



Hospitality Directions Europe Edition*

Issue 12 September 2005

Latest UK hotel sector forecast: the effect of the summer's terrorism attacks on London is likely to be short lived but significant for trading this year and, together with the economic slowdown, will set back recovery



The July 7 attacks on London marked the beginning of a period of uncertainty for many businesses linked to tourism. Our latest forecast reflects the effect on hotel trading of the economic slowdown, the terrorist attacks in the summer and consequently a more uncertain travel environment.¹ We expect the worst of the impact will be on London and short-term, and have revised our latest forecast downwards. Accordingly, whilst the terrorism may hurt consumer confidence, it is not expected to depress overall economic growth figures; rather it will displace activity for a while. However the effect will be seen in the short-term indicators for tourism in London.

So far tourism and hotel indicators are mixed, and many operators remain optimistic, but the attacks have shaken consumer confidence and kept travellers away from London. For the Provinces, which were not impacted directly, there has been speculation that they may 'benefit' from London's displaced travel, although as a major gateway city for the rest of the UK, this effect could be mitigated if travellers do not come at all to the UK. There have been reports of August's revenue from room sales down by almost ten per cent in London but, on a brighter note, UK domestic overnight trips are said to be proving robust.² Hotels and restaurants have (so far) bucked the

trend, in terms of the consumer slowdown in comparison to some other sectors on the High Street but whether this will continue in coming months remains to be seen and analysts are speculating whether the High Street downturn may be spreading to the service sector.

At the time of our last forecast in May prospects looked the best for years, with economic growth for 2005 forecast at 2.7 per cent, with a further 2.5 per cent GDP growth expected in 2006. These have now been revised down to 2 per cent and 2.4 per cent respectively for 2005 and 2006. This forecast is, as a consequence, significantly less optimistic than then. We still expect three years of growth in 2005-2007 but at a substantially lower level. RevPAR growth has been halved for the UK for this year and virtually halved for 2006. For London the downward revision is an even higher percentage.

¹ Oxford Economics envisage overall GDP growth moderating from 3.2 per cent in 2004 to around two per cent this year, climbing a little to 2.4 per cent in 2006 and further to 2.8 per cent in 2007.

² Caterer & Hotelkeeper 15 September 2005



This forecast aims to give an insight into current and future market conditions and introduces:

- The latest PricewaterhouseCoopers (PwC) UK forecast to 2007 utilising new models based on monthly hotel performance statistics (as reported by Deloitte/Smith Travel Research) which, as a consequence, are more robust.
- Expanded coverage of UK hotel markets, including individual forecasts for Birmingham, Manchester, and Edinburgh, in addition to our regular coverage of the UK, London and the Provinces.

Forecast summary

- Our latest forecast for the UK is for 3.3 per cent RevPAR growth in 2005 and a further 3.3 per cent in 2006, with a gain of 4.0 per cent in 2007. This growth will be driven primarily by room rate growth, way down on the 7.9 per cent and 6.5 per cent we had expected back in May for 2005 and 2006.
- For London, despite the problems, we anticipate 2.5 per cent RevPAR growth in 2005 and a further 2.6 per cent in 2006, with a gain of 3.9 per cent in 2007. Average room rates should top the £100 mark again in 2006 but occupancies, already much higher than many other European and UK cities, are not expected to ‘thrive’ over this forecast period, showing only marginal growth and likely to linger in the high 70’s. For London, singled out for the terrorist attacks, this represents a substantial downward revision on our last forecast.
- For the Provinces, reflecting uncertainty following the summer’s events and the effect of the economic slowdown on consumers expenditure, we forecast reasonable RevPAR gains of 4.5 per cent in 2005, and further growth of 4.6 per cent in 2006 and 3.7 per cent in 2007.

“Since 2000 PwC has implemented advanced econometric techniques to produce forecasts for the Hospitality industry in the UK. With the latest innovations PwC continues building on its commitment to provide the most advanced and accurate forecasts among professional forecasters”

- For Manchester, a strong commercial market, our forecast is for above average growth for 2005 of 5.9 per cent, slipping slightly to 5.4 per cent in 2006 but increasing to 6.1 per cent in 2007.
- For Birmingham, suffering from a weakening economic backdrop and a reliance on lower rate conference and meetings business, we forecast RevPAR growth of 1.7 per cent in 2005, 2.7 per cent in 2006 with further growth of 2.6 per cent in 2007, slightly below our forecast for UK and the Provinces.
- For Edinburgh, with a good mix of high-end leisure and corporate business and some of the highest room yields in the country after London, we forecast RevPAR growth of 3.4 per cent in 2005, 3.3 per cent in 2006 and 2.7 per cent in 2007.

Our forecasts are now even better... PricewaterhouseCoopers have developed new integrated forecasts of UK hotel trends

With this issue of *Hospitality Directions*, we present an updated forecasting approach that integrates short-term monthly forecasts (looking one year ahead) with structural model-driven annual forecasts.

In each issue of *PricewaterhouseCoopers Hospitality Directions – Europe Edition* you will find an analysis of the annual (three-years ahead) expected trends in the Hospitality industry in the UK, London, the Provinces as a whole and for, Birmingham, Manchester and Edinburgh. We will also produce short-term monthly forecasts which we will use internally as a consistency check for the short-term market trends and to provide the benchmark for the long-term forecasts. The integration of short-term with long-term forecasting will provide the industry with a consistent framework of analysis and planning.

The introduction of monthly statistics to our models allows for the development of updated forecasting

“The integration of short-term with long-term forecasting will provide the industry with a consistent framework of analysis and planning”

models that are expected to enhance the accuracy of our forecasts as well as provide more consistent and timely monitoring of the hotel industry. Using two modelling approaches which include both univariate modelling and structural modelling, has allowed us to combine both a short-term and long-term approach to anticipating future trends. We have used monthly data from January 1999 for occupancy, ADR, and RevPAR.

PricewaterhouseCoopers' structural models – inputs and strengths

Consistent with our previous forecasting methods, we have updated and re-estimated our hotel econometrics models with the new monthly/quarterly hotel performance data.

The following provides a brief review of PwC's structural modelling approach:

Macroeconomic – Industry Inputs

Hotel industry forecasts and their accuracy partly depend on the macroeconomic inputs used to produce them. PwC uses Oxford Economic Forecasting (OEF) a well-respected firm specialising in UK and global macroeconomic forecasting. (See Box opposite.) On a quarterly basis OEF provides PwC with detailed historical and forecast data for:

- ✓ real gross domestic product;
- ✓ consumer price trends;
- ✓ industrial production;
- ✓ employment;
- ✓ consumer sentiments;
- ✓ consumer consumption and business investment; and
- ✓ exchange rates with the U.S. and other major UK trading partners.

In addition, in close collaboration with OEF, the PwC hotel team tracks quantitative information, such as airline passenger trends, as well as qualitative information from trade publications and hotel experts to provide a consistent framework for understanding the current hospitality and economic trends in the UK.

Structural Model Development

In the February 2003 *PricewaterhouseCoopers Hospitality Directions – Europe Edition*, we provided an in-depth overview of the modelling approach and its forecasting accuracy. In summary our approach allows for a causal-dynamic structure among the dependent and independent variables. The advantage of this causal structure is its ability to utilise the observed stable historical relationships to predict the future course of hotel performance.

Macroeconomic Inputs: Oxford Economic Forecasting

Oxford Economic Forecasting (OEF) is one of the world's leading providers of macroeconomic forecasting models, with over 300 clients including international organizations (such as the International Monetary Fund, the World Bank and the Asian Development Bank); government departments (including the UK Treasury and various departments in the US government); central banks (including The Bank of England and the Bank of Spain); as well as a large number of banks, fund managers and blue-chip companies in the UK, Europe, the USA and Asia across the whole industrial spectrum.

OEF's main focus is on modeling and analysis of developments and prospects both across the international macroeconomy and in a range of industries/markets. The key framework in which this analysis is conducted is OEF's own **global econometric models**, which cover 40 economies in detail and provides headline forecasts for another 40 or so countries. This provides a **rigorous and consistent structure for forecasting**, and allows the implications of **alternative global scenarios** and **policy developments** to be readily analyzed at both the macro and sectoral level.

OEF's modeling approach allows for international economic interactions. Therefore, fiscal and/or monetary policy changes as well as exogenous shocks in one country are allowed to "flow" through that country's major trading partners. For example, a change in US monetary policy, or oil and commodity price shocks have been a major source of terms of trade movements in Europe and in the UK in particular.

Thus, PwC's hotel models incorporate the various global interactions through the use of the macroeconomic inputs as provided by OEF in a consistent modeling framework.

"Fundamental in PwC's modelling approach is the idea of parsimony, or striving to achieve the "simplest" structure that maximizes forecasting accuracy. Often, complex modelling approaches are prone to forecasting errors as they are more vulnerable to 'noise' in their multiple data inputs. This is especially prevalent in cases where uncertainty is high due to unusual exogenous events, e.g. the events of September 11 in the US or July 7 in the UK"

Each of our econometric models consists of a system of two stochastic equations, the first structures occupancy as a function of relevant macroeconomic and hotel, (e.g. lagged real ADR), variables, while the second structures

room rate behaviour as a function of occupancy pressures and consumer price trends. The two equations are then estimated with appropriate statistical techniques ensuring the consistency of the estimated relationships.

PRICEWATERHOUSECOOPERS LATEST UK FORECAST

Weakening macro economic outlook

The UK economy grew by 0.5 per cent in the second quarter of 2005, slightly up from 0.4 per cent in the previous quarter. Consumer spending continued to weaken while investment and export growth strengthened.

Oxford Economic Forecasting's latest macroeconomic forecast expects GDP growth to moderate from 3.2 per cent in 2004 to around two per cent in 2005, strengthening to 2.4 per cent in 2006 and 2.8 per cent in 2007. The forecast for this year is less optimistic than previously expected, over one per cent less than the Chancellor's budget forecast, and compares to the 2.7 per cent forecast for this year at the time of our previous forecast in May 2005. Despite this, OEF believe the economy is growing near potential at the moment.

Consumer spending remained weak and growth is expected to slow from 3.7 per cent in 2004 to around 1.75 per cent on average in 2005 and 2006 as the lagged effects of earlier interest rate rises and the recent cooling of the housing market come through. This slowdown in consumer spending growth reflects the continued fading of the 'feel good factor'.

Implications for the hotel sector

Hotels and restaurants have (so far) been more resilient than some other sectors on High Street but whether this will continue in coming months remains to be seen and analysts are speculating whether the High Street downturn may be spreading to the service sector. The closely watched CIPS purchasing managers' index slipped to 55.2 in August, down from 56.3 the previous month, the

slowest growth for three months but still well above the psychologically critical '50' level. The hotels and restaurants sector enjoyed the strongest growth in the survey.³ OEF believe the High Street Slump may have been over-exaggerated. With reference to figures on tourist spending in London's shops in August 2005 compared to a year earlier, the decline in transactions was four per cent, a relatively "light" after-effect of the attacks.⁴

Nevertheless, the hotel sector will face growing cost pressures and deteriorating consumer confidence may hurt some travel plans. Cost pressures include the knock-on effect on oil prices of Hurricane Katrina, minimum wage requirements impacting labour costs and distribution costs likely to have increased by the end of 2005 as a result of legislative change governing working time and increasing fuel prices⁵.

In terms of the impact of the terrorist attacks, they may hurt consumer confidence but OEF comment that the overall impact of terrorism will probably not turn up in overall economic growth figures; rather it will displace activity for a while. However it will be seen in the short-term indicators for tourism in London.

UK travel update

While many believe that the terrorism attacks of 7 and 21 July have had a limited impact on demand for travel, these incidents together with oil price rises and the pound dollar exchange rate have created tough trading conditions for the travel sector. Trading conditions are expected to challenge travel and hotel operators for at least the rest of the autumn and probably until early next year, especially if consumers continue to defer travelling to the UK.⁶ London is likely to be worse affected.

Table 1: Macroeconomic Data for the UK

	1999	2000	2001	2002	2003	2004	2005F	2006F	2007F
Real GDP per cent change from prior year	2.4	3.1	2.0	1.6	2.2	3.2	2.0	2.4	2.8
Consumer prices % change from prior year (CPI) Q4	2.3	2.1	2.1	2.2	1.4	1.4	1.7	1.8	1.8

Source: Oxford Economic Forecasting, August 2005 F - Forecast

³ Soaring oil price takes its toll of service sector, Evening Standard, 5 September 2005

⁴ Global Refund Data in Retail Week September 9 2005

⁵ Katrina will hit eurozone finances hard, Anatole Kaletsky, The Times 6 September 2005

⁶ UKInbound press release on their website 5 September 2005

The inbound visitor organisation, UKinbound, has commented that despite an excellent first six months of the year they now expect visitor numbers to the UK for 2005 to rise only very slightly, one to two per cent, on last year and revenue to remain flat or even fall back slightly.

A statement on UKinbound's web site comments:

"Latest research prepared by Oxford Economic Forecasting for the Tourism Industry Emergency Response (TIER) group confirms that, following the 7 and 21 July incidents in the capital, London and the UK's visitor economies are still expected to see overall growth in the long term but there is real concern for forward bookings and revenues for the rest of the year. There is also evidence of dispersal of visitors from London to the rest of the UK."

They go on to comment that:

"With other destinations also suffering there is a danger that reactive and unrealistic discounting could undermine a sustainable recovery."

Evidence that travellers are still flying comes from low cost carriers such as Ryanair that carried 3.3 million passengers in August, a 27 per cent increase on the same month last year; the 12-month passenger figure was almost 31m. Clearly much of the traffic will be UK outgoing but domestic intercity breaks are also popular.⁷ BAA, the operator of seven UK airports including Heathrow and Gatwick, has reported that only Heathrow saw a drop in overall passenger numbers during July and this was only 0.6 per cent. Overall traffic levels at the seven were up 2.6 per cent, perhaps evidence that those that have already booked came and that those that haven't might hesitate?⁸

The Office for National Statistics reported that 3.15m people visited Britain in July - up 7 per cent on the same month last year. But many believe it is still too soon to say that there has been no impact. Tourists already booked to visit the UK were likely to have gone ahead with their travel plans despite the attacks on the capital. Domestic travel and short breaks are expected to be more resilient to recent terrorist attacks although there has been speculation that this market too had already started to slow prior to July. Statistics from VisitBritain's weekly Short Term Domestic Tracker have either been static or have shown growth in terms of the number of UK adults taking overnight trips in England since the attacks.

For those that have visited, a recent Condé Nast Travel reader's survey highlighted the most popular cities for eating out, culture and entertainment in the UK. London topped the poll; Edinburgh also appeared in all categories and Manchester in both the food and entertainment categories. The article and poll was reflective of the revival of many of Britain's cities, the strong competition between cities and their popularity for domestic short breaks. See Table 2 above.

Table 2: How Britain's cities scored in a recent Condé Nast Traveller Magazine poll of 30,000 readers

Culture	Food	Entertainment
1 London	1 London	1 London
2 Edinburgh	2 Glasgow	2 Edinburgh
3 Glasgow	3 Manchester	3 Glasgow
4 Oxford	4 Edinburgh	4 Manchester
5 Cambridge	5 Leeds	5 Oxford
6 York	6 Bath	6 York
7 Cardiff	7 Brighton	7 Newcastle
8 Bath	8 Bristol	8 = Brighton Leeds

What's the impact so far for UK hotel operators?

Several operators have issued statements on the London bombings as a supplement to their first half results but the depth and likely timescale of these impacts compared to those of the eroding macroeconomic environment is far from clear yet. There can be no doubt that the terrorist attacks have damaged the sector in what had been a strong period of trading. For some operators like Hilton, there were signs of softening demand prior to the terrorist attacks and others mention the cost pressures facing the sector, however, a generally hopeful picture emerges. Indeed, some such as Whitbread, are already tackling cost saving issues.⁹

Despite the set backs of the summer there are signs that business may recover slowly and benchmarking analysis

"Signs are positive that business is coming back this September" James Chappell, The Bench

from companies such as The Bench, a supplier of daily market information to the hotel industry, support this.

Hilton reported a disappointing performance in its Interim Results for the six months to June. For its UK provincial hotels, "even excluding the Metropole in Birmingham, RevPAR was up less than one per cent - well below the 2-3 per cent growth in the market". In response to the bombings Hilton commented in September that:

"overseas tourists are still coming to London, despite the July terror attacks"

and that it was more likely to be the British that didn't visit. Despite a fall in London occupancy of around five per cent, occupancies were later reported climbing back up again, according to the group finance director Brian Wallace in an interview given towards the end of August.¹⁰

⁷ Ryanair tops BA as Europe's most popular airline, 6 September 2005, The Times

⁸ London returns to business as usual, Bob Cotton in Leisure Opportunities

⁹ Financial Times 27 September 2005

¹⁰ Wall Street Journal 26 August 2005

InterContinental Hotel Group (IHG) announced that the UK market performed well in the first half of 2005, with Holiday Inn RevPAR up by 7.9 per cent. The group said there had only been 'limited impact' from the London bombings with weekend breaks alone affected and a lower growth in RevPAR in July. "The business and conferences market had proved resilient and September and October bookings looked good" said Andrew Coslett.¹¹

Britain's largest budget brand, Whitbread's Premier Travel Inn achieved an eight per cent improvement in like for like sales over the 24 weeks to 18 August and opened some 500 new bedrooms during the last six months bringing the total to over 29,000, with another 1,000 rooms in the development pipeline.¹²

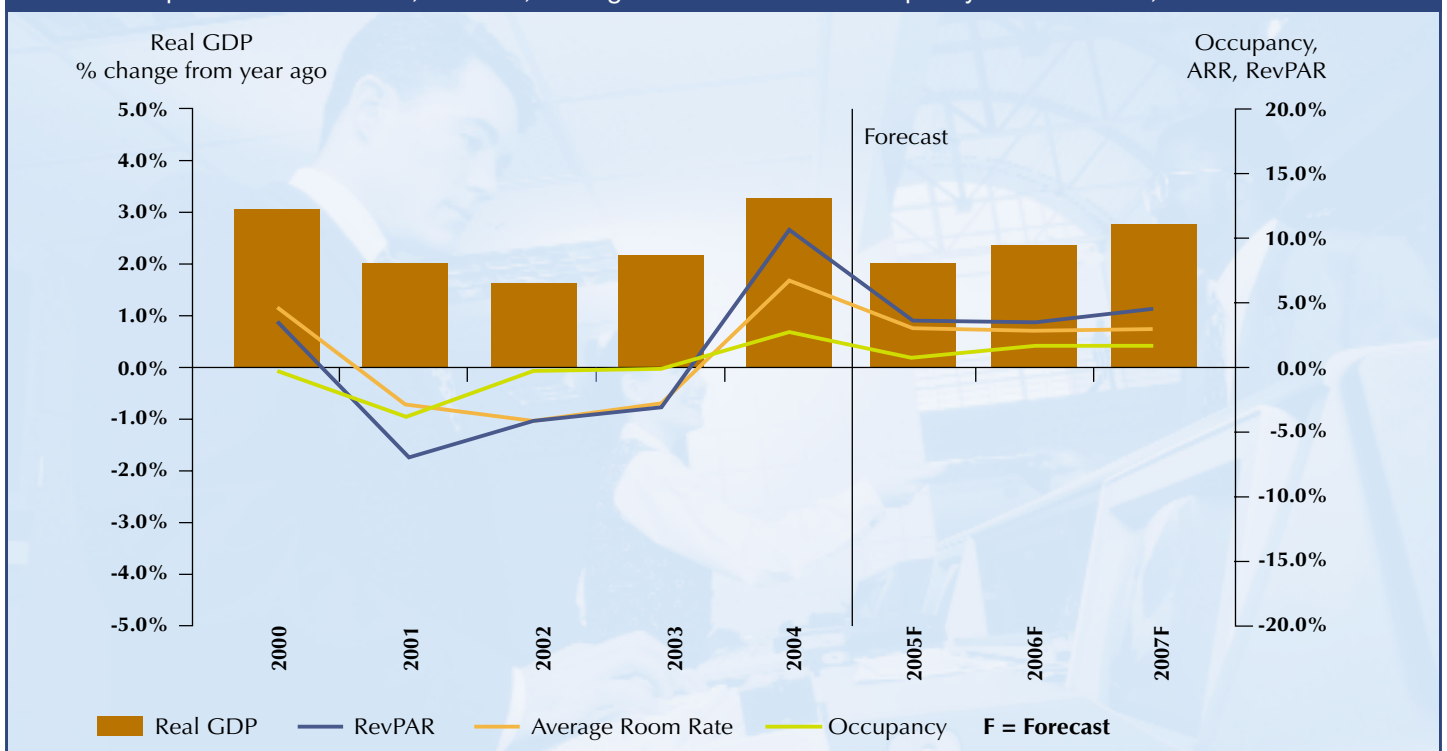
Millennium & Copthorne commented on weaker leisure travel in September, but balancing this, they also reported business travel in line with expectations and a satisfactory regional performance. Interim results for the first half of 2005 showed healthy growth in the second quarter of 2005, with some occupancy growth in London allowing room rates to grow. The company anticipated a highly profitable outcome to the year despite increasing cost pressures. Tony Potter, chief executive, said the pace of bookings dropped in the immediate aftermath of the two attacks and "had not recovered as quickly" after the second attack. "We couldn't expect it to because August is not a busy corporate month," he said. "We can't see right now but I expect the booking pace will return to normal pretty quickly. I'm not seeing any cancellations."¹³

At Jurys Doyle, Chairman Richard Hooper said trading was satisfactory and 12 hotels in UK (for first half of 2005) reported a 25 per cent growth in trading profit. More recently in a trading update issued in September, the group added, "The recent events in London are having some, but not a material, impact on the Group's operations in London".

PricewaterhouseCoopers latest forecast shows slower growth throughout UK and key cities for 2005-2007

Graph 1 and Table 3 show the latest PricewaterhouseCoopers forecast for the UK hotel sector for 2006 and 2007. Unsurprisingly, we no longer forecast the record years for hotel performance anticipated at the time of our last forecast in May 2005. We still expect moderate growth but the softening macroeconomic environment and the travel slowdown, especially to London, have resulted in a downwards revision to this forecast and although we continue to expect RevPAR gains, we now expect RevPAR growth for the UK of 3.3 per cent for 2006 (taking RevPAR to £55.73), increasing to four per cent for 2007 (taking RevPAR to almost £58). This compares to 6.5 per cent in 2006 and 6.1 per cent in 2007 expected in our previous forecast. In terms of the outcome for 2005, with only a few months to go and against the backdrop of a good first half, we anticipate 3.3 per cent RevPAR growth, driven largely by ADR growth.

Graph 1: UK - Real GDP, RevPAR, Average Room Rate and Occupancy Growth Rates, 2000 to 2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

11 Interview with Andrew Coslett, AFX International 8 September 2005

12 Western Morning News 2 September 2005

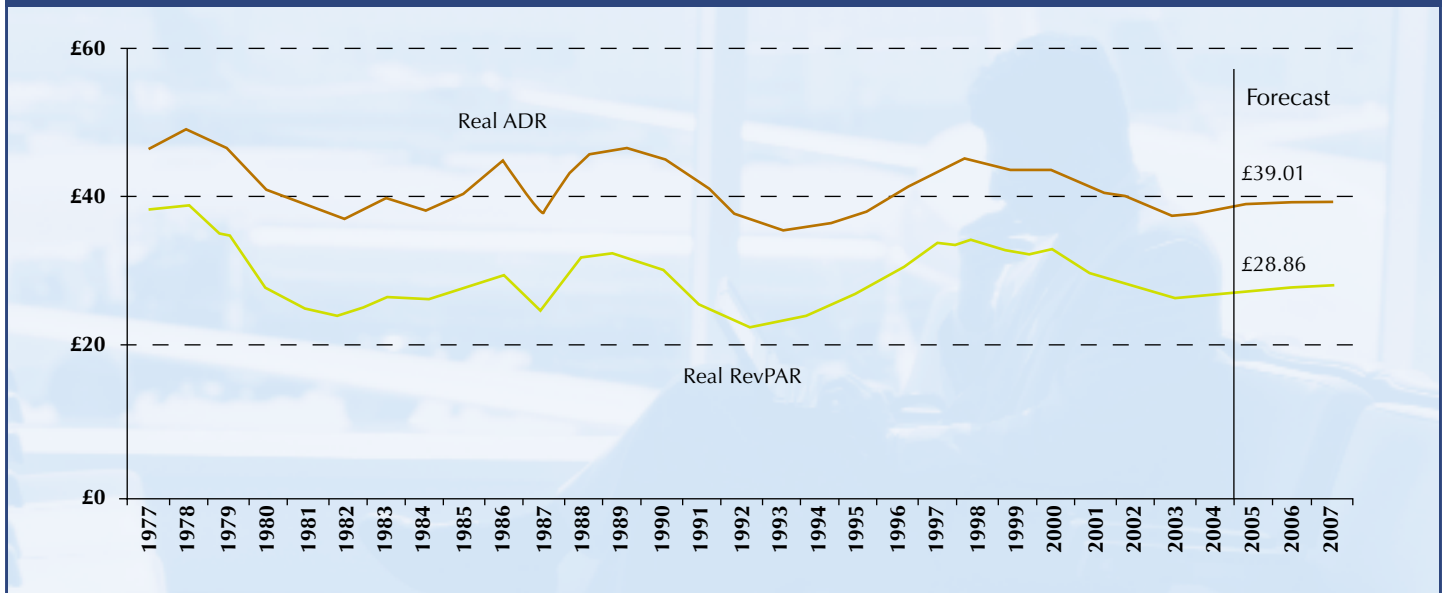
13 Millennium expects terror fears to ease 5 August 2005 The Daily Telegraph

**Table 3 : PricewaterhouseCoopers September 2005 Forecast
Hotel Statistics for UK, London, Provinces, Edinburgh, Manchester and Birmingham**

Hotel Statistics for the UK	2000	2001	2002	2003	2004	2005F	2006F	2007F
Average Room Rate (£)	75.17	73.22	69.01	69.31	72.87	74.92	76.54	78.36
% Change	3.8%	-2.6%	-5.8%	0.4%	5.1%	2.8%	2.2%	2.4%
Occupancy (%)	72.4	69.7	70.0	69.5	71.7	72.0	72.8	74.0
% Change	-0.5	-3.7%	0.4%	-0.7%	3.1%	0.4%	1.2%	1.6%
RevPAR (£)	54.40	51.06	48.30	48.16	52.22	53.93	55.73	57.98
% Change	3.3%	-6.1%	-5.4%	-0.3%	8.4%	3.3%	3.3%	4.0%
Hotel Statistics for London	2000	2001	2002	2003	2004	2005F	2006F	2007F
Average Room Rate (£)	108.23	103.15	94.04	91.46	96.73	98.93	101.26	104.39
% Change	5.1%	-4.7%	-8.8%	-2.7%	5.8%	2.3%	2.3%	3.1%
Occupancy (%)	80.8	73.4	74.4	72.5	76.5	76.7	76.9	77.5
% Change	0.9%	-9.1%	1.4%	-2.6%	5.6%	0.2%	0.2%	0.8%
RevPAR (£)	87.40	75.80	70.00	66.30	74.00	75.90	77.85	80.89
% Change	6.0%	-13.4%	-7.6%	-5.3%	11.6%	2.5%	2.6%	3.9%
Hotel Statistics for the Provinces	2000	2001	2002	2003	2004	2005F	2006F	2007F
Average Room Rate (£)	57.88	59.21	57.88	59.12	61.43	63.62	65.79	67.62
% Change	2.9%	2.3%	-2.2%	2.1%	3.9%	3.6%	3.4%	2.8%
Occupancy (%)	68.4	68.1	68.2	68.1	69.5	70.1	70.9	71.5
% Change	-1.3%	-0.6%	0.2%	-0.2%	2.1%	0.9%	1.1%	0.9%
RevPAR (£)	39.61	40.29	39.46	40.24	42.68	44.58	46.61	48.36
% Change	1.5%	1.7%	-2.1%	2.0%	6.1%	4.5%	4.6%	3.7%
Hotel Statistics for Edinburgh	2000	2001	2002	2003	2004	2005F	2006F	2007F
Average Room Rate (£)	66.36	66.54	67.56	68.48	72.40	74.20	75.80	77.36
% Change	-2.0%	0.3%	1.5%	1.4%	5.7%	2.5%	2.2%	2.1%
Occupancy (%)	71.2	71.2	73.4	74.2	76.4	77.1	77.9	78.4
% Change	-2.6%	0%	3.1%	1.1%	2.9%	0.9%	1.1%	0.6%
RevPAR (£)	47.25	47.38	49.59	50.80	55.29	57.19	59.05	60.60
% Change	-4.5%	0.3%	4.7%	2.4%	8.8%	3.4%	3.3%	2.7%
Hotel Statistics for Birmingham	2000	2001	2002	2003	2004	2005F	2006F	2007F
Average Room Rate (£)	60.78	59.77	60.48	62.70	65.22	66.42	67.62	69.04
% Change	-0.8%	-1.7%	1.2%	3.7%	4.0%	1.8%	1.8%	2.1%
Occupancy (%)	64.7	64.2	67.7	67.7	69.4	69.2	69.8	70.2
% Change	2.3%	-0.7%	5.5%	0.1%	2.4%	-0.2%	0.8%	0.5%
RevPAR (£)	39.30	38.37	40.94	42.47	45.23	45.98	47.21	48.45
% Change	1.5%	-2.4%	6.7%	3.7%	6.5%	1.7%	2.7%	2.6%
Hotel Statistics for Manchester	2000	2001	2002	2003	2004	2005F	2006F	2007F
Average Room Rate (£)	59.3	60.7	60.9	63.2	65.9	68.8	71.6	74.7
% Change	-1.1%	2.3%	0.4%	3.7%	4.3%	4.5%	4.0%	4.3%
Occupancy (%)	73.4	71.6	71.5	70.9	73.5	74.5	75.5	76.8
% Change	1.8%	-2.3%	-0.2%	-1.0%	3.7%	1.4%	1.4%	1.7%
RevPAR (£)	43.50	43.48	43.58	44.74	48.41	51.29	54.06	57.34
% Change	0.7%	-0.1%	0.2%	2.7%	8.2%	5.9%	5.4%	6.1%

Source of Forecast: PricewaterhouseCoopers Forecasting Model, September 2005. Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

Graph 2: UK Real RevPAR in 2006 Still Below its 1990's Peaks



Source: PricewaterhouseCoopers 2005

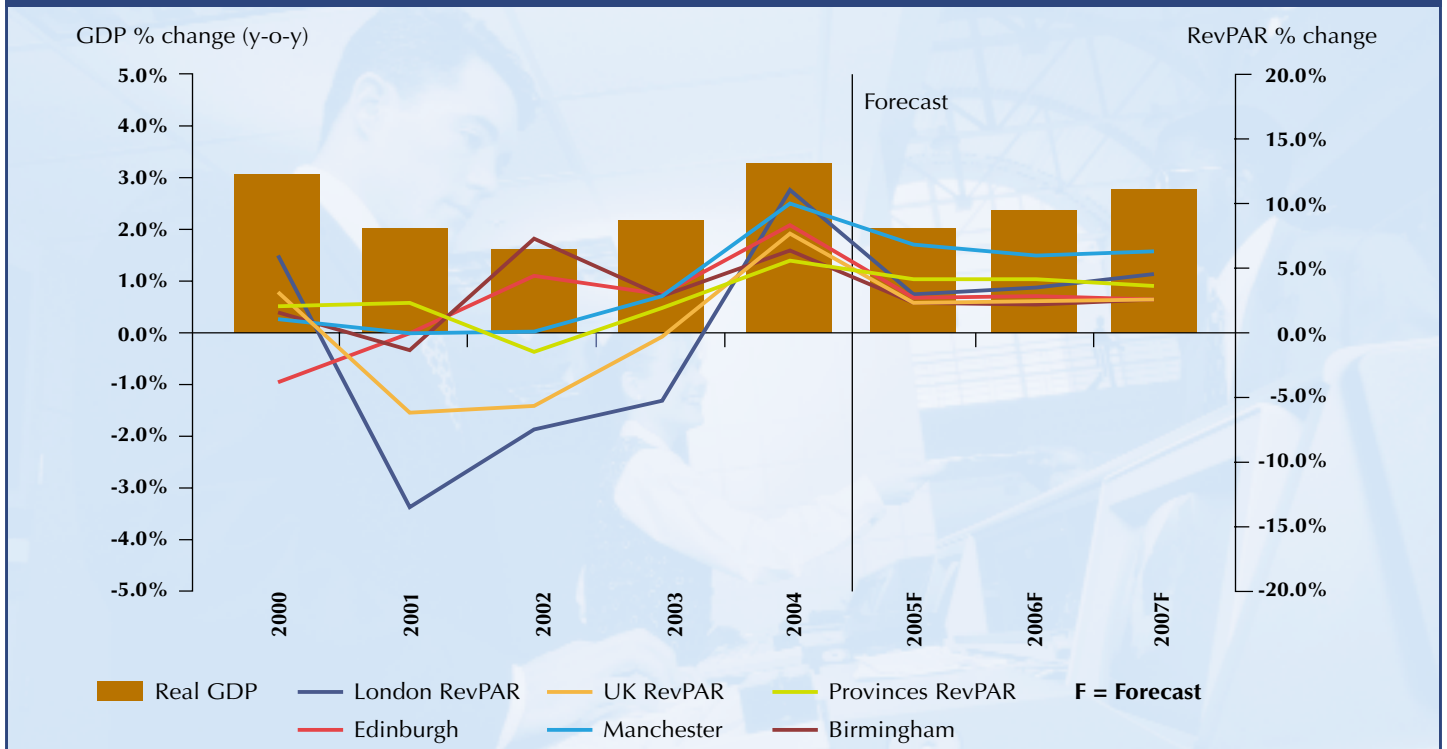
In terms of the timescale for recovery, Graph 3 looks at RevPAR growth alone and compares historic UK RevPAR trends since 2000 for UK, Provinces, London and the three cities we have commenced forecasting for in this edition (Edinburgh, Birmingham and Manchester), as well as the future outlook.

The graph shows the recovery setback for the UK, following a very strong 2004, itself coming after three poor years, especially for London. It is certainly not all doom and gloom but slower RevPAR growth rates are

expected to 2007. The chart shows the cyclical nature of the UK hotel sector as well as the particular cycles of local markets, for instance Birmingham, driven by the conference and convention market.

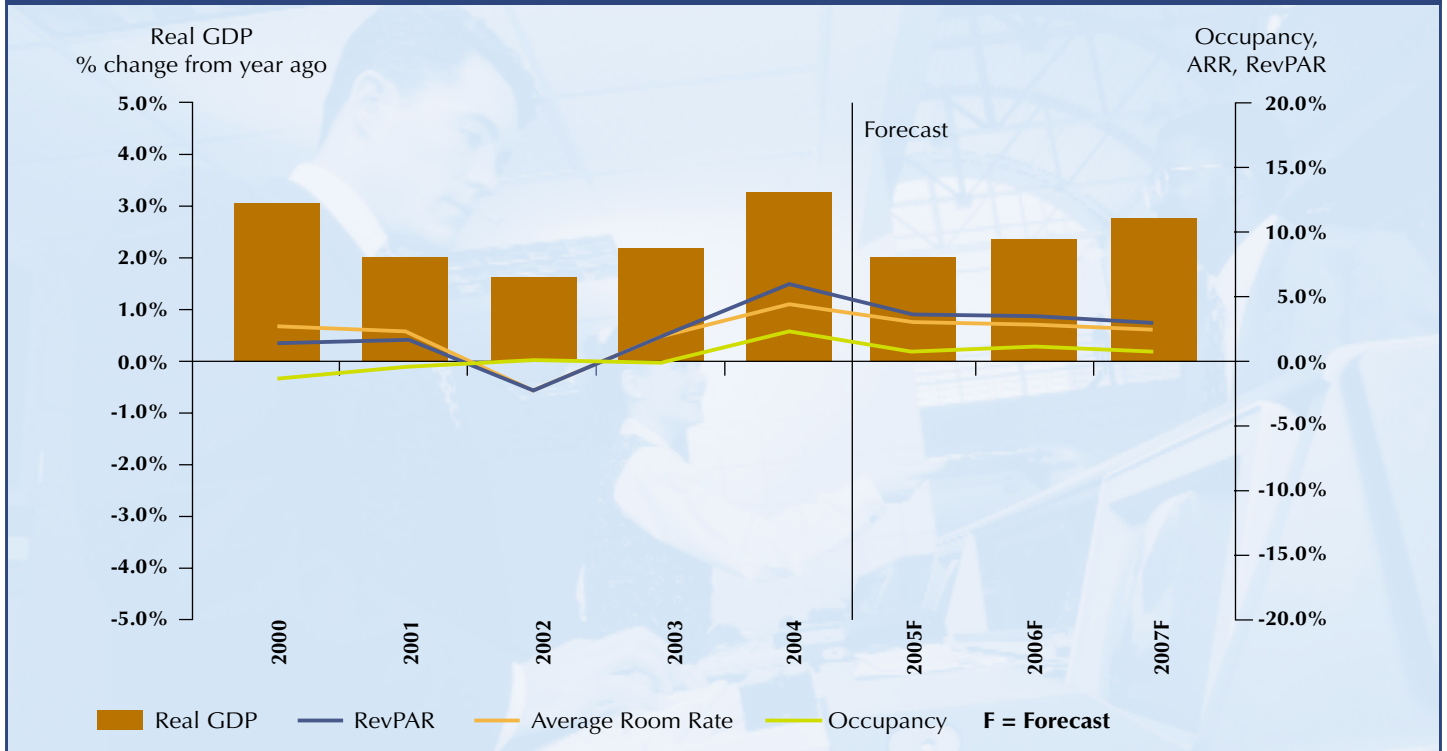
Just a setback to the recovery process then, but it should be remembered that if inflation is stripped out, it demonstrates how hard the sector has been working and the challenge of the journey ahead to regain the former peaks of the late 1980's and 1990's. (See Graph 2).

Graph 3: Slower RevPAR Growth Throughout UK and Key Cities 2000-2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

Graph 4: Provinces - Real GDP, RevPAR, Average Room Rate and Occupancy Growth Rates, 2000 to 2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

Provincial forecast

There has been speculation that the Provinces may actually 'benefit' from some of the displaced travel demand from London. As a major gateway city for the rest of the UK this effect could be mitigated if travellers do not come at all. However, this seems unlikely and some uplift is anticipated. Competition between the UK's destinations for overseas and domestic business remains tough.

Overall, our latest forecast is for Provincial RevPAR gains of 4.5 per cent in 2005, 4.6 per cent in 2006 and 3.7 per cent in 2007. (See Table 3 and Graph 4.) Occupancy rates are not expected to show much movement but ADR should manage above average UK-wide growth to 2007 and we expect 3.6 per cent ADR growth this year, followed by a further 3.4 per cent in 2006 and 2.8 per cent in 2007.

Brakes on London's recovery again?

London's tourism economy had been recovering very strongly. The Capital had just celebrated the Olympics win. VisitLondon was forecasting a 3.5 per cent increase in overseas visitors this year to reach 13.9m and the city had been welcoming record numbers of visitors. The terrorist attacks damaged what had been a strong period of trading for London hotels, many more than 80 per cent full. Yes, the capital will rebound without further attacks but it has put the brakes on for a while and it will take longer to recover lost ground. Should the macroeconomic environment aggravate postponed travel plans further, it is likely to take even longer.

"Sales are coming back but it's a slow process"

Ian Mounser, Superbreak Mini Holidays 26 August 2005

Although travel operators and hoteliers hope for an autumn recovery, it appears more likely that demand will remain soft into 2006. Traditionally September and October benefited from strong leisure demand coupled with the return of the corporate and conference markets from the long summer break. It remains to be seen whether this autumn reaches the peak demand experienced historically.

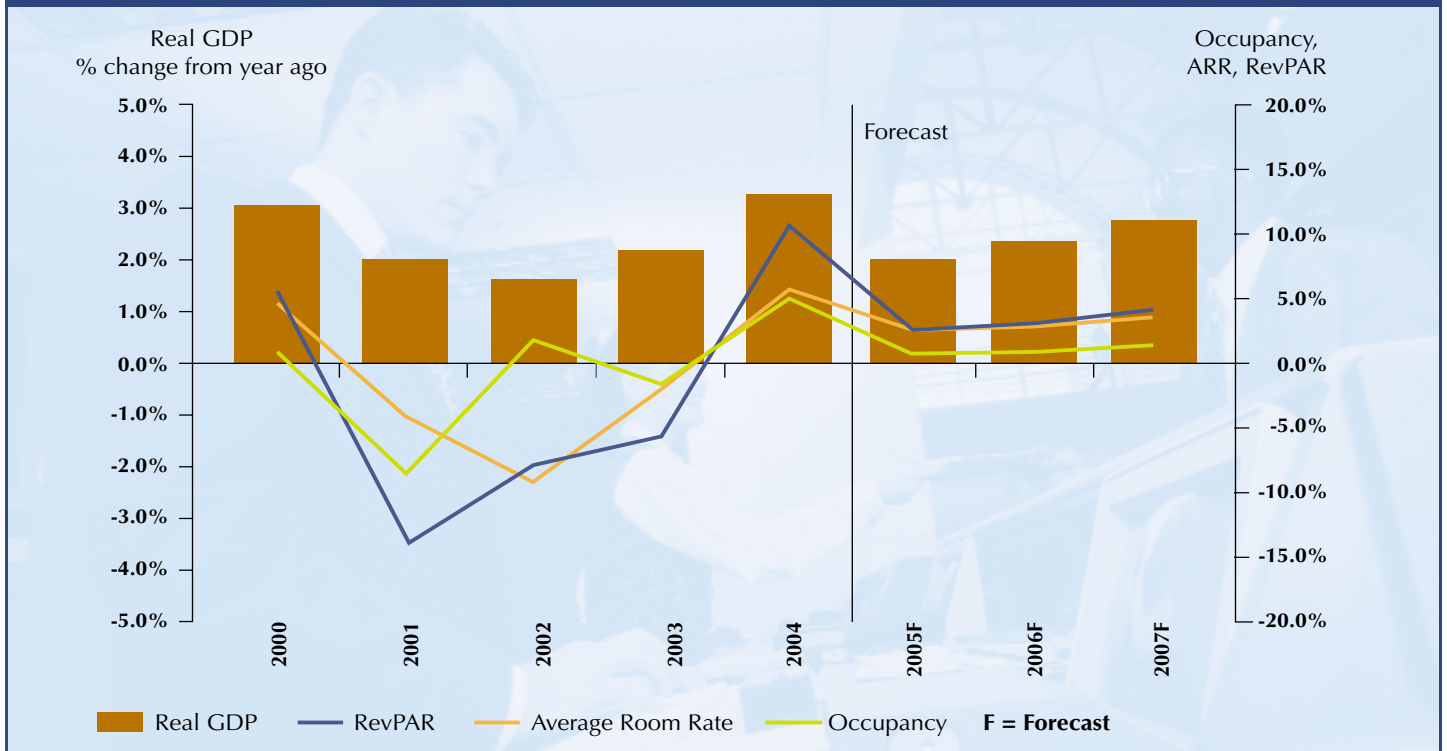
With cities increasingly competing with each other and other worldwide cities for investment from global businesses and for the tourist dollar, the Mayor of London's recent announcement that London is to get an image makeover at the hands of marketing experts, is a positive move.¹⁴ Underscoring this, commentators have predicted that winning London's bid to host the 2012 Olympic Games could earn the UK more than £2b in extra tourism revenue, while JPMorgan Asset Management has gone further and said that London can expect to see a lift of as much as 0.4 per cent in its GDP as a result of the Olympics coming to town.

PricewaterhouseCoopers forecast for London:

Table 3 and Graph 5 show PricewaterhouseCoopers revised forecast for London to 2007. In contrast to strong RevPAR performance of 2004 (11.6 per cent growth), for 2005 we now expect only marginal movement on occupancy overall for the year (0.2 per cent growth). Occupancies are not expected to grow much in 2006 or 2007 either and combined with evidence of some room rate discounting in order to bring tourists back, we expect

¹⁴ PR Newswire London Named One of the Top Three City Brands in the World, 14 September 2005

Graph 5: London - Real GDP, RevPAR, Average Room Rate and Occupancy Growth Rates, 2000 to 2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

ADR growth of around 2.3 per cent in 2005 (compared to 5.8 per cent in 2004) with further ADR growth of 2.3 per cent in 2006 (taking ADR to £101.26) and a further 3.1 per cent growth in 2007 (taking rates to £104.39). Marginal occupancy growth together with some ADR movement will mean RevPAR growth of 2.6 per cent in 2006, climbing further to 3.9 per cent by 2007, lifting RevPar up to a very healthy £80.89.

NEW CITY COVERAGE

Manchester

Lies at the heart of the UK's largest provincial conurbation. Administrative and commercial hub of the North West region.

Population: 420,000 Pop within 20 km of centre 2.2 m

Tourism profile: Hosted Commonwealth Games in 2002 when large parts of the city were regenerated, its international profile and tourism were boosted and the City of Manchester stadium built.

Hotel demand drivers:

Economy: The City's main industries include education, health, public administration and financial services. The economy has significantly restructured over the past two decades as a successful service economy while manufacturing has declined. Employment growth is now close to average and the city has a favourable employment forecast to 2009

Economic outlook: Generally positive

Hotel performance outlook: RevPAR growth for 2005 of 5.9 per cent, slipping to 5.4 per cent in 2006 and 6.1 per cent by 2007

Manchester

Manchester sits at the centre of a city region of 2.2 m people living within 20 km or 3.2m people if you include places such as Salford, Wigan, Bury, Bolton and Oldham. It is the regional capital of the north-west, the biggest regional economy outside London and the south-east. The Manchester city region generates nearly half the output of the north-west economy, which is more than 25 per cent larger than the West Midlands or Scotland. Manchester's city centre has been transformed since the 1996 IRA terrorist bomb, and the city council has shown that it can deliver successful big events, such as the 2002 Commonwealth Games. Next year it will host the Labour Party conference. Over the past four years 95,000 jobs have been created in the Manchester city region. Another 100,000 jobs are expected to be created by 2015, with rapid growth in professional services offsetting a continued decline in manufacturing employment.

Ambitious tourism strategy

"Figures recently published show a distinct increase in both leisure and business tourism within the city. This is a definite indication that Manchester both demands and can easily sustain a range of top quality accommodation and reflects the growing number of 5-star hotels. With new developments continually taking place throughout the city centre, Manchester's international image is being strengthened by its changing skyline. With events such as Manchester International Festival in 2007 we are confident the increase in visitor numbers and hotel bedrooms will continue."

Paul Simpson, deputy chief executive, Marketing Manchester



The Lowry Hotel

Since 2003 the North West Development Agency has taken over strategic responsibility for tourism, with Marketing Manchester one of its five sub-regional boards and coming formally into effect in April 2004. The organisation has an ambitious five year tourism strategy and vision for the wider Greater Manchester area. In the last five years Manchester has seen growth in visitor numbers, with 89 million arrivals in 2003 including day trips. In 2003 there were 8.5 million bed nights and this is forecast to rise to 9.4 million bed nights by 2005 and 10.3 m by 2007. Overseas visitors accounted for 740,000 visitors in 2003, up to 780,000 in 2004 and an expected 825,000 this year, rising to 910,000 by 2007. The tourist board's strategy is to attract more city short break tourists, as well as those using the city as a gateway to visit the Lake District and other areas of the North West. Manchester has developed a strong proposition with many new attractions such as entertainment and arts facilities including the Manchester Evening News Arena; concert venues such as the Bridgewater Hall; the performing arts centre, the Lowry Centre; Manchester's shopping facilities including the Millennium Quarter development around the Cathedral and Corn Exchange. The introduction and extension of the Metrolink has made the city more accessible to visitors and residents and links Salford Quays with the city centre.

Hotel development continues

Manchester has seen the opening of a number of high quality hotels, branded budgets and lifestyle properties such as the Malmaison and Alias' Rossetti have developed around Piccadilly railway station, and a new boutique hotel, the Great John Street Hotel, opened recently. Once a Victorian school, it is located next to the Granada TV studios, with 30 suites.¹⁵

Other developments include Sir Rocco Forte's Lowry Hotel, the city's first five-star hotel which opened back in 2001. Although it is in the Salford area of the city, it is only five minutes' walk from Number One Deansgate, a smart Manchester city centre apartment block favoured by wealthy footballers and rising young professionals. Manchester's second five-star hotel, the 263 room Radisson Edwardian, built behind the facade of Manchester's Free Trade Hall, opened last year and backs on to Manchester's G-MEX exhibition and conference centre, which will host next year's Labour Party conference. The 126 room Queens Moat House at Manchester Airport is to be re-badged as a Holiday Inn as a part of QMH franchise deal with IHG. The changeover should be complete by December this year.

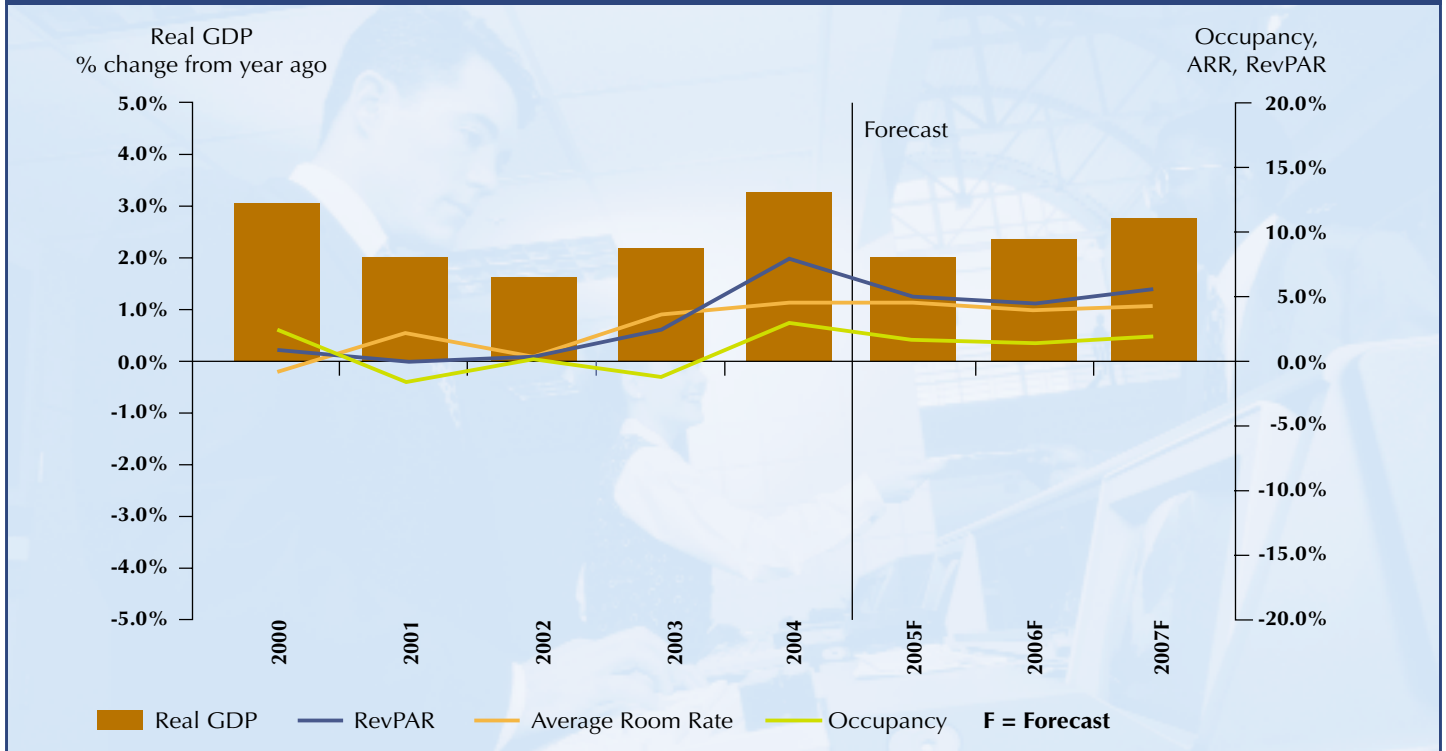
Hilton has commissioned a new 365 bedroom four-star hotel located on Deansgate in Manchester. The city centre site forms Phase 3 of the "Great Northern" retail and leisure development located adjacent to the G-MEX. The 48 storey hotel will be in the tallest UK building outside London and will feature among the tallest primarily residential buildings in Europe. It is due to be completed in 2006.

Oversupply concerns could depress operating performance. Bed supply increased by five per cent in 2001, declined in 2002 but saw a sharp 8.8 per cent rise in 2003 according to data from Marketing Manchester (indeed occupancies fell by one per cent that year). Since then the city has seen and expects to see around five per cent annual increases. 2005 bed supply is expected to



Harvey Nichols opened in Manchester in 2003 as part of the Exchange Square Development.

Graph 6: Manchester - Real GDP, RevPAR, Average Room Rate and Occupancy Growth Rates, 2000 to 2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

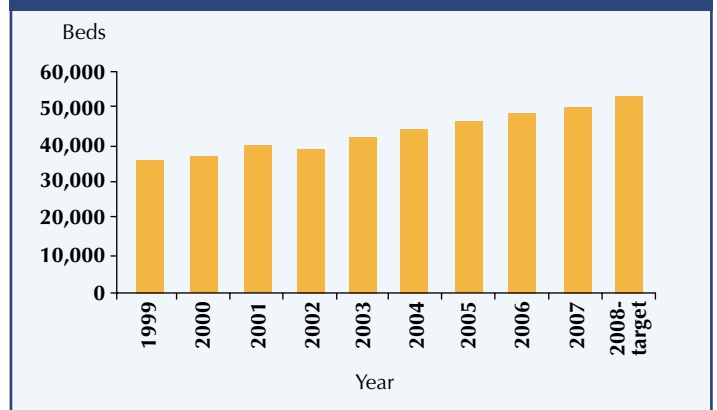
reach 45,705 beds in 2005. (See charts 1 and 2). Jones Lang La Salle commented in 2003 that Manchester's hotel market had been relatively sheltered from the negative influences that had affected trading in other markets such as Birmingham, which had suffered due to a fall in conference business.¹⁶

Recent trading data (see Table 3) shows that Manchester has performed favourably compared to some other UK cities. Given the redevelopment of the city and the generally positive economic prospects for the city, Manchester is well positioned to develop slightly above average regional trading in the next few years

PricewaterhouseCoopers forecast for Manchester:

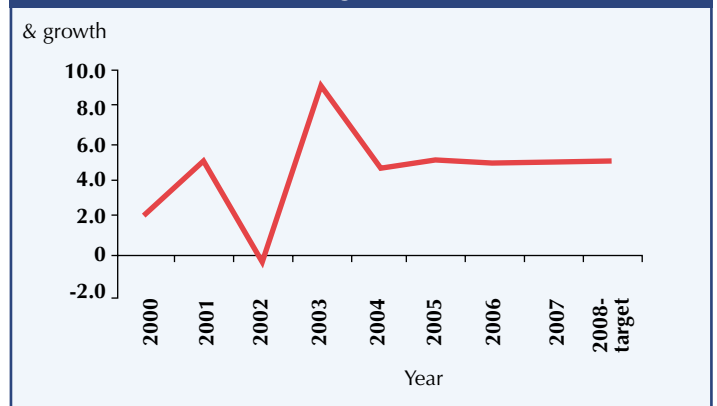
Our overall forecast for Manchester reflects its strong economy and is for RevPAR growth for 2005 of 5.9 per cent, slipping slightly to 5.4 per cent in 2006 but edging up again to 6.1 per cent in 2007, taking RevPAR to £57.34. ADR has been climbing for the past two years and is expected to continue to grow by 4.5 per cent overall this year, with a further four per cent in 2006 and 4.3 per cent in 2007. Occupancies declined between 2001 and 2003 but showed a staged a recovery last year with 3.7 per cent growth. Occupancies are expected to end 2006 a little higher, with 1.4 per cent growth taking occupancy to 75.5 per cent and a further 1.7 per cent growth in 2007, taking them to 76.8 per cent. (See Graph 6 and Table 3).

Chart 1: Manchester Bedstock 1999-2008



Source: Marketing Manchester 2005

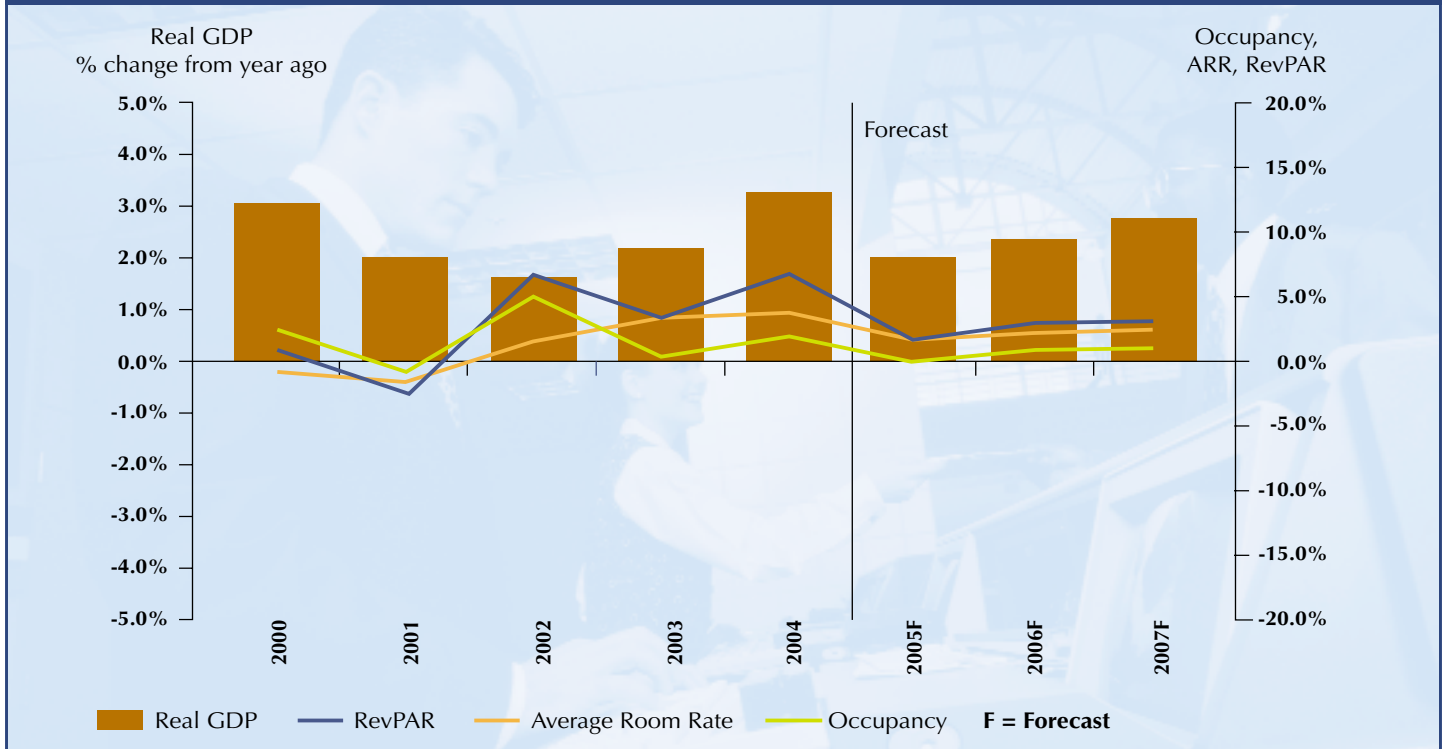
Chart 2: Bedstock growth rate 1999-2008



Source: Marketing Manchester 2005

¹⁶ Jones Lang La Salle Hotels, Digest Europe 2003

Graph 7: Birmingham - Real GDP, RevPAR, Average Room Rate and Occupancy Growth Rates, 2000 to 2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

Birmingham

Second largest UK city which acts as a regional centre for the Midlands region

Population: 0.97m (2001). Pop within 20 km of centre 1.3m

Tourism profile: Urban regeneration has improved the environment including the opening of new Bullring. Tourism is a key industry, particularly business and conference visitors, accounting for some 75% of all tourism. International overnight visitors 720,000 in 2003 (from 450,000 in 2001)¹⁷ The largest exhibition and events venue in the UK (7th largest in Europe) with the National Exhibition Centre (NEC) and International Conference Centre (ICC) accounting for over 40 per cent of all major exhibition and conference events held in the UK

Hotel demand drivers: Primarily business demand (see below) from city's role as a conference /convention destination. Many leisure travelers staying as a part of a heavily discounted weekend 'deals' associated with leisure or cultural related events at the NEC, NEC Arena or National Indoor Arena (NIA).

Economy: Whilst manufacturing is still important to the city's economy, the service sector is now the main employer covering such sectors as distribution, retail, computing services, professional services and other business services. Also one of UK's largest office economies with a large public sector; retail and leisure are also important employers¹⁸ (Total employment is 490,000 employees in central area).

Economic outlook: subdued employment prospects and moderate economic growth prospects¹⁹.

Hotel performance outlook: Overall RevPAR growth of 2.7% in 2006 and 2.6% in 2007 largely driven by room rate

Birmingham – key business and conference city

Birmingham is one of the leading business tourism destinations in the UK. Reliance of the city's hotel market on NEC and ICC related business, leads to a cyclical market, because key events themselves operate on a cycle that may occur every few years. This can be seen clearly on Graph 3 compared to other key cities.

Hotel room supply increased by around 26 per cent between 1999 and 2002. This increase was driven mainly by the development of budget hotels both in the city centre and the NEC locations. Since 2002 supply growth has only increased by 1.8 per cent to 6,921 (3-5 star) graded rooms.²⁰ There are a number of existing and potential hotel development projects planned, including the 220-room five-star Radisson SAS hotel located in the city centre, which is the first new hotel scheduled to enter the market since 2002 and due to open in December 2005. Other projects are reported as planning to enter the market by 2006, but most are of a speculative nature as no operators have yet been assigned.

PricewaterhouseCoopers forecast for Birmingham:

During 2004 Birmingham's ADR and occupancy rates had climbed back up to higher 'peaks' than had been witnessed for some years, helped by ADR growth of 4 per cent and occupancy growth of 2.4 per cent, RevPAR reached £45.23.

Although we continue to expect some growth in 2005, the rate of growth will not be as buoyant as in 2004, as

¹⁷ Promis Property Market Analysis 2005 sourced from ONS

¹⁸ PROMIS property Market Analysis 2005

¹⁹ PricewaterhouseCoopers UK Economic Outlook July 2005

²⁰ according to JLL data.

decelerating economic growth moderates demand. Overall our forecast is for RevPAR growth of 1.7 per cent for 2005, 2.7 per cent in 2006 and further growth of 2.6 per cent in 2007. This growth will be driven largely by ADR gains of 1.8 per cent in 2005, 1.8 per cent in 2006, and 2.1 per cent for 2007, which will drive ADR to £69.04. See Graph 7 and Table 3.

Occupancies were at their highest for some years in 2004 reaching 69.4 per cent, but are expected to slip slightly this year and then to start to climb a little in 2006, reaching over 70 per cent by 2007.

Birmingham should benefit from some strengthening in the UK economy next year and 2007 and also from continued efforts to enhance the attractiveness of the city.

Edinburgh

Historic, financial and administrative capital of Scotland and home of the Scottish Parliament

Population: 450,000. Pop within 20 km of centre 697,000

Tourism profile: Tourism is a major industry and the City has high corporate and conference demand driven by the representation of national and international companies. Also good leisure tourism demand, fuelled by the attractiveness of the city and numerous cultural festivals, particularly in the summer. Gateway city to Scotland

Hotel demand drivers: Strong corporate and leisure demand (particularly high-end) from domestic and international markets. Also group business generated by events at the convention centre and group travel. Attracts second and third breaks markets. Over supply concerns reported having moderated and as a result Edinburgh has some of the highest room yields in the UK, outside London.

Economy: Main industries include banking, tourism, life assurance and fund management. Economy dominated by a few major firms.

Economic outlook: Above average growth expected in future. Favourable employment forecasts, although some pressure on public sector employment to relocate outside Edinburgh

Hotel performance outlook: Following a strong 2004, overall RevPAR growth of 3.3% is forecast in 2006 and a further 2.7% in 2007, driven by modest room rate gains

Edinburgh

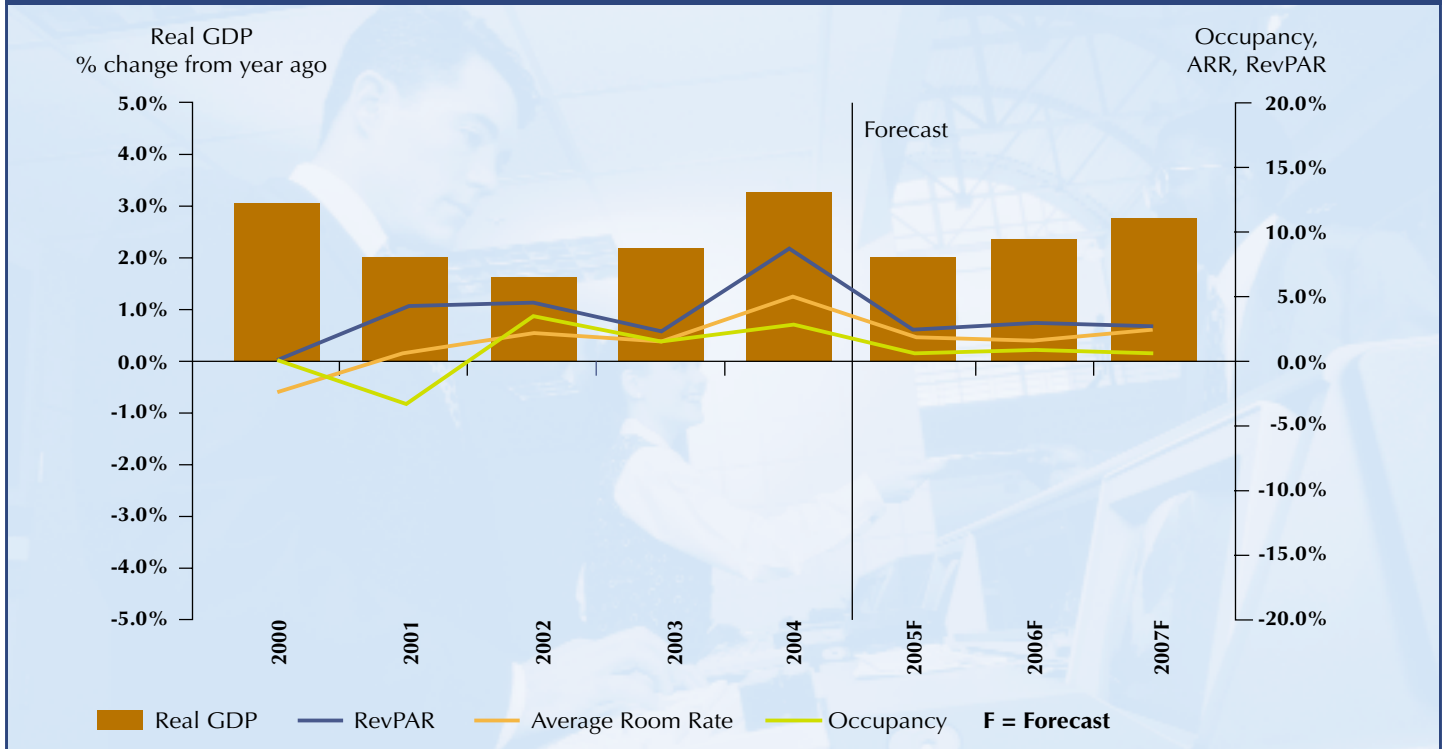
A short-term drop in tourism numbers was experienced this summer, attributed to the city hosting the G8 summit, high petrol prices and the London bombings. In contrast tourism officials have also reported attracting a good increase in second and third short breaks to Scotland.

Following large increases in supply, driven primarily by the development of budget hotels in the late 1990's and early 2000's (approx 30 per cent increase in total room supply), the rate of growth slowed considerably. However, in 2004/5, with only limited new budget development and minimal upscale city centre increases in supply (due to the barriers to entry in the central part of the city), Edinburgh now benefits once again from a healthy supply and demand balance. Hotel performance should reflect this.

New hotels planned in Edinburgh include the Columbus Hotel, a 100 bedroom lifestyle hotel at Edinburgh Airport which is due to open in 2007; Montpeliers, a 31 bedroom hotel and bar venue will open in 2006 and MWB, owner of the Hotel du Vin brand, are planning to develop a hotel in central Edinburgh in 2007. More speculatively, renovations and extensions include Principal Hotels which plans to spend £12m refurbishing their 2005 acquisition, the 195 room George Hotel; The Radisson SAS hotel (formerly Crowne Plaza) has completed a multi million upgrade of 238 guest rooms in early 2005; the Apex International Hotel is opening a Spa in Autumn 2005 and the Marriott Dalmahoy Hotel and Country Club has completed a £1m development of the Championship East Course to enable the venue to host major golf tournaments. A hotel is proposed as part of Phase 2 of Edinburgh Park to serve mainly business clientele. Elsewhere in Edinburgh, the development of purpose-built hotels is encouraged by Edinburgh Council.



Graph 8: Edinburgh - Real GDP, RevPAR, Average Room Rate and Occupancy Growth Rates, 2000 to 2007



Source: Econometric Forecasts: PricewaterhouseCoopers September 2005, Macroeconomics Data: Oxford Economics August 2005, Benchmarking Data: Smith Travel Research/Deloittes Benchmarking 2005

PricewaterhouseCoopers forecast for Edinburgh:

London is an important gateway for UK tourism and a drop in overseas visitors is expected to affect Scotland and, together with the economic slowdown, this is expected to moderate demand in 2005 and beyond. Overall we expect RevPAR growth of 3.4 per cent in 2005 compared to 8.8 per cent in 2004. This is likely to remain broadly similar level with 3.3 per cent growth in 2006 but slow to 2.7 per cent by 2007. (See Graph 8 and Table 3). Occupancy rates reached 76.4 per cent last year, almost a three percentage point improvement over 2003 and only modest increases are expected over the next few years, but occupancies could reach 78.4 per cent by 2007. ADR growth rates are forecast to slow from 5.7 per cent in 2004 to 2.5 per cent this year, and 2.1 per cent by 2007.



Contacts:

If you would like to discuss any of the issues in this paper, please contact:

Robert Milburn
 UK Hospitality & Leisure Leader
 020 7212 4784
 robert.j.milburn@uk.pwc.com

Liz Hall
 Head of Research – Hospitality & Leisure
 and Editor Hospitality Directions
 020 7213 4995
 Liz.hall@uk.pwc.com

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