HOTEL + LEISURE

UK Hotel Trading Performance Review 2022

GRAHAM + SIBBALD
Chartered Surveyors and Property Consultants

As we look back on what has been another challenging year for the UK, we have continued to see the exponential growth of Graham + Sibbald across England. In addition to our 16 established Scottish offices, we have seen the rapid expansion of our office in Manchester, the acquisition of Keningtons Chartered Surveyors, giving us an established Central London team as well as further office openings in key locations including Birmingham, Bristol, and Swindon.

Our national Hotel + Leisure Team is also growing, and we are excited to announce that well known hotel and leisure industry specialist James Williamson has joined our team as a Director in January 2023. James is based in the London office where he will be responsible for helping the company to further increase market share across England and the wider UK. Having worked in the hotel property sector for more than 25 years he joins Graham + Sibbald at an exciting time in the firm's continued growth plans, following the appointment of Martin Davis and Hugh Anderson to the team just over a year ago.

Demand for the services of both our consultancy/valuation and agency brokerage teams has continued to grow despite the headwinds of rising inflation, increased supply and utility costs, as well as the continued labour shortages impacting many hotel and leisure businesses.

For owner operators that are highly geared and who haven't invested in their hotels over the last few years, these pressures are likely to further intensify given the expected drop in consumer confidence and the impact this may have on occupancy and rate, ultimately impacting upon the bottom line. Interest rate increases have added a further unwelcome cost for many business owners at a time when hotels and leisure businesses are struggling to adapt to economic pressures.

We continue to work closely with clients to help them navigate the future, with quality advice and constructive solutions being paramount at a time when the lending environment is expected to further tighten and businesses may well be facing falling demand, lower profitability and greater debt servicing burdens.

Our dedicated team of experienced professionals are well placed to provide owners and operators with guidance to help them navigate the future, providing helpful and constructive solutions.

We are increasingly seeing the need for operational reviews and analysis of costs to ensure that businesses make the right decisions with a view to securing a solid financial position to weather the challenges and reduce the risk of failure.

During 2022 we facilitated a number of successful turnarounds of businesses, working collaboratively with owners, operators and stakeholders to achieve a long-term viable outcome.

Graham + Sibbald's UK Hotel + Leisure team have seen a number of successes throughout 2022 including the sales of Hotel Indigo, Birmingham; McMillan Hotel portfolio, Scotland; Queens Hotel, Perth; Ravensworth Hotel, Lake District and Rowton Castle, Shropshire to name but a few. Yet while we don't have the benefit of a crystal ball, market activity at the moment still remains positive, driven predominantly by cash-rich individuals, well capitalised groups or private equity money.

Photo caption: Hotel Indigo, Birmingham, SOLD July 2022

Photo caption: McMillan Hotel portfolio, Scotland, SOLD June 2022

Photo caption: Queens Hotel, Perth, SOLD February 2022

We are therefore confident there will be a number of significant sales completed in Q1 & Q2 2023 throughout the sector despite the uncertainty in the economy. Values continue to hold for the moment, with buyers having largely been prepared to pay based on pre covid trading patterns, reassured by the performance of the sector since May 2021 when restrictions were eased. However, increased costs, particularly utilities are inevitably being factored into all parties views on sustainable EBITDA going forward, we therefore expect to see some price re-alignment as a result.

Photo caption: Ravensworth Hotel, Lake District, SOLD June 2022

Photo caption: Rowton Castle, Shropshire, SOLD July 2022

Photo caption: Glenridding Hotel, Cumbria, SOLD February 2022

2022 Market Performance Observations

Hotel performance throughout 2022 remained buoyant, although there have inevitably been trend fluctuations across various UK locations from London to Inverness. We note below some key observations across the market.

Looking at the data, despite a mild recession forecasted for the UK in 2023, the London market is expected to be more resilient and less likely to be impacted according to Oxford Economics. We note Heathrow airport reported 55 million passenger arrivals (equivalent to 75% of pre-pandemic 2019 levels), making it the busiest European hub airport of 2022.

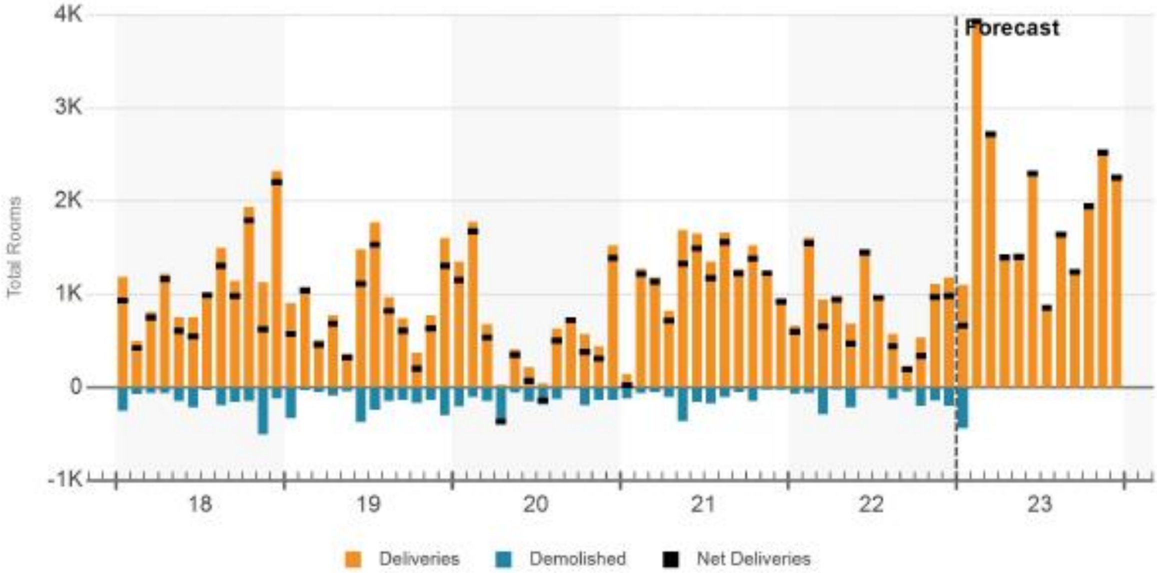
In Manchester, the city's extensive pipeline could delay its full recovery from current market headwinds, with around 1,900 rooms under construction and expected to open over the next three years. This equates to around 7% of the current existing room stock across Manchester, with 2022 seeing around 1,500 rooms open, with another 650 expected to have opened by end of 2023 – this is the largest increase to supply since 2018.

Looking at the Scottish markets, Glasgow has established itself as a prime destination for large-scale events, both across the music industry and sporting events, on the back of the European Championships in 2018 and the Commonwealth Games in 2014. The city has seen its international visitor base grow year or year pre-pandemic, known for its architecture and largest retail centre in the UK, outside of London.

Edinburgh saw the full return of the Edinburgh Fringe Festival after a hiatus due to the Covid-19 pandemic, providing a welcome boost to local hotels and operators alongside other events throughout the year. As demand increases, the greatest recovery has been leisure-led (similar to the wider national trend) boosted by the holiday season and people still looking to leisure breaks and celebrate special occasions at both local and national hotel and leisure premises.

In the North of Scotland, the Dundee hotel market contains around 1,800 rooms spread across 34 properties, with room demand up 4.7% in recent months. The Inverness market has 2,800 rooms across 69 properties with room demand up 5.6% across the city. The Aberdeen market continues to be largely impacted by the highs and lows of the oil and gas industry, with 6,500 rooms available, market fundamentals since the oil price crash and the pandemic remain extremely challenging, many properties have closed as a result – losing nearly 1,500 rooms since 2014.

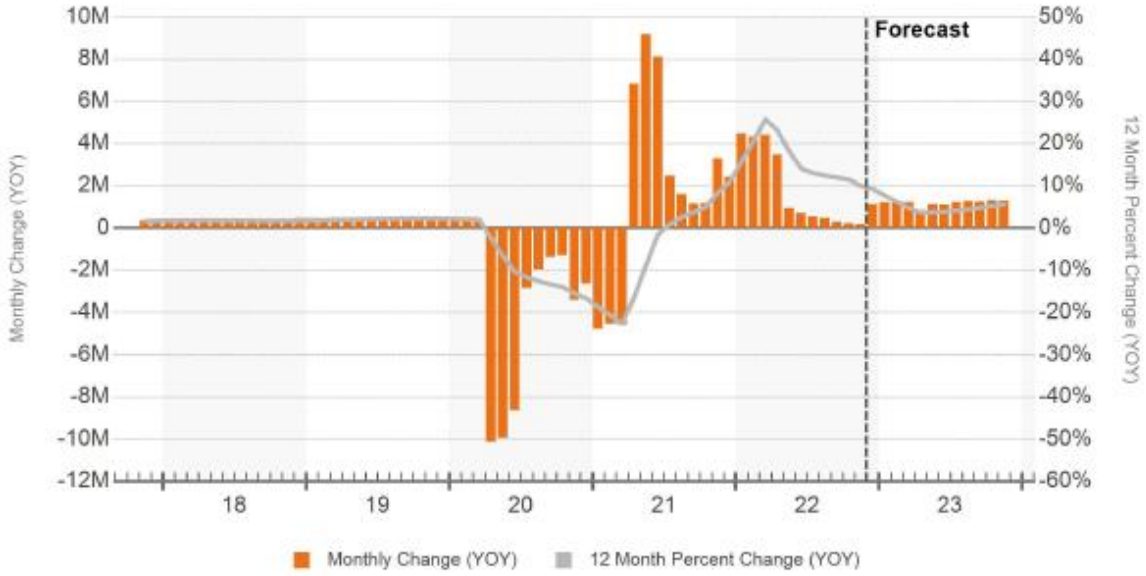
The table below shows the expected Room Deliveries and Demolitions going forward –



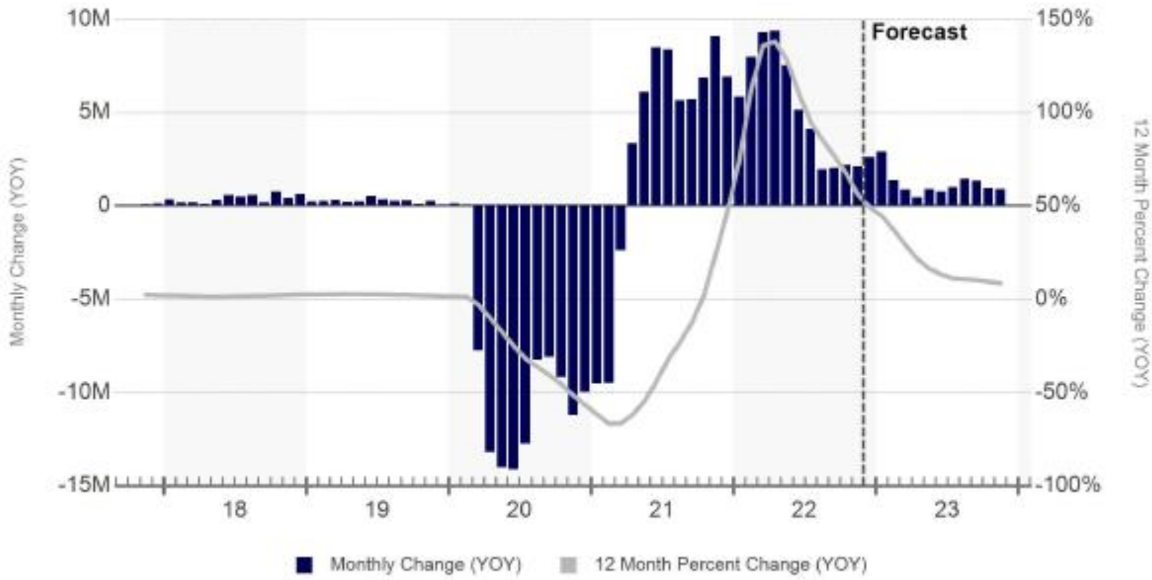
Graph data provided by CoStar

While the hotel market in 2022 performed well, with transaction volumes rebounding in the first half of 2022, it is clear that deal volumes are still lagging behind pre-pandemic levels and the five year average. It was reported by Hotel News Now that in the first half of 2022, UK hotel transactions were down 32% compared to 2019 levels, but up around 32% compared to the first half of 2021. However, despite the strong start to the year transaction activity slowed in Q3 & Q4, with a total of £3 billion of transactions estimated to have completed in 2022, representing a drop of 28% on the £4.14 billion achieved in 2021.

The below table illustrates the expected future Supply Change, we note that volume continues to be impacted by high build costs and a challenging funding climate for development –



The below table illustrates a softening of the market and expected Demand Change –



Graph data provided by CoStar

The cost of living squeeze is expected to continue to impact upon consumer purchasing power, with the greatest affect being on discretionary spend segments of the market into 2023. Operators in the budget and luxury ends of the market are expected to be more resilient, mid-scale and underinvested hotels are expected to see a greater impact on demand.

The current challenges posed by the macroeconomic climate, which followed Brexit and the COVID-19 pandemic, continues to test the financial resilience of many businesses, especially those in our sectors. A significant number of independent hoteliers have emerged considerably more indebted following the pandemic, given the additional loans that were taken on through the government-backed schemes. Many hoteliers have also relied on forbearance from lenders and other creditors, including HMRC, to survive.

The below table shows expected continued ADR growth into 2023/24 –

Graph data provided by CoStar

Speaking to Garin Davies, Chief Executive of Vine Hotels, he commented; *"2022 was a challenging year with strong ADR growth and a continuation of the recruitment difficulties that the industry has seen since the end of the Pandemic. As we move into 2023, rapidly increasing costs and interest rates will create significant problems for poorly managed and highly leveraged hotels. I would anticipate a high number of hotel sales transactions over the next 15 months before operational trading begins to improve in 2024."*

Scott Murcott, Managing Director of Montane Finance, also provided a view on hospitality funding and said; *"Since Covid, the hospitality sector has had to deal with an almost unbearable and unparalleled level of challenges. From agency support, staffing and training demands, rocketing energy costs, capex requirements, through to the reality of being forced to close the front doors. Despite this, and in the face of these hurdles, the sector has rebounded in true British tradition, epitomising why the sector is so important to the UK economy. After a resilient 2022, the sector has evidenced excellent uplifts in key performance indicators such as occupancy levels, average room rates and sales with an expected gain of £36bn compared to pre-pandemic revenue, and £54bn more than in 2021."*

We asked in relation to finance and the likelihood of being able to obtain 'fit for purpose' commercial lending within the sector what will 2023 look like?

"Firstly, the banking landscape has changed dramatically through Covid. Positive feedback from lenders suggests that competitive finance will be made available for owners and operators, seeking to acquire or refinance existing loan facilities. With High Street banks having substantially reduced their appetite for the hospitality sector and in particular, new lending, we have witnessed the birth and expansion of new challenger lenders who hold the scope, ambition, and credibility to aggressively increase market share within the SME sector.

In 2023, we expect to see High Street and institutional funders to continue to lend within a conservative framework, experience and track record remain the pre-requisite. The challenger space continues to be a highly fruitful and lucrative area, holding the ability to provide a more pragmatic and holistic appetite to risk. Debt capacity, pace and continuity of credit policy remain their biggest hurdles.

This year, an increased level of transactional movement is forecasted within hospitality. With an ever changing, diverse and complex landscape of lending options within the hospitality SME space, partnering with a sector specific specialist broker, holding a concise and balanced 'view from the bridge', could be pivotal in terms of securing appropriate lending solutions with competitively priced terms and rates."

Kerian Barnes, Operations and Commercial Director of Starboard Hotels, told us; *"From a personal perspective hospitality is possibly one of the most exciting and resilient industries anyone can be part of. It offers opportunities faster career paths for those willing to take advantage of the training offered and can lead to positions which are highly specialised. The reward and recognition is there but recruitment particularly now more challenging than any time in my 40 years plus in the industry.*

From a business perspective every day is a learning day and the challenges post COVID are certainly there but they can be overcome. For me there are three things which we need to focus on this year; (1) The ability to track the business costs demonstrate clearly we have to increase the rates and I think the corporate guests understand this. After all they are seeing it in their business, (2) As an industry we have to look more to managing our carbon footprint, we do a lot but we need to engage more with the guests in communicating this and encourage their support and (3) Look after our people. This encompasses their welfare, their remuneration and benefits through to training and development. Engaging with education is important in engaging with the future employees."

Outlook for 2023/24

Whilst our sector continues to face some significant challenges and head winds in the months ahead, the outlook for the hotel and leisure sector in the UK (and the rest of the world) is not all doom and gloom. It would seem that inflation may be cooling across housing, fuel, supply costs (including food, liquor and labour) raising the possibility that central banks may not need to increase interest rates as much as initially feared.

Pressure on global supply chains also appears to be easing, it is hoped that the government may be willing to consider changes to UK immigration policy to address the labour supply shortages that have had such significant impact on our sector. Any significant down valuing of assets may also encourage further disposals, with re-aligned pricing seeing buyers and investors with cash looking to take advantage of more realistically priced opportunities.

Whilst trading data points to robust metrics in 2022 and into 2023, one note of caution when reviewing current trading metrics in certain markets relates to the quantum of hotels currently under contract to accommodate asylum seekers.

Reportedly there are in the region of 37,000 asylum seekers in hotels at a cost to the government of around £5.6 million a day. While we cannot verify the accuracy of these figures, it is reasonable to consider that such business benefits the hotel sector in two ways; the generation of significant direct business from the government into certain hotels and the displacement of non-asylum business from those properties into other hotels.

This has undoubtedly enhanced hotel industry key performance indicators, but it may give rise to some future trading challenges when, as anticipated, the demand for accommodating asylum seekers recedes and hotels need to remarket themselves to previously displaced transient business.

The Energy Bill Relief Scheme (EBRS) has provided an estimated £18.4 billion worth of vital support to help businesses persevere through a period of skyrocketing wholesale energy prices. However, the government has been clear that this support would be time-limited and the current iteration of the support scheme will end on 31st March. Replacing it from 1st April is the Energy Bills Discount Scheme (EBDS) which will provide discounts on energy bills which exceed threshold prices, subject to a maximum discount.

Between April 2023 and March 2024, the new scheme will provide a per-unit discount to energy bills if the wholesale price exceeds a threshold value. For most businesses, the maximum discounts will be £19.61 per MWh for electricity over the threshold price of £302 per MWh and £6.97 per MWh for gas over the threshold price of £107 per MWh.

The new scheme attempts to strike a balance between sheltering businesses from sustained volatility in the energy market whilst also reducing the cost burden to taxpayers. Consequently, energy subsidies are to be limited to £5.5 billion in the next financial year. The drastically reduced support offered by EBDS in comparison to its predecessor may leave many concerned about managing future costs.

While wholesale energy prices are reducing and have returned to levels seen before Putin's invasion of Ukraine, the market remains unstable, therefore, the latest government scheme intends to reduce businesses' exposure to this risk and provide the certainty needed to plan ahead. With no further support on offer, businesses must maximise efforts to reduce energy consumption to guard against the risk of enduring high energy costs.

While hotels have in many cases been able to absorb increased costs through higher room rates, the sector will need to continue to seek new efficiencies beyond energy, across areas such as payroll and supply chains. However, where it comes to energy and sustainability, hotel guests themselves are becoming increasingly aware of environmental issues, expecting hotels to assume responsibility and conduct their business sustainably.

Increasingly, we expect this to not only influence a hotel guests booking decisions, but may in the future have a wider impact upon the ability to secure funding and ultimately the marketability of an asset.

The hospitality industry has been relatively quick to respond to necessary changes, with policies and practices being put in place in order to recycle, prevent waste, reduce energy use and lower carbon footprints. Many major players within the hotel sector including Hilton Worldwide, Intercontinental Hotel Group, Marriott, Starwood and Carlson Rezidor, regularly publish sustainability reports and highlight initiatives undertaken to reduce negative impacts on the environment. However, we have seen an increasing demand from hoteliers for robust advice, with many of our clients taking a pro-active rather than re-active approach.

Graham + Sibbald's in-house Carbon + Sustainability team commented, *"The tourism industry is intrinsically linked with the natural environment, often relying on it to attract visitors as well as to provide the natural resources to fulfil their needs during their stay. The industry must strike a careful balance between maximising the opportunities nature provides and protecting it for future generations.*

With pressure being applied on all sides, it is more important than ever that the hotel sector takes measures to understand and reduce the environmental impacts of its operations. Embracing sustainable practices and implementing meaningful change will not only help to attract increasingly environmentally conscious travellers but will also present opportunities to alleviate rising energy cost burdens, reduce carbon emissions, and increase resilience to the effects of climate change. A robust sustainability strategy is no longer an optional 'nice-to-have' but must become a business imperative to remain competitive in a difficult hospitality landscape."

Another fresh concern for the sector is the upcoming Business Rates Revaluation, which may pose a specific disadvantage to many hotels, licensed and leisure premises given that turnover is included as part of the calculated value, the tone date for which is 1st April 2021, which just so happens so coincide with when lockdown restrictions ceased and pent-up demand saw a number of businesses boom, with the effect of the "Staycation" market benefitting many hotels.

Our in-house Business Rates team commented, *"At the Autumn Statement on 17 November 2022, the Chancellor announced the introduction of a new business rates relief scheme in England and Wales for retail, hospitality and leisure properties worth around £2.1 billion in 2023 to 2024.*

The 2023/24 Retail, Hospitality and Leisure business rates relief scheme will provide eligible, occupied, retail, hospitality and leisure properties with a 75% relief, up to a cash cap limit of £110,000 per business.

In Scotland, by comparison, businesses have been back to full rates since the summer of 2022 putting Scottish hotels at a significant disadvantage in their recovery, particularly given the current challenges they are facing with staff shortages and large increases in utility costs.

Rating Revaluations are taking place throughout the UK as from 1 April 2023, however, the value dates differ with Scottish values based on turnover and value evidence as at 1 April 2022 but in England and Wales as from 1 April 2021. It is likely value changes will differ significantly reflecting the covid effect with turnover lower in equivalent English/Welsh subjects.

The proposal by the Scottish Government to 'freeze' the poundage at the previous years' level is a red herring as historically the poundage rate reduces taking into account increases in rateable value countrywide. The process of appealing and challenging value has also been adjusted and has become more complex hence the importance of obtaining professional advice."

Despite the macro-economic conditions, the expected rise in business distress and insolvency in 2022 did not materialise despite the early predictions of many at the start of 2022. However, the economy is expected to contract in 2023, although there is much speculation over the depth and extent of any period of recession, increases in business distress appear to be inevitable.

In 2023 it is expected that non-performing assets will increasingly be brought to market, creating opportunities for well-funded experienced operators, speculative investors and private equity that have been waiting for an increase in the "distressed" market. However, we expect there to continue to be an underlying volume of quality opportunities brought to market that are not distressed and that transact readily as a result of robust trading fundamentals and market demand, underpinned by a continued degree of pent up demand.

How can we help?

Any rise in business distress and insolvency will lead to the increasing need for the sector to seek robust advice. The prudent approach for clients is to seek quality brokerage, valuation and consultancy services as the compounding challenges facing the sector further impact on operational real estate.

Graham + Sibbald are increasingly recognised as one of the leaders in hotel, leisure and hospitality across the UK, our team working across a range of business types and sectors, with a particular strength of expertise in the Hotel, Licensed and Leisure sector.

Graham + Sibbald are retained by many of the UK's leading hospitality and leisure groups to provide advice from a team that boasts years of experience and an excellent track record. Together with our multi-disciplinary service lines, we are currently providing strategic reviews, valuations and managing the disposal process and acquisition of hotel assets and business portfolios across the industry.

The team believe that we are well placed to advise upon all aspects of the market and the challenges facing the hotel, licenced and leisure sectors. Indicators are that the market downturn will hopefully be relatively short lived (assuming that consumer confidence is not too hard hit).

As part of the teams proactive response to our clients needs, in October of 2022 two of our hotel and leisure specialist Directors, Martin Davis and Hugh Anderson, were appointed as Associate Members of The Institute for Turnaround.

The IFT is the UK's leading membership organisation for turnaround experts. The members of the institute are accredited to the highest standards and together with their corporate partner organisations, help underperforming businesses avoid unnecessary insolvencies.

Graham + Sibbald can advise and support our clients through the current challenges and welcome any opportunity to discuss specific needs and help identify opportunities.

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