Asylum Accommodation Contracts: The Next Chapter

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Background
The UK is obliged to provide accommodation and related services to asylum seekers who would otherwise be destitute*.

The Home Office awarded Asylum Accommodation and Support Contracts (AASC) in January 2019 which commenced in September 2019 (replacing the prior COMPASS contracts) to three companies with specific regional coverage. They are listed below.

- Serco for the Midlands the East of England and the North West.
- Mears Group for the North East, Yorkshire and Humberside, Scotland and Northern Ireland.
- Clearsprings Ready Homes for the South and Wales.

These providers in turn make contracts with hotels, but remain responsible for related services, property maintenance plans and inspections.

The AASC contracts run through to September 2029 and, when announced, the Home Office estimated that the value of these contracts would be £4 billion.

As geopolitical events unfolded, the number of refugees and asylum seekers surged and the backlog of asylum applications grew rapidly, amplified by limited number of caseworkers and a reduced rate of application processing (The UK's asylum backlog). Inevitably, the number of hotels required has increased massively.

What does this mean for the hotel industry?
From just 24 hotels at the end of Q4 2019, the number grew to 100 in late 2020 and then doubled to 207 by the end of 2021 (Experiences of people living in hotel asylum). By mid-2023, the number of contracted hotels across the UK surpassed 400 and accounted for around 5% of all sold room nights in the country (CoStar).
In some local submarkets, Horwath HTL estimates that the AASC contracts accounts for up to 25% of all hotel rooms.

This rise in hotels joining the scheme, has led to a huge increase in costs for the government. In 2022/2023 alone, the Home Office spent around £3 billion on asylum accommodation, which is 75% of their original 10-year budget. Despite government plans to the contrary, the asylum application backlog continues to grow. At the end of June 2023, 134,000 asylum applicants (around 165,000 people) were awaiting decisions.

The Home Office's use of hotels has attracted a high level of scrutiny and media attention, fuelling concerns for the safety and wellbeing of the asylum seekers, potential negative impacts on local communities, and t he cost to the taxpayer.

For hotel owners, however, these contracts have provided some relief in an otherwise desperate trading landscape. As COVID took hold in early 2020, devastating hospitality businesses across the country, demand for exclusive-use properties provided a lifeline for many hotel owners and operators, allowing them to continue trading and buying time to plan for the future.

In addition to offering fixed, stable revenue to owners, reduced service and marketing requirements can make exclusive-use operations more profitable than regular hotel operations. Furthermore, at a time when retaining and recruiting staff for hospitality roles has been particularly difficult, the low-staffing requirement of exclusive-use can be a benefit for owners.

It also seems clear that, by reducing the supply of hotel rooms to the public, the Home Office contracts have effectively boosted overall UK hotel market occupancy and income throughout the sector.

Beyond the simple financial case, however, hoteliers are proud that they have been able to provide accommodation for people arriving in the UK in such challenging circumstances and, while angry resident protests grab the headlines, operators of many hotels have been struck by the generous support of local communities for their asylum-seeking guests.

Major global hotel brands and operators have similarly been supportive of hotel owners allowing reasonable interim variations to operating and franchise terms to accommodate the requirements of the exclusive-use contracts, but are looking forward to getting back to "business as usual."

Reducing dependence on hotels for asylum accommodation is a headline policy of both the government and opposition, which will feature prominently in party manifestos and campaigning for the upcoming general election. Although the growing backlog of asylum applications and the lack of credible alternatives suggests that dependence on hotel accommodation will continue for some time, it is surely a question of when, not if, most contracted hotels will move back to regular hotel operations, or alternative use.

The good news is that, with public demand for hotels already back to pre-COVID levels, the prospect of returning to normality for many owners of exclusive-use hotels should make long-term commercial sense. This is particularly the case for high-quality, well-located properties.

Challenges to be aware of

Although the timing seems right for a return to the open market, owners and operators face unique challenges and so they need to plan carefully for the transition.

Perhaps the most significant challenge will be funding the transition.

AASC hotels will likely need to be physically refreshed or even completely renovated after a period of heavy use and minimal capital investment. They may also need to be re-launched onto the market to raise awareness of their services, in which case, a full pre-opening plan will need to be prepared and funded.

Compared to pre-COVID times, construction and material costs have inflated, and more stringent ESG / sustainability standards will add to the total funds required. In addition to renovation costs, owners may also need to fund a re-launch, depending on the hotel's positioning and location. This would involve a pre-opening period incurring staffing and marketing costs before income can be generated. Unfortunately, if owners need to borrow, interest rates have risen significantly.

Some lenders are reluctant to engage with owners of AASC hotels. This is because the asylum accommodation contracts can typically be terminated at three months' notice. As such, despite strong month-by-month operating results, future income is uncertain, which makes potential lenders cautious. Consequently, they may increase their rates further to compensate for this risk. The perception of increased risk ultimately means that property values are discounted compared to full-service hotels with similar earnings.

To secure finance and optimize future asset value, owners must present a clear and credible business plan for the property including its transition into an alternative operating model with long-term income stability. Best use and feasibility analysis may determine that the property is most viable as a hotel or some other alternative use.

Such a business plan should also consider appropriate IT solutions to optimise operating efficiency, given that operating costs, especially energy, food and labour have risen significantly over the past three years. A recruitment strategy should also be included in the plan, taking into account local staffing constraints. Sustainability is another factor that must be planned for.

A careful market analysis will also be critical, because supply and demand is evolving post pandemic. Competition will increase as the number of new and renovated exclusive-use properties grows across the country, so the timing of any re-launch needs to be carefully planned.

In the meantime, where possible, owners should take the opportunity to build capital reserves while maintaining obligatory licenses, permits and the C1 (Hotel) Use Class. Though some owners may be tempted to apply to change to C2 (Residential Institutions) Use class to avoid paying business rates, such a change may impact the value and make a reversion to hotel use more challenging.

In summary, while exclusive-use contracts have provided a lifeline for many hotels around the country over the past four years, hotels now face a transition to full-service operations or alternative uses. Careful professional planning, considering the various challenges, is crucial to success.

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