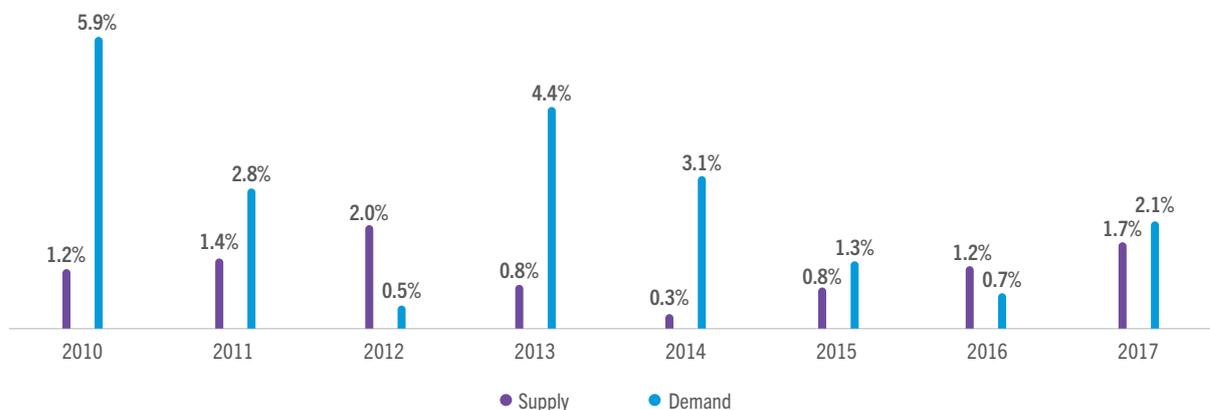
year from 2015-17. At 76.7% through July, 2018 is on course to continue the trend.

The strong occupancy performance has given hoteliers reason to lift average daily rate (ADR), which eclipsed GBP92.00 in July 2018—this was the highest ADR for any month in STR's database for the market.

As a result of this performance strength, the hotel sector has been sought out for its potential in terms of profitability yields and return on investment.

Figure 1

UK Hotels enjoyed buoyant demand since 2010 Supply & Demand % Change, July 2018 YTD



Solid foundations, uncertain times

Uncertainties surrounding Brexit are raising questions on profitability margins in the real estate sector. Rental agreements could potentially be affected by shifting demand for office, retail and hospitality spaces. If real estate demand wanes to lower levels, hotels will likely feel the effects, especially in regards to performance, which in turn is likely to affect the bottom line.

However, hotels have generally outperformed other real estate sectors in terms of yield in recent years, due to strong profitability performance levels. Over the past four years, U.K. hotels have seen gross operating profit (GOP) grow at an average of 3% per annum, as illustrated in figure 2.

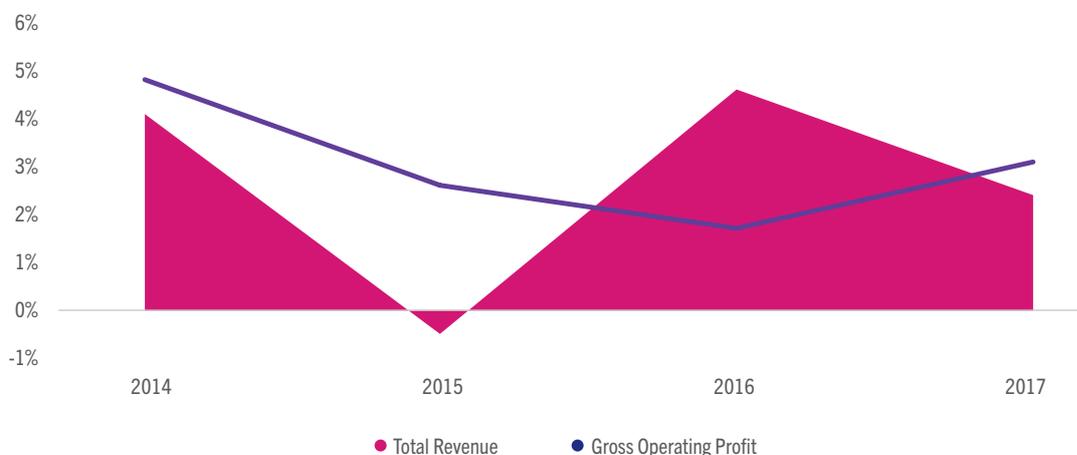
The success of the hotel business model as a mean of return on investment, especially buoyed by its strong performance, has allowed a blossoming of real estate investment in the sector, with the U.K. continuing to top the market in terms of transaction value in Europe.

Growth in demand in the hotel sector buoyed recently by the weaker pound has led to some interesting developments and an increasing appetite among the investment community in the 'bed sector'. Strong international and U.K. brands are increasing their footprint in the U.K., and new concepts are emerging that target a more experienced traveller. Mixed-use developers are seeing the benefits of including a lodging element in their planning, while innovative brands are finding ways to maximise their space allocation to create 'hot spots' among retail, residential, office and leisure spaces.

In addition to mixed-used developments, the hospitality sector is also witnessing a diversification of the accommodation offering. We will investigate some of the new trends in hospitality in the next chapter and shed some light on the possible impact of development and management of those concepts.

Figure 2

UK Total Revenue & Gross Operating Profit % Change Full Year 2014-2017 (GBP)



Alternative accommodations: emerging trends and their impact on the real estate development and hotel-management industries analysed by PKF

People have more reasons and ways than ever to travel. The emergence of “bleisure”, “staycations” and “digital nomads” as new demand categories highlights the increasing interest in travel across generations. The accommodation sector is evolving to meet the needs of those seeking greater flexibility, value and more experience-focused leisure and business trips. Real estate developers and management companies are increasingly looking for hybrid or alternative accommodations to diversify their portfolios. This section highlights some of the changing trends and provides examples of what innovative real estate developers and hotel-management companies are doing to adapt both in the United Kingdom and around the world.

Private club/hotel

PKF research suggests the most successful and innovative new concepts aim to fulfil many needs simultaneously and maximise the use of the available real estate. For example, private-member clubs such as The Ned or The Curtain cater to both digital nomads and “time-poor” professionals. In international locations, digital nomads can find a place to live and work. Professionals can use the same private club for work, to socialize, or even enjoy a staycation, giving the feeling of a holiday without the added time and cost of long-distance travel. According to the Sykes Staycation Index 2018, 54% of British travellers surveyed said that they prefer a staycation over traveling abroad because it is easier.

Bleisure hotel

This aim to promote bleisure trips and increase flexibility for digital nomads has given rise to mixed-use lifestyle developments such as Village Hotel Club, which labels itself as ‘urban resorts’. Village Hotel Club, conceived as hotels with a heavy emphasis on leisure facilities, is now adding a shared office concept to several existing properties. Village Hotel Club is opening its 30th property in the U.K. this year with several more in the pipeline.

Conversely, the shared office providers WeWork has launched its WeLive brand to cater to the lodging needs of an expanding client base. In this type of hybrid property, you may find a hot desk, an entire floor of offices, conference rooms, state-of-the art gymnasiums, spas, live entertainment or organised professional and social events.

These hybrid hotels come with the added flexibility for guests to use a combination of the available amenities and spaces for a period that suits them, be it an afternoon, a night or three months. These concepts are growing incredibly quickly, with WeWork planning to open an additional 33 locations globally in August 2018. In the U.K., WeWork has 40 existing or planned locations, already showing space commitments of roughly 240,000 sqm of office space, and has submitted plans for the first WeLive in London.

Aparthotels and dual brands

The growing mobility of today's workforce, and a need for flexibility and space for travellers, has led to increased demand for medium to long-term accommodation which blurs the lines between hotels and residential developments. Private equity and increased institutional real estate investors have been dipping their toes into the serviced-apartment and "aparthotel" sector. The investment community is realising that the return on investment for well-located and conceived projects can be substantial, and can outperform the returns of traditional hotels. The operating model for these longer stay aparthotels tends to be less labour intensive than for traditional hotels. Furthermore, aparthotels can succeed in secondary locations that would be less suited for traditional short-stay properties. As many markets have a limited supply of quality extended-stay hotels, prospective guests must currently seek alternative accommodation either in a short-stay hotel, Airbnb or private rental. If the growth of this sector in the U.S. is anything to go by, we foresee a significant increase in aparthotels in the U.K. and across mainland Europe in the coming years.

Statistics from STR show that in July there were around 22,700 rooms of serviced apartments in the U.K., accounting for 3.5% of the total hotel supply in the country. While the segment can be considered small when compared with the total accommodation landscape, it is interesting to note that year-to-date performance through July 2018 reveals that serviced apartments in the U.K. achieved higher occupancy (79.0%) and ADR (GBP127.00) levels, compared to 76.7% occupancy and ADR of GBP92.32 in the hotel sector. This suggests that there is scope for this segment to be more profitable operationally when compared with the average U.K. hotel.

Developers are increasingly considering dual-branded concepts, which create synergies from a management perspective and allow hotel operators to target more diverse segments of demand. Examples of this include the dual-branded IHG property at Heathrow, which features a Holiday Inn and Staybridge Suites, or the combination of Hyatt Place and Hyatt House planned to open at Charles De Gaulle airport in Paris. Outside of the major brands, the innovative developers of the Zoku Hotel in Amsterdam have developed a standard hotel room with a kitchen, living and working space, and a mezzanine level sleeping area in a 24 sqm space. The public space at the hotel at the rooftop level has flexible space for guests to meet, work and socialise. Having now successfully tested their concept, the group is actively seeking to roll out across Europe.

Student accommodation/hotel

Hybrid lodging developments are also emerging in the student housing sector. An increasing student population in the U.K. has fuelled the expansion in the supply of purpose-built student accommodation. Developers and operators of student accommodation are also innovating to maximise the use of their properties during low student-demand periods. The Student Hotel, a brand with 11 locations in continental Europe and an additional 12 in the pipeline, is a mixed-use lodging/living concept targeting locations with strong student populations to accommodate both students and hotel guests. These locations incorporate many hotel features designed to attract a more diverse client base such as shared workspace and social areas.

Micro Living/Co-Living

Likewise, the residential sector is borrowing elements from the hospitality industry with the emergence of micro-living and co-living. These concepts allow developers to provide housing and luxury amenities to people in a space-efficient way. London and other cities with considerable pressure to add affordable housing, are potentially important growth markets for this type of accommodation. Once reserved for students, co-living developers are now targeting young professionals. Many variations of this concept are being developed and tested around the world, some have multi-room apartments with shared kitchens whilst others have fully self-contained units with hotel-like amenities such as gyms, swimming pools, cafes, restaurants and co-working areas. However, due to the hybrid nature of these developments, planning standards have not yet been established in some areas of the UK.

Hostels

The hospitality industry is also adapting to cater to increasing global demand at lower price points. Hostel operators target a more budget conscious and typically younger visitor, improving the quality of their offering and recognising the advantages of scale when developing strategies to attract visitors from around the world. Brands are starting to proliferate in a sector that was for a long time quite fragmented. Names such as Generator Hostels, Wombats, Code Hostels, St. Christopher's Inn Hostels and JO&JOE are opening properties in cities across Europe. St. Christopher's Inn Hostels have brought the capsule-hotel trend to London, giving a new meaning to the

term micro-living. Brands like Meininger Hotels have developed their concept as a hybrid between a hotel and a hostel to include multi-bed rooms as well as single and double rooms. The returns when developing a hostel can be substantial, particularly in locations that have solid access to the city centre and tourist spots but might be considered less favourable for traditional hotel development. The investment in the sector by Accor Hotels, developers of the JO&JOE brand, is the first foray by an international hotel group into a growing market that will likely continue to expand in years to come.

Recognising the growing importance of the sector, STR is now collecting data to allow hostel companies to benchmark their success using metrics such as revenue per available bed (RevPAB), a more relevant metric for hostels than the traditional RevPAR used for hotels. To better understand the returns possible from these new developments, stakeholders are also starting to look at total revenue per square meter, a metric which if expanded to other lodging types, could help developers compare revenue opportunities across segments.

Annualized data for the hostel market in London shows that bed occupancy declined from a peak of around 84% in 2016 to roughly 83% as of June 2018. While 83% is still a very healthy occupancy level, the decline reflects an increase in the home-rental sector and other low cost beds in London which have an impact on occupancy, especially during the quieter winter months. At the moment, the total supply for hostels in London is 64 properties consisting of more than 2,300 rooms, a total which is stable from last year.

Temporary lodging

Hospitality groups are finding opportunities to capture new customers by targeting seasonal increases in demand, particularly related to festivals and sporting events. Accor has recently announced that it will expand its Flying Nest concept, whereby fitted-out shipping containers are installed temporarily in locations to meet surges in demand which often occur during large events. Other options for on-demand accommodation include Pitch, the luxury tent company offering glamping style bell tents which are delivered, set up and furnish. These concepts may benefit existing hotel owners in certain markets as well by alleviating excess demand without creating oversupply during other periods. According to The New Horizons IV Survey, travellers under 30 were far more likely to splurge on experience-based

purchases rather than flight or accommodation upgrades. Approximately 37% said that they would splurge on food and drink, and 27% would spend more on events or festivals, whilst only 10% said they would pay extra for an accommodation upgrade. In these out-of-the-box lodgings, guests have an added experiential aspect, giving hotel-management companies a compelling reason to invest in them.

As needs continue to change and cities look to find space saving ways to meet these demands, real estate developers and hotel-management companies will continue to innovate. It is likely that experiential purchases and community generating programs will continue to grow in popularity. Key areas for improvement include increasing flexibility and choice whilst minimizing the stress of travel by integrating products and services into a single development.



Challenges and opportunities for the U.K. hospitality industry analysed by STR

In this section, we aim to illustrate some of the recent trends that are likely to affect the hotel and wider accommodation sectors.

While the industry has proven resilient in recent years, a fast-paced environment and uncertainties derived from Brexit and macroeconomics are likely to shape the near future. This is particularly true as the diversification of the offering will continue the recent trends experienced thus far.

Supply balancing act

London's hotel inventory is expected to increase at an average pace of 2.9% per annum over the next three years. For Regional U.K. (U.K. excluding London), inventory is expected to rise above the 3% mark in 2019 and 2020—the strongest such increases since 2008.

The balance between supply and demand will play a crucial role over the next year and beyond for hotels throughout the U.K.

When looking at serviced apartments for example, the sector has grown considerably recently, with a 3.7% increase in 2017. If this trend continues in the medium term, it could put strains on the occupancy and ADR levels experienced by the sector, potentially affecting the bottom line returns of these types of development.

Rising costs: controlling the burden?

Costs have risen in recent years for U.K. hotels. In 2017, however, costs (+2.1% per available room) increased in line with revenue (+2.4% per available room), indicating that hotels were able to maintain some control over the bottom line despite no major changes in occupancy levels.

In 2017, hotels in both London and Regional U.K. maintained stable labour costs compared with the previous year. While labour talks have shifted from the rising minimum wage to resourcing staff post-Brexit, hotels have responded with flexibility and adaptability recently. If this operational trend continues, it will be pivotal in helping the market navigate coming changes.

Construction costs are also likely to drive diversification even further in the sector. The scarce availability of spaces in certain U.K. locations has pushed developers into conversions as well as into developing more space optimised rooms. A typical example of this trend are hotel projects that are developed in central locations but provide smaller than usual rooms.

In addition, the cost of construction labour, as well as the cost of raw materials, are weighing on the equation, especially in the context of devalued British pound and additional cost related to import of materials.



Inbound arrivals likely to shape demand

With tourism arrivals reaching 39.2 million in 2017, the hospitality sector has continued to enjoy buoyant demand. According to Oxford Economics, arrivals are expected to grow 3.3% in 2018 and 2.9% in 2019. This will likely create opportunities for hotels to capitalise on international business, and STR expects demand will keep rising steadily over the next five years.

Revenue management sophistication

While hotels have been at the forefront of revenue management in recent years, the diversification of the accommodation offering is also likely to expand this expertise into a different source of accommodation, leading to some shifting or changing in ways in which those are run. Student accommodation, for example, is likely to benefit from a more business approach, while some hostel brands have already developed sophisticated revenue management systems to increase profits.

Data driven solutions for hospitality real estate

The real estate sector continues to be highly competitive, with buyers constantly seeking deals, even during downturns. Investment opportunities are linked to the business cycle, and given the fast-paced nature of investments, real estate professionals are frequently in need of data to justify purchases and sales.

With the importance of net asset value in assessing the value of real estate properties, data transparency is becoming increasingly critical for professionals that use benchmarking and the transparency of data to make informed decisions related to investments.

It is interesting to note, however, that in the accommodation sector, this diversification is facing a bit of a 'lack of data'. We expect that there will be a development of data collection and transparency especially as new forms of accommodation consolidate, which is likely to affect the way we assess new investment opportunities in the real estate sector.



About STR

STR provides clients from multiple market sectors with premium, global data benchmarking, analytics and marketplace insights. Founded in 1985, STR maintains a presence in 15 countries with a corporate North American headquarters in Hendersonville, Tennessee, and an international headquarters in London, England. **For more information, please visit str.com.**

About PKF

PKF hotelexperts is an internationally recognised market leader in the field of hospitality, tourism and leisure consulting.

PKF hotelexperts is a member firm of PKF International, one of the largest global associations of audit, accounting, tax and consulting firms. With more than 200 member firms in 400 locations in over 100 countries, PKF is a truly global player. With a track record dating back as far as 1869, PKF was the pioneer in hotel consulting. The introduction of the Uniform System of Accounts for the Lodging Industry (USALI) in 1927, spearheaded by PKF's founding father William J Forster, marks the beginning of the firm's dedicated hospitality advisory activities, supported by elaborate financial surveys and relevant benchmarking services tailor-made for a globally emerging industry.

For many years, our experienced and dedicated consultants have been providing quality services for the hospitality, tourism and leisure sector, including feasibility studies, operator search, project development, asset management, research + benchmarking, valuations, strategic advice, financing and investment, transaction support, as well as services related to knowledge and networking.

PKF hotelexperts currently maintains offices in Argentina (Buenos Aires), Austria (Vienna), China (Shanghai), Germany (Munich), Italy (Milan), South Africa (Cape Town), Turkey (Istanbul), Ukraine (Kiev), and United Kingdom (London).

Contact

STR Analysts:

Michele Pasqui - forecast@str.com

Natalie Weisz - nweisz@str.com

PKF hotelexperts:

Adam MacLennan - Adam.MacLennan@pkfhotels.com

Anna Church - Anna.Church@pkfhotels.com

