Kimmre

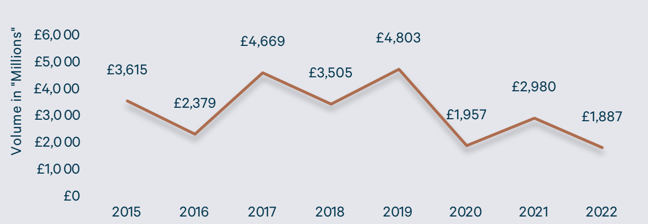
Thought leadership from the Kimmre team

HOTEL EDITION

The Kimmeridgean

H1 2023

Hotel Deals volume 2015-22, United Kingdom



Deal volumes across the entire hotel investment market remain low, hindered by a very slow H2 2022 following the mini budget. Investor appetite appears to be growing at the start of 2023 with signs of renewed interest across the leased and operating space. The UK is sitting in pole position globally in terms of occupancy rates at 72.1% according to STR compared with an average of 62.2% across the remaining top 10 countries. Occupancy has however been boosted by ongoing Government asylum contracts, which further enhances the supply/ demand in-balance across the UK and while the Government would like this to be a short-term solution, there does not appear to be an end in sight for these contracts. Will this help drive investor interest?

Prime Hotel Leased Yields

	Pre-Covid	Post-Covid	Post Mini-Budget/Current	Yield Trend
Premier Inn	4.00%	3.75%	4.50%	
Travelodge	4.50%	5.25%	5.75%	
Other long lease hotel brands	4.25%	4.00%	5.00%	

Post mini budget, the first Premier Inn sale was Red Lion Square in Holborn which was bought by Whitbread at 4.75%, however this provided some much-needed market confidence and saw some gazumping attempts by UK funds. Since then we have seen a flurry of deals setting strong evidence including Borehamwood, Dalston and Ringwood, demonstrating a tightening between the pre budget yields and current values. Kimmre have also been very active in the Travelodge market which has been more challenging given the tenant credit risk and recent CVA. The evidence being set is more haphazard with larger swings and less pattern in pricing, albeit there still appears to be a growing depth of investor demand across all lot sizes. Kimmre's recent sale of the Travelodge in Whetstone has set a good benchmark for current evidence.

Pre Mini-Budget

Travelodge Battersea
Dec-21 – 4.25% - £36.50m

Premier Inn – Peterborough
Jan-22 – 3.65% - £16.50m

Post Mini-Budget

Travelodge Wrexham
Oct-22 – 5.75% - £2.09m

Latest Deals

Travelodge Whetstone
Mar-23 - Sold – 5.75% (THL only)

Premier Inn - Ringwood
Jan-23 - Sold – 4.63%

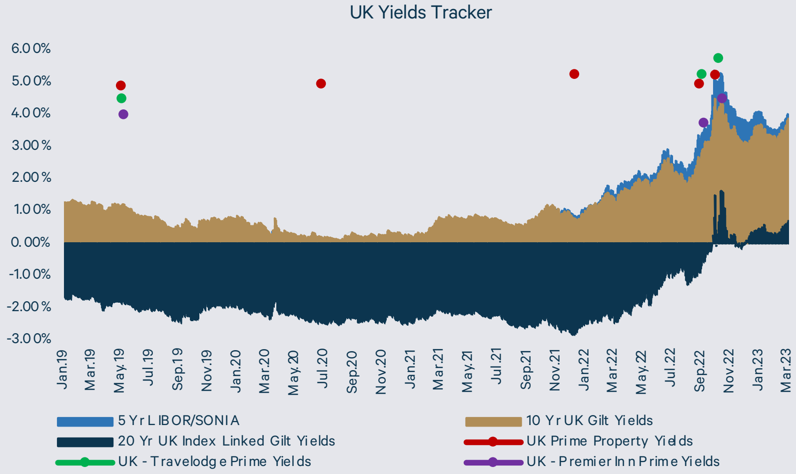
Investment Market Overview:

- **Positive Investment Activity:** Since H2 2022 there have been 4 Premier Inn, 5 Travelodge sales (with a further 10 understood to be in legals). There is a renewed interest in other leased hotel sales and some positive signs in the managed hotel space. The Native Hotel on Bankside sold in Dec 2022, on a long lease to a weak covenant at a yield reflecting 5.1%, with the purchaser subsequently surrendering the lease with Native and now operating the hotel under a long-term management agreement.
- **Historic Trend:** Although the overall investment levels dropped dramatically in Q4 to £173m from £593m in Q3 as inflation and interest rates continued to rise, £150m changed hands in December 2022 highlighting a recovery in investor's confidence as wholesale gas prices started to fall and inflation eased slightly.
- **Yield Stability:** Premier Inn (PI) average yields had hardened by c50bps during H1 2022 in comparison to pre-covid average yields before it started to soften following Kwasi's mini-budget. Recent transactions are showing strong signs that yields appear to only have moved by 50bps from peak, pre Covid levels.
- **Opportunities:** Travelodge (TL) yields remain volatile with yields ranging from 5.00% to 8.50% with the current evidence for prime yields being set at 5.75%. We also believe that there is value to be had in the direct management and franchised hotel market. New developments will prove difficult from a viability perspective leading to more repositioning and refurbishment opportunities as generational owners seek an exit due to rising debt costs and capex obligations.
- **Pricing Discovery:** There has been a dramatic change in sentiment in February 2023 with the return of the UK funds seeking prime, long income opportunities. A stark contrast from the end of Q4 2022.

Green Shoots or Smoke on the Horizon?

Is this a false dawn or is there some long term stability. The next speed bump in the road will be as banks start to test ICR and LTV covenants which will put pressure on vendors to sell. Kimmre believe that we will see a continued, yet volatile recovery with bumps along the way. There is a surprising depth and breadth of equity in the market and borrowing costs appear to be falling slightly making leveraged acquisitions slightly more viable.

UK Yields Tracker



Kimmre view – Net purchase yields need to be 5.5% plus to make leveraged acquisitions viable and long income margins appear to be tightening between gilt, lending rates and purchase prices, albeit with much lower deal volume. Pre Covid, the delta between PI headline yields and index linked gilts was 600bps. Today that delta appears to be half that.

Top 10 Cities	Occupancy	ADR	Rev Par
Pre Covid	77.9%	£81.70	£63.64
Post Covid	72.5%	£96.16	£69.71
Change	-6.93%	+17.70%	+9.53%

With occupancy rates showing strong signs of recovery, ADR levels have already surpassed pre-covid levels in top 10 cities on average reflecting a 17.70% premium over pre-covid levels resulting in an overall 9.53% growth in RevPAR over pre-covid levels. The outlook from operators remains positive for hotel trade throughout 2023 despite the well documented macro economic headwinds. Whilst the Government contracts are contributing to some of this performance, given the lack of viable alternative options for asylum contracts, this is likely to be a long term contributor to performance and also throttle supply of remaining hotel accommodation for the private market.

Kimmre's UK pick – star performing location by RevPAR recovery - **Nottingham (18.7% growth since 2019).**

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