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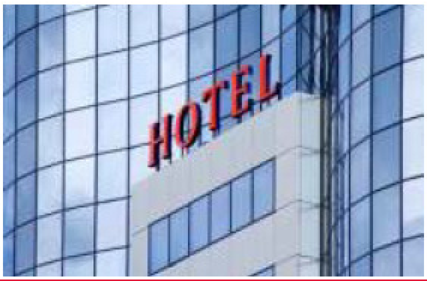
IN FOCUS: EDINBURGH HOTEL MARKET

HOMECOMING SCOTLAND 2014

Harry Douglass, MRICS
Senior Associate


Introduction

As Scotland prepares to host the Commonwealth Games in Glasgow from 23 July to 3 August and the Ryder Cup at Gleneagles two months later, the spotlight is firmly on the country which may become an independent state after the Referendum on 18 September.

Following the disruption to hotel room occupancy caused by the 2012 Olympic Games in London, hotel performance in Edinburgh largely improved in 2013.

As a new five-star hotel operator for the old Royal High School building is announced and future performance forecasts for Edinburgh are positive across the scale, evidence suggests however that despite robust occupancy, the average rate of the market as a whole has been compromised in the medium term by several limited-service hotel developments.

Whilst the capital city remains an attractive market with one of the highest RevPARs in Europe, hotel owners and investors should be aware of the requirement to employ dynamic management with strong marketing and sales skills to maintain market share.

Introduction

With a population of 1.3 million, Edinburgh is the UK's second financial centre after London and ranks 22nd in Europe's Global Financial Centres Index (GFCI, September 2013). The city has the highest Gross Value Added (GVA) per capita of any UK city outside London with five of the ten largest companies by employee numbers operating in financial services. The wider economy is supported by significant leisure and tourism.

Edinburgh has a significant public sector workforce and a full and part-time student population of around 100,000 including 15,000 international students at its colleges and four universities. Strong research and development capabilities in mathematics, engineering and medicine have been developed.

EDINBURGH CITY CENTRE

A compact city steeped in history with notable cityscapes and exceptional vistas, it is also a popular weekend-break destination. One can walk from Haymarket at the western end of the city centre to the old Royal High School building and Regent Gardens at the eastern end in 40 minutes. This convenience contributed to the UNESCO World Heritage Site's award of 'Europe's Leading Destination' at the 2012 World Travel Awards.

Visitor Attractions

Edinburgh benefits from some important city centre attractions throughout the year with attendance figures for 2013 up on 2012 and a significant increase on 2010 during the global recession.

Overall, more than 8 million people visit Edinburgh and The Lothians' attractions every year. Elsewhere, the East Lothian 'Golf Coast' boasts over 15 world class links courses with year round playability due to the favourable ground conditions and prolonged milder climatic periods.

FIGURE 1: TOP FIVE EDINBURGH VISITOR ATTRACTIONS

Rank	Edinburgh Attraction	Visitor Numbers 2010	2011	% Change	2012	% Change	2013	% Change
1	National Galleries of Scotland	1,281,000	1,533,000	19.7	1,290,000	(15.9)	1,200,000	(7.0)
2	National Museum of Scotland	619,000	1,495,000	141.5	1,894,000	26.7	1,768,000	(6.7)
3	Edinburgh Castle	1,210,000	1,303,000	7.7	1,204,000	(7.6)	1,420,000	17.9
4	Royal Botanic Gardens Scotland	707,000	791,000	11.9	722,000	(8.7)	680,000	(5.8)
5	Edinburgh Zoo	547,000	537,000	(1.8)	595,000	10.8	761,000	27.9
	St Paul's Cathedral, London[1]	-	1,819,000	-	1,790,000	(1.6)	2,138,000	19.4
	Edinburgh Totals:	**4,364,000**	**5,659,000**	**29.7**	**5,705,000**	**0.8**	**5,829,000**	**2.2**

[1] *Provided for comparison*

Sources: The GCU Moffat Centre & ALVA 2014

FIGURE 2: TYPICAL ANNUAL FESTIVAL EVENTS

Edinburgh Festival Event	Date	Attendance *
Edinburgh Jazz & Blues Festival	July	40,000
Edinburgh Art Festival	August - September	700,000
Royal Edinburgh Military Tattoo	August	230,000
Edinburgh Fringe Festival	August	2,000,000
Festival of Spirituality & Peace	August	30,000
Fringe by the Sea	August	8,000
Edinburgh Interactive	August	5,000
Edinburgh International Festival	August - September	400,000
Edinburgh International Book Festival	August	320,000
Festival of Politics	August	55,000
International Television Festival	August	5,000
Edinburgh Mela	August - September	35,000
Total		**3,828,000**

* Approximate number of ticket holders
Source: Edinburgh City Council 2013

The Edinburgh Festival

The Edinburgh Festival is a defining period in the city's calendar with marketwide hotel occupancy at or near 100% over the six-week period in high summer. Broad attendance figures for the typical events are shown in Figure 2.

Edinburgh also benefits from a varied calendar of other events generating significant visitation. In 2013 alone, more than 1 million people travelled to the city for three Six Nations rugby

FIGURE 3: PROXIMITY TO LEISURE ATTRACTIONS

Place of Interest	Distance from Edinburgh (km)	Typical Journey Time By Road (mins)
Pentland Hills Regional Park	10	15
Lomod Hills Regional Park	32	45
Gleneagles Country Club & Perthshire	64	60
St Andrews Golf Destination	80	85
Clyde Muirshiel Regional Park	104	90
Loch Lomond & The Trossachs National Park	112	110
Northumberland National Park	112	120
Cairngorms National Park	144	130

Source: Google Maps & HVS Research

internationals, several literary and sports festivals, the Open Golf Championship at Muirfield and the Christmas period. An estimated 100,000 people stay in the city over the New Year's Eve Hogmanay celebrations every year.

Strategic Importance

Forty minutes from Glasgow, two and a half hours from Aberdeen, three and a half hours from Manchester and four and a half hours from London by train, the city may also benefit from Phase 3 of the HS2 network. The Scottish capital is also centrally located for a number of natural and other attractions which explain its strategic geographical importance as shown in Figure 3.

International Connectivity

There are five principal international airports within 200 km or approximately two hours travel time of the city, servicing a range of international low cost and conventional carriers, making the city easily accessible from overseas.

Some 64% of annual visitation to the city is still domestic with the balance principally from Europe (Visit Scotland 2013).

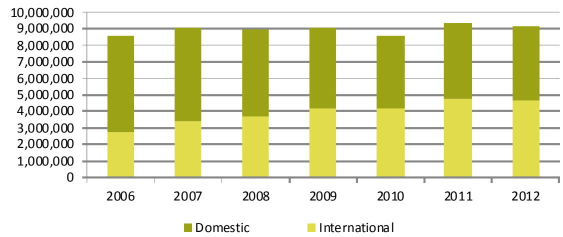
FIGURE 4: MAIN AIRPORTS

Airport	Distance from City Centre (km)	Typical Journey Times (mins) By Car	Typical Journey Times (mins) By Train
Edinburgh Airport	10	20	—
Glasgow Airport	88	60	120
Glasgow Prestwick Airport	122	90	135
Newcastle International Airport	168	120	120
Aberdeen International Airport	208	160	150

Source: Google Maps & National Rail Enquiries

Edinburgh Airport is Scotland's largest airport and the fifth largest in the UK by passenger movements, with over 40 carriers servicing more than 100 destinations. The airport's top three international destinations, in order, are Amsterdam, Paris Charles de Gaulles and Dublin. Both Geneva and New York are in the top ten and direct links operate to both London Heathrow and Gatwick.

FIGURE 5: EDINBURGH AIRPORT PASSENGER VOLUMES



Compound Annual Growth Rate 2006-2012	
Total	2.3%
International	9.0%
Domestic	(1.8)%

Source: Airports Council International 2014

2013 market its busiest year ever with a 6.3% increase in passenger numbers on 2012. This was due to EasyJet's introduction of two additional planes providing links from Berlin, Hamburg, Reykjavik, Dubrovnik, Prague and Copenhagen which are estimated to generate an estimated 15 million more passengers to Edinburgh over the next five years. Air Canada Rouge now operates a route from Toronto, Canada and Qatar Airways a direct service to Doha which complements Emirates' twice daily flight from Glasgow to Dubai. A master plan is also in place to ensure that Edinburgh airport can handle an increase in international passenger movements to 12.3 million by 2020 and to 20.5 million by 2040.

Conventions

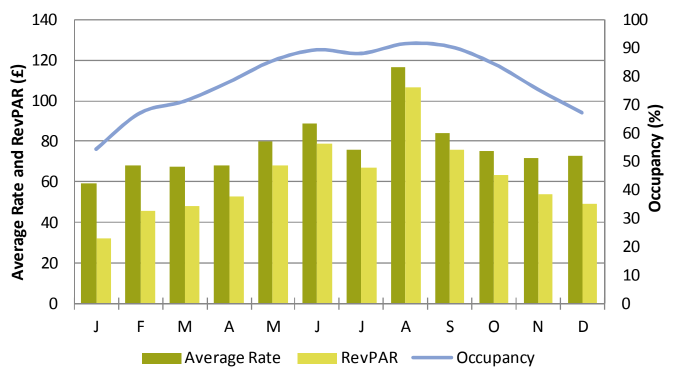
The city has 18 principal venues as well as the Edinburgh International Conference Centre (EICC) which provides six suites arranged over 1,600 m^2 including a new state-of-the-art multi-purpose hall with a 3,200 delegate capacity designed to attract international executive level events.

These combine to secure Edinburgh's position as the UK's most popular city after London for hosting international association meetings (ICCA 2013).

Seasonality

The market benefits from the Edinburgh Festival around August with the conference and events season typically following from September to November. The marketwide Average Daily Rate (ADR) is consistently above £60.00 and, excluding January and February, occupancy is in excess of 70%. Many of the city centre hotels, however, operate at 90% occupancy throughout the year.

FIGURE 6: SEASONALITY



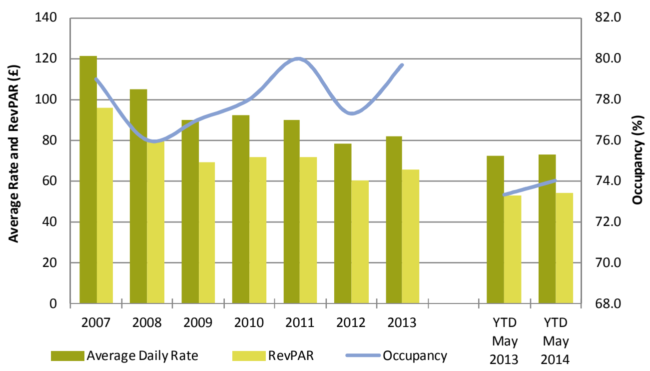
Source: STR 2013

Marketwide Hotel Performance Overview

Figure 7 summarises the Edinburgh marketwide hotel performance for the last seven years from a representative sample of hotels covered in our research.

From the 2007 economic peak, occupancy declined to 76% in 2008 before a rally in 2011 saw it climb to 80% which preceded a weaker 2012, resulting from recessionary pressures and the disruption caused by the Olympic and Paralympic Games in London.

FIGURE 7: MARKETWIDE HOTEL PERFORMANCE 2007-2015



Source: HVS 2014

The ADR achieved in 2013 was an improvement on 2012; however, there has been an overall decline over the last seven years due to continued economic pressures and perhaps due to the introduction of a high volume of additional limited-service hotel inventory. As a result of these dynamics, Revenue Per Available Room (RevPAR) has also declined by 31% in the same period.

As has been seen elsewhere in the UK, RevPAR for the year to date May 2014 is up on the previous year. We also forecast an overall increase in ADR this year due to the impact of the Commonwealth Games and Ryder Cup, coupled with some corporate demand growth. We anticipate that new supply however will compromise future short term occupancy preventing a further improvement in RevPAR in 2015. Our forecasts here and for the latter sub-sectors largely account for a spike this year and further economic improvement in 2015

Five-Star Hotel Market Overview

There are four established five-star hotels with a total bedroom inventory of 834 rooms across Edinburgh city centre.

Having arguably the best location in Edinburgh at the eastern end of Princes Street by Waverley Station, the Balmoral boasts a Michelin starred restaurant and the JK Rowling Suite, where the author stayed to complete Harry Potter and the Deathly Hallows in 2007.

Following a comprehensive £24 million refurbishment completed in November 2012, the Caledonian Hotel at the western end of Princes Street became the Waldorf Astoria and has reported its first full year results following the rebranding.

FIGURE 8: FIVE-STAR HOTELS

Property	Number of Rooms	Year Built / Last Renovation	Restaurants & Lounges	Spa & Health Club	Meeting Rooms	Meeting Space (m^2)	Management Entity
The Balmoral	188	2010	4	Y	10	1,120	Rocco Forte Hotels
The Caledonian	241	2012	4	Y	8	545	Hilton Waldorf Astoria
Quorvus (formerly Missoni)	136	2009	2	Y	4	250	Carlson Rezidor Hotel Group
The Sheraton Grand Hotel & Spa	269	2012	4	Y	14	990	Starwood Hotels & Resorts
Totals	**834**					**2,905**	

Source: HVS Research 2014

The designer Missoni hotel was purpose-built in 2009 for the Rezidor Hotel Group and occupies a prominent position on the Royal Mile. The hotel has now been rebranded a Quorvus Collection as part of the group's new strategy.

THE OLD ROYAL HIGH SCHOOL BUILDING

In May 2012, the Sheraton Grand completed a comprehensive renovation. Situated on Festival Square, the hotel is adjacent to the EICC and markets itself as the city's premier incentives hotel.

We understand that the old Royal High School building on Regent Road to the east will be part of this market in the near future.

Figure 9 summarises Edinburgh's five-star hotel market performance.

Occupancy is broadly stable at 73.0% where we expect it to remain. After a sustained increase from 2010 to 2012, ADR declined in 2013 suggesting a highly competitive environment. As a result of these dynamics, RevPAR has followed a similar pattern marking only an 8.3% increase since 2010.

EDINBURGH POINTS OF INTEREST

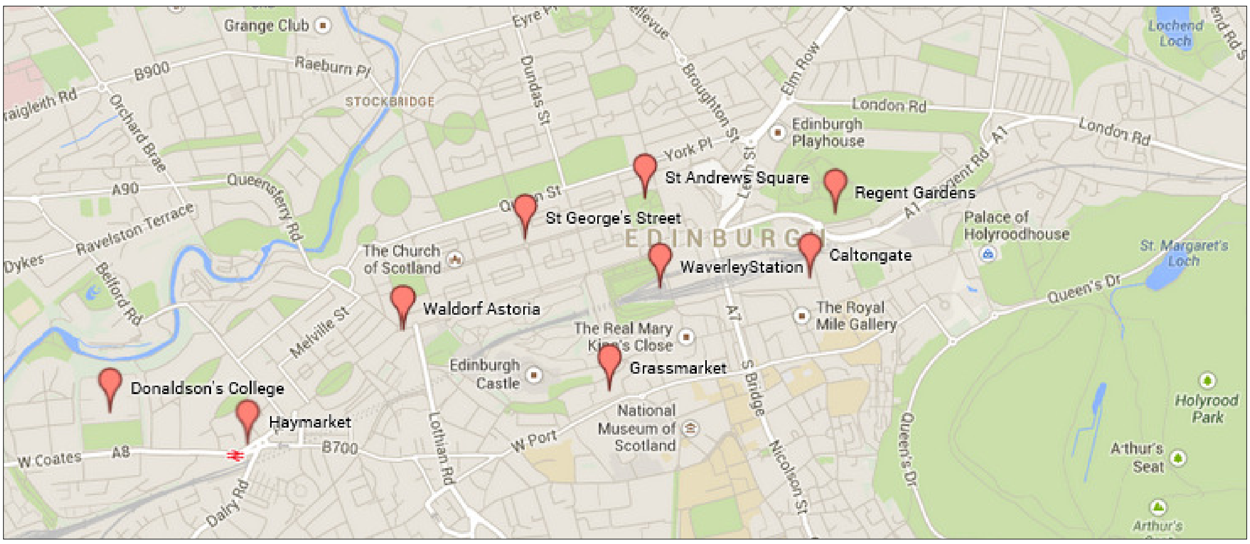
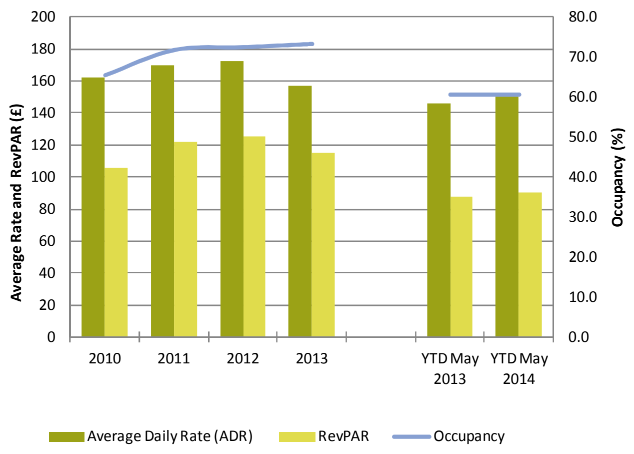


FIGURE 9: FIVE-STAR HOTEL MARKET PERFORMANCE



Source: HVS 2014

There is broadly no change in RevPAR for 2014 year-to-date compared to 2013. We forecast an overall year-on-year increase in ADR through 2014 and 2015 due to the lack of new supply and demand for centrally located accommodation.

Upscale Hotel Market Overview

The city also features a number of upscale hotels that are equally reliant on the corporate and leisure markets and which comprise a range of bedroom inventories. They are spread over a larger geographical area, some of which are summarised in Figure 10.

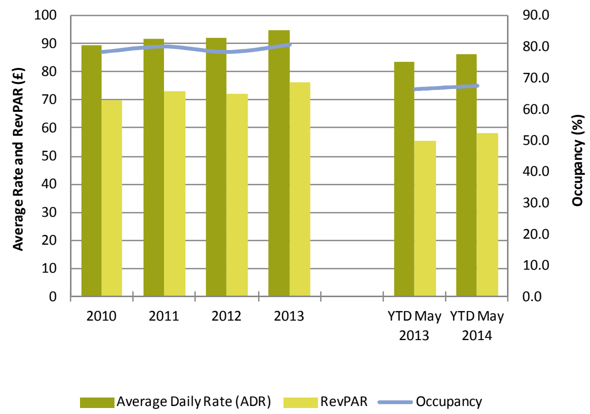
Figure 11 summarises Edinburgh's upscale hotel performance demonstrating recent occupancy of around 79%, an ADR of £87.

FIGURE 10: UPSCALE HOTEL MARKET

Property	Number of Bedrooms	Number of Meeting Rooms	Meeting Space (m²)	Management / Ownership Entity
George Hotel	249	8	615	Principal Hayley
Radisson Blu	238	8	1,050	Carlson Rezidor
Roxburghe Crowne Plaza	199	7	645	IHG
Carlton Hotel	189	10	905	Puma Hotels
Apex Waterloo Place	187	5	312	Apex Hotels
Hilton Grosvenor	184	7	720	Hilton Hotels
Novotel Edinburgh City	180	5	225	Accor Plc
Apex International	169	3	141	Apex Hotels
Mercure Princes Street	158	6	210	Accor Plc
Royal Terrace Hotel	107	3	170	Prima Hotels
Malmaison Hotel	100	5	175	KSL Capital Partners
Norton House	83	13	565	Hand Picked Hotels
The Scotsman	69	7	765	JJW Hotels & Resorts
Glasshouse Hotel	65	3	100	Marriott Autograph
Hotel du Vin	47	4	80	KSL Capital Partners
Totals	**2,224**		**6,678**	

Source: HVS Research 2014

FIGURE 11: UPSCALE HOTEL MARKET PERFORMANCE



Source: HVS 2014

After a challenging operating period, we anticipate a much more subdued increase in overall RevPAR as the upscale market competes with the new limited-service hotel inventory whose 'amenity creep' (as acknowledged by some of the city's key operators) is becoming apparent and the gap narrows with the quality of hotels such as the new Hotel Indigo (60 rooms in 2012) and the adjacent Holiday Inn Express (161 rooms). The 138 room Point Hotel on Bread Street in the financial centre also recently re-branded to Hilton Doubletree.

The performance of this sector broadly reflects the static four-star trading conditions experienced elsewhere in the UK up to now. Our medium term forecast however is more positive due to the anticipated increase in domestic MICE demand and overall visitation. A rate premium still exists for well presented central hotels in good condition, as there are considerable differences in the quality within this sample.

Limited-Service Hotel Market Overview

Edinburgh has experienced a 170% increase in its limited-service hotel inventory in the last eight years. The quality of the individual hotels in this sector again varies, with older stock having to compete with contemporary brands.

These include the easyHotel (29 rooms in 2011), the Residence Inn by Marriott (107 rooms in 2011), the new Travelodges on Queen Street and Princes Street (181 rooms in 2012), Premier Inns on The Gyle and Princes Street (198 rooms in

2012), the Tune Hotel Haymarket (179 rooms in 2013), two Motel One hotels on Market Street (208 rooms in 2012) and Princes Street (138 rooms in 2014), and the Ibis Cowgate (259 rooms in 2014). Figure 12 illustrates the performance of this sector.

Future Supply

We are aware of a number of additional hotels in the pipeline, some of which are summarised in Figure 13. These illustrate the continued demand for locations across the capital for a variety of accommodation types. Just as we have focussed on the city centre, this schedule largely ignores new supply on the outskirts and towards the airport where there is continued investor interest.

FIGURE 13: FUTURE SUPPLY 2014-2018

Property	Anticipated Service Level	Number of Rooms	Estimated Opening Year	Development Stage
De Vere Village Urban Resort, Leith	Upscale	120	2015	Under Construction
Hub by Pemier Inn, Rose Street	Budget	157	2015	On site
Hub by Premier Inn, Caltongate	Budget	131	2015	On site
Four Star Hotel, Market Street	Upscale	120	2016	Operator Selection
Four Star Hotel, Victoria Street	Upscale	267	2017	Operator Selection
Staycity, Haymarket	Limited Service	170	2017	On site
Courtyard by Marriott, Baxter's Place	Midscale	230	2017	On site
Royal High School, Calton Hill	Five Star	150	2018	Operator Selection
Donaldson's College, West Coates	Five Star	120	2018	Scheme promotion
King's Stables Road, Edinburgh Castle	Midscale	150	2018	Scheme promotion
42 St Andrews Square, George Street	Upscale	125	2018	Scheme promotion
New Waverely	Apart-hotel	146	2017	Early development
Total		**1,886**		

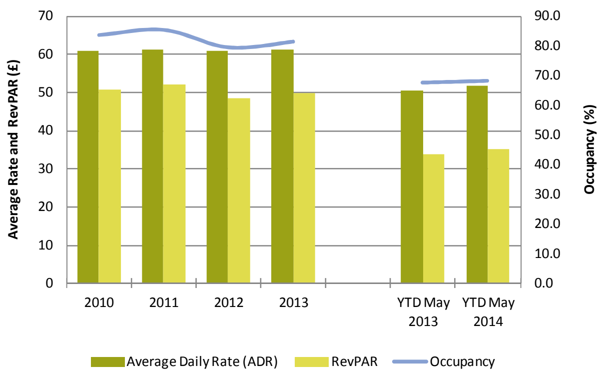
Source: HVS Research 2014

Conclusions

With improved international connectivity and a robust local economy, the outlook for the capital city of Scotland is good. The destination attracts a more diversified visitor profile than before with the southern hemisphere now an important source market following the regional connections to the middle-eastern airline hubs at Doha and Dubai. Our analysis however confirms the market is demonstrating clear price-sensitivity and that significant rate growth in the five-star market especially is unlikely in the medium term.

Despite the compact nature of the destination, the location of hotels is arguably more important than in larger cities, although the core centre is expanding with new developments in emerging locations as a result of the weight of demand. The tone of the market is also extending eastwards.

FIGURE 12: LIMITED-SERVICE HOTEL MARKET PERFORMANCE



Source: HVS 2014

The city has experienced a population increase in recent years and was named the second best place to live in the UK after Bristol in MoneySuperMarket's *2013 Quality of Living Index*. This interest is pushing up owner-occupier demand for residential properties as well as attracting significant interest from international and London based investors which may mean hotel use will be in direct competition with new residential developments.

The hotel development environment comprises a handful of established developers with strong track records, the proactive city council and various other institutions and family trusts. Hotel operators seeking to establish a presence are in competition with other property classifications and are aware of the potential necessity to convert a centrally located opportunity within the highest concentration of listed buildings anywhere in the UK – or be prepared to take a purpose-built scheme in a more peripheral location or with a longer entry horizon.

Whilst we are aware of several international requirements across all service levels including amongst notable others: Jumeirah, Hard Rock, Starwood, Hyatt, Hilton and MEININGER, we consider that future visitation to the city will be sufficient to support far more international brands that offer something different and who are aware of the local nuances and commit to appropriate scale.

About HVS

HVS is the world's leading consulting and services organisation focused on the hotel, mixed-use, shared ownership, gaming and leisure industries. Established in 1980, the company performs 4,500+ assignments a year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.

With an office in London since 1990, HVS London serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised some 4,000 hotels or projects in 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuations and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks which finance hotels and portfolios.

About the Author

Harry Douglass is a Senior Associate with the HVS London office's valuation & consultancy division. He holds an MSc in Real Estate Management and qualified as a member of the Royal Institution of Chartered Surveyors (MRICS) in 2006. Harry joined HVS in 2012 bringing with him experience in the UK commercial property and alternative investment sectors. Recent assignments at HVS have included hostel and hotel feasibility studies, loan security valuations, market assessments, transaction negotiation and due diligence, and development consultancy.

For further information, please contact:
hdouglass@hvs.com
+44(0) 20 7878 7720

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