

*September 2014: UK hotels are benefiting from a resilient economy and buoyant travel markets. We are seeing real evidence of a sustained and bedded-in growth story in the Provinces, as well as continued growth in London.*

# *Growth beds in UK hotels forecast 2015*



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***Foreword***  
Growth beds in

*A year ago we commented that for the first time in three years the economic outlook looked rosier. A year on from that and it's fair to say that we (along with most others) underestimated the level of economic growth in 2014. The bounce back of the important services sector in particular has helped confirm Britain's encouraging economic recovery. Against that backdrop the UK hotel sector has performed strongly so far in 2014 and further growth next year appears almost certain if the forecasts of economic growth prove realistic again.*

London has been trading at a very high level and although it wobbled a bit in the middle of the year, we expect hotels in the capital to resume growth in the latter part of 2014 and we forecast over 5% RevPAR growth next year as the Rugby World Cup will have a positive knock-on impact on demand (and will benefit the Provinces too). Trading records are there to be broken by London.

Having seen performance languish for some years, the Provinces have benefitted from the economic recovery and have set a blazing pace and we forecast further RevPAR growth in 2014 and 2015 of 7% and 6% respectively. Occupancy in 2014 and 2015 is set to reach new highs and 2015 ADR is set to outperform past years (at least in nominal terms).

The sector however still faces plenty of challenges and geopolitical uncertainty. New products and business models can sometimes represent a challenge for existing businesses. Every so often a new trend has the potential to change the established way of doing business and can leave some businesses ill prepared for the new order. A case in point that is relevant to the UK hotel sector is the potential impact of so called shared economy models such as Airbnb or onefinestay. In this edition of the UK forecast we provide an insight into this new trend and provide our views on what steps can be taken to ensure the impact on the traditional hotel model is minimised.

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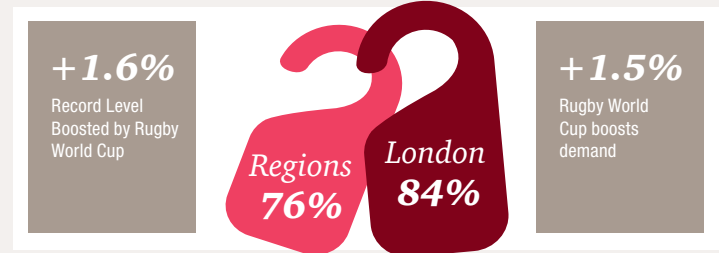
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## At a glance

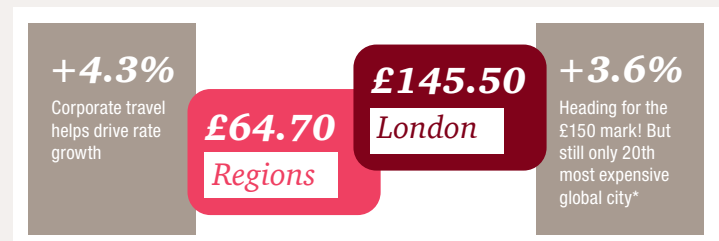
- We expect growth for London and Provincial hotels for the 2014 outturn and for 2015, underpinned by a resilient economy, buoyant business travel and a knock-on effect from the Rugby World Cup in 2015
- Modest growth in occupancy is expected in both the Provinces and London and will be enough to lift occupancies to record levels
- With occupancies high, we anticipate ADR growth will drive a strong RevPAR resurgence in nominal terms. In real terms we are seeing the beginning of a sustained and bedded-in period of growth in the Provinces – which could be very good news for hoteliers in these locations.
- However the sector continues to face plenty of challenges and geopolitical uncertainty

## PwC's 2015 UK hotels forecast Growth beds in

### Occupancy



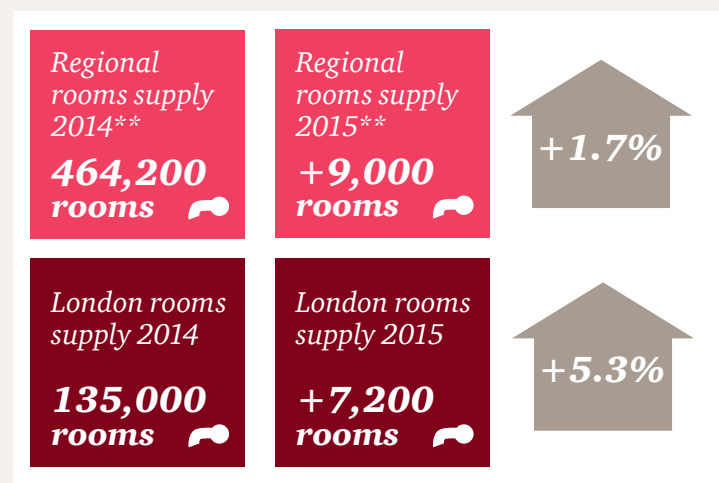
### Average daily rate (ADR)



### Revenue per available room (RevPAR)



### Supply pace will accelerate with economic growth and more finance opportunities



\* HRG 2014

\*\* Regions excluding London

Charts show absolute trading and percentage change on previous year

Sources: PwC; STR Global; AM:PM Hotel Database (supply), August 2014

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# Introduction and key themes

## Overall growth story forecast for UK

PwC's latest UK hotel forecast expects growth for the 2014 outturn and into 2015. (See Table 1). Overall UK hotels are expected to see a 5.6% gain in RevPAR in 2015 (to £67.39), driven by a 4% rates growth (to £86.49) and a 1.6% increase in occupancy (to 78%). This is underpinned by a continued strong recovery in the Provinces as well as strong growth in London, especially next year.

Table 1: UK hotels forecast

	London			Provinces			UK		
	2013	2014	2015	2013	2014	2015	2013	2014	2015
Occupancy %	82%	83%	84%	73%	75%	76%	75%	77%	78%
ADR (£)	136.57	140.52	145.54	59.75	62.07	64.73	80.44	83.19	86.49
RevPAR (£)	112.62	116.41	122.36	43.35	46.37	49.14	60.31	63.82	67.39
<b>% growth on previous year</b>									
Occupancy	2.3%	0.5%	1.5%	4.0%	3.0%	1.6%	3.6%	2.3%	1.6%
ADR	-2.0%	2.9%	3.6%	1.3%	3.9%	4.3%	-0.2%	3.4%	4.0%
RevPAR	0.3%	3.4%	5.1%	5.4%	7.0%	6.0%	3.3%	5.8%	5.6%

Econometric Forecasts: PwC August 2014

Benchmarking Data: STR Global July 2014

### With Provinces setting a blazing pace in 2014...

2014 saw a tremendous start with RevPAR up over 9% in H1 2014 compared to the same period in 2013 and many cities saw double digit growth. PwC has upped its forecast significantly for 2014 and we expect the Provinces to see out 2014 with further growth in all key metrics and finish the year with a 7% RevPAR uplift, underpinned by improving confidence and economic prospects, buoyant business travel, events like the Glasgow Commonwealth Games and the hot summer weather.

### ...and the pace continuing in 2015 as the Rugby World Cup lifts demand

Building on 2014 growth, the pace is expected to continue in 2015 and we anticipate further robust growth in ADR and RevPAR, with gains of 4.3% and 6%, taking ADR to over £64 and RevPAR to £49 – the highest for 15 years on both counts (in nominal terms). We also expect occupancies to set new highs, reaching 76% in 2015 as the Rugby World Cup (which will take place between 18 September and 31 October 2015) provides a demand fillip.

### London summer trading turbulence fails to halt growth in 2014

London also saw a great start to 2014 and H1 2014 RevPAR was up 3.8% over the same period in 2013. A bit of a trading wobble set in during May, June and July for a number of reasons, including the timing of Ramadan, and fewer events including no Champions League final. Rooms supply growth is expected to remain at around 4% overall this year, according to data from AM:PM and of the hoteliers we spoke to none cited supply as an issue in the recent slowdown. We expect the full 2014 outturn to be similar to our previous forecast in March, and will see marginal 0.5% occupancy growth taking occupancy overall to a heady 83 percent; almost 3% ADR growth to £140.52 and 3.4% RevPAR growth to £116.41.

### The Rugby World Cup will have a knock-on effect in London in 2015

We anticipate that the Rugby World Cup could be a significant demand driver, pushing London hotel occupancy up further. Overall we forecast occupancy to pick up quite briskly in 2015 with a 1.5% gain taking occupancy to 84%. We anticipate 3.6% growth in ADR will mean rates reaching £145 i.e. £5 higher than 2014. This combination will drive a 5.1% RevPAR advance to take yields to over £122.

### **Resilient UK economic recovery is a key driver**

The UK economic recovery is gathering momentum and as it takes a stronger hold it should boost London and regional travel and consumer confidence. PwC has upped its GDP growth forecast for 2014 to 3%, building on 1.7% growth in 2013 and moderating slightly to 2.6% in 2015. All the UK regions should grow at a faster rate than in 2013 with London seeing the fastest growth, and this should continue in 2015.

As always there are uncertainties inherent in our growth projections with considerable downside risks relating to trends in the Eurozone and emerging markets and geopolitical uncertainties in Ukraine and in the Middle East. On the upside, there could be a virtuous circle of rising confidence and spending as in past economic recoveries.

### **Travel dynamics are positive but geopolitical uncertainty could cause disruption**

A calmer Eurozone is positive news for sustaining demand from major inbound travel markets, although value concerns are likely to be important still. In the US the economy appears on the road to recovery and this is also positive for the UK's most valuable inbound market. Growing tourist volumes from emerging markets may be impacted by slower growth. Chinese economic growth, although slowing down, remains high in absolute terms and is good news for a growing visitor market.

The UK saw an encouraging start to the year, with UK inbound visitors currently forecast to see around 2.5% growth in 2014 and further modest growth in 2015, according to Visit Britain. Forecasts prepared by UNWTO in January 2014 point to global growth of 4% to 4.5% in international tourist arrivals in 2014 – above the long-term forecast of 3.3% a year.

On the other hand, the surging value of sterling may act as a brake on the recent growth seen in spend per visit as visitor's find things more expensive. It could also impact negatively on domestic leisure tourism as Brits feel more confident about the economy and can get more foreign currency for their pound.

### **Supply growth should pick up as economy and access to finance improves**

While the pace of development is picking up a bit and the number of new rooms expands, the overall supply situation is still relatively subdued. At the end of June there were around 23,000 rooms in the development pipeline in UK, with 10,000 of these in London alone (rooms set to open during H2 2014 and 2015). Budget hotels continue to lead the charge but four and five star hotels are also a popular segment for developers and are forecast to add almost another 4,000 rooms over the next three years. Those seeking to expand in big UK cities may find more competition for sites from offices and residential developers pushing up costs. A push on rebranding properties around the country may reflect the growing perception from owners of the power of certain brands.

### **Can hotels avoid disruption from the sharing economy?**

While achieving any forecast is not easy and hotels clearly face many challenges, there is a new trend emerging that has significant potential to win market share and drive down profitability in the traditional serviced accommodation sector. The potential negative impact on profitability has been likened by some observers to the growth of the budget hotel segment in the 1990's and the emergence of Online Travel Agencies (OTAs) in the 2000s. Sharing economy platforms provide new entrants and individuals the opportunity to present travellers with non-hotel alternatives in great mass under a trusted brand.

### **Deal talk**

UK hotel deal volumes have historically tracked market trading fundamentals with the recent growth in M&A activity reflecting the return to RevPAR growth, especially in the provinces which will likely make up nearly 60% of the total hotel transactions in 2014. In the last two years the banks have been offloading their hotel portfolios through asset and recently more prevalently debt transactions, while investor confidence has returned to the UK hotel sector with both capital and debt much more readily accessible.

Continued forecast RevPAR growth should drive further investor interest although deal volumes in 2015 could be constrained by a potential limit to available supply in provincial portfolio deals, similar to the lack of product experienced in London recently.

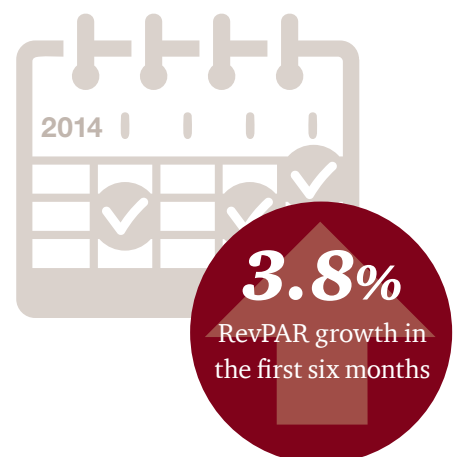
# London forecast

*2014 saw a great start but then hit some summer trading turbulence. Hotels are confident that the remainder of the year will get back on track and that the Rugby World Cup will boost 2015*

## **2014 recap: a great start but a summer dip**

*2013 was a bumper year and London hotels reported a great start to 2014, some enjoyed 15% revenue growth in the first 5 months. Overall, London is operating at a high level and the first half of the year saw the capital's occupancy averaging 80%; ADR averaged £136.60 and RevPAR reached £109.65, according to data from STR Global. Overall, in the first half of 2014 RevPAR was up 3.8%, driven mainly by rate increases of over three percent.*

Picking apart the individual months though reveals weakness in May and June with many hoteliers reporting that this continued into July. Luxury hotels in general were impacted more adversely than the market as a whole but as usual some bucked the trend. Figure 1 shows past trading by month.



What caused the wobbles? Not one reason hoteliers tell us but a combination of:

1. Fewer events: especially no Champions League Final. In 2013 it was held at the Wembley Stadium and attracted up to 150,000 fans
2. The impact of the euro and dollar exchange rates: making London expensive compared to some other destinations. This has led to a vigorous push by 4 star chains to target the FIT (Fully Inclusive Tour) market (impacting rates)
3. The earlier timing of Ramadan in 2014: squeezing into the school term and keeping wealthy Middle East visitors away – in contrast to the pre Ramadan period in 2013
4. Adverse publicity: around security concerns at some London hotels and streets involving Middle East guests
5. General competition from other destinations: many have easier visa procedures – and also may be linked to point 2 above
6. A quieter second week of Wimbledon and a weaker Farnborough “effect”

**PwC 2014 forecast outturn: back on track**

It remains unclear how the slowdown in the Russian outbound market will impact London overall but at this stage we expect London to largely get back on track in the autumn after the summer dip discussed above.

We expect the full 2014 outturn will show marginal 0.5% occupancy growth taking occupancy overall to a heady 83 percent; almost 3% ADR growth to £140.52 and 3.4% RevPAR growth to £116.41. Rooms supply growth is expected to remain at around 4% overall this year, according to data from AM:PM.

It may have been a patchy year but it's still a growth story which inevitably means further records broken.

**PwC 2015 forecast: a knock-on Rugby World Cup effect?**

In 2015 PwC expects trading fundamentals to remain sound, driven by the economic momentum and a buoyant travel market – despite global

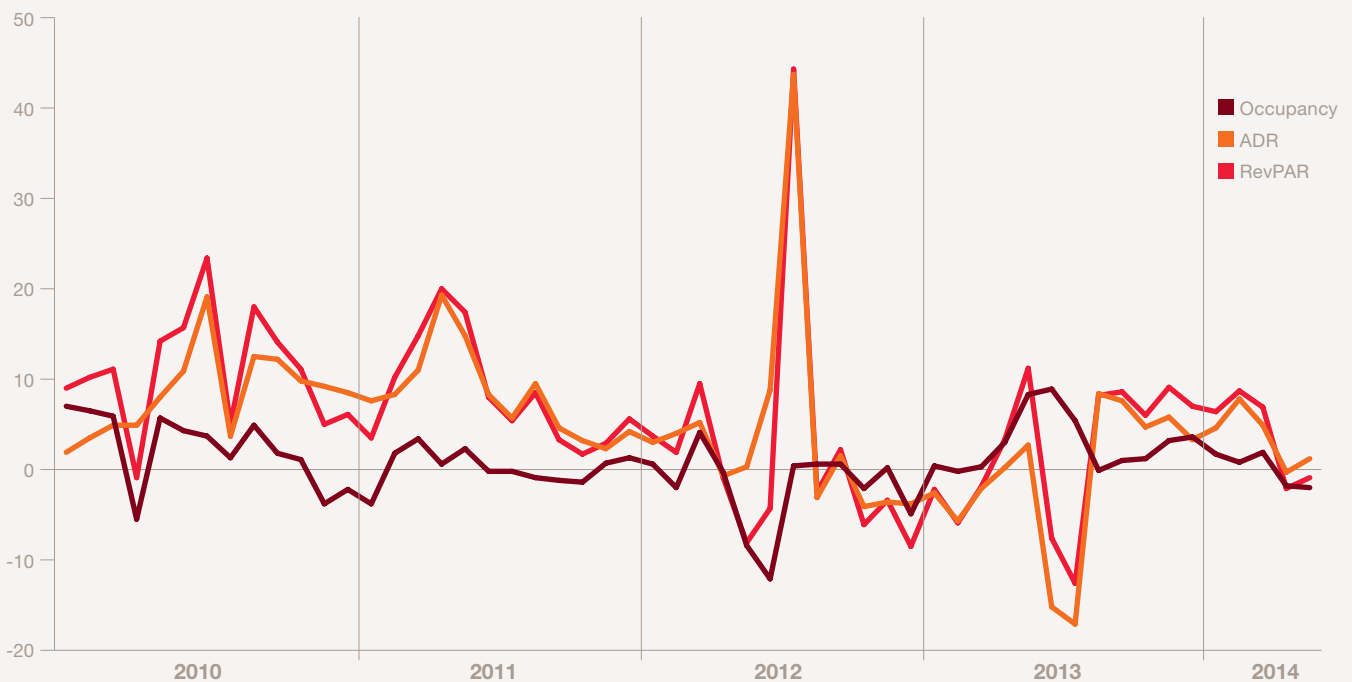
geo-political uncertainties. AM:PM forecast a pick-up in supply growth in London in 2015 but we don't think this poses a significant threat to drag down performance overall, although the impact will vary by sub-market.

We anticipate that the impact of the Rugby World Cup, which will take place between 18 September and 31 October 2015, could be a significant demand driver, pushing London occupancy up further. The Olympic, Twickenham and Wembley Stadiums will see 5, 10 and 2 matches apiece and Twickenham will host the final match.

We forecast occupancy to pick up quite briskly in 2015 with a 1.5% gain, taking occupancy to 84%. We anticipate 3.6% growth in ADR will mean rates push over £145 i.e. £5 higher than 2014. This combination will drive a 5.1% RevPAR advance to take yields to over £122.

See Table 1 and Appendix 1 and the long term chart Figure 4.

**Figure 1: London monthly trading to June 2014 – Strong RevPAR growth flips in May and June**



Source: Benchmarking Data STR Global 2014

# Provinces forecast

## Blazing pace continues into 2014

Regional hotels got off to a blazing start this year, following a strong 2013 performance. Many cities around the country have seen double digit RevPAR growth in the first five months to May including Aberdeen, Bristol, Cardiff, Coventry, Manchester York, Plymouth and Southampton. Belfast and Glasgow saw over 15% RevPAR growth.

As a whole, the Provinces saw over 9.5% RevPAR growth in the first six months of this year compared to the same six months last year, driven by strong occupancy growth and an impressive acceleration in ADR growth – unbroken since August last year and pushing RevPAR to £44.46. Figure 3 shows past trading by month.



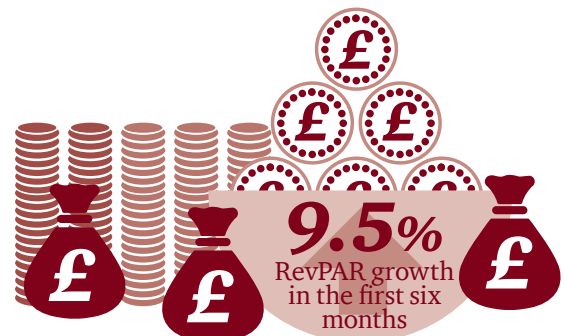
“...a buoyant hotel market, driven by continuing growth in London and clearer signs of economic recovery in the UK regions.”<sup>1</sup>

### PwC 2014 outturn forecast: another year of recovery

Despite the poor weather and floods at the beginning of the year, there have been many positives to help lift hoteliers' fortunes, ranging from the continued economic recovery across the regions; muted new supply; sunny summer weather; some great sporting occasions from Glasgow's Commonwealth Games to the Ryder

Cup at Gleneagles this year; and successful festivals such as Edinburgh.

We expect the full 2014 outturn will show 3% occupancy growth taking occupancy overall to a heady 75 percent – the highest for 14 years; almost 4% ADR growth to £62 – not quite back to 2007/8 even in nominal terms and 7% RevPAR growth to £46.37, which is the highest since 2001.



1. Stuart Harrison CEO Premier Inn, Hotel Analyst Perspective 4 July 2014 \*\*\*

**Figure 2: Rugby World Cup Venues 2015**



**PwC forecast for 2015: corporate travel should keep the pace up**

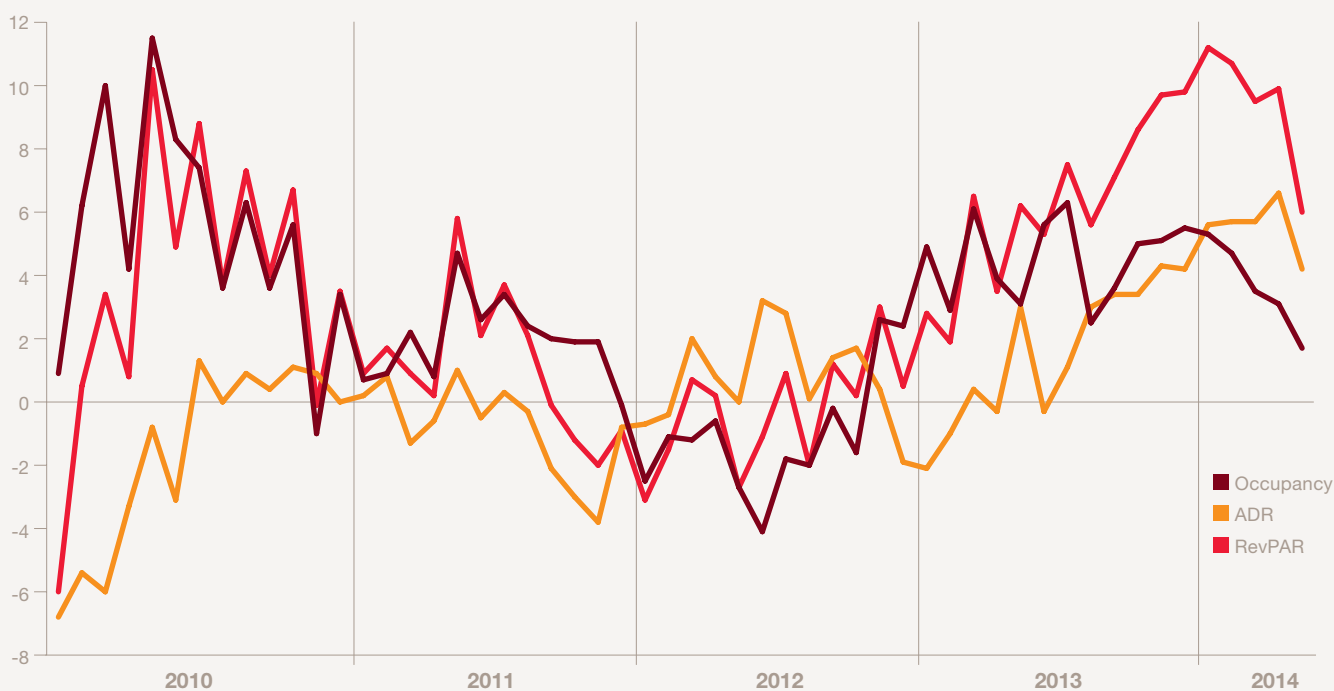
All UK regions are now achieving reasonable positive growth but variations remain. When compared to our March 2014 UK Economic Outlook, London is still expected to grow the fastest this year (at 3.4% now compared to the 3.1% rate we projected in March) and Northern Ireland is still expected to grow the slowest (at 2.2% compared to our projection of 1.9% in March). However, all regions are expected to show a higher rate of growth in 2014 than they achieved in 2013. This growth will underpin the regional hotel sector.

We expect further growth in the sector in 2015 from demand to visit Rugby World Cup matches in 2015. The event will be held across the country in Birmingham, Brighton, Exeter, Cardiff, Gloucester, Milton Keynes, Leicester, Leeds, Newcastle and Manchester as well as London and the RFU expect domestic as well as 500,000 overseas fans. See Figure 2.

Overall we forecast occupancy growth to moderate a little in 2015 with a 1.6% gain taking occupancy to 76%. We anticipate 4.3% growth in ADR will mean rates push up to average almost £65. This combination will drive further RevPAR growth of 6% to take yields to almost £50 – the best result ever in nominal terms.

See Table 1 and Appendix 1 and the long term chart Figure 4.

**Figure 3: Provincial monthly trading to June 2014 – RevPAR growth in all the past 12 months, although pace slowed June 2014**



Source: Benchmarking Data STR Global 2014

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# Economic Outlook

## Continuing recovery

*After a period of generally disappointing growth in 2011 and 2012, the UK economy showed clear signs of recovery during 2013 that have continued in the first half of 2014. The UK economy grew by 0.8% in the first quarter of 2014 compared to the previous quarter, and was up by just over 3% on a year earlier. The recovery has now gathered real momentum.*

Official GDP data are only available up to Q2 2014, but more recent business surveys suggest that the relatively strong UK recovery is expected to continue into the third quarter. The latest Markit/CIPS Purchasing Managers' Indices (PMIs) for services and manufacturing were both significantly above 50 meaning that activity in these sectors is increasing at a relatively strong pace. The construction PMI has also been above 50 for a sustained period of time due in particular to stronger house building activity.

UK employment has continued to rise strongly, which has supported consumer spending growth despite persistent subdued rates of real earnings growth. Rising house prices have also supported consumer confidence and spending, but have also raised concerns about over-heating. Business investment has also shown signs of recovery since early 2013, although it remains well below pre-crisis levels.

We project UK GDP growth to average around 3% in 2014 and around 2.6% in 2015. Consumer spending growth is projected to follow a broadly similar pattern to GDP, with some moderation over time.

As always, there are uncertainties inherent in our growth projections. There are considerable downside risks relating to trends in the Eurozone and emerging markets (including Ukraine). However, there are also upside possibilities if these problems can be avoided and a virtuous circle of rising confidence and spending can be established as in past economic recoveries.

### ***Inflationary challenges***

Inflation has fallen below the 2% target, to 1.6% in the year to July 2014, and we expect it to remain at or slightly below target in 2014-15. There could still be upside risks to this inflation outlook in the longer term, however, if stronger global growth pushes commodity prices up again at some point, or if domestic wages start to recover without a corresponding rise in productivity.

### ***UK regions: Opportunities and challenges***

All UK regions are now achieving reasonable positive growth but variations remain. London is still expected to grow the fastest this year at 3.4% now compared to the 3.1% rate we projected in March and Northern Ireland is still expected to grow the slowest at 2.2% compared to our projection of 1.9% in March. However, all regions are expected to show a higher rate of growth in 2014 than they achieved in 2013. See Figure 5.

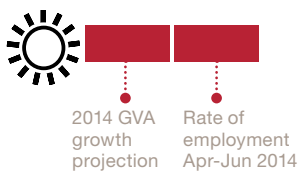
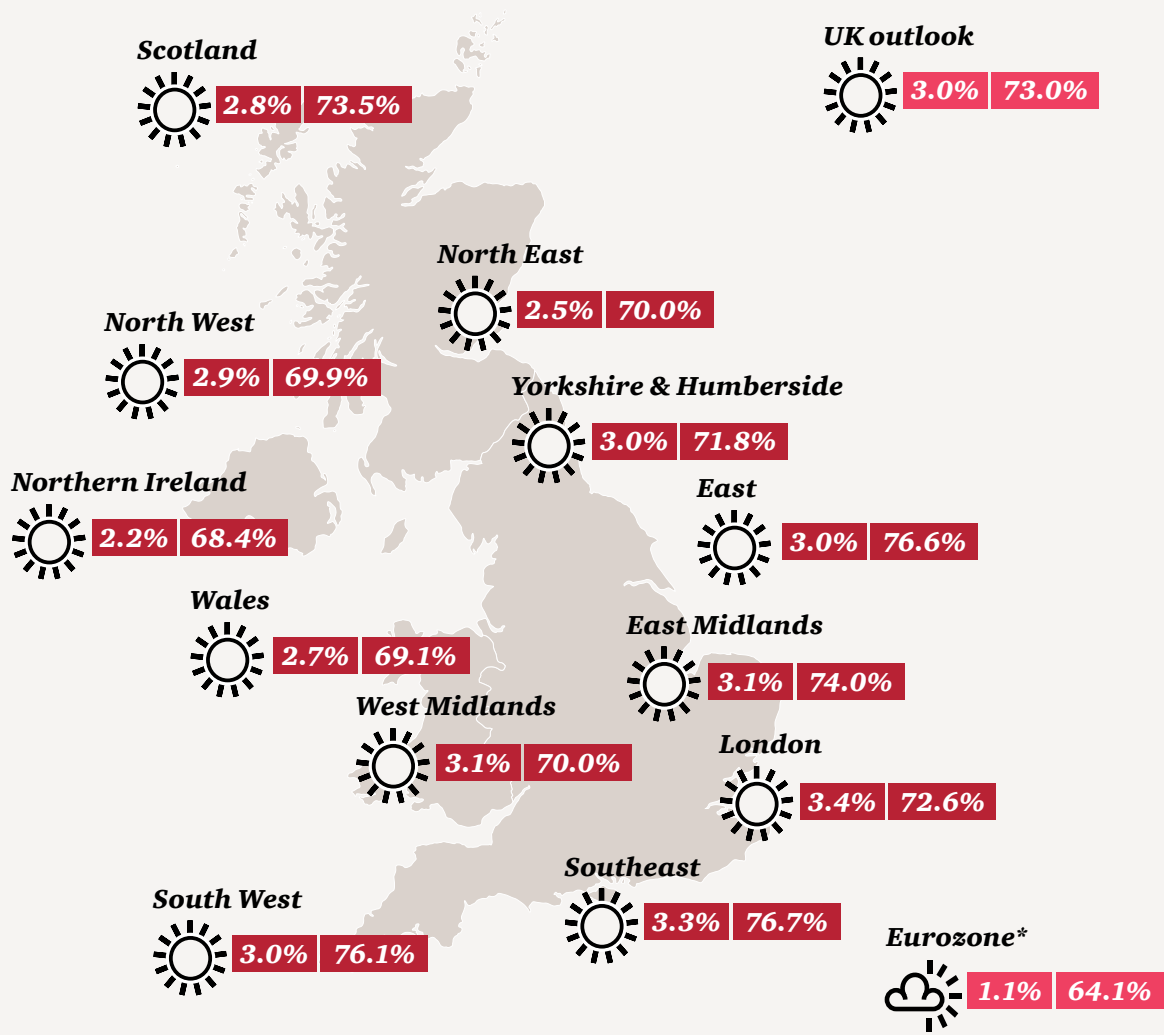
### ***A calmer Europe but slower growth elsewhere***

A calmer situation in the Eurozone has supported financial markets since autumn 2012, while the US economy still seems to be on the road to recovery despite some dip in activity in early 2014 due to heavy snowfall. The US remains a key market for the UK hotels sector and though its post-crisis recovery has been far from easy.

Emerging market performance has been much less strong, however, with Chinese growth slowing (but remaining fast in absolute terms), and more marked downturns in economies such as India, Brazil, South Africa and Turkey.

The situation with Russia and Ukraine also remains an important source of geopolitical uncertainty, as does the ongoing conflict in the Middle East. A marked increase in global oil prices could have a significant negative impact on GDP growth.

Figure 5: UK business climate



Sources: PwC, ONS, Eurostat

\* Eurozone employment rate as of Q1 2014





# ***Travel Outlook***

## ***Positive dynamics but geopolitical uncertainty***

### ***Encouraging start for UK inbound***

*The UK saw a record number of overseas visits in 2013 – the best result since 1961. And although it will be a tough year to follow, Q1 2014 data show a very positive start as visits increased by 11.7% to 7.1 million. The first five months of the year saw 7% more visitors compared to the same period in 2013, whilst spend was down 1% in nominal terms.*

*Top source markets from January to May were Europe and Rest of World while the USA remains the most valuable market.*

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2. Times 5 August 2014 Russian firms leave tourists stranded

3. 2014 UK Events Market Trends Survey (UKEMTS),



### ***An uncertain world***

There is always uncertainty however. A number of geopolitical events including those in the Ukraine and the Middle East may impact aviation costs and travel trends. Russians travelling abroad are reported to be down 30-50% from 2013, according to media reports in August 2014.<sup>2</sup> Current concerns regarding the ebola health epidemic could also disrupt travel markets.

### ***But the global travel forecast is above trend***

Globally, demand for international tourism remained strong in the first four months of 2014 according to the latest UNWTO World Tourism Barometer. International tourist arrivals worldwide grew by 5%, the same rate as during the full year 2013. Prospects for the current peak tourism season are forecast to remain very positive. This growth consolidates the already strong increase registered in 2013 (+5%) and is well above the long-term trend projected by UNWTO for the period 2010-2020 (+3.8%).

### ***An improving business travel outlook***

Business travellers are crucial for hotel mid-week demand and typically higher spending patterns. A positive outlook from major travel organisations confirms that the economic recovery means business travel should be on the up for 2014 and beyond. The Global Business Travel Association (GBTA) expects to see business travel grow by 5.1% in Western Europe this year and to see travel spend reach a record \$1.2 trillion globally in 2014, up 6.9% year over year. GBTA also expect the trend to continue, with a 6.5% growth in spending expected in 2015. This translates into stronger expectations of an improvement in the UK. In support, one-third of UK travel managers expect business trip numbers to increase over the next 12 months, according to the 2014 International Travel Management Study.

### ***But a challenging conferences and meetings market***

On a less positive note operators tell us that while they believe the conferences and meetings market continues to improve, it is far from fully recovered. As the economy improves and businesses invest in hiring, we expect to see an increased investment in learning, development and training.

This view is supported by 2014 research by EVCOM<sup>3</sup> which shows that while 2013 saw 6.4 per cent more delegates attend events in the UK, the number of business events fell by almost 4 per cent and overall there were 1.25m business events in the UK, compared with 1.3m in 2012. Most respondents expected business to be up in 2014, and 30 per cent project it will be at a similar level to 2013 – only 6 per cent foresee a decline in business. ADR for venues was on a par with 2012 (£42 including VAT), but residential rates rose to an average of £136 including VAT, compared with £129 in 2012.

2014 (Jan to May)  
inbound tourism

7%  
Up

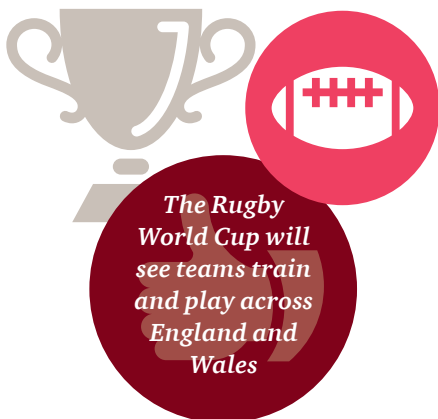


and global travel  
forecasts remain  
above trend

***Eventomania: the Rugby World Cup could make hoteliers happy in 2015***

Events can be a powerful demand driver. Fewer events in London this spring were reported to have had a negative impact on accommodation demand compared to last year – e.g. the Champions League final. In July the Tour de France powered into the UK for three legs of the 2014 race and managed to revive some of the Olympic spirit. Many in the crowd were local visitors but some along the route were out of town visitors which will have helped hotel demand. Outside London, the long awaited Glasgow Commonwealth Games were held between 23 July and 3 August and the city will be hoping for the halo effect London has seen since the Olympics. Visitor numbers to Glasgow are expected to grow by up to one million a year until 2016.

The Rugby World Cup is the third largest global sporting event and will be hosted in England from September 18 to October 31, 2015. The Tournament, which is contested every four years, will see the top 20 International teams travel to England in 2015 and compete in front of well over 2 million fans in stadia across the country. The event is expected to attract large numbers of affluent domestic fans, as well as an anticipated 500,000 visitors into the UK. With a third of matches set to be played on a Sunday (traditionally a low occupancy night) the event is a great opportunity for hotels.



***Domestic travel: sunny weather versus a strong pound***

Domestic holiday prospects should be enhanced by the surprisingly good summer weather and some domestic cottage and holiday parks businesses are already reporting an 11% increase in bookings; hotels will be well pleased if this is the case for them too. In contrast it will be interesting to see if the strong pound lures travellers abroad in large numbers – some trips are reported 31% cheaper. In July sterling went to a six year high against the dollar and a 22 month high against the euro. The passport office backlog may also represent a sign of overseas holiday ambitions.



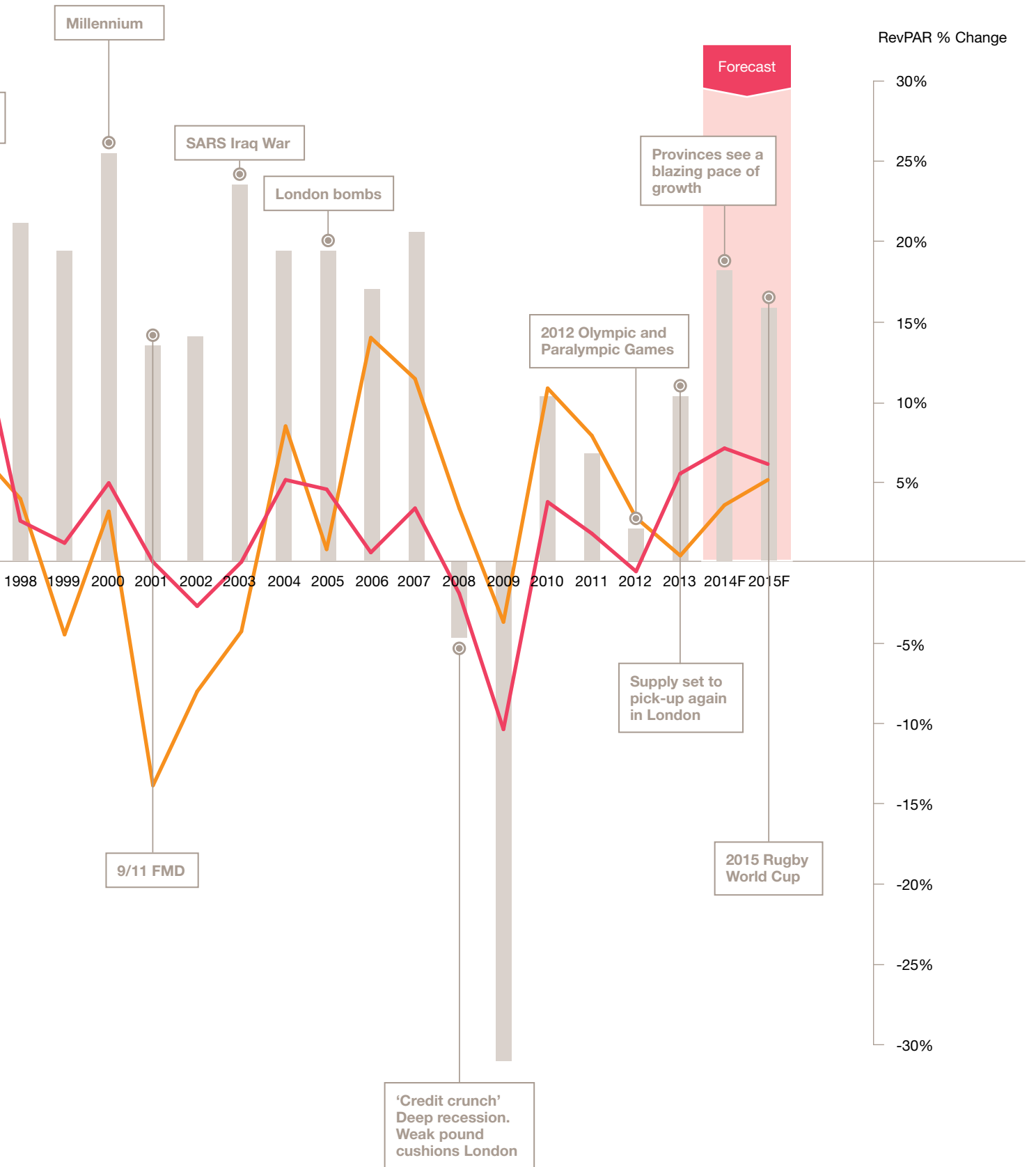
*Domestic holiday prospects should be enhanced by the surprisingly good summer weather and some are already reporting an 11% increase in bookings*



Figure 4: Growth story as hotel cycle rejuvenated by economic recovery – 2014 and 2015 forecast  
1979 – 2015 (% change on prior year)



Source: Econometric forecasts: PwC August 2014 Macroeconomic data: National Statistics Benchmarking data: Hot Stats STR Global



# How will the sharing economy disrupt hotel business models?

## Introduction

*While achieving any forecast is not easy and hotels clearly face many challenges, there is a new trend emerging that may not be front of mind for hoteliers currently – but probably should be soon – because it has potential to steal market share and drive down values in the traditional serviced accommodation sector. The question is whether the impact will be as significant as the growth of the budget hotel segment in the 1990's and the emergence of OTA's in the 2000s.*

Our recent research shows that a sharing economy is resulting from the collision of four megatrends: breakthroughs in technology and connectivity, rising urbanisation, a growing environmental conscience and shifting social preferences. In the hospitality and leisure sector, a new breed of traveller is emerging from this coming together. Call them “Generation Y”, Millennials or Digital Natives, much has been written about a young, tech-savvy generation, who see through hotel marketing literature with a quick scan of TripAdvisor – and who, with one click, get the best deal available through price comparison websites like Trivago. Oh, and they’ll probably do all of this on their smartphone or tablet.

## What is the sharing economy?

Consumers are increasingly valuing access over ownership, playing out in a dynamic collection of sectors and is becoming known as the sharing or collaborative economy. Many sectors in the economy offer alternatives to ownership, but “sharing economy” sectors are different because they hold three core features:

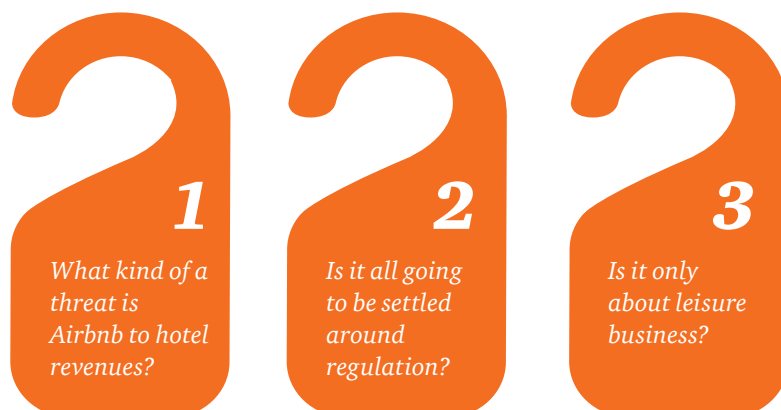
- Business models are hosted through digital platforms which connect demand and share capacity dynamically in real-time
- Transactions are completed through a variety of methods that offer access over ownership (e.g. P2P sharing, subscribing, re-selling and swapping)
- Consumers are more comfortable with consuming products in a way which involves deeper social interactions than traditional methods of exchange

## Why does it matter for hotels?

Clearly there is much to play for. Sharing economy platforms provide new entrants and individuals the opportunity to present travellers with non-hotel alternatives in great mass under a trusted brand, and travellers are taking them up on the offer. Sharing platforms such as Airbnb are growing rapidly, and are expected to continue to do so. Some of this growth could come at the expense of hotels. Demand growth is enabled by a number of drivers which also impact hotels. Consumers are increasingly willing to use sharing platforms as friends and family try it, creating a self-reinforcing feedback loop.

Airbnb is working with Concur Technologies Inc. (CNQR), a corporate travel and expense service, to offer accommodation for business travellers. Reports suggest that 10% of Airbnb business was already accounted for by corporate travellers.

**Below we highlight the results of research by our megatrends and hotels teams, including the views of a cross section of hotel chains in the UK. We have focused the research results around three questions:**





## What does the industry currently think?

How does all this matter for hotels and what could they be doing about it? Below we highlight the results of research conducted in July 2014 by our megatrends and hotels teams, including the views of a cross section of hotel chains in the UK.

Of travellers would be happy to rent someone else's holiday house



## What kind of a threat is Airbnb to hotel revenues?

### Industry response:

- The hoteliers we spoke to said that 'sharing economy' business models are not a significant threat to traditional business models (yet) and that OTAs were the biggest threat
- But around 21% said they had already seen some impact. This included 10% who had seen demand impacted negatively. A third had seen a hybrid traveller who now mixes different accommodation models.
- Luxury operators especially did not believe the sharing economy (business models like Airbnb) could consistently compete with a 5 star business model. Others thought corporate 'heavy' operators were also better protected from these new models
- Several operators with properties in London explained that occupancies remain high with no sign of any impact

### PwC view

- Anecdotal evidence from the US suggests that hotel occupancy levels in areas with considerable numbers of home share listings are impacted adversely and occupancies are lower than in areas with more limited listings
- Hotels which trade heavily on packaging and service may be more protected, particularly high-end segments
- The threat to hotels may increase over time as new companies evolve to provide service offerings, providing improved consistency and convenience for both providers and users

One operator commented:

*"There would have to be a seismic intrusion in the market for us to really notice (...an impact on revenue.)"*

## 2

### Is it all going to be settled around regulation

#### Industry response:

- 60% of those we surveyed this summer thought that the new sharing models were operating outside the law and that the regulatory framework needed to adapt
- Suggested areas to resolve included tax and health, safety and security
- The British Hospitality Association (BHA) recently issued a warning to all home exchange websites operating in the UK to improve their safety requirements

#### PwC view

Other segments of the sharing economy, such as car sharing, P2P lending and ride sharing, suggest that regulators usually have to adapt to meet consumer's best interests. Generally regulators are hesitant to extinguish emerging business models – although the outcome for accommodation is far from certain

*“...it could be a risk issue as private accommodations would not have the same fire standards or other health and safety requirements of hotels.”*

Samantha van Leeuwen, PwC Head of Hotels and Venues Procurement

## 3

### Is it only about leisure business?

#### Industry response:

- Over half those surveyed thought that the tech-savvy generation Y corporate travellers are an important segment driving the new trends
- There was a feeling that corporate travel would not consider 'sharing' as much as leisure travellers and there are health and safety concerns from corporate travel organisers

#### PwC view

- As the industry evolves and provides increasingly compliant and consistent quality of stay, businesses may be increasingly likely to approve use of sharing economy sites for travel
- Employees are increasingly likely to demand use of such sites as more digital natives enter the workforce and personal travel impacts business behaviours

## How should hotels respond?

*Clearly its early days, but with some hotels already admitting to experiencing some form of impact, hotels should be thinking about developing strategies now to ensure they are prepared for the future.*

Organisations should start the process of identifying the potential for disruption. The music and TV sectors didn't identify the challenge quickly enough, and value has been displaced whilst they waited. In contrast, the automobile industry spotted the trend early and got ahead of it: most car manufacturers now run their own car-sharing schemes; and others have made strategic investments in new entrants – such as Avis in Zipcar and BMW in parkatmyhouse.

The next step is take a point of view and develop some possible strategic options. Clearly the right option will differ across organisations; whether that's acquiring a new entrant, partnering or investing in them; or differentiating products to continue to justify the existing pricing structure. There's also an opportunity for organisations to develop their own sharing economy concepts. In our UK research over half of respondents saw continued efforts to differentiate their product as the best way to fight back to justify hotel pricing structures. Over a third surveyed said they would consider

listing their rooms on peer to peer (P2P) platforms. None admitted (to us) to considering acquiring or investing in players in this space yet. But half of those hotels not currently considering a strategic response would consider doing so in the future and more might do so.

It's important hotels don't miss out on opportunities. None of those we spoke to are looking at using sharing platforms to increase asset utilisation – that's value left sitting on the table.



# Supply

## A sleeping giant?

*At the end of June there were around 23,000 rooms in the UK development pipeline expected to open within the parameters of this forecast period i.e. the rest of 2014 and 2015. Of this total over 10,000 new rooms are expected in London, according to AM:PM. This means 5.3% forecast annual room growth for London in 2015 – see below – compared to around 4% this year and 1.2% in 2013. In the regions the rate of growth is expected to be around 1.7% next year.*

Growth clearly varies between regions and segment with London forecast to see the highest growth in supply. Outside London, those cities with the largest active pipelines include Manchester (1,900 rooms), Edinburgh (1,370 rooms), Birmingham (1,055 rooms), Aberdeen (960 rooms), Glasgow (920 rooms), Liverpool (900 rooms)

Are these data significant? Is supply expected to plod along slowly or are we on the cusp of another building boom? Overall, the general feeling is that supply is not currently an issue; however, evidently in some areas too many hotels may exacerbate any demand weakness. We would expect the pace to accelerate more steeply as economic growth takes hold and access to financing improves.

In counterbalance, there have been warnings that in the UK's big cities hotels face competition for land from residential and office developers. This may impact the development pace as it gets harder and more expensive to acquire sites.<sup>4</sup>

Brands and products evolve to match changing consumer tastes and aspirations. As well as more openings from familiar brands, there are newer names opening in 2015, such as Marriott's Moxy brand in Liverpool, Heathrow and Westfield Stratford; Gansevoort Hotel Group, Morgans and a Hub by Premier Inn in Edinburgh.

### **Structural shifts still squeezing the middle**

While budget hotels comprise almost 23% of current supply they make up a 50% of the total pipeline – even in London (for 2014 and 2015). Mid market (2 and 3 star) encompass some 42% of current supply but only 3% of the UK pipeline. The four and five star segment account for almost 40% of the active pipeline and four star rooms are expected to grow by over 3,600 rooms over the next three years.

### **Add apartments into the competitive mix**

Over 1,300 rooms opened in apartments in 2013 and to date in 2014 and a further 1,740 rooms could open in the apartment sector in 2014/2015 with brands like Adagio, Urban Villa, Roomzzz, Bridgestreet, Go Native, StayCity, Cheval, Marlin and Staybridge Suites – adding to the choice for consumers visiting UK cities.

*Four star rooms are expected to grow by over 3,600 rooms over the next three years\**



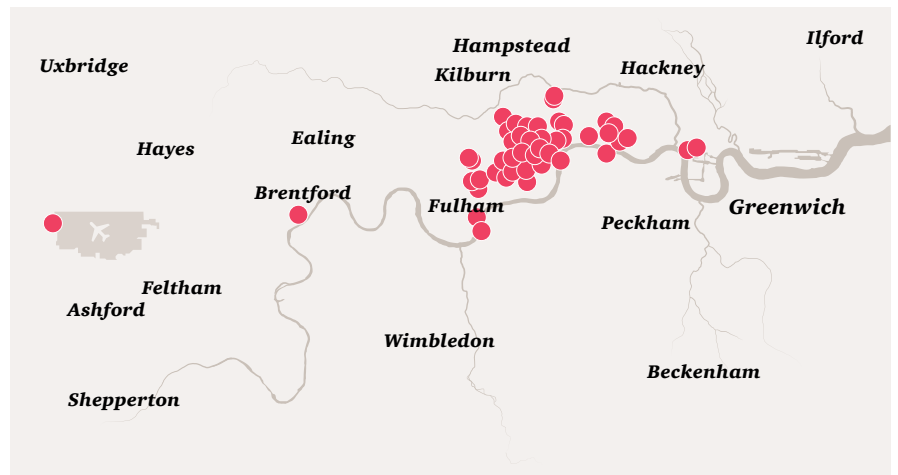
4. A pod of one's own: no room in the capital for hoteliers Property Week 11 July 2014

**London luxuriates**

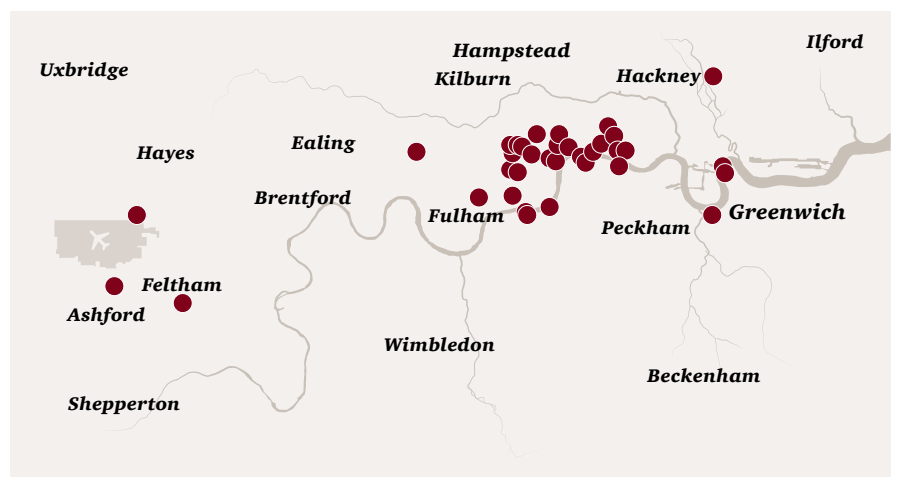
Between 2014 and 2017, 15% of London’s room pipeline comprises five-star hotels. This compares with 29% in the four-star sector and 44% in the budget sector. In addition to the recent additions of the Shangri La; the Chiltern Firehouse; the Dorsett in Shepherd’s Bush and Firmdale’s Ham Yard Hotel in Soho, London can expect over 1,000 new five star hotel rooms to open in the rest of 2014 and 2015 including the Beaumont, the InterContinental at the O2 and the Hilton Bankside.

There has been a slight shift in terms of new luxury hotels towards the south, east and west and out from the central London. See Figures 6 and 7. This is likely due to a shift in major new regeneration and infrastructure schemes, for example, the Vauxhall Nine Elms Battersea area where Battersea Power Station re-development and the new American Embassy will help revitalise the area; as well as the availability and cost of land and perhaps a trend to more modern luxury. Attracting guests far afield from traditional core areas may be a more difficult task than building the hotels.

**Figure 6: Five Star supply now**



**Figure 7: Five Star supply pipeline is pushing the boundaries**



**Power of the brand**

2014 marks some interesting rebrands as brand power comes into its own: Hilton will open the 5-star 256-bed Conrad Westminster in September after the rebranding of the InterContinental London Westminster; Carlson Rezidor has announced two inaugural UK hotels joining its recently launched Quorvus Collection including the former Hotel Missoni, Edinburgh; base2stay have rebranded several hotels as apartment hotels under the Nadler brand; Accor and Moorfield

Group have announced the addition of three hotels in Aberdeen, Cheltenham and Windsor to the MGallery Collection – all currently operate under the Mercure brand.; and several Jurys Inn will become Hiltons.

Meanwhile, GLH Hotels has launched its third new brand. The Singapore-listed group, which is London’s largest owner operator of hotels, has created Every, to stand alongside the previously announced Amba and Clermont brands.



# Deal talk

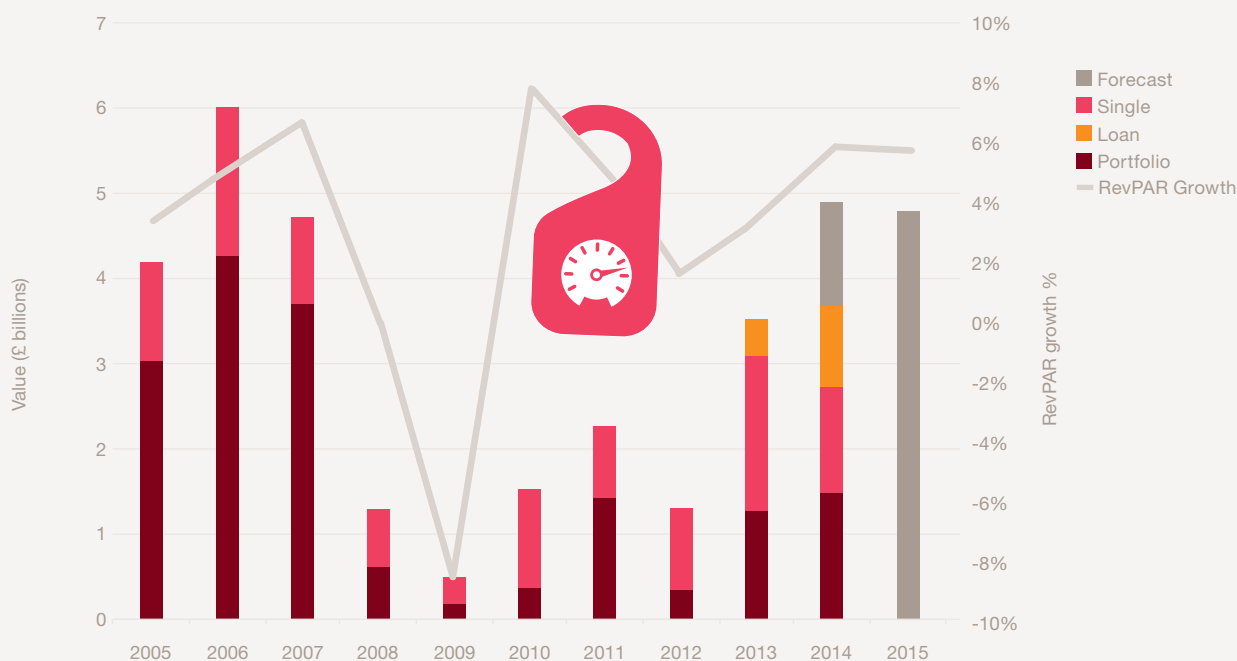
## Onward and upward



*Past performance may not always be a guide to future returns, but in the UK hotel market it appears to be a reasonable indicator of future deal volumes. Over the last decade there has been a clear relationship between the growth in RevPAR and the volume of M&A deals the following year. The upward trend we saw in both measures between 2005 and 2007 has resumed since 2012, even if deal volumes have not returned to pre-crash levels. The M&A market is taking time to recover from the aftermath of the credit crunch, when many banks put up ‘do not disturb’ signs while reviewing their options, and investors saw hotel assets, especially in the Provinces, as risky until a solid return to RevPAR growth.*

So if RevPAR growth is a principal impetus, what other factors have been driving deal volumes in the last two years? We’ve seen a renewed appetite from PE houses, especially for provincial hotels, and the banks have taken this opportunity to offload some of the distressed, over-gearred assets – there were 37\* provincial “distressed” sales in 2011 and 2012, and 30\* in 2013. This included a group owning 42 hotels (managed by Marriott) which were sold by administrators in 2012, and the Hotel du Vin and Malmaison chains were put up for sale later the same year, after their parent company was unable to meet its debt obligations. Both these completed, together with the Principal Hayley portfolio deal, in 2013.

Figure 8: UK Hotel Deal Value



Source: Dealogic, HVS, PwC analysis

\* Includes portfolios counted as 1

Year to date 2014, deal volumes have continued to rise steadily, and we predict the final volume will be significantly ahead by the end of this year, up nearly 40% compared to 2013 (depending on current transactions completing before year end). Major transactions have included the buy-back by Travelodge and Accor of the freehold interests in a significant number of leased hotels; the sale of QMH UK, 21 hotels from the LRG portfolio, and both Venues and Golf Resorts from the De Vere group, with their third and final disposal, Village Urban Resorts currently underway. London transactions have included the sale of the Marriott Grosvenor Square lease, and the newly opened Marriott London Edition. Reports in the media suggest that the Grosvenor House could be sold shortly too.

Another interesting feature in the hotel deal market is the significant growth in loan rather than asset-based transactions, which represented over 15% of the total deal volume in 2013, and one quarter so far in 2014. US hedge funds are the big buyers here, attracted either by the possibility of good returns on the debt itself, or a desire to set up a hotel management platform in the growing UK market. Notable recent loan transactions include the hotel loans sold by Lloyds Bank in its Project East portfolio, and the sale of the Q, Somerston, Curzon and Puma hotel loans within the Project Rock loan portfolio from IBRC.

So what trends do we see driving the M&A market in 2015? We believe strong RevPAR growth will continue to drive deal volumes, though these may be slightly lower in the Provinces than 2014 with the slight decline in forecast RevPAR growth and the potential lack of equivalent supply of portfolio deals. We believe the PE houses will remain active and interested buyers, especially where there are opportunities to make potential cost savings through the integration of hotel portfolios with existing management platforms. Middle East and Asian investors will also be significant players in London, though in the long term this could leave the market less liquid, as they tend to hold their assets longer term.

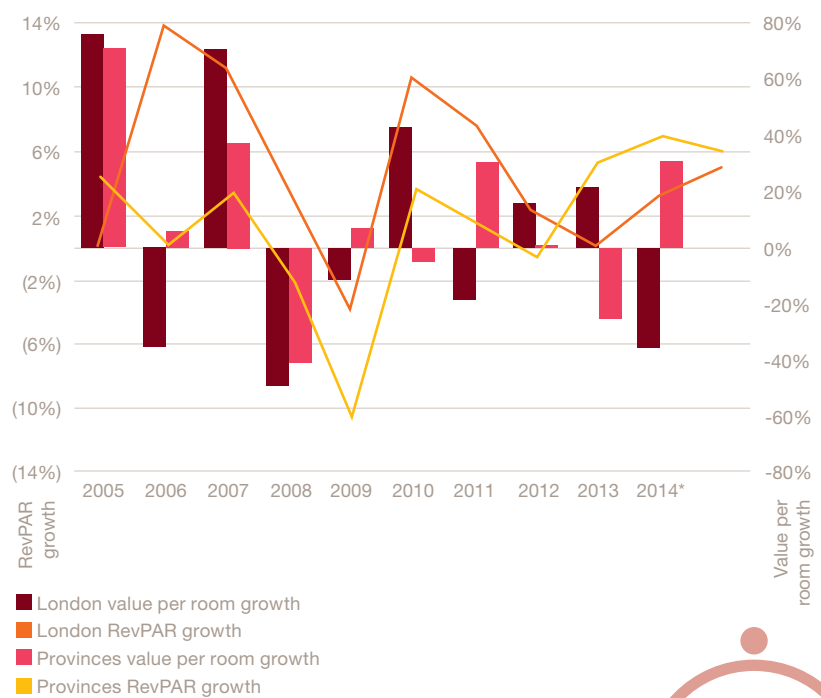
### A game of two halves: London and the Provinces

If there is a clear correlation between RevPAR and deal volumes in the UK market as a whole, the picture is slightly more nuanced when you look at deal values in London and the Provinces.

The relationship between provincial RevPAR growth and transactions is very strong, with the deal value per room lagging RevPAR by about twelve months. The correlation is not so clear-cut in London, but the exceptionally high property values in the capital mean that one or two flagship sales can easily skew the underlying trend. There was also a significant 'Olympic effect' up to and

including 2012, which expressed itself in seller unwillingness to dispose of assets ahead of a potential Games bonanza. Since then performance has generally been strong, with several major sales in 2013 coming in at around £900k per key, including the InterContinental Westminster and Berners Hotel, as well as the InterContinental Park Lane sale and manage-back by IHG. We have not seen any sales around this value level as yet this year (the highest to date has been the Royal Bayswater at just over £600k per key), though the potential Grosvenor House disposal could have a significant effect on the final year average if it does take place.

Figure 9: London and Provincial values to performance



\* Value growth year to date 2014  
Source: Whitebridge Hospitality, PwC analysis



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# *Appendices*

# Appendix 1

## Annual hotel statistics for London, Provinces and UK 2008-2015 (F)

Table 2:

London	Actuals						Forecast	
	2008	2009	2010	2011	2012	2013	2014	2015
Occupancy %	80%	81%	82%	82%	81%	82%	83%	84%
ADR (£)	119.85	113.90	123.45	133.42	139.35	136.57	140.52	145.54
RevPAR (£)	95.37	91.73	101.61	109.54	112.34	112.62	116.41	122.36
% change on previous year								
Occupancy	-1.5%	1.2%	2.2%	-0.3%	-1.8%	2.3%	0.5%	1.5%
ADR	4.7%	-5.0%	8.4%	8.1%	4.4%	-2.0%	2.9%	3.6%
RevPAR	3.2%	-3.8%	10.8%	7.8%	2.6%	0.3%	3.4%	5.1%

Provinces	Actuals						Forecast	
	2008	2009	2010	2011	2012	2013	2014	2015
Occupancy %	69%	66%	69%	71%	70%	73%	75%	76%
ADR (£)	64.03	59.70	58.68	58.43	58.99	59.75	62.07	64.73
RevPAR (£)	43.93	39.28	40.76	41.39	41.13	43.35	46.37	49.14
% change on previous year								
Occupancy	-3.5%	-4.1%	5.5%	2.0%	-1.6%	4.0%	3.0%	1.6%
ADR	1.5%	-6.8%	-1.7%	-0.4%	1.0%	1.3%	3.9%	4.3%
RevPAR	-2.0%	-10.6%	3.7%	1.6%	-0.6%	5.4%	7.0%	6.0%

UK	Actuals						Forecast	
	2008	2009	2010	2011	2012	2013	2014	2015
Occupancy %	71%	69%	73%	74%	72%	75%	77%	78%
ADR (£)	79.06	74.29	76.12	78.62	80.63	80.44	83.19	86.49
RevPAR (£)	56.37	51.57	55.27	57.87	58.38	60.31	63.82	67.39
% change on previous year								
Occupancy	-3.0%	-2.6%	4.6%	1.4%	-1.6%	3.6%	2.3%	1.6%
ADR	2.8%	-6.0%	2.5%	3.3%	2.6%	-0.2%	3.4%	4.0%
RevPAR	-0.2%	-8.5%	7.2%	4.7%	0.9%	3.3%	5.8%	5.6%

Econometric Forecasts: PwC August 2014

Benchmarking Data: STR Global July 2014

# Appendix 2

## 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 into account only rooms let. Room revenue divided by rooms sold.

#### RevPAR

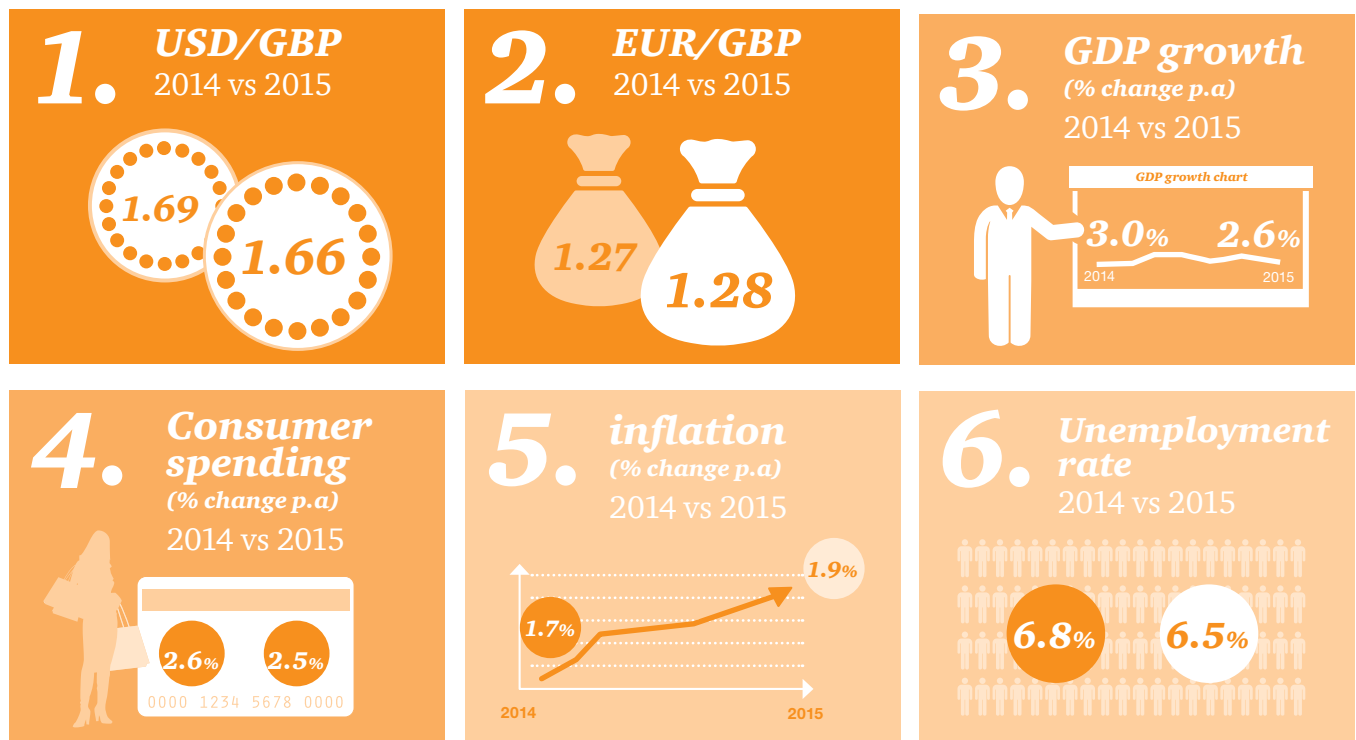
*Revenue per Available Room* Room revenue divided by rooms available (occupancy times average room rate will closely approximate to RevPAR). Also known as yield.

#### Occupancy

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

# Appendix 3

## PwC hotel model GDP and other economic assumptions



# Appendix 4

## Methodology for hotel forecasts

*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 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 Table 2.

### Our approach

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 used the 2-stage least squares (2SLS) instrumental variables approach. We now use an 2SLS approach which 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 has an influence on hotel demand.

Our model specification includes quarterly dummies, the lag of GDP growth, the lag of the difference in prices as instruments for both the London and Provinces model specifications, with terrorist events included as an additional instrument for the London model. Results from the Durbin-Wu-Hausman test indicate that the instruments used are exogenous and the model is sufficiently over identified at a 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. Adjustments were made to ensure the comparability of STR and AM:PM data and an attrition factor was applied to simulate periodic drop-off in rooms supply. RevPAR forecasts were constructed using ADR, demand and supply forecasts. This model was used to generate forecasts through to Q4 2014, 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.

### The Rugby World Cup 2015

To account for the additional demand to the rugby world cup, we have used historic data on the 2007 World Cup in France along with the schedule and stadium capacity for the 2015 World Cup to estimate the additional international and local demand for hotel rooms in London and the Regions. This additional impact on demand, and therefore on occupancy rates, is then combined with econometric price elasticity estimates to obtain the impact on prices.

**Table 3: Final specifications of the London and Provinces models**

	London	Provinces
<b>1st stage</b>	<p><b>Dependent variable</b> Growth in London hotel demand</p> <p><b>Explanatory variables</b></p> <ul style="list-style-type: none"> <li>Country-weighted GDP growth in the previous quarter<sup>5</sup></li> <li>Growth in previous quarter London ADR</li> <li>Seasonal dummies</li> <li>Dummy for the Olympics</li> <li>Terrorist events dummy (7/7 and 9/11)</li> </ul>	<p><b>Dependent variable</b> Growth in Provinces hotel demand</p> <p><b>Explanatory variables</b></p> <ul style="list-style-type: none"> <li>UK GDP growth in the previous quarter</li> <li>Growth in Provinces ADR in the previous two quarters</li> <li>Seasonal dummies</li> </ul>
<b>2nd stage</b>	<p><b>Dependent variable</b> Growth in London ADR</p> <p><b>Explanatory variables</b></p> <ul style="list-style-type: none"> <li>Growth in London hotel demand</li> <li>Growth in previous quarter London ADR</li> <li>Change in previous quarter nominal Euro-GBP exchange rates</li> <li>Seasonal dummies</li> </ul>	<p><b>Dependent variable</b> Growth in Provinces ADR</p> <p><b>Explanatory variables</b></p> <ul style="list-style-type: none"> <li>Growth in Provinces hotel demand</li> <li>Growth in previous quarter Provinces ADR</li> <li>Dummy for the Olympics</li> <li>Seasonal dummies</li> </ul>

5. Growth 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.

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### **PwC can help you understand the implications of the megatrends for your organisation**

Over the last year, we have been working with our clients to help them understand the big changes that are disrupting their organisations and the economy as a whole. We have distilled our research into five global shifts that we have seen have a major influence today and we believe will permeate all sectors of the economy and society over the next decade. We call these the megatrends – the implications of which will vary significantly across sectors and organisation types. We help our clients understand how the megatrends – and their collisions such as the sharing economy – impact their organisation; and identify how they can best adapt and respond.

### **PwC forecasting capabilities in the hotels sector**

We use econometric models for forecasting for our clients as well as for thought leadership. A few recent examples are:

#### **Hotel forecasts:**

We provide forecasts for hotel room occupancy rates and prices for the hospitality and leisure thought leadership reports. We have produced forecasts for the UK, for 17 other European cities and for 6 cities in the Middle East.

#### **PwC's macroeconomic consulting services include:**

- Revenue and cost forecasting for business planning and budgeting
- Market attractiveness assessment
- Review of existing processes and advice on leading practice

#### **Impact assessment and policy analysis**

- Measuring economic, social, fiscal and environmental impacts
- Policy impact analysis
- Regulatory impact assessment

#### **Stress testing**

- Support in meeting regulatory stress-testing requirements
- Scenario analysis under different macroeconomic assumptions

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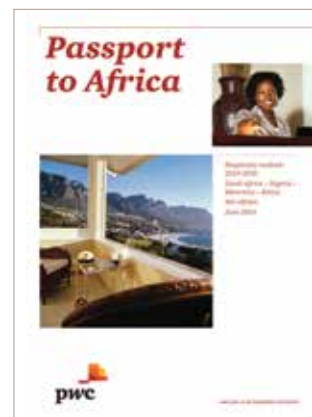
Our in-depth sector knowledge, and experience global networks and understanding of specific issues that may be affecting your business, means we can provide the specialist knowledge you need.

Our hotel advisory deals team can help you to meet your objectives at every step of the hotel value chain including:

- Acquisition
- Asset management
- Disposal
- Making the right investment choice

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