

UK hotels update:

Two-track recovery continues: provinces may need a jump-start

- London driving UK recovery as provinces see only modest improvement
- Public sector cuts likely to dampen rather than de-rail altogether UK economic recovery
- Consumers and corporates remain price sensitive and public sector cuts will hurt

Background

Back in March we reported that UK hotels were clearly on the comeback trail¹, with London very much on a super-highway and the engine driving overall UK revenue growth. Outside the capital, lacklustre domestic business demand saw the provinces stuck on a rougher trail and likely to experience a more difficult recovery. We reported an incipient return of the business traveller and hoped holiday travel would continue to hold up. A meetings and conference market recovery remained elusive.

Now, at just past the half-way stage, against continued economic uncertainty and looming public spending cuts, we take a look at whether the recovery is still on track or likely to be de-railled; the first-half reality for the UK hotel sector and the prognosis for demand in the second half of the year. We also summarise the latest economic data and re-visit what the scale of the new public sector cuts mean for hotels – there's a lot to lose with public sector travel procurement estimated to be worth around £3bn².

So far so good

Despite the ash cloud, strikes and bad weather, our March forecast has proved largely accurate, with a recovery in progress, especially in London, but varying in intensity across the rest of the UK. To date, comparables with the same period in 2009 are, with the exception of Provincial ARR, much improved. See Table 1. Overall, for the first half, provincial RevPAR saw a 1.2% gain compared to a 9.2% gain in London. This takes RevPAR to almost £39 in the provinces and £95 in London.

Business visits to the UK saw a modest 2% increase in Q1 2010 compared to Q1 2009, when a 26% decline was recorded. In contrast leisure visits in the same period slipped by 4%. Conferences and meetings, especially training courses, have seen enquiries picking up (at last) but a recovery remains patchy.

Room rates are rising in London but languish in many other cities. Occupancy gains have driven some bounce-back in tourist centres but hotels are not full up. Global hotel companies report improved trading

“From the Midlands down, southern Britain is performing better than northern Britain, although there are some notable exceptions, such as York and Edinburgh, which are performing well... London emerged from the recession in September 2009, whereas elsewhere this came in the first quarter... London is busier now than it was at the peak in 2008”

Interview with Guy Parsons, CEO
Travelodge, Independent, 8 July 2010

Table 1 On the up: the PwC forecast versus the trading reality
(% change on previous year)

	Forecast for 12 months to Dec 2010	Forecast for 6 months to June 2010	Actuals to June	Forecast for 12 months to Dec 2010	Forecast for 6 months to June 2010	Actuals to June	Forecast for 12 months to Dec 2010	Forecast for 6 months to June 2010	Actuals to June
	UK			London			Provinces		
Occupancy	1.3%	2.3%	▲ 3.7%	2.3%	3.4%	▲ 2.7%	0.9%	2.0%	▲ 4.0%
ARR	1.8%	1.3%	▲ 1.2%	3.5%	3.7%	▲ 6.4%	0.6%	-0.4%	▼ -2.6%
RevPAR	3.1%	3.6%	▲ 4.9%	5.8%	7.3%	▲ 9.2%	1.6%	1.6%	▲ 1.2%

Econometric Forecasts: PricewaterhouseCoopers February 2010
Benchmarking Data: STR Global July 2010

“London rate is up significantly...we are discounting a lot less this year, so some markets have seen occupancy declines as a result but with overall revenue gains”

“As a result (...of less discounting) we have seen declines in eChannel production such as Expedia (weekends) and this will impact the EU source markets which are more rate sensitive”

Revenue Director, Global hotel chain, to PwC July 2010

as they see the high-end business travellers return. Growth in transient and group business has improved business mix and lifted rates in some cities. In contrast, others report continuing challenges. Closer to home, PwC’s travel office supports this trend, seeing rates only really picking up in London, Edinburgh and Glasgow.

Many hotels have high hopes for the second half of the year and those in the south anticipate an added boost from the Farnborough Air Show. For London the impact on Middle Eastern markets of the earlier timing of Ramadan this year may dampen trading in the first week of September.

First-half realities

London in a league of its own

London has performed in a league of its own, underpinned by solid ARR gains of over 6% as the business mix reflects more transient mid week travellers. As we anticipated in March, Q1 and Q2 occupancies in London actually broke past records for those quarters.

In terms of which markets have performed well, last year Spain and France helped uplift leisure visitors but may prove price sensitive this year. Some hoteliers have reported an increase in US visitors.

Branded budget operators are clearly starting to see better times, as are luxury. Luxury hotels are often the first to dive in bad times, but can enjoy a rapid recovery when times get better. Several international operators are reporting seeing a return of the high-end business traveller to their upscale hotels. Overall for the half year London luxury ARR has seen a 7% gain to £235.

Provinces need a jump start

More dependent on a domestic business travel upturn, provincial recovery has, so far, been largely occupancy driven, and ARR declines continue to be reported. Nevertheless any improvement is a welcome move in the right direction and overall provincial RevPAR to June showed a 1.2% gain, despite a 2.6% ARR decline to £60.50. Star performers

Has the public spending threat to hotels worsened?

Following the Budget Report published by HM Treasury on 22nd June 2010, a number of austerity measures have been announced. Since the UK hotels sector is dependent on the public sector for a sizeable proportion of its revenue, it would see a potentially substantial impact due to government spending cuts. Now the threat has crystallised we anticipate more damage could be inflicted on travel and hotels than we previously did in March this year. See ‘UK hotels forecast: 2010 and 2011: On the comeback trail (quantifying the public sector spending threat to hotels)’. We have updated our estimate of this impact based on the new austerity measures.

Most government departments have been asked to prepare cost-

cutting plans for two scenarios. The first scenario sees budgets being reduced by 25%, albeit with some departments’ spending protected more than others’. We have assumed that the cuts will result in a reduction in total government expenditure of around 15% and that the cuts will be implemented over a four-year period, with budgets being reduced by around 3.9% each year, starting in the second half of 2010.

We estimate that this will have the effect of reducing our original 2010 RevPAR forecast by 0.4% to 2.7% and our original 2011 RevPAR forecast by 0.8% to 3.9%. This is compared to the estimate that we made in our March forecast of a 0.6% reduction due to public spending cuts in both years. This is actually harsher than originally thought, as for 2010, the effect is concentrated largely into the second half of the year.

However, the figures above assume that the hotel industry is dependent on the public sector for 20% of its revenue. We noted in our March forecast that the true figure could be up to 30%. If this is the case, and if public spending cuts end up closer to the government’s second scenario of 40% (considered unlikely by many commentators), then the impact on the hotel industry could be significantly worse.

While it is clear that hotel income will suffer, it is not clear whether rates or occupancy will be most affected. Will there be sweeping bans on travel or will government departments seek to keep travelling but bargain for reduced rates? Hoteliers will be pondering this question as they consider how best to respond to the coalition’s plans for ‘Austerity Britain’.

include Glasgow and Edinburgh, which saw occupancy boosted to reach 89% in June. Rates have struggled to move forward in many cities though.

On the up

A reminder of PwC's March Forecast for the full year 2010 as well as for the first half is shown in Table 1 above alongside the actual trading results to date.

In answer to the question "is the forecast on track?", Yes it is broadly. London has done better on rates than we expected whereas provincial hoteliers, hit harder, have struggled to get prices up. In fact, overall they have continued to fall.

If we look at how the first two quarters have worked through for the UK in terms of what we expected and the trading reality, London performed very much as we anticipated in Q1 although with hindsight we were a bit downbeat on ARR. See Table 2. In Q2 ARR in London grew more strongly than we thought it would, although the occupancy growth deceleration was in line with our view. In the

provinces we were almost dead on for occupancy gains in Q1 at around 2.2%, but under-played the ARR declines. For Q2 we were pretty close on RevPAR but under-played the occupancy gain of 4.8%.

Second-half hopes and forecasts

What is likely to happen in the second half of the year? Are there any compelling factors likely to shrink or swell the numbers of prospective travellers? What is our thinking regarding updating our forecast outlook? Benchmarking reports show a positive start to Q3 with week one of the quarter recording provincial RevPAR up around 6%, still occupancy driven, as rates remain flat. London's RevPAR was up almost 16% largely driven by rate growth of 14%.³

Of course as the year progresses stronger trading comparables in Q4 2009 will impact the picture and the public sector cuts are liable to dampen a recovery – especially in the provinces. So, with the half year

up, we would anticipate revising our forecast to reflect the stronger than expected rate gains in London in the first half and the lower than expected rate gains in the provinces. We expect to publish updated forecasts for 2010 and 2011 in mid September.

The factors that are likely to influence the second half include:

Economic growth: Continued economic recovery remains good news for travel and hotels. See Economic update box.

Business travel: Hotels already report seeing more business travellers midweek. Although travel budgets and corporate policies may be loosening a little, they remain comparatively tight. Overseas business visits to the UK have shown a modest increase in Q1 2010 admittedly against poor comparables in Q1 2009. Domestic business travel should start to see a slow recovery from the private sector as companies acknowledge they have to travel more to grow, but public sector travel cuts will counter-impact. On the flipside, hoteliers we have

Table 2 The 2010 quarterly trading pattern: forecast versus reality

	2010Q1		2010Q2	
	Forecast	Actual	Forecast	Actual
UK				
Occupancy	3.6%	3.5%	1.1%	3.5%
ARR	0.1%	-0.4%	2.5%	2.1%
RevPAR	3.7%	3.2%	3.6%	5.9%
London				
Occupancy	7.2%	5.9%	-0.3%	0.6%
ARR	2.8%	4.4%	4.6%	7.5%
RevPAR	10.3%	10.8%	4.3%	8.5%
Provinces				
Occupancy	2.2%	2.5%	1.7%	4.8%
ARR	-1.6%	-4.6%	0.9%	-1.4%
RevPAR	0.6%	-2.0%	2.7%	3.5%

Econometric Forecasts: PricewaterhouseCoopers February 2010

Benchmarking Data: STR Global July 2010



spoken to say they intend to bargain hard when contracts are renegotiated this autumn.

Meetings and conferences: There are reports of enquiries picking up around the UK, especially for training courses as companies accept they can put off training their staff for only so long. Some also detail a slight loosening on team building and 'awayday' type get-togethers. This is likely to continue but bookers are price conscious and lead times remain very short with trading down to non-residential prevalent.

Consumer spending: Travel remains a priority for consumers although many are likely to have less cash in their pockets as the austerity measures bite and paying off old debt continues. Consumers recently told us they intend to take more holidays over the next 12 months, especially short breaks, but that budgets remain tight and searching the internet for a good deal is key. However, 'Austerity Britain' may catalyse a downturn in both confidence and disposable income. Many major inbound European markets also face turbulent economic times and this may impact inbound

travel. Good weather may encourage the staycation trend to continue this summer benefitting some resorts.

Upcoming events/changes: The potential Farnborough and Ramadan 'effects' have been mentioned. September and October traditionally benefits hotels, especially in London, with strong business and leisure demand coupled with the return of the corporates from the summer break. Casting some gloom are rumours of more BA strikes in September. The VAT rise to 20% in January 2011 may affect demand perhaps by bringing forward travel or other purchases.

Supply: A 'bright' spot as the continued lack of development finance effectively suppresses many new hotel starts. The exceptions being projects started prior to autumn 2008, budget and some limited service hotels. Those already under construction then continue to open and in some cases to exacerbate trading difficulties for various cities.

"We anticipate even more favourable pricing in the second half of 2010 and into 2011"

Bill Marriott, Chairman and CEO Marriott International, on announcement of the company's Second Quarter Results July 2010

Economic update*

- Globally, the economic recovery has been relatively strong although key UK export markets in Europe lag behind.
- In the UK key fiscal initiatives already announced, include initial spending cuts of £6.2bn, the establishment of the Office of Budgetary Responsibility (OBR) and a rigorous spending review, scheduled for October 2010.
- Two quarters of positive GDP growth are now behind us and a positive result for Q2 growth is encouraging.
- Overall the UK economy is projected to see a gradual recovery in our main scenario with GDP growth of around 1% in 2010 and 2.2% in 2011.
- Evidence is patchy but recovery to date has been led more by London and the South East. Businesses and regions dependent on public spending face serious challenges over the next 5 years.
- We expect a turbulent economic climate in many UK travel source markets in 2010 although a gradual pick-up is expected, contrasting with a strong surge in Asia.

* PricewaterhouseCoopers UK Economic Outlook published 12 July 2010

Table 3 Hotel statistics for UK, London and Provinces 2009 and 2010 Q1 and Q2

	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2
UK						
Occupancy %	61.94	70.60	74.75	68.66	64.08	73.10
% change	-6.9%	-5.7%	-2.5%	0.6%	3.5%	3.5%
ARR (£)	76.53	78.12	77.39	80.23	76.20	79.76
% change	-5.2%	-8.4%	-8.2%	-2.8%	-0.4%	2.1%
RevPAR	47.40	55.15	57.85	55.09	48.92	58.43
% change	-11.8%	-13.6%	-10.5%	-2.2%	3.2%	5.9%
London						
Occupancy %	72.04	82.23	84.86	82.55	76.29	82.68
% change	-4.0%	0.1%	1.4%	6.1%	5.9%	0.6%
ARR (£)	109.62	115.01	114.56	123.14	114.47	123.69
% change	-5.1%	-8.9%	-8.8%	0.4%	4.4%	7.5%
RevPAR (£)	78.97	94.57	97.22	101.65	87.50	102.63
% change	-8.9%	-8.9%	-7.5%	6.5%	10.8%	8.5%
Provinces						
Occupancy %	58.35	66.53	71.23	63.83	59.81	69.72
% change	-8.1%	-7.9%	-4.0%	-1.6%	2.5%	4.8%
ARR (£)	62.02	62.16	61.90	60.88	59.17	61.32
% change	-5.8%	-9.3%	-8.4%	-6.6%	-4.6%	-1.4%
RevPAR (£)	36.19	41.36	44.09	38.87	35.48	42.80
% change	-13.4%	-16.4%	-12.1%	-8.0%	-2.0%	3.5%

Benchmarking Data: STR Global July 2010

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1. Hospitality Directions Europe, PricewaterhouseCoopers UK hotels forecast 2010 and 2011: On the comeback trail
2. 'Companies reposition to avoid funding axe', Financial Times, 13 July 2010, value estimates for 2008/2009
3. Barclays Capital European Leisure Report 15 July 2010

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