

After the party UK hotels forecast 2013

November 2012

At a Glance

- *The Olympics meant highs and lows for London but 2012 should end with record breaking rates and revenues*
- *A generally poor summer in the provinces but a glimmer of hope that ADR falls have stabilised*
- *2013: We forecast a flattish year in the provinces and a hangover in London as record high rates and above average supply additions leave their mark.*



Foreword

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What is the 'new normal' for hotels?

As the major western economies emerge from the turmoil of the global financial crisis, we find ourselves in a strange and uncertain world.

Growth rates are disappointing, relative to the experience before 2007. In the UK, economic growth averaged 3% per annum from 1982 until 2007, more than doubling the size of our economy in 25 years. The only comparable period of sustained UK economic growth was the post-war 'golden age' of the 1950s and 1960s. But since the trough of the recession in 2009, UK economic growth has averaged not much more than 1% per annum.

Other major western economies are also struggling – with modest growth in the United States and the euro area in recession. Emerging and developing economies – by contrast – are performing much more strongly. Though growth has slowed down in some of the emerging superpowers like China and India, the IMF is still projecting growth of 5-6% in the emerging and developing world this year and next.

With strong growth outside the West pushing up energy and commodity prices, we are living in a world of relatively high inflation. And volatility in financial markets is continuing to add to uncertainty about economic prospects and access to finance.

The tailwinds which supported growth for over two decades prior to the financial crisis – easy money, cheap imports and strong confidence – are no longer available to provide momentum to developed economies. The UK and other western economies are going through a prolonged period of structural adjustment and relatively low growth and volatility is likely to persist through the mid-2010s.

Against this disappointing backdrop, the London hotel market has demonstrated remarkable resilience. RevPAR dipped by 5% in 2009, but has since rebounded by 25% to reach a record high. This has been helped by one-off events such as the Jubilee and Olympics, but it also reveals a more fundamental strength: that London's status as one of the leading global cities means it can attract people from all around the world, including those from emerging markets whose economies continue to prosper.

We do expect a weaker hotel market in 2013, as the inevitable Olympic hangover kicks in. The surge in new supply during 2012 and 2013 may bring down occupancy and rates but we don't expect these temporary factors to hold London back for long.

In the UK regions, the picture is different. Here demand is more dependent on the domestic economy, which has been squeezed by high inflation and the aftermath of the financial crisis. RevPAR is still 10% below its 2007 level. Despite near 70% occupancy rates, hoteliers have been unable to pass price increases through to the market. We expect RevPAR and rates to remain broadly flat in 2013, as they have since 2009.

This two-speed economy – with a healthy London market but much weaker demand in the UK regions – looks set to persist in the 'new normal' world. Even though growth may pick up next year and beyond, there is unlikely to be a return to the very strong consumer-driven growth we saw before 2007. However, London should continue to benefit from its role as the UK's international gateway and links to a stronger global economy.

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Introduction and key themes

It's hard to feel confident about 2013, there will be winners but a weak economic and travel environment, a fight for market share and more new rooms to fill, mean many will feel the chill.

2012: a year of highs and lows

2012 was always expected to be a complex year to forecast as economic growth stalled, the Euro crisis continued, a supply spike impacted London and considerable uncertainty surrounded the extent of any pre and post Olympics demand dips. London's hotel performance in particular was boosted, and underlying trends clouded, by "a summer like no other", to coin a phrase from London's Mayor, Boris Johnson. But of course averages hide a wide range of data and despite some London hotels doing well, many did not.

PwC always maintained that the boost to hotels from the Games would not be as great as many hoped, and it would be congratulations for London but commiserations outside the capital as the Games scared off all but essential travel, and this has been borne out by what happened. Indeed, in March we forecast a record year with RevPAR at almost £113.81 and the year looks like coming in very close to this level. We expected London would be busier than it actually was though and the 44% boost to rates in August (luxury hotels outgunned the market with a 60% ADR lift) was very much at the expense of occupancy.

For London we have broadly maintained our RevPAR forecast for the rest of 2012 calling for growth of 4%, taking RevPAR to a record high of £114.71.

In the Provinces we didn't expect an overall boost from the Olympics and it didn't materialise but some cities reported a local lift from training camps and events such as the football in Cardiff, Newcastle and Coventry. The Provinces had a poor summer, with occupancy down. The bad weather clearly had a part to play and we are more pessimistic about the 2012 outturn than we were in March, reflecting the continued weak economic climate.

2013: uncertainty weighs heavily

Can UK hotels enter 2013 more confidently? While business and leisure markets have held up reasonably well, London room rates will be entering the New Year at very high trading levels and it's hard to envisage this continuing. A weak travel environment, at home and in key markets in Europe, considerable new room supply to fill, and above average room openings expected through 2013, make it hard to feel confident. Hotels tell of us of little transparency on future bookings. Some key drivers such as the conferences and meetings market appear to be moving (albeit very slowly) in the right direction and UK GDP growth is forecast to be stronger in 2013 – but leisure and business demand remains fragile and price aware, residential meetings are hard pressed and we anticipate another challenging year ahead.

For 2013 we expect occupancy and ADR declines of 3.6% and 3.5% respectively, giving a RevPAR drop of 7.2%. Table 1 opposite shows our revised forecasts and Chart 2 gives an historical perspective to the forecast.

Overall we project a broadly flat picture for RevPAR in the provinces for 2013, with a slight decline in occupancy, but we hope for a marginal rates gain and a stop to the rates clock ticking backwards.

Table 1: PwC UK hotel forecast 2012 and 2013

	London		Provinces		UK	
	2012	2013	2012	2013	2012	2013
Occupancy%	80.1%	77.2%	68.9%	68.4%	71.8%	70.7%
ADR (£)	142.68	137.70	58.39	58.45	83.72	82.26
RevPAR (£)	114.71	106.42	40.31	40.02	60.33	58.21
% growth on previous year						
Occupancy	-2.4%	-3.6%	-2.8%	-0.7%	-2.7%	-1.6%
ADR	7.2%	-3.5%	0.1%	0.1%	3.6%	-1.7%
RevPAR	4.0%	-7.2%	-2.8%	-0.7%	0.9%	-3.5%

Econometric Forecasts:PwC October 2012
 Benchmarking Data:STR Global October 2012

***The economic backdrop:
 cloudy but improving***

While many uncertainties remain, our main economic scenario is for real Gross Domestic Product (GDP) to be broadly flat in 2012 as a whole but picking up later in the year, and for growth of around 1.8% in 2013. Our latest UK business climate forecast is, therefore, for a ‘cloudy but improving’ outlook and this is mirrored in most UK regions, though the sunshine may come through a bit sooner in London and the South East. See Chart 1 and Appendix 4.

London has a post Games legacy of modernised and new hotel products to attract visitors and compete with the world's best.

London: a tough act to follow in 2013?

London saw a year of falling occupancies but rising rates in 2012. London hoteliers reported softer trading during Q4 2011 and, while the first six months of 2012 still painted a positive revenue picture, it was increasingly clear things were changing. June was very disappointing (albeit against very high comparables in 2011) and occupancy fell by over 8%. July was even worse as occupancy fell over 12% to 80.7%, although ADR grew strongly. Many tour operators left London out of their 2012 programmes.

In August, as the Games came to town, ADR soared by almost 44% but occupancy nudged up only marginally. During the Paralympic Games ADR rose more modestly and now the holiday season is over there are questions whether pre Olympic softness has returned or an improving business climate will stabilise demand. A lack of transparency on future bookings does little to assuage any worry and recent weekday trading data in London suggests continued lower occupancies, although ADR remains positive. Weekends are also reported softer.

The Olympics kept London's growth story going in 2012 but what of 2013? Our latest forecast for 2013 is very much about the economy (when is it not?) and the supply hangover. We forecast occupancies could fall back further by 3.6%, ADR by 3.5% and RevPAR by 7.2% to £106.42. This is similar to what we expected in our March forecast – albeit off a higher ADR level and a slightly lower occupancy level. See Table 1, Chart 2 and Appendices.

Provinces: has the rates clock stopped ticking backwards?

Location has been key to provincial success stories in 2012. For example, Belfast stormed ahead with 20% RevPAR growth to August driven by strong occupancy and rates growth – see feature in this forecast – as the new Titanic Belfast Exhibition and other events drew in over half a million visitors to the city. But, many cities had an erratic and unsatisfactory year as the Olympic effect put off visitors travelling around the UK. London acts as a gateway for much of the country’s visitors and with numbers down, some tourist destinations reported a poor season although Edinburgh reported strong ticket sales at the festivals, despite this. Overall it appears that the clock may have stopped ticking backwards (or at least stopped) on room rates. Despite the marginal rates growth, we expect the provinces will see a 2.8% decline in RevPAR in 2012. We don’t expect much to change in 2013 either, with both occupancy and ADR broadly flat year on year.

Supply hangover or future legacy?

Supply growth remains above average and in a weaker travel environment this will inevitably take longer to absorb and will impact occupancy rates. London is likely to see supply growth of around 7.2% and 3.8% in 2012 and 2013 respectively. In the Provinces pockets of supply also remain above average levels and new branded budgets force down average rates. London has a post Games legacy of modernised and new hotel products to attract visitors and compete with the world’s best. Charts 3 to 4 clearly highlight the trends.

Polarised performance: luxury and budgets squeeze the middle harder

In retail it’s called “the squeezed middle”. This is a trend that’s also evident in the hotel sector with the polarisation of buying behaviours at the top and value ends of the hotel market. There has been a flurry of high end, boutique and branded budget openings across London, often in newer hotel locations, including south and east of the capital. These new hotel products clearly differentiate themselves and, as they open their doors, often offer lower rates to gain market share and lure consumers away from mid range products. With at least 2,400 high end and boutique rooms soon set to open in London in the next few years, this could make the going tougher for many incumbent operators.

Economic backdrop

UK: Business climate outlook is cloudy but improving

Despite the better than expected 1% expansion in the third quarter of 2012, the post-crisis economic recovery in the UK remains sluggish. The economy has recovered from the contraction during the double dip recession, but output is no higher than one year ago, according to official estimates, and ongoing challenges surrounding the Eurozone debt crisis continue to weigh on business and consumer confidence.

The services sector expanded by 1.3% in the third quarter, and the production sector (which includes manufacturing) grew by 1.1%. The malaise in construction continued, with a 2.5% contraction which added to major declines in the first half of the year. The continued uncertainty and decline in confidence in key export markets in the Eurozone has contributed to the weak performance of the manufacturing sector; whereas the construction sector remains at the receiving end of significant cuts to the government's infrastructure budget. House prices have fallen recently and are indicative of the tight credit conditions faced by consumers; though the government's Funding for Lending Scheme may ease some of this pressure.

Confidence is fragile and while economic growth will remain flat this year, it is unlikely to persist. There are some bright spots: inflation has declined gradually and the UK economy will have enjoyed a boost in spending due to the 'Olympic effect'.

Europe: Weighing heavily on prospects

As the UK's main tourism market, the ongoing debt crisis is a concern and continues to weigh heavily on prospects. For now Eurozone leaders are committed to holding the Euro together and monetary policy has been kept expansionary by the ECB to help support spending

However the necessary economic reforms and austerity measures that have been put in place to restore the health of public finances have had serious impacts on economies. Countries at the epicentre of the crisis such as Spain, Portugal, Greece and Italy are experiencing high levels of unemployment, with youth unemployment reaching as high as 50%. As a result, demand for business and holiday travel are likely to remain muted as long as the crisis persists.

Other economies that impact UK tourism and hotel demand

The US remains a key market for the UK hotels sector and though its post-crisis recovery has been far from easy, it has experienced reasonably steady output and productivity growth since the crisis. The newly-announced round of 'quantitative easing' by the Federal Reserve and recent gains in the labour market have alleviated fears of a renewed slowdown somewhat. New orders in the non-manufacturing sector have also improved; however the manufacturing sector is feeling the effects of a slowdown in China and the recession in the Eurozone, as well as the uncertainty surrounding the impending 'fiscal cliff' in the US.

Growth in other markets such as Australia and emerging economies are expected to remain steady, though a slowdown in key economies such as China and India will have an adverse impact on tourist numbers.

**Other UK regions:
Opportunities and challenges**

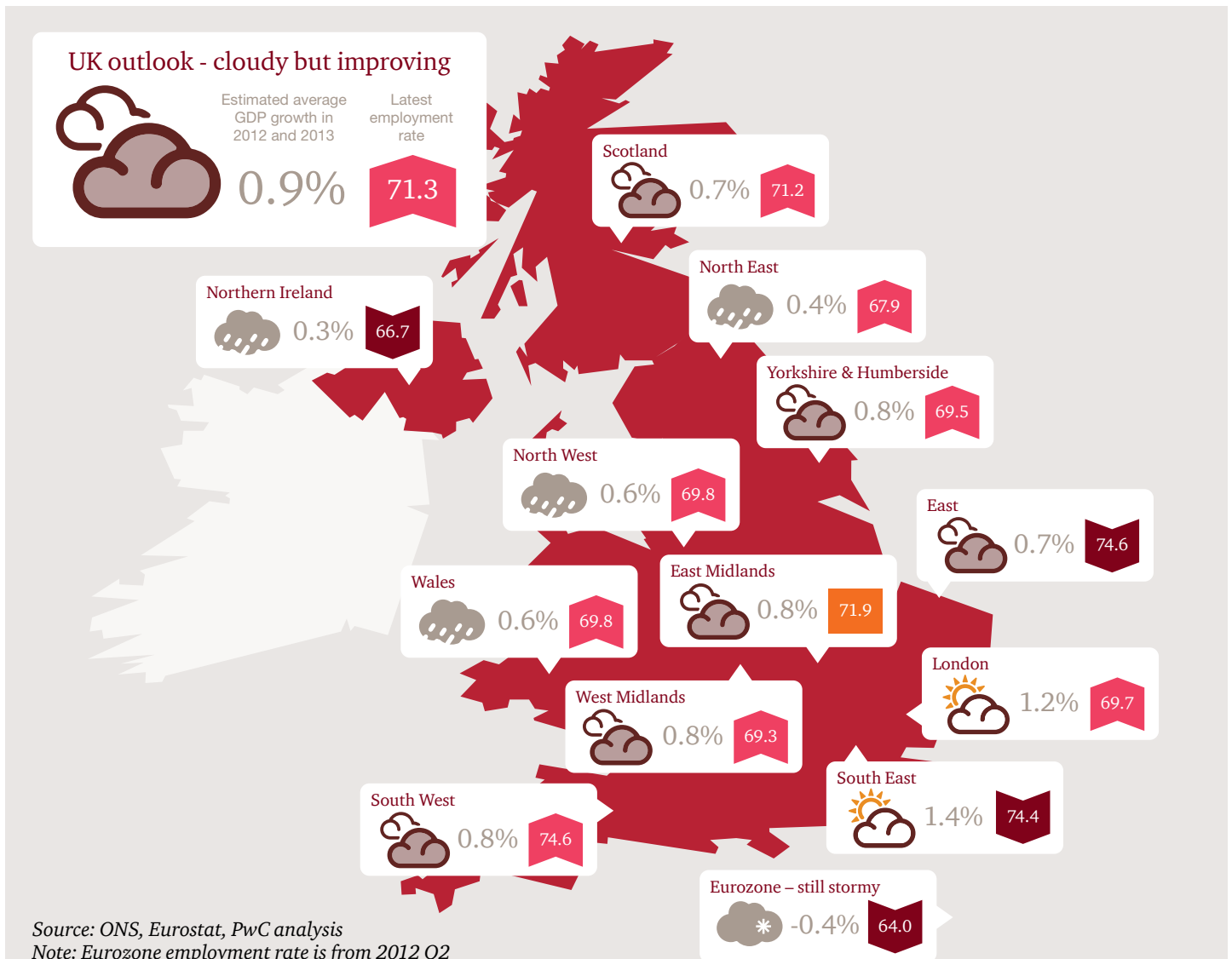
The economic downturn has hit regions in the North the hardest, with substantial increases in unemployment output losses; and has further widened the gap between the North and the South. For the UK as a whole the outlook remains cloudy but with scope for improvement: we see broadly flat GDP in 2012, but picking up in 2013 in our main scenario. London and the South East are projected to lead this gradual recovery, but all regions are projected to see at least modest average growth in 2012 and 2013. See business climate map below.

Unemployment and inflation

While official data show that the economy fell back into a technical recession in the first half of 2012, the economic outlook has become more positive with the the recent growth over the third quarter, while labour market and business survey data suggest continued modest growth. Recent labour force surveys indicate that the employment rate is on the rise, reaching 71.3% in June to August 2012. This is 0.5% higher than the March to May figure.

Another positive development has been lower inflation, which we expect to fall back to 2.5% over the next year unless there is a significant resurgence in global commodity prices. This should allow the Bank of England to continue to maintain an accommodative monetary stance.

UK business climate



Source: ONS, Eurostat, PwC analysis
Note: Eurozone employment rate is from 2012 Q2

Consumer spending

Consumer spending has been relatively weak this year, falling by 0.2% over the second quarter of 2012. However, as the severe squeeze on real disposable incomes from high inflation starts to fade over the course of this year and into 2013, it's likely that spending will pick up, so long as there is no renewed sharp rise in global commodity prices. Retail sales volumes have held up reasonably well, growing by 2.5% in the year to September 2012, and are likely to remain in positive territory up to and over the Christmas period.

We project consumer spending to rise slightly faster than overall GDP growth on average in 2012, but somewhat slower than GDP in 2013, which is consistent with the views of most other forecasters. This is due to subdued prospects for earnings growth and house prices, and the drag from high household debt levels and public sector job cuts. But lower price inflation should help consumers to avoid a repeat in 2012-13 of the sharp cut in real spending they were forced to make in 2011.

Against this backdrop the key assumptions underlying our latest forecast are summarised below:

GDP growth

is likely to remain flat this year, but strengthen in 2013.

Inflation

is also expected to fall towards the Bank of England's target level of 2% in 2013.

Exchange rates

the Pound is expected to strengthen slightly against the USD, but weaken slightly against the Euro.

Consumer spending

is likely to remain weak this year, but strengthen in 2013.

Unemployment

is expected to decline in line with economic growth.



What factors will drive demand growth?

Though growth may pick up next year there is unlikely to be a return to the very strong consumer-driven growth we saw before 2007.

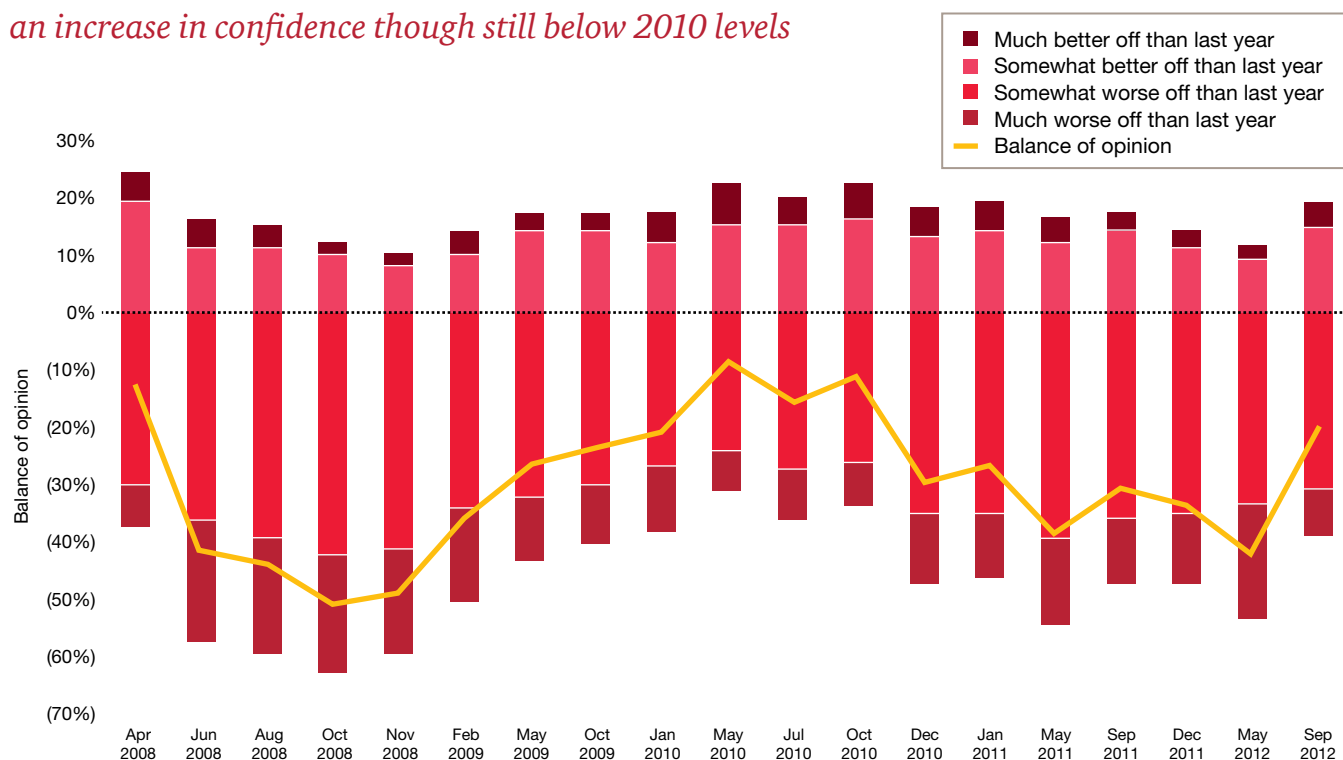
Business travel: Cautious recovery continues into 2013.

The outlook for business travel is highly dependent on the pace of the economic recovery, which is expected to be unexciting, at best. Companies remain cautious and cost conscious and corporate travel policies reflect this. Recently it has been difficult to disentangle the pre and post Olympic downturn from any underlying softness in London. Some hoteliers report things have picked up and others comment on weakness. In the Provinces hoteliers tell us that business demand, which fell from 2007-2010, continues to be weak but shows glimmers of hope. The Global Business Travel Association expects UK business travel spending to remain flat in 2012 but pick-up in 2013, as the UK economy manages a little growth.

Leisure travel: Belt tightening takes its toll.

Many consumers remain gloomy about austerity and consumer spending has languished around the mid-2005 level. Overall, main holidays remain important, even though financing them has been tough for some. The average number of holidays taken remains around 20% below what respondents to PwC research see as normal and short breaks have suffered. While consumers have been hit hard by a decline in living standards in recent years, there is now some expectation that next year real household disposable incomes will show their first annual increase since 2010. Incomes are not expected to surpass 2010 peaks until 2015 at the earliest (Centre for Economics and Business Research). So while it's a positive trend it may be a slow process. Chart 1 shows confidence levels have seen a much welcomed improvement recently according to research by PwC. While many tour groups shunned the capital in 2012, London will be back for many next year and this is positive news.

Chart 1: Far from confident consumers?
PwC's most recent consumer barometer shows
an increase in confidence though still below 2010 levels



Source: PwC consumer research

Doing more to attract the Dragon: there is a consensus that to capitalise on the Olympics, the UK needs to become more competitive and relax visa restrictions, particularly for Chinese visitors.

International travel: Onward and upward post Olympics?

The 'Olympic effect' on travel meant downward pressure on UK arrivals in June, July and August and many tourist attractions around the country reported a dearth of visitors. In contrast, spending by visitors rose in August. The UK hopes the legacy from the unparalleled global media coverage of the highly successful Diamond Jubilee, Olympics and Paralympics will be an increase in international visitors in 2013 and beyond. London & Partners is forecasting an additional one million 'Olympics induced' tourists between now and 2017. This equates to an average of about 200,000 visitors per annum (although there is no guarantee any boost will be so accurate or orderly or that 2013 will see the benefits). In the context of 15 million arrivals this would add about 1%-1.5% to the visitor count each year. Balancing this, further economic contraction in the Eurozone is likely to impact negatively on the UK's largest inbound travel markets.

Meetings and events: Has the market bottomed out?

While badly impacted by the recession and often the last demand segment to recover, there has been some recent hope that the downturn in this sector has bottomed out. Such optimism has been notable in the corporate sector rather than the association/not for profit sector, which may be anticipating some fall-out from the public sector cut-backs. But, hoteliers tell us that any stabilisation is in the day meeting market and that the number of residential events being booked remains moribund. Recent research from BDRC Continental shows that the majority of hotel chains have had to accept slightly lower quoted day delegate rates in the first half of 2012. However, they point out that those hotel chains that are up year on year, are up significantly, implying confident revenue management is paying off. The meetings market is especially vital in the regions but everywhere hotels have seen a continued tightening of budgets in a highly price sensitive market.

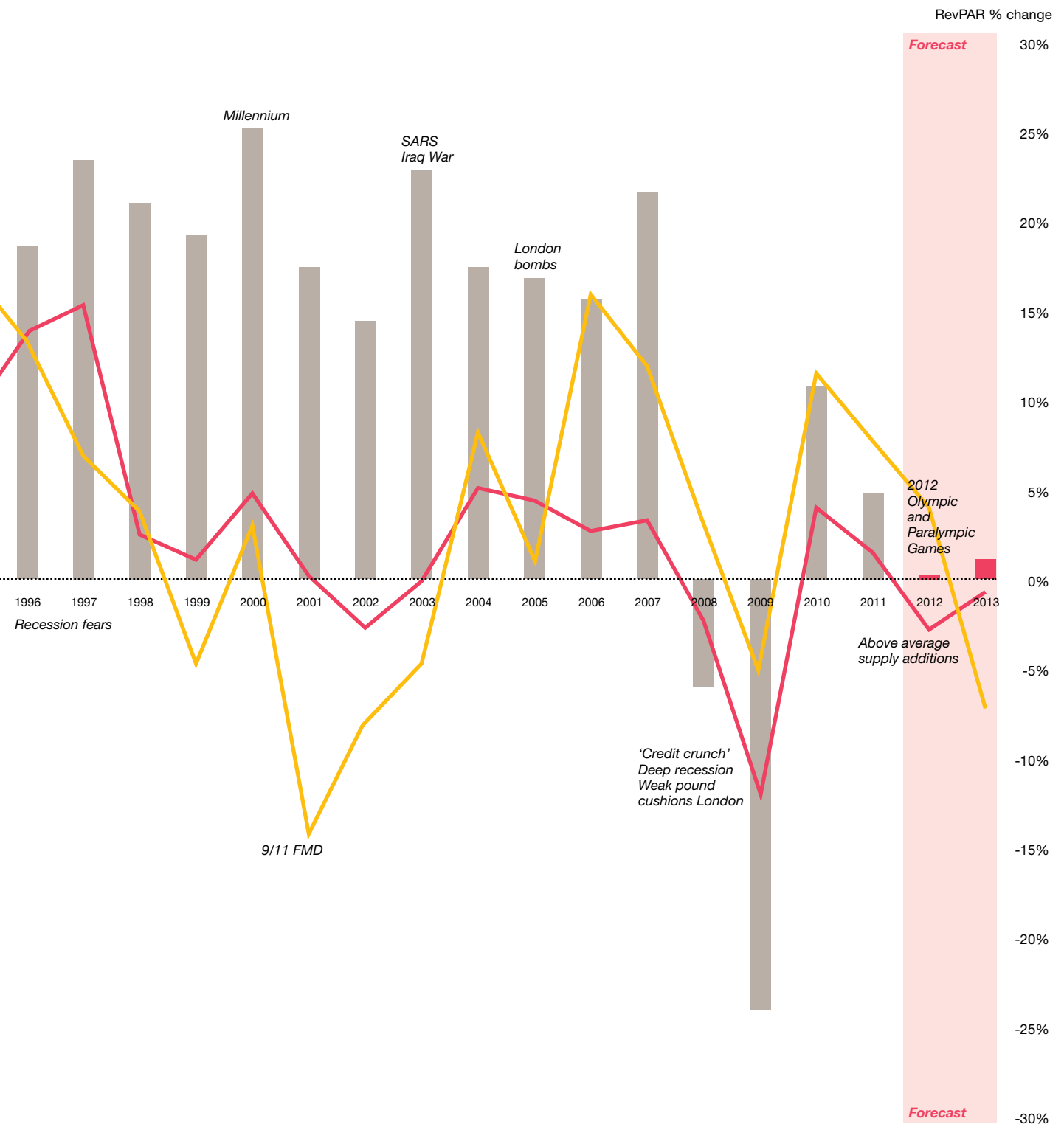
Day delegate rates: those hotel chains that are up year on year, are up significantly, implying confident revenue management is paying off.

Chart 2:
What can we learn from past experience?
Real GDP London and Provincial RevPAR growth rates (% change on previous year)

Not just about the economy: a cocktail of issues ranging from exchange rates, to local and world events and supply swirl around.



Source: Econometric forecasts: PwC October 2012 Macroeconomic data: National Statistics Benchmarking data: TRI Hospitality Consulting and STR Global



Supply hangover or future legacy?

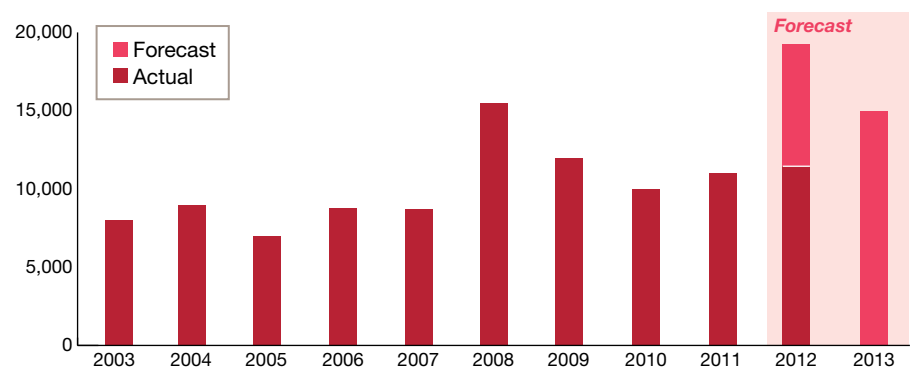
Some brands, in the right location and with a relevant product, will be able to sleep easy, others may be more troubled.

While there are mixed demand driver messages, the supply side is somewhat clearer. There are above average supply increases which are likely to impact future occupancy rates in London and in some cities around the country, though the credit crunch has done much to dampen development. 2012 saw the UK's largest room supply increase from new developments in the last decade. The resurgence in popularity of many UK cities as short-break destinations in recent years has stimulated considerable development and in London the Olympics has catalysed development on a scale unlikely to be seen again. For London there is worry of a post Olympic supply overhang with another 5,000 rooms coming on-line in 2013 (AM:PM Database), in addition to the those which opened ahead of the Olympics. This compares to the long term historical average of 1,500 rooms per year.

Many operators are positive about London's prospects after the Games, encouraged by the global awareness of the capital as a destination and the ongoing improvements in infrastructure. But others, including PwC, have voiced concerns about the supply spike and how it will be absorbed. Chart 4 shows the impact of supply growth on rates and occupancy in London since 1992. It is clear that supply growth is driven by high occupancies and ADR, and may result in a period of adjustment while new supply is absorbed. There may also be periods where demand runs ahead of supply resulting in shortages, high occupancy rates and high prices, as happened between 1995 and 1997.

Chart 3: Too many rooms at the inn?

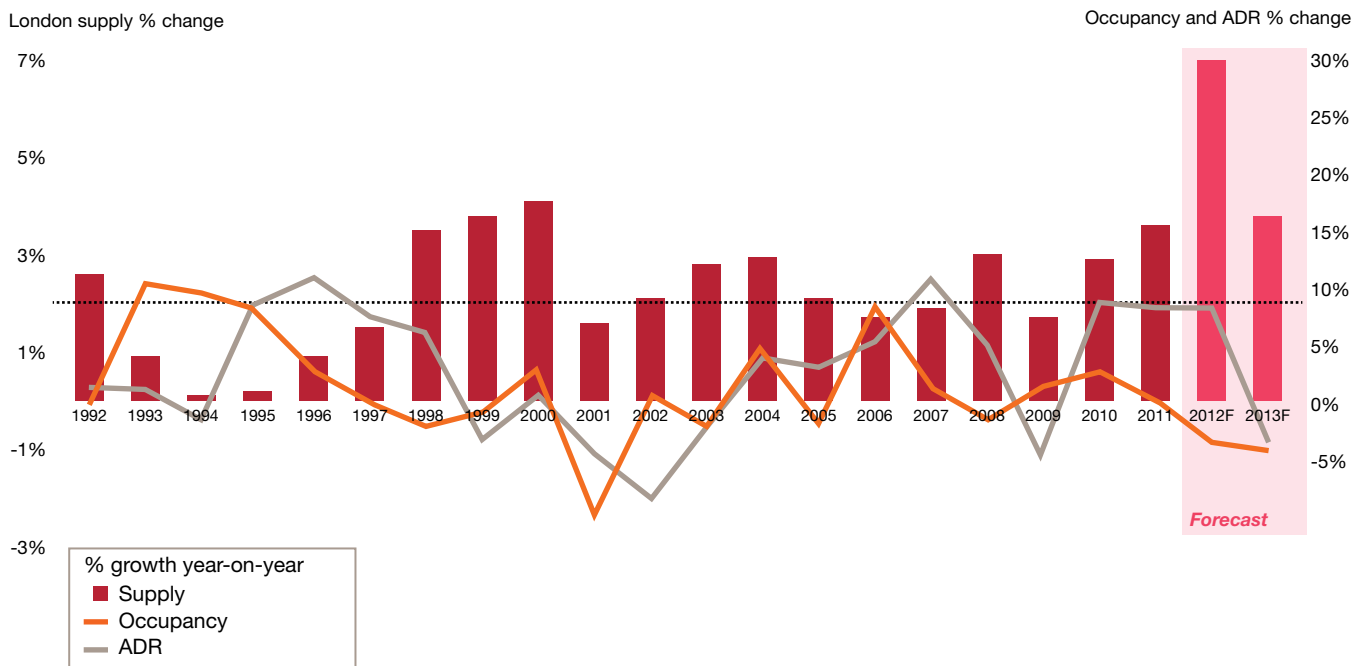
UK room supply increase from new hotel construction (2003-2013)



Source: AM:PMDatabase October 2012

Chart 4: Ups and downs

The impact of supply on London occupancy and rates (1992-2013F)



Source: Econometric forecasts: PwC October 2012 Macroeconomic data: National Statistics Benchmarking data: TRI Hospitality Consulting and STR Global: Supply Data: AM:PM Database 2012

The Provinces have seen an increase in room supply over the past 10 years of around 22%. Branded budgets have been leading the pipeline with around 125,000 rooms by the end of 2012, around 20% of the UK serviced sector.

The shortage of debt funding has meant many new projects are conversions, involving rebranding and considerable refurbishment and improvement. Cities around the UK have seen new branded products like Doubletree, Indigo, Hampton by Hilton, Park Plaza and Radisson Blu and this has increased pressure on existing under-invested operators. Accor has announced plans for the UK including growing its midscale Mercure brand to total 75 UK properties. Four hotels are set to open as part of the Mercure portfolio in the next four months in London, Eddlestone by Peebles in Scotland, Milton Keynes and Darlington.

A lack of available sites and competition for secondary sites has caused developers and operators to seek out new and unusual locations, including sports venues. St George's Park, Staffordshire, the newly opened home to England's new national football centre, offers visitors and footballers 228 new hotel rooms in two onsite hotels including a 142 bedroom Hilton and an 86 bedroom Hampton by Hilton.

Polarised performance: luxury and reinvented budgets squeeze the middle harder

Polarised performance: 2012 saw announcements by both IKEA and Harrods that they intend to enter the global hotel business.

Two concurrent supply trends have led to polarisation of buying behaviours at the top and value ends of the hotel market and a so called ‘squeezed middle’. Both Harrods and IKEA have announced plans to open hotels in the future. London has already seen a flurry of both high end as well as budget hotels open their doors to guests.

PwC research shows almost 4,000 new ‘luxury’ rooms since the announcement of the Olympics in 2005 and the end of this year. This compares to around 9,700 budget rooms over the same period – in a sector that has seen a 13% increase in just three years. Budgets now account for around 18% of London’s rooms and there are more to come, both in the form of market leaders such as Premier Inn announcing more London openings, and as a new generation reinvents the budget product their way: for example Citizen M, Tune, Z, Motel One and Snooze Box who are here or coming to town. As each segment reaches up or down into the ‘squeezed middle market’ to tempt consumers, the need to differentiate the middle ground becomes ever more necessary.

Despite the challenges of getting a foothold in London, recent openings include: Ecclestone Square, South Place, the Bulgari, Belgraves, 45 Park Lane, ME London, Dorset Square and the Ampersand.

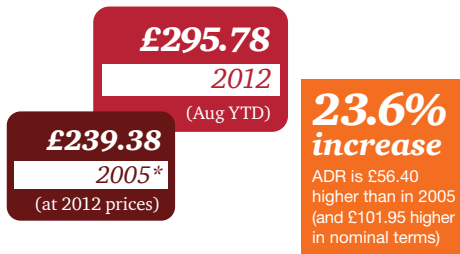
The flurry of high-end and boutique hotels and brands still to come will mean over 2,400 new rooms:

- Cafe Royal (159 rooms)
- The Wellesley (36 rooms)
- Tobacco Dock Hotel (242 rooms)
- InterContinental Westminster (258 rooms)
- Shangri La at the Shard (195 rooms)
- 10 Trinity Square (121 rooms)
- Hilton London Bankside (281 rooms)
- Firmdale Ham Yard (90 rooms)
- Beaumont (85 rooms)
- London Edition (175 rooms)
- Four Seasons London at the Heron Plaza (192 rooms)
- Morgan’s Mondrian (358 rooms) and The Hudson (234 rooms)

Jewel in the crown

London's luxury hotels move with the times

Real Average Daily Rate (ADR)

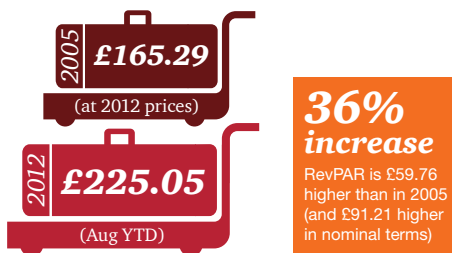


New rooms: luxury versus budget

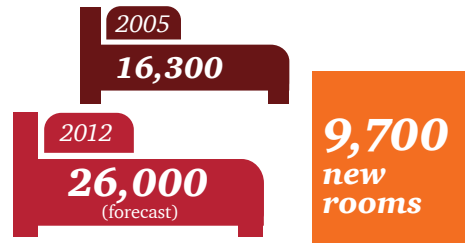
5 star / Luxury



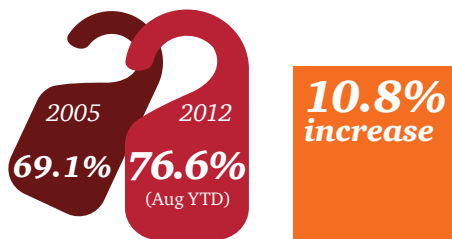
Revenue Per Available Room (RevPAR)



Budget



Occupancy levels



*When London won the Games
 Sources: PwC; STR Global; AM:PM Hotel Database (supply)
 © www.pwc.co.uk

UK hotel forecast 2013

Occupancy

While travel still continues to display resilience there are now more hotels to fill and this, together with weaker demand, has been impacting occupancy levels. London occupancy has remained high by many standards, averaging 79% in H1 2012 but occupancy growth has been erratic, slipping back in eight of the 12 months to June 2012. The Olympics run up and displacement effect this summer appears to have hit June and July particularly badly and no occupancy records will be broken this year or next; in fact, if we are right, occupancy in 2013 will be at its lowest since 2005. Hoteliers in London clearly raised ADR at the expense of occupancy over the Olympics.

London: lower but still high by many cities' standards.

We expect London occupancies to drop to 80.1% this year, a fall of almost two percentage points over 2011 and to fall further to 77.2% in 2013. See Table 1, Chart 2 and Appendices.

In terms of segments, London luxury hotels suffered in the run up to the Olympics but enjoyed both a large 16% jump in occupancy during the Olympic period as well as a massive 60% ADR leap, according to data from STR Global.

Provinces: more falls but some bright spots

In the Provinces, cities such as Aberdeen and Belfast have seen healthy occupancy gains so far, according to data from STR Global. There was little to celebrate in many cities though and no overall Olympic (or much of a Farnborough) effect this year. During August itself, the Olympic football matches helped Cardiff see a 7% occupancy lift, as well as lifting some other cities like Coventry. Plenty of poor weather in H1 2012 no doubt dampened holiday demand and is expected to drag down occupancy by 2.8% to almost 69% in 2012. We anticipate only a marginal decline in 2013 as occupancies end the year at 68%. See Table 1, Chart 2 and Appendices.

London: RevPAR dropped by 5% in 2009 – but has since rebounded by 25% to reach a record high in 2012.

ADR and RevPAR

Hotels experiencing rising occupancy levels are generally in a favourable position to realise greater ADR gains. For example, London often benefits from compression in various submarkets – a good example is the Farnborough International Air Show which pushes demand out from the south and into London. This year hoteliers tell us they did not benefit from this displacement of excess demand in July and there was no Farnborough ‘effect’. They similarly reported little uplift from events such as Wimbledon. Next year leisure travellers and particularly tour business should help fill rooms again.

London: weaker occupancy levels could impact 2013

Despite some erratic occupancy behaviour recently, London has still seen very large increases in ADR in recent years but it’s not clear how long this can continue. London ADR should end 2012 at around £143, that’s £20 higher than 2010, a record year, and almost £10 higher than in 2011, another record year. Look back further and ADR is £50 higher than in 2003 (in nominal terms). This will help drive RevPAR to rise by 4% to a record £114.71 this year. By 2013, RevPAR is forecast to fall back by 7.2% to £106.4 as supply issues, the economy and particularly comparisons with the Olympics, will weigh negatively. See Table 1, Chart 2 and Appendices.

London: luxury outguns the market

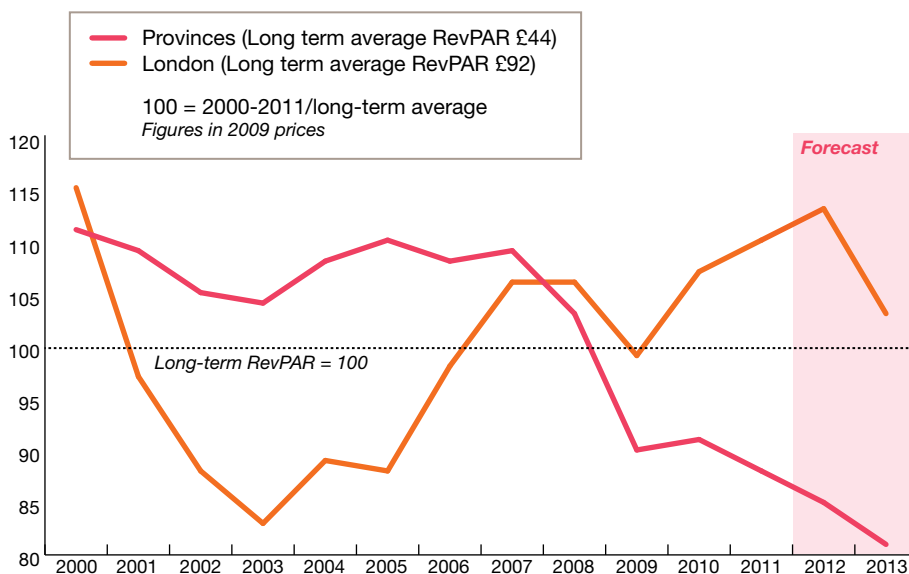
Bursting at the seams with new properties, London’s luxury hotel scene is thriving and saw some incredible performances over the Olympic period despite weak demand from June and during the post Olympic period. The luxury segment saw a 16% occupancy lift in August and a jump of 59% in ADR driving an 84.5% RevPAR boost, according to data from STR Global, taking RevPAR to £271.76

Provinces: marginal ADR gains possible

The situation for London is in sharp contrast to the regions where steady rate gains to 2008 have been all but eroded by austerity and cost cutting as well as by competition posed by the budget sector. A comparison with 2003 shows virtually no gain over this period. We hope the regions will see a marginal ADR gain this year (to £58.39) – the fourth year ADR has languished around £58. Moving into 2013 we don’t expect much change (to £58.45), but at least no slide backwards (in nominal terms). With weak occupancies, 2013 RevPAR could see a marginal decline of 0.7% to £40.02, following a 2.8% decline this year. See Table 1, Chart 2 and Appendices.

The chart below compares the long term average real RevPAR growth from 2000 to 2013 – we can see how far London sat above the average recently and just how far the Provinces have slipped back since 2008.

Chart 5: Slip sliding away
London and Provincial RevPAR relative to the long-term average



Source: Econometric forecast PwC
Benchmarking data: STR Global

Provincial RevPAR remains 10% below its 2007 level in 2012.



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Featured city:

Belfast sees a Titanic year

It's the 39th most famous movie quote of all time, but that didn't bother the Northern Ireland Assembly and the local Tourist Board. £300m of infrastructure investment, some nifty event sponsorship and celebrating the greatest marine disaster of all time has more than delivered on the whispered hint that , "...if you build it, he will come."

It started with the MTV Europe Music Awards in November 2011 and it's still going strong, with every key performance metric showing the best outcomes for Belfast's leading hotels since 2006.

Occupancy, for the eight months to September 2012 in Belfast Metro's 38 leading hotels is up by 15%. RevPAR is up 20% and Room Revenue has jumped by more than a fifth on the same period in 2011.

The MTV Music Awards accounted for around 8,000 room nights in 40 hotels – and that was just for the crew and artists – with the week-long music bash and its 33,500 revellers delivering an estimated £22 million to the Belfast economy.

That shimmied neatly into 2012 and the region's 'our time, our place' year of celebration, commemoration and – well, fun. The last week in March saw the Titanic Belfast Festival and the opening of the iconic £97m visitor attraction, which also delivered the biggest jump in March hotel occupancy in nearly a decade and a 12% year-on-year hike in revenues.

In April: year-on-year occupancy was up 25%, ADR was 15% ahead of 2011, while RevPAR went up a stratospheric 45%, as did revenues.

Since then the Irish Open in Portrush, Derry's Maritime Festival and a raft of social, sporting and arts events has kept the media buzzing and the visitors coming. And on 19 September, just six months after opening, the highly-acclaimed Titanic Belfast welcomed Canadian, Lynda Price – born in east Belfast and the great-granddaughter of a shipyard riveter who worked on Titanic – as its 500,000th visitor.

To put that half million visitors in context, Northern Ireland Tourist Board chairman Howard Hastings said that Titanic Belfast had a target of 450,000 visitors for the first year; so half a million in six months reflected just how Belfast has dominated the national tourist agenda during 2012.

With July and August year-on-year hotel metrics showing RevPAR up 31% and 21% respectively, and revenues increasing month on month, Belfast hotels will be keen to see just how the Tourist Board plans to follow that in 2013.

A tourist benefit that managed to elude even the Belfast hotels was the visitors who turned up with their own beds. It's been a cruise ship bonanza for Belfast in 2012, with 44 cruise liners offloading 75,000 high-spending visitors into the city. Amongst the last of the season's big boats was the 290m, 3,100 passenger, Emerald Princess, one of the biggest of the vessels from the 17 cruise lines that committed to Belfast for their 2012 season.

With 55 cruise liners already booked to dock in Belfast in 2013, that particular segment will swell the coffers of the city's attractions, even if the local hoteliers have to look elsewhere for trade.

This time last year, PwC forecast that 2012 would be a pivotal year for visitors to Belfast and maybe even a make-or-break year for some hoteliers who had seen virtually no growth in occupancy, ADR, RevPAR or revenues since 2006. Well, the Assembly committed to build it and the visitors came; so staying with movie themes, the industry now has to emulate the 1962 Elvis Presley classic and Follow that Dream.

Appendix 1

Annual hotel statistics for London, provinces and UK 2006-2013

<i>London</i>	Actuals						Forecast	
	2006	2007	2008	2009	2010	2011	2012F	2013F
Occupancy %	80.0%	80.7%	79.5%	80.4%	82.3%	82.1%	80.1%	77.2%
ADR (£)	103.37	114.16	119.40	113.51	123.00	133.08	142.68	137.70
RevPAR (£)	84.22	94.25	97.14	92.00	102.62	110.34	114.71	106.42
% change on previous year								
Occupancy	8.4%	0.9%	-1.6%	1.2%	2.3%	-0.2%	-2.4%	-3.6%
ADR	5.2%	10.4%	4.6%	-4.9%	8.4%	8.2%	7.2%	-3.5%
RevPAR	15.9%	11.9%	3.1%	-5.3%	11.5%	7.5%	4.0%	-7.2%
<i>Provinces</i>	Actuals						Forecast	
Occupancy %	70.7%	71.1%	68.6%	65.8%	69.4%	70.9%	68.9%	68.4%
ADR (£)	61.39	63.09	64.07	59.75	58.73	58.35	58.39	58.45
RevPAR (£)	43.41	44.85	43.98	39.31	40.86	41.47	40.31	40.02
% change on previous year								
Occupancy	1.5%	0.5%	-3.5%	-4.0%	5.6%	2.1%	-2.8%	-0.7%
ADR	-1.1%	2.8%	1.6%	-6.7%	-1.7%	-0.6%	0.1%	0.1%
RevPAR	0.2%	3.3%	-1.9%	-10.6%	3.9%	1.5%	-2.8%	-0.7%
<i>UK</i>	Actuals						Forecast	
Occupancy %	73.1%	73.6%	71.4%	69.6%	72.8%	73.8%	71.8%	70.7%
ADR (£)	74.00	78.44	80.69	75.91	78.04	80.80	83.72	82.26
RevPAR (£)	54.16	57.74	57.70	52.84	56.90	59.80	60.33	58.21
% change on previous year								
Occupancy	3.4%	0.6%	-2.9%	-2.5%	4.6%	1.4%	-2.7%	-1.6%
ADR	1.4%	6.0%	2.9%	-5.9%	2.8%	3.5%	3.6%	-1.7%
RevPAR	4.8%	6.6%	-0.1%	-8.4%	7.7%	5.1%	0.9%	-3.5%

Econometric forecast: PwC October 2012
 Benchmarking data: STR Global October 2012

Appendix 2

Quarterly hotel statistics for London, provinces and UK 2011Q1-2013Q4

London	Actuals						Forecast					
	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Occupancy %	75.0%	84.5%	87.1%	81.7%	74.6%	82.8%	84.4%	78.5%	72.8%	78.7%	81.2%	76.2%
ADR (£)	120.49	139.83	135.58	136.43	124.24	141.43	161.21	143.83	131.40	139.27	138.29	141.85
RevPAR (£)	91.88	119.89	118.11	111.46	92.65	117.11	136.12	112.96	95.67	109.68	112.28	108.07
% change on previous year												
Occupancy	-1.5%	2.0%	-0.6%	-0.9%	-0.6%	-2.0%	-3.1%	-3.9%	-2.4%	-4.9%	-3.8%	-3.0%
ADR	7.8%	14.7%	7.6%	3.1%	3.1%	1.1%	18.9%	5.4%	5.8%	-1.5%	-14.2%	-1.4%
RevPAR	6.6%	17.4%	5.7%	0.9%	0.8%	-2.3%	15.2%	1.3%	3.3%	-6.4%	-17.5%	-4.3%
Provinces	Actuals						Forecast					
Occupancy %	62.6%	73.7%	78.8%	68.6%	61.7%	72.7%	75.3%	65.9%	61.4%	71.1%	74.5%	66.5%
ADR (£)	56.88	58.89	60.46	57.15	56.49	59.53	59.41	58.15	57.43	58.89	59.15	58.32
RevPAR (£)	35.62	43.41	47.62	39.22	34.88	43.25	44.77	38.33	35.26	41.90	44.08	38.81
% change on previous year												
Occupancy	1.4%	2.6%	2.7%	1.6%	-1.4%	-1.4%	-4.3%	-3.9%	-0.5%	-2.1%	-1.1%	1.0%
ADR	0.5%	-0.2%	-0.1%	-2.8%	-0.7%	1.1%	-1.7%	1.7%	1.7%	-1.1%	-0.5%	0.3%
RevPAR	1.9%	2.5%	2.6%	-1.2%	-2.1%	-0.4%	-6.0%	-2.3%	1.1%	-3.1%	-1.5%	1.3%
UK	Actuals						Forecast					
Occupancy %	65.8%	76.5%	80.9%	72.0%	65.1%	75.3%	77.7%	69.2%	64.4%	73.1%	76.3%	69.0%
ADR (£)	76.00	83.21	83.03	80.97	76.85	84.14	90.00	83.89	79.66	83.05	82.93	83.42
RevPAR (£)	50.03	63.66	67.19	58.31	50.00	63.35	69.93	58.04	51.27	60.72	63.24	57.60
% change on previous year												
Occupancy	0.6%	2.4%	1.8%	0.8%	-1.2%	-1.6%	-4.0%	-3.9%	-1.1%	-2.9%	-1.9%	-0.2%
ADR	3.8%	6.8%	3.5%	0.1%	1.1%	1.1%	8.4%	3.6%	3.7%	-1.3%	-7.9%	-0.6%
RevPAR	4.4%	9.4%	5.4%	1.0%	0.0%	-0.5%	4.1%	-0.5%	2.5%	-4.1%	-9.6%	-0.8%

Source: Econometric Forecast PwC October 2012
 Benchmarking data; STR Global October 2012

Appendix 3: Glossary

Glossary of terms used in this forecast

ADR – Average Daily Room Rate

The average price a room is sold for in a hotel or group of hotels taking in to account only rooms let. Room revenue divided by rooms sold.

RevPAR – Revenue Per Available Room

Room revenue divided by rooms available (occupancy times average room rate will closely approximate to RevPAR). Also known as yield.

Occupancy

The percentage of available rooms that have been sold over any given period. Rooms sold divided by rooms available.

Appendix 4: PwC hotel model GDP and other economic assumptions

USD/GBP

EUR/GBP

GDP growth
(% change p.a.)

Consumer spending
(% change p.a.)

Inflation
(% change p.a.)

Unemployment rate

2012 vs 2013



Appendix 5

Methodology for hotel forecasts

To continue to best explain travel and hotel trends in this “new normal” world, PwC have recently developed a new econometric model that is much more responsive to the new economic environment. We have re-modelled because markets change over time and major shocks (like the financial crisis) lead to structural changes. These need to be accounted for by testing different model structures and different variables and we are confident we are now well prepared for forecasting hotel performance over the coming years.

This section outlines in more detail the PwC model used to forecast hotel occupancy, Average Daily Rate (ADR) and Revenue Per Available Room (RevPAR).

Data

Our hotels dataset provided by STR Global contained ADR, hotel room supply, demand and occupancy on a monthly basis. Macroeconomic variables such as GDP growth, unemployment and CPI were obtained from the Office of National Statistics (ONS) and GDP data for key tourist markets were obtained from the OECD; and these were available on a quarterly basis.

Econometric model

We developed a 2-stage least squares (2SLS) instrumental variables approach that projects hotel demand and price (ADR) using a two-stage process with the specifications set out in the Table 2 below.

Table 2: Final specifications of the London and Provinces models

	London	Provinces
1st stage	<p>Dependent variable Growth in London hotel demand</p> <p>Explanatory variables</p> <ul style="list-style-type: none"> • Country-weighted GDP growth in the previous quarter • Change in previous quarter nominal Euro-GBP exchange rates • Growth in previous quarter London ADR • Seasonal dummies • Terrorist events dummy (7/7 and 9/11) • Previous quarter UK unemployment rate 	<p>Dependent variable Growth in Provinces hotel demand</p> <p>Explanatory variables</p> <ul style="list-style-type: none"> • UK GDP growth in the previous quarter • Growth in Provinces ADR in the previous two quarters • Seasonal dummies
2nd stage	<p>Dependent variable Growth in London ADR</p> <p>Explanatory variables</p> <ul style="list-style-type: none"> • Growth in London hotel demand • Growth in previous quarter London ADR • Change in previous quarter nominal Euro-GBP exchange rates • Seasonal dummies • Previous quarter UK unemployment rate 	<p>Dependent variable Growth in Provinces ADR</p> <p>Explanatory variables</p> <ul style="list-style-type: none"> • Growth in Provinces hotel demand • Growth in previous quarter Provinces ADR • Seasonal dummies

¹Growth weighted by GDP growth in main origin countries of London hotel guests, which include North America (US and Canada), Europe (Belgium, France, Germany, Ireland, Italy, Netherlands, Spain and Poland) and the UK

Key differences with the previous approach

For our previous forecasts we used a vector autoregression (VAR) approach to model hotel occupancy rates and ADR. For the current forecasts we conducted a literature review of academic research and tested several model specifications as part of an ongoing process to improve model performance. Based on our findings we updated our model to the 2-stage least squares (2SLS) instrumental variables approach.

The 2SLS approach has several advantages, namely it does not require any distributional assumptions for explanatory variables, e.g. variables may take a binary or non-normal form. It is also computationally simple and allows the use of diagnostic testing procedures for problems such as heteroscedasticity and specification error. In addition, the two-stage approach also allows us to estimate demand and price separately rather than projecting occupancy rates directly, recognising that these are driven by different factors.

However, the challenge of producing robust estimates using the 2SLS approach is the selection of 'instruments' or variables that are sufficiently exogenous to price, but have an influence on hotel demand; whereas the VAR model treats all variables as endogenous, which does away with the need to identify such variables as instruments. Our model specification includes quarterly dummies, the lag of GDP growth and the lag of the difference in prices as instruments for both the London and Provinces model specifications, with terrorist events and the UK unemployment rate included as additional instruments for the London model.

Results from the Durbin-Wu-Hausman test indicate that the instruments used are exogenous and the model is sufficiently overidentified at 5% significance level. The first stage test of instrument strength also indicates that the instruments are correlated with hotel demand and have sufficient explanatory power after controlling for other exogenous variables.

Forecasts

Forecasts for ADR growth and hotel demand were generated using PwC forecasts of macroeconomic variables, supplemented by additional forecast data for hotel supply for London and the Provinces provided by AM:PM to produce forecasts for occupancy rates, and OBR projections of UK unemployment. Adjustments were made to ensure the comparability of STR and AM:PM data and an attrition factor was applied to simulate periodic drop-offs in rooms supply. RevPAR forecasts were constructed using ADR, demand and supply forecasts.

This model was used to generate forecasts through to Q4 2013, and these were generated separately for London and the Provinces, with forecasts for the UK as a whole constructed from a weighted average of the London and Provinces forecasts. These weights were generated using the share of London and Provinces hotel room demand as a percentage of total (London + Provinces) demand.

Further reading



US Hotels Forecast

Quarterly outlook for the US lodging sector



South African hospitality outlook: 2012-2016

How the hospitality industry in South Africa is expected to develop in coming years



What's happening in Hospitality & Leisure

A review of sector trends and the deal market

***Coming soon:
European cities hotel forecast 2013***

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