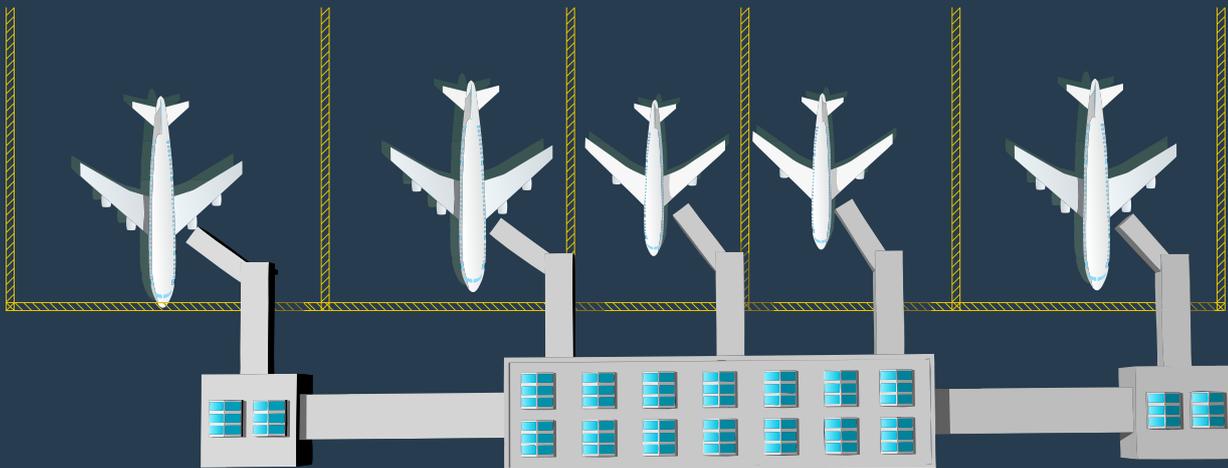
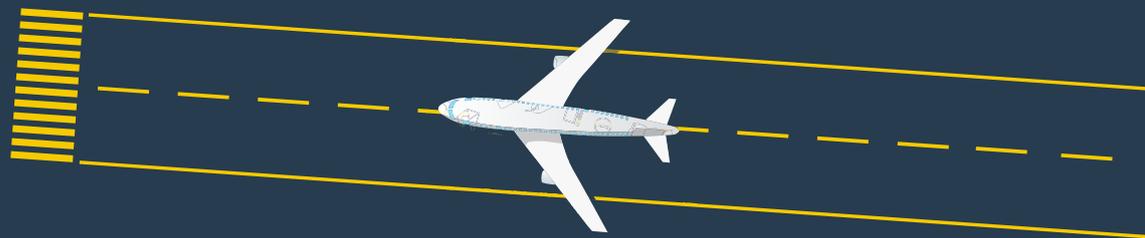


Heathrow's third runway and the opportunity for the hotel sector



What does a third runway mean for the Heathrow Hotel market?

For almost half a century there has been disagreement about where to build additional airport capacity in the UK, with Heathrow being both the most favoured, as well as the most controversial option.

Since opening Heathrow Airport has grown to be one of the world's largest handling over 76 million passengers each year. Proponents of a third runway at Heathrow have long argued that, without the expansion, the Airport will lose out to its European and Global rivals and the central importance this has to the UK's economy. Critics have cited the environmental cost of increasing air traffic movements and the disruption to the local community. The result of this is that the South East hasn't had a new runway since World War II.

We have modelled the potential impact of a third runway for hoteliers and developers. We have been following developments at Heathrow closely, having worked on multiple hotel projects there over the last decade, including the Moxy by Marriott, Ibis Styles and Ibis Budget, Holiday Inn and Staybridge Suites, to name a few.

The principal interest of the hotel community has always been whether or not the third runway will go ahead and what demand would this generate for new hotels? It is important to remember that, in addition to generating increased demand for hotels, an expansion to Heathrow would have a major impact on existing hotels around the airport, a number of which sit within the area ear-marked for construction and may be subject to demolition.

Following the vote in favour of the new runway this year, we thought it was time to consider the proposals in detail. We analyse hotel demand moving forward in order to gauge the volume of room stock required to 2040, and the level of jobs this will provide the local area.



What's been happening in 2018?

On 25 June 2018, MPs voted overwhelmingly in favour of a third runway for Heathrow, dashing the hopes of "Gatwick, Obviously" in one fell swoop. After decades of debate, a series of challenges remain in the way of expanding Britain's biggest airport: a legal case (brought by a group that includes four local councils -Wandsworth, Richmond, Hillingdon and Hammersmith and Fulham, the Mayor of London Sadiq Khan and Greenpeace), a judicial review, public consultation and a planning application. Construction could begin in 2021, with flights launching in 2026.

Why has this taken so long? According to some commentators, Heathrow is simply in the wrong place. It is surrounded on all sides by almost a million disgruntled residents where prevailing winds force planes coming into land to fly low over the city. The latest proposals will see the Airport pay 'noise pollution compensation' to 400,000 homes, and those are the lucky ones as almost 800 (three whole villages), are set to lose their homes entirely. Drivers can look forward to five years of road chaos as the M25 is moved underground. The current estimated cost is £14 billion – double Gatwick's proposals - on top of a further £10 billion picked up by the tax payer to fund the revised transport links. This is all of course, on top of the environmental impact campaigners have long warned of.

Despite all this, the case for Heathrow has proven overwhelming. Heathrow is the UK's key hub airport, ranked 7th busiest in the world with over half a million flights each year and is 'at capacity'. Keen to maintain the Airport's position ahead of its two European competitors, Schiphol and Charles de Gaulle, and in the face of Brexit, Heathrow needs to offer direct access to new and expanding markets. The third runway at Heathrow has come to represent Britain's commitment to being outward looking and maintaining London's global city status.

Whilst, in the end, MPs voted unanimously in Heathrow's favour, the issue has polarised parliamentarians, none of whom have come out of the debate unscathed.



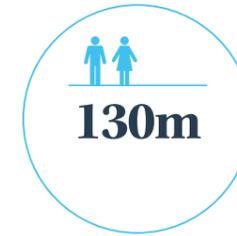
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Heathrow's expansion proposals

Heathrow published the 'Heathrow Expansion – Our Emerging Plans' report in January 2018 setting out the latest proposals for the third runway.

The runway, along with a possible new satellite terminal will be built north-west of the current two runways. Through the scheme, the Airport hopes to:



Increase passenger capacity from 76 million to 130 million, deemed to be sufficient until 2040 for the 'hub' Airport



Increase in annual Air Transport Movements (ATMs) from an average of 473,000 today – up by approximately 55%



Cargo transportation per year up from 1.5m tonnes

The preferred expansion of Heathrow



Source: 'Heathrow Expansion – Our Emerging Plans', January 2018

How quickly will the expanded Airport grow?

Up to the anticipated opening of the third runway, passenger numbers are expected to continue growing from 76 million to approximately 85 million through reconfigurations in existing operations. When the new runway launches, scheduled for October 2026, passenger numbers are forecast to increase to 95 million, reflecting a growth of 11%, and then continue growing incrementally up to 130 million.

Which hotels will be 'displaced'?

Heathrow has estimated that a north-west expansion could displace between 2,355 and 2,960 hotel bedrooms, dependant on the final Masterplan selected. From an examination of the current preferred option, presented in the map), it would indicate the hotels most likely to be impacted include: Heathrow Lodge Hotel, Thistle London Heathrow Hotel, Premier Inn London Heathrow Airport Terminal 5, Harmondsworth Hall Hotel and The Sheraton Hotel Heathrow. This accounts for 1,134 bedrooms.

The Hyatt Place London Heathrow Airport, and soon-to-open Holiday Inn, Ibis Budget and Staybridge Suites may also be affected by the development of 'airfield infrastructure', meaning a possible impact on 1,222 additional bedrooms.



Heathrow is served by 50 hotels and almost 13,000 bedrooms, 52% of which are four-star



Heathrow's estimate of required hotels

Currently, Heathrow has 50 hotels and almost 13,000 bedrooms, of which 52% are four-star with the next largest segment is limited service hotels comprising over a quarter of the room stock. Over 1,800 rooms have opened since 2014 and demand has continued to grow, with a further 23 projects in the pipeline and almost 3,000 rooms due to come online in the next 18 months.

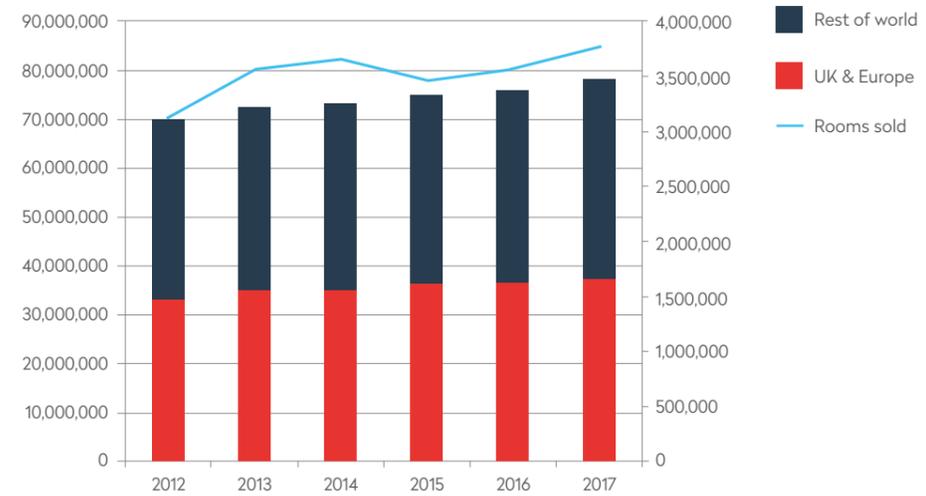
Heathrow's 2018 strategic report indicates a need for 9,260 additional bedrooms to 2040 across three categories: terminal-linked, bus-linked and more distant rooms.

Heathrow needs between 21,200 and 23,800 bedrooms

GVA reviewed Heathrow's historic passenger numbers, including the proportion of these that are from domestic flights and the growth in demand for hotel rooms to understand the correlation. Over the last three years there has been growth in overall demand, alongside a slight increase in the proportion of rooms sold to total passengers as domestic passenger numbers have declined.

Domestic passengers as a proportion of the total have been decreasing over time, and we expect this trend to continue due to the growth of regional airports and because of consumers increasingly choosing smaller, less busy airports than Heathrow for shorter journeys. We expect domestic demand to remain relatively flat in terms of volume, stabilising at around 5 million passengers per annum, resulting in a decline in proportion due to continued growth overall.

The relationship of total passenger numbers to hotel rooms sold



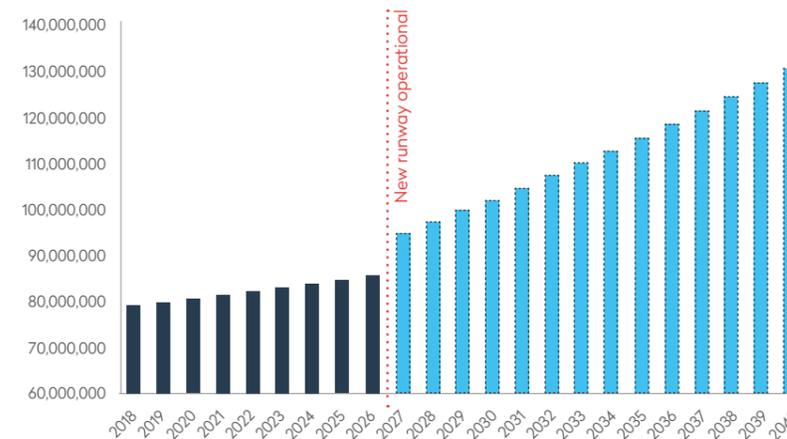
Source: GVA

This decision is positive for hotel demand as it appears increasing overseas flights drives greater hotel business in the area. From an analysis of rooms sold versus passenger numbers between 2012 and 2017, on average 4.8% of all passengers required a hotel room. However, the number of actual stays has increased over this time because new hotel supply has absorbed this demand. We would expect this ratio to increase as the proportion of long haul flights grows, reaching 5.5% by 2040.

We have modelled two scenarios. The first is a base model assuming 4.8% of passengers continue to require hotel accommodation to 2040, and the second upper model assumes that this increases to 5.5%.

We have assumed that the hotels impacted by the third runway will close in 2021 at the start of construction and passenger numbers will continue to grow, hitting 85 million in 2026. We anticipate that by 2040 Heathrow will require between 21,200 and 23,800 hotel bedrooms.

Forecast passenger numbers 2018-2040

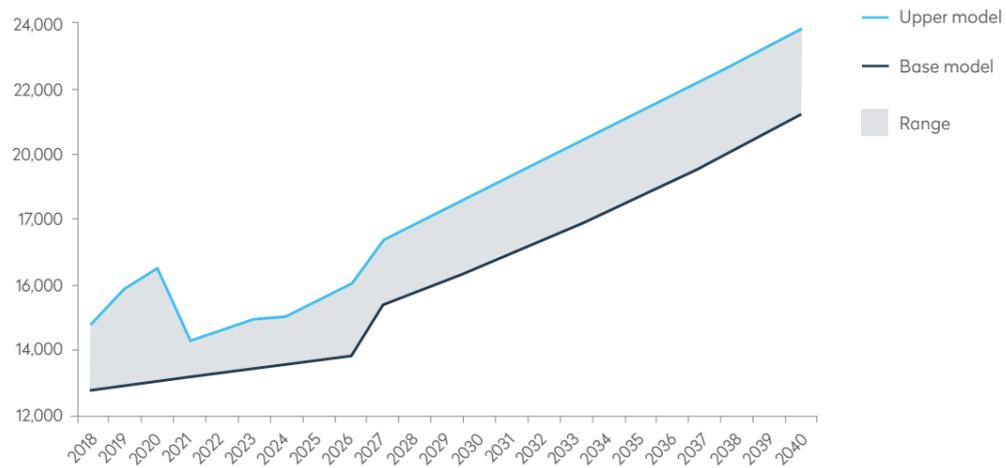


Source: Heathrow / GVA

Assuming the new runway will open in 2026/27, the most significant passenger number growth is anticipated at that time, increasing to some 95 million passengers.

Thereafter, we believe passenger numbers will increase by a similar rate to the present day, a compound annual growth rate of about 2.5% to reach a peak of 130 million in 2040.

Forecast range of additional rooms required



Source: GVA

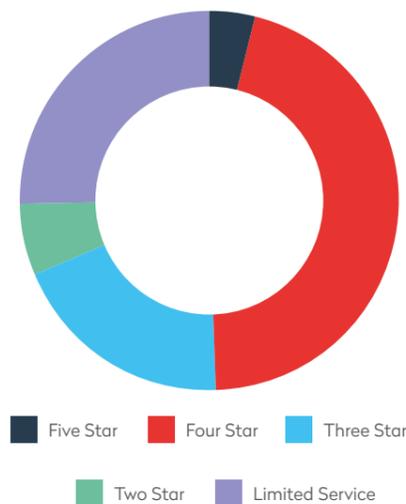
At least one new hotel needed every year from 2027 to 2040

We have reviewed the current average size of hotels by grade to assess the likely number of additional hotels needed.

In order to keep pace with demand from 2027 we expect that the number of additional bedrooms required per year will range from 384 to 517, equating to at least one additional hotel per year. Furthermore given the likelihood of a number of hotels being lost through compulsory purchase orders when construction commences, a number of new hotels will be required between 2021 and 2027. There will need to be a period of accelerated construction at this time to accommodate the initial demand once the new runway comes 'on-stream'.

Considering the current supply and pipeline we would expect the proportion of room stock when construction commences in 2021 to reflect the following segmentation:

Forecast segmentation of Heathrow's hotel market by grade 2021



■ Five Star ■ Four Star ■ Three Star
■ Two Star ■ Limited Service

In order to keep pace with demand from 2027 we expect that the number of additional bedrooms required per year will range from 384 to 517, equating to at least one an additional hotel per year.

Projecting this forward using our upper case model and assuming current trends in hotel grade, we believe there is the potential for the following types of hotels to be developed, although this will be subject to potential changes in development trends and demand for particular product types.

Rating	Number of additional bedrooms required	Current average hotel size	Likely number of additional hotels
Five-star	433	605	1
Four-star	4,517	377	12
Three-star	1,904	175	11
Economy Class	3,089	183	17
	9,943		40

Source: GVA

Our experience of large scale infrastructure projects is that a high volume of hotels are usually required prior to construction for contractor stays. We have not factored this additional demand into our projections but have ensured there is sufficient bed space to accommodate a portion of this demand.

A positive future for Heathrow's hotel market: a further 2,035 jobs

Given our operational experience, and utilising the research presented above, we forecast the new developments will bring 2,035 full time equivalent (FTE) jobs to 2040. These would be permanent operational positions, and does not include employment generated in the wider supply chain or the construction phase.

Rating	Bedrooms	FTE
Five-star	400	110
Four-star	380	75
Three-star	175	40
Economy Class	183	35

Source: GVA



Significant hotel development needed to support terminal three proposals

Under the current proposals, we forecast the market will require 9,943 additional rooms to 2040 to maintain occupancy at 80%. This is higher than Heathrow's own estimates. This level of hotel development could support in the region of 2,000 full-time jobs.

According to the latest plans, room stock will reduce dramatically when construction commences which will have a major impact on the market. A strategy is required to ensure new hotels are planned and opened in time to infill demand and maintain sufficient supply up to 2027.

There will be an immediate increase in demand upon the launch of the third runway, and this is expected to grow steadily until Heathrow reaches its new capacity of 130m passengers per year in 2040.

The twelve year period following the opening of the new runway will require investment in hotel stock, which, in turn could equate to over 2,000 additional new full-time jobs at Heathrow's hotels.



There will be an immediate increase in demand upon the launch of the third runway and demand is expected to grow steadily until Heathrow reaches its new capacity of 130m passengers per year in 2040



If you'd like to talk to one of our team to discuss this report, please get in touch.

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