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The right kind of growth

UK hotels forecast 2014

September 2013

At a glance

- *We remain cautiously upbeat, but increasingly optimistic, on the outlook for UK hotels*
- *The Provinces have seen a stronger performance in 2013 and we expect more growth in 2014*
- *London has experienced a weaker, more volatile performance but we anticipate stronger pricing in 2014 and record RevPAR*

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Foreword
Confidence returns at last

Things may change of course, but right now in the first week of September things feel rosier for the UK economy than at any point over the past three years. The services sector in particular is experiencing a good run and signs are that prospects for the hotels sector have picked up as well.

For London, after a poor end to 2012 and a disappointing start to 2013, June saw both occupancy and ADR in positive territory for the first time since last October. With occupancies at around 81-82%, London is technically full five and half nights a week and looks likely to remain so despite the new supply that continues to open especially in the east. Rates may have tumbled from their 2012 Olympic-fuelled peak, but they look set to rise again in 2014 – even if they still have some way to go to overhaul 2012's record year in real terms.

The Provincial story has been a depressing one for the past three years and long term average real RevPAR has been in decline since 2007. But in 2013 and 2014 it looks as though this decline may have been halted. Occupancies have climbed back up slowly from 66% in 2009 and now stand at 71% – about as high as they get – having been on a rising trend since July last year. As we would expect, this improvement in occupancy is now feeding through into rates, which are beginning to harden and should continue to do so in 2014.

With some tangible improvement now expected for the top line, the challenge for hotels is to keep a tight rein on costs and remain nimble in the face of continued high levels of new supply. Embracing the opportunities of the new digital wave will be one of the features of those who succeed – as will the good 'old-fashioned' concepts of location, service and attention to detail.

Robert Milburn
UK Hotels Leader, PwC
Editor in chief

In this issue

At a glance

PwC's 2014 UK hotels forecast

Moving in one direction, with the right kind of growth

Occupancy

+0.4%
Staying high

Regions 71%
London 82%

+0.9%
Very high

Average daily rate (ADR)

+1.4%
Signs of stabilisation at last

£59.40
Regions

£138.20
London

+1.5%
Heading back up

Revenue per available room (RevPAR)

+1.8%
Moving in the right direction

Regions
£42.40

London
£112.80

+1.5%
At a record level (in nominal terms)

More supply, more competition

Regional* room supply 2013
448,440 rooms

Regions 2014
+8,232 rooms

+2%

London room supply 2013
128,681 rooms

London 2014
+5,644 rooms

+4%

* Regions excluding London
Charts show absolute trading and percentage change on previous year

Sources: PwC; STR Global; AM:PM Hotel Database (supply), August 2013

- We remain cautiously upbeat, but increasingly optimistic, on the outlook for UK hotels
- While it's early days for an economic recovery, GDP growth is good news for hotel revenues
- But it remains a difficult trading environment as cost increases put margins under pressure
- The Provinces have seen a stronger performance in 2013 and we expect more growth in 2014
- London has experienced a weaker, more volatile performance but we anticipate stronger pricing in 2014 and record RevPAR
- New supply rumbles on, adding to the competitive environment, as budget hotels increase their share of rooms

Introduction and key themes

With economic growth picking up and consumer confidence reported to be recovering, we are more optimistic about the UK hotel outlook than we were back in March.

Cautiously upbeat

After a first half which saw strong provincial demand but a rather more difficult London performance, we have revised our 2013 forecast upwards (it remains negative in London but less so). We now forecast a RevPAR decline of 1.9% in London (due to comparisons with the Olympics in 2012) and a gain of 1.3% in the Provinces in 2013. In our first forecast of 2014, we expect 2.4% RevPAR growth in London and further growth of 1.8% in the Provinces.

While this forecast benefits from a brighter starting point than in our last forecast in March, which has lifted the data, we remain cautiously upbeat rather than wildly optimistic about improved prospects and revenues for hotels. Hoteliers continue to face a challenging time, in an uncertain world, where the tailwinds that supported economic growth prior to the financial crisis have been replaced by global and local headwinds that are contributing to a 'new normal' of low growth for western economies. The 2.3% GDP increase that PwC is forecasting for next year would be strong by the standards of the current recovery, but is weaker than any year between 2002 and 2007.

The backdrop for consumer and corporate travel volumes and expenditure remains challenging – most people remain worse off in real terms than they were five years ago. Cost reduction and operational efficiency remains a key concern for businesses. With no compelling reason for believing hotel demand is going to increase substantially or new hotel supply reduce significantly, we think the prospect is for modest RevPAR growth in 2014.

PwC 2013 and 2014 forecast summary

Overall, UK occupancy rates should remain high in 2013 and 2014, at 74%. ADR is expected to see a decline of 1.5% in 2013 but a 1.4% gain in 2014, taking the average price for a hotel room in the UK to £83. We expect no UK RevPAR growth this year but 2% growth in 2014, taking RevPAR to £61.75 – the highest, in nominal terms, for the past 13 years. Taking out inflation tells a very different story though with no records broken.

London: Back to 'normal' in 2014

Despite a volatile 2013 so far, with weak pricing, occupancy rates remain high and could end 2013 at 81%, creeping up a bit to 82% next year, as high as they were in 2010/11. With occupancies already high and significant supply additions continuing, the opportunity is for out performance on rate in 2014. Despite our forecast for a 2.3% fall in ADR this year, we anticipate modest ADR growth of 1.5% next year taking rates to £138.19, only one pound below 2012's record level (in nominal terms) but six pounds behind in real terms (2012 prices). We anticipate a 2.4% gain in London RevPAR in 2014 to take it to £112.80 – another record in nominal terms.

Provinces: Some signs of trading stabilising

Occupancy in the Provinces remains high by historical standards, at 71% (as high as back in 2007 and 2008). So far 2013 has seen only one month of occupancy decline (in January). We expect ADR to reach almost £60 in 2014 – still below the 2008 peak, even in nominal terms, but the best result since 2009. We expect 1.8% RevPAR growth in the Provinces in 2014, taking RevPAR to £42.44 – again the best result since 2008. In real terms, the Provinces have slipped a long way though, as Chart 1 shows. However, the chart also shows that in 2013 and 2014 long-term average real RevPAR could have begun to stabilise, at last.

Table 1: UK hotels forecast

	London		Provinces		UK	
	2013	**2014**	**2013**	**2014**	**2013**	**2014**
Occupancy%	81%	82%	71%	71%	74%	74%
ADR (£)	136.17	138.19	58.61	59.44	81.92	83.10
RevPAR (£)	110.16	112.80	41.68	42.44	60.56	61.75
% growth on previous year						
Occupancy	0.4%	0.9%	1.9%	0.4%	1.5%	0.5%
ADR	(2.3)%	1.5%	(0.5)%	1.4%	(1.5)%	1.4%
RevPAR	(1.9)%	2.4%	1.3%	1.8%	0%	2.0%

Economic Forecasts: PwC August 2013
Benchmarking Data: STR Global July 2013

Key themes

UK GDP recovery is good news for the hotel sector

Historically there has been a close relationship between RevPAR and GDP growth so a sustained recovery in GDP should lead to increased levels of room demand and revenue growth for the following few years. See long term trends Chart 6.

But there is still continuing pressure on room rates

With living standards squeezed, consumers remain price sensitive and their appetite for discounts and deals continues. It's going to be difficult for brands and operators to shift this longstanding expectation. Hoteliers report strong resistance to passing on rising costs through room prices, from both leisure and corporate markets. As consumers push back, book late in the hope of a bargain and use the pricing transparency of the internet to help them make a choice, this is unlikely to change much. The procurement process and an emphasis on value for money and showing a ROI on events means this is also true of the public sector and corporate buyers. Recent PwC research shows that short lead times, a push for added value and an attitude that a better deal is to be had through booking late, continue[1].

Performance volatility in the Provinces

Despite strong monthly (largely occupancy driven) RevPAR growth in the Provinces, UK city performance is very mixed with RevPAR growth on the prior year ranging from around -5% to +15%, according to data from STR Global. Some cities have seen consistent growth e.g. Aberdeen; others such as Liverpool, Edinburgh and Cardiff, have been up and down. These variations appear to be caused by a number of factors including the quantum of recent new supply, strength of local demand drivers and sometimes dire or exceptional prior year performance. London has also experienced volatility this year.

1 PwC Research with HBAA and Conference Centres of Excellence, Trends in the Conference and Meetings Market, July 2013

But also some encouraging signs of stabilisation

It's far from clear but we hope that the early signs of stabilisation in performance that we are seeing taking hold in the Provinces this year, continue into 2014. We do not expect a dramatic shift in relative regional economic fortunes over the next two years, faster rates of growth again tending to be experienced in the South and Midlands. However, all regions should follow the same broad upward trend and this will help support travel and hotel performance.

Averages hide the story as location and product assert their importance

While the London market is up 0.2% overall in RevPAR terms in H1 2013, some segments have outperformed the market as a whole. Leading the field is the upscale or four star segment, which has performed particularly well, with 4.3% growth in RevPAR terms in the half year to June, and over 18% growth in June itself, according to data from STR Global. Upscale segments have seen lower supply growth in the first half of this year than some other segments including economy and luxury. The luxury segment saw ADR growth but occupancy declines while the economy segment saw quite the reverse. Of course London is not a homogenous market and location will also have impacted performance.

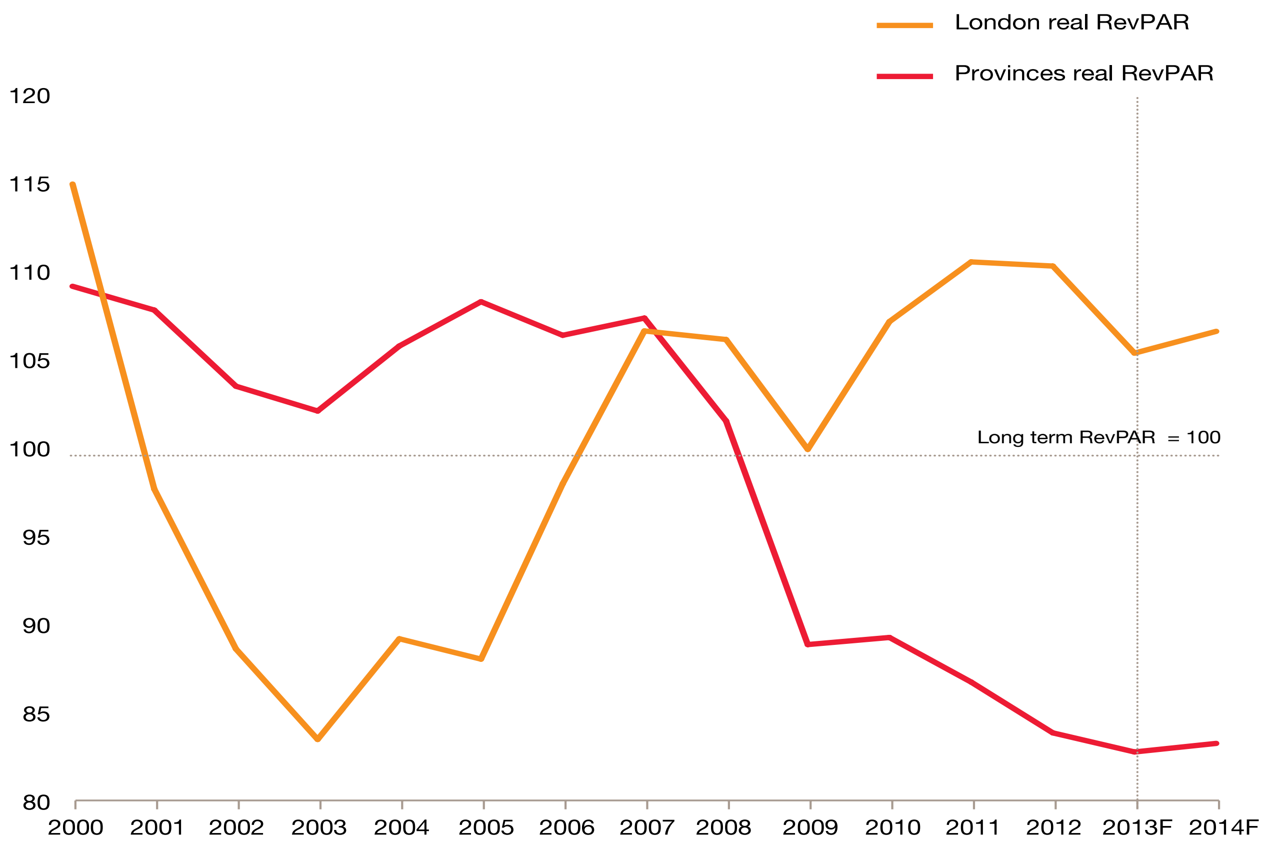
There are some tough comparisons with 2012

Lapping the Olympics, particularly in Q3 this year has meant some tough comparisons for London hotels as well as some regional cities. Travel trends too may be obscured by comparisons with last year, when the Olympics attracted a very different type of sports fan and tourist to the usual profile. A return to some kind of 'normal' in 2014 will be welcomed.

Chart 1: Moving on up

London and Provincial RevPAR relative to the long term average

At 2012 prices – Long term averages: London £101, Provinces £49



Source: PwC

Business and leisure travel prospects will also pick up further with GDP growth

International inbound tourism to the UK continues to show steady growth and in H1 2013, there were 15.24 m international visits to the UK – a 4% increase over the same period in 2012 and the best first half since 2008. But with weak economic growth in many of our main European tourism markets, it's unlikely any inbound tourism records will be broken in 2013 or 2014. But, positively, business travel should pick up faster than leisure travel, where improving economic prospects will take longer to feed into discretionary income gains. Meetings and conferences are an important driver of demand and food and beverage spend for hotels, but again the outlook is far from fully recovered, nor is it likely to be in 2014.

There is more new hotel supply, especially branded hotels and budgets

New brands, products and revamped existing products continue to open and a further 200 hotels and 19,500 rooms will open in the remainder of 2013 and 2014 alone[2]. While this is below recent growth rates, London continues to see high rates of new supply. A high proportion of these new rooms will be in the budget segment – so it's no wonder rates and independent operators are feeling the heat. Recent research from BDRC Continental shows budget operators, Premier Inn and Travelodge are now the top two brands in both the business and the leisure travel segments – the first time this has been recorded[3].

It's a challenging environment

With all markets changing like never before, hoteliers face a myriad of challenges. Mastery of the digital space is essential for future success but identifying the real opportunities is not always easy – Accor's recent decision to offer free wi-fi across its properties has put pressure on other operators. At the same time the cost of operating hotels continues to increase, squeezing margins across most areas of the business including food and drink, energy, technology, social media and so on.

2 AM:PM Hotels Database July 2013

3 BDRC Continental, Quarterly update on the British Hotel Guest Survey

London forecast

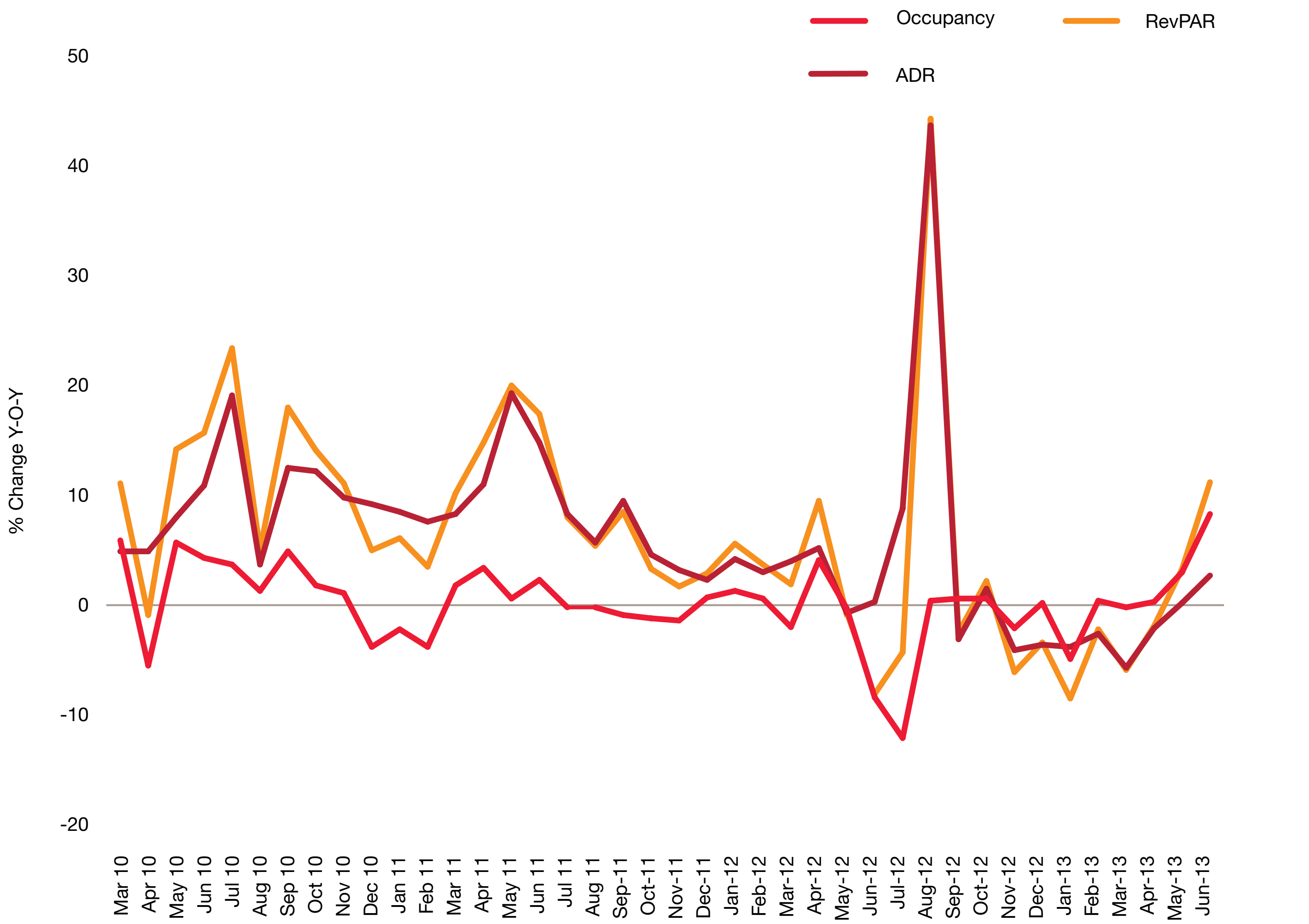
The first half of the year has been volatile, with a poor end to 2012 and a disappointing first few months of 2013.

2013: A post Olympic correction?

London saw RevPAR growth in only four of the 12 months to June this year. H1 2013 saw a 1.3% occupancy gain, to 79.7% but a 1.1% ADR decline, to £133, leaving RevPAR up just 0.2%, at almost £106. June was an excellent month for the capital as occupancy leapt by 8.3%, ADR was up 2.7% and RevPAR bounded ahead by 11.2%, against a very poor pre-Olympic June 2012. The chart below shows this uptick as occupancy and ADR recovered together. A more telling two year comparison shows RevPAR in 2013 flattish against June 2011. Looking ahead, London faces some tougher upcoming comparisons with the Olympic period in 2012, when the capital saw a meagre occupancy metric in July 2012 and an exceptionally strong ADR spike in August 2012.

Chart 2: London monthly trading to June 2013

RevPAR growth in only four of the past 12 months reflects weak pricing



Source: STR Global 2013 and PwC

2014: Back to normal?

Occupancy

London's status as a global city means it can attract people from all over the world, including those from emerging markets whose economies continue to prosper, even if some have seen the pace slow a little recently. London managed almost 80% occupancy for the first six months of 2013 – despite some erratic performances. We expect a marginal increase in the second half, taking occupancy to 81% in 2013 as a whole, nudging up further to 82% in 2014 – just about as high as occupancies can go and effectively full up.

ADR and RevPAR

2014 should mean a return to more normal conditions. Although we forecast a decline of 2.3% in ADR for 2013, we expect 1.5% growth in 2014, taking ADR to £138.19 – almost a record in nominal terms but not in real terms. RevPAR could reach £112.80 in 2014.

Segments: Upscale outgunned the market in H1 2013

The four star (upscale) sector performed particularly well in H1 2013 with ADR and occupancy growth driving 4.3% RevPAR growth, according to data from STR Global. Jones Lang La Salle Hotels Hotel Investor Sentiment Survey identifies particular interest in upscale assets in EMEA. This sector has seen lower new supply growth in H1 2013 than some other segments including economy and luxury. However, looking ahead it comprises around 22% of the four year London pipeline.

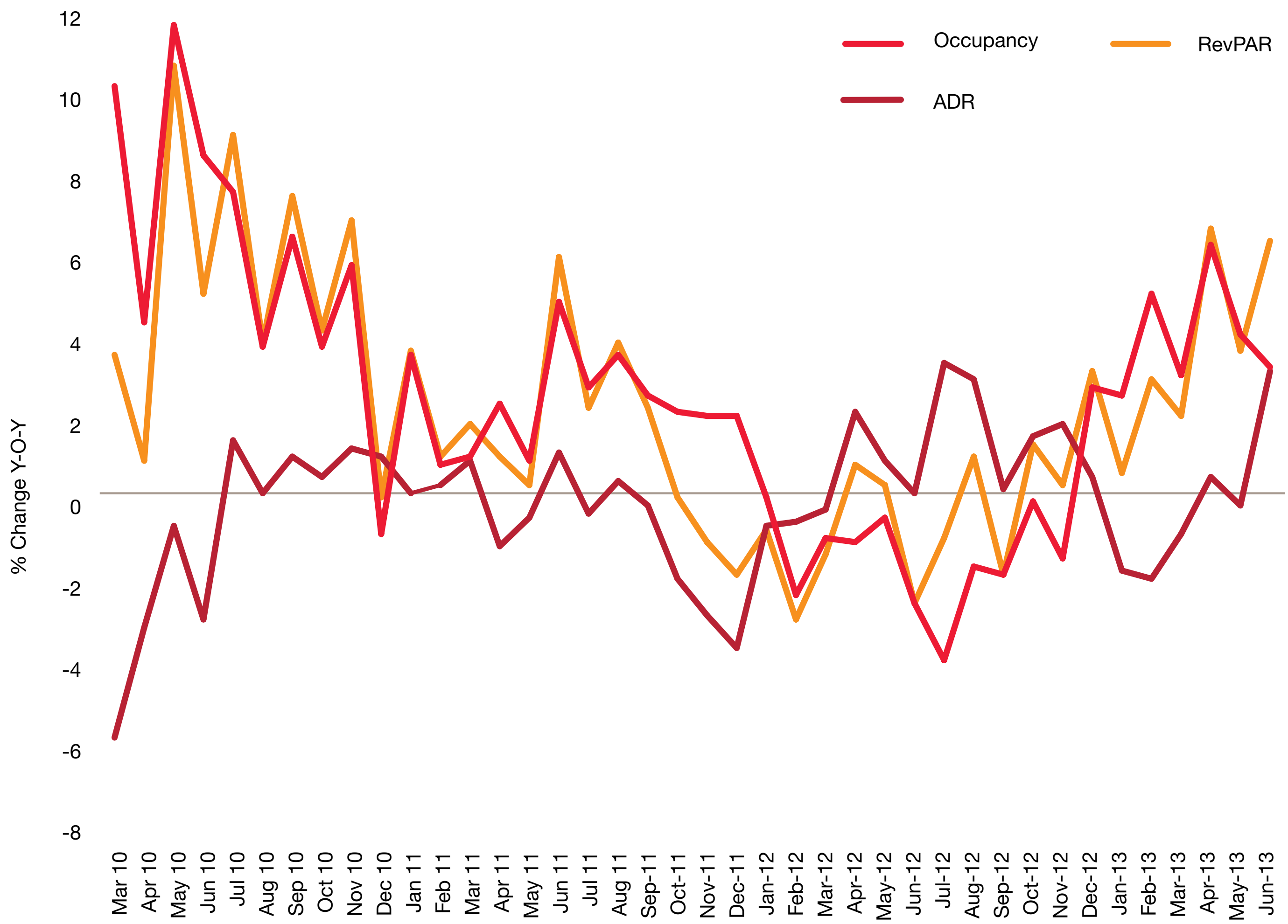
Provinces forecast

2013: Mixed bag of performances

It's been a mixed bag of performances across the Provinces, with a wide variation both between cities and from month to month. Overall, H1 2013 saw a 3% jump in occupancy and a marginal fall in rates, allowing RevPAR growth of 3.7%. Cities such as Aberdeen, Bradford, Coventry, Milton Keynes, Leeds and Sheffield saw high RevPAR gains. Glasgow – soon to host the Commonwealth Games and featured later in this report, – saw an almost 5% RevPAR gain. In contrast, ADR falls were common, even in cities that saw overall RevPAR gains, as occupancy cushioned growth and hoteliers discounted to keep business. Birmingham, Bristol, Coventry, Newcastle, Nottingham were among those that saw ADR falls. But despite this some prospered and Aberdeen, Bradford, Coventry and Milton Keynes saw double digit RevPAR growth and Bristol, Cardiff, Leeds and Sheffield over 6% RevPAR growth in the first six months of the year.

Chart 3: Provincial monthly trading to June 2013

RevPAR growth in 10 of the past 12 months but resistance to rate rises



Source: STR Global 2013 and PwC

2014: Stabilisation at last?

Looking ahead, our estimates for economic growth in 2013 range from 0.7% GDP growth in the North East to 1.6% GDP in London, while projected regional growth in 2014 ranges from around 1.7% to around 2.7%. We do not expect a dramatic shift in relative regional economic fortunes over the next two years, with faster rates of growth again tending to be experienced in the South and Midlands. However, all regions should follow the same broad upward trend in 2013-14.

Occupancy

Even though there are more hotels to fill – especially budgets around the country – occupancy has remained high by historic standards averaging almost 70% in H1 2013 and enjoying strong growth in each of the first six months. For 2013 and 2014 we forecast 1.9% and 0.4% growth in occupancy respectively, taking occupancy to 71% – as high as it has ever been since 2000 – reflecting the higher occupancies of budget hotels.

ADR and RevPAR

Hotels experiencing rising occupancy levels are generally in a favourable position to realise greater ADR gains. However pressures from the economic slowdown, the rise of the budget sector, consumers looking for deals etc. has meant ADR declines in the first six months of 2013 and we forecast a marginal decline overall this year, but 1.4% growth in 2014. This would be a great achievement and take ADR to almost £60. In real terms of course the story is very different and ADR remains about £20 below 2000 (at 2012 prices). The strong occupancy gains this year mean RevPAR should nudge ahead by 1.3% in 2013 and see further 1.8% growth in 2014, to £41.68 and £42.44 respectively. In nominal terms though, RevPAR remains more than 5% below its 2007 value.

Economic outlook
Some good news

After a period of generally disappointing growth in 2011 and 2012, the UK economy has shown signs of recovery in the first half of 2013.

Business climate outlook: Cloudy but improving

The UK economy grew by 0.3% in the first quarter of 2013, ending fears of a return to technical recession after the post-Olympics fall in GDP in the fourth quarter of 2012. Growth in the first quarter was driven entirely by services, with manufacturing and particularly construction still acting as a drag on the economy.

Preliminary estimates suggest that GDP grew by 0.7% in the second quarter of 2013. All the industrial groupings (agriculture, production, construction and services) saw increases with the largest contribution to growth coming from services.

The last few months have generally brought more positive news, with the latest PMI surveys indicating recovery in all major sectors of the economy and retail sales showing solid growth in July. A somewhat calmer situation in the Eurozone has generally supported equity markets since last autumn, despite some recent volatility. The strong improvement in UK employment in 2012 has slowed somewhat this year, but the underlying trend is still upward. The Chancellor's Spending Review in June confirmed there will be more pain to come in the public sector, but private sector job gains should continue to offset public sector losses.

In our main scenario we expect GDP growth to pick up gradually from 0.2% in 2012 to around 1.3% in 2013 and around 2.3% in 2014. Risks to growth are now more balanced, having previously been weighted to the downside. However significant risks remain, including instability in the Middle East and the eurozone fiscal environment.

Services will remain the main engine of growth, but we also expect a gradual recovery in manufacturing and construction over the next 18 months. Subdued real earnings growth should, however, help to keep total UK employment growing at a healthy rate over the next five years, despite continued public sector job losses over this period.

Inflationary challenges

Consumer price inflation (CPI) has been volatile in recent months and has risen close to 3% over the summer, but it is being restrained by continued low earnings growth and some easing of past pressures from global commodity prices.

Consumer price inflation is likely to remain above target at around 2.7% in 2013 and 2.4% in 2014. We expect some moderation in inflation next year unless there is any renewed rise in global commodity prices in 2014.

Our main scenario for inflation implies a continued decline in real earnings growth in 2013-14, making six successive years of negative real growth. We would expect a gradual recovery in real earnings in 2015-17, but the level of real earnings in 2017 would nonetheless remain around 5% below its peak level in 2008.

UK regions: Opportunities and challenges

We expect London and the South East to continue to lead the recovery, but all regions should return to positive growth in 2013-14 (see Chart 5).

As shown in Chart 4 below, economic growth is not likely to be distributed uniformly across the regions. Our estimates for 2013 range from 0.7% growth in the North East to 1.6% in London, while projected regional growth in 2014 ranges from around 1.7% to around 2.7% (See also Chart 5).

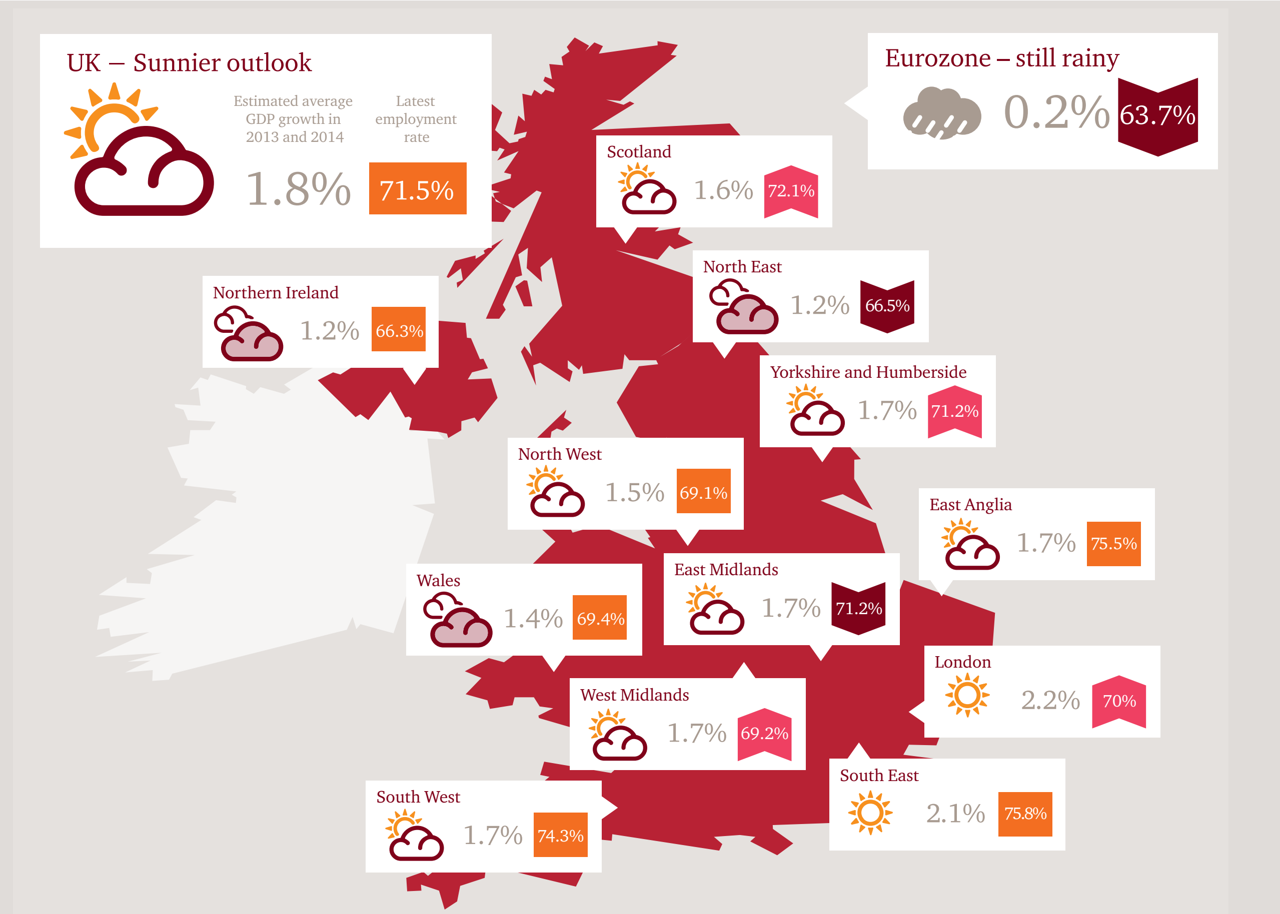
This chart demonstrates that we do not expect a dramatic shift in relative regional fortunes over the next two years, with faster rates of growth again tending to be experienced in the South and Midlands.

However, all regions should follow the same broad upward trend in 2013-14 and the differences between regions are not large relative to the significant margins of uncertainty surrounding any such projections.

There has been strong growth in employment over the past three years. Almost all regions of the UK have seen a rise in total employment over this period, with growth led by London, Yorkshire and Humberside and the East of England. Relatively strong employment growth has also been seen in Wales and Scotland, which out-performed England and the UK as a whole over this period.

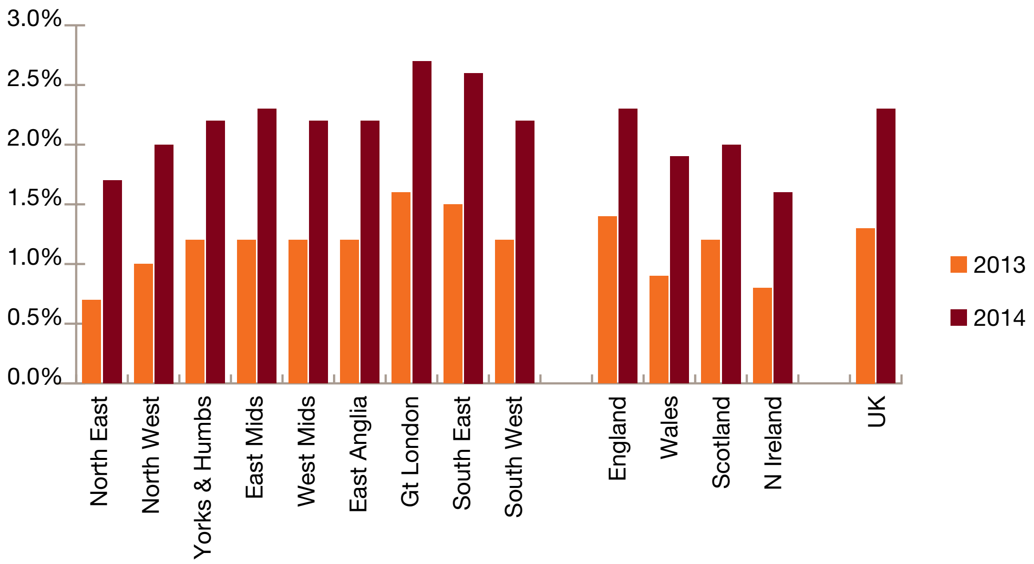
A key driver of strong employment growth has been the fall in real earnings. This has helped to price people into jobs, which has cushioned the overall employment impact of the financial crisis. This in turn has limited the loss of employment-related skills and demonstrated the UK labour market's flexibility.

Chart 4: UK business climate



Source: ONS, Eurostat, PwC analysis
Note: Eurozone employment rate is from Q4 2012

Chart 5: PwC main economic scenario – GDP growth by region



Source: ONS, PwC forecasts September 2013

Europe: The good, the bad and the ugly

On the bright side, Portugal, Ireland, Italy, Greece and Spain have all made significant progress in regaining some of the competitiveness lost in the years before the crisis.

The state of public finances across the peripheral economies remains bad. Progress has been made in reducing government spending – in Portugal spending has decreased by around 20% since 2011. However, the lack of economic growth has meant that the size of the stock of government debt relative to the economy continues to increase.

The status of the labour market in peripheral Europe remains ugly. Unemployment in Greece and Spain is roughly double the Eurozone average of 12%, with high and rising youth unemployment.

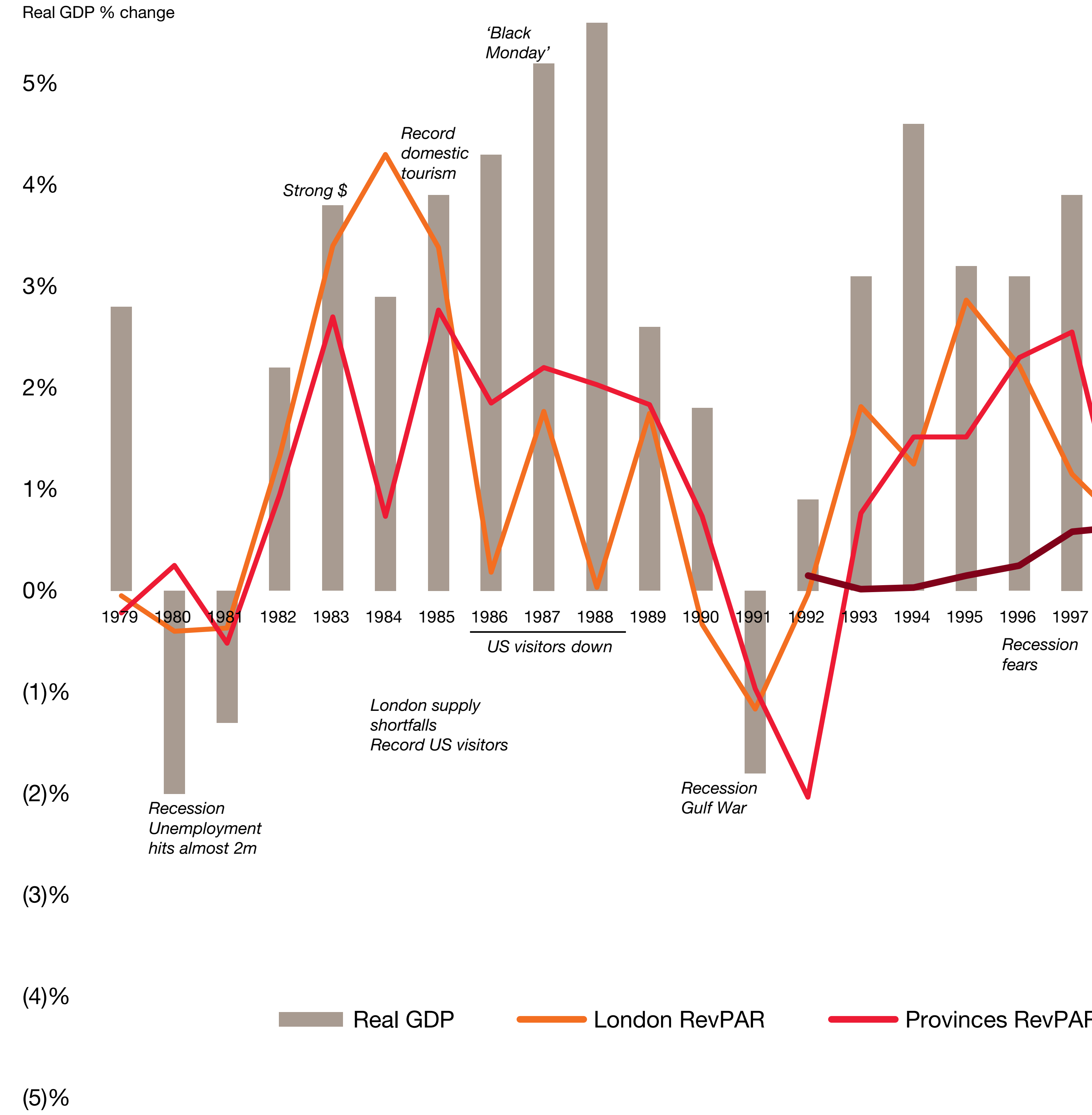
Other markets

The US remains a key market for the UK hotels sector and though its post-crisis recovery has been far from easy, it has experienced reasonably steady output and productivity growth since emerging from the depths of the crisis. The quantitative easing by the Federal Reserve and recent gains in the labour market have alleviated fears of a renewed slowdown somewhat.

Emerging market performance has been more mixed, however, with Chinese growth slowing a little (but remaining high in absolute terms) and disappointing recent growth figures from India and particularly Brazil.

Chart 6: London and Provincial RevPAR u

1979-2014 (% change on prior year)



Sources:

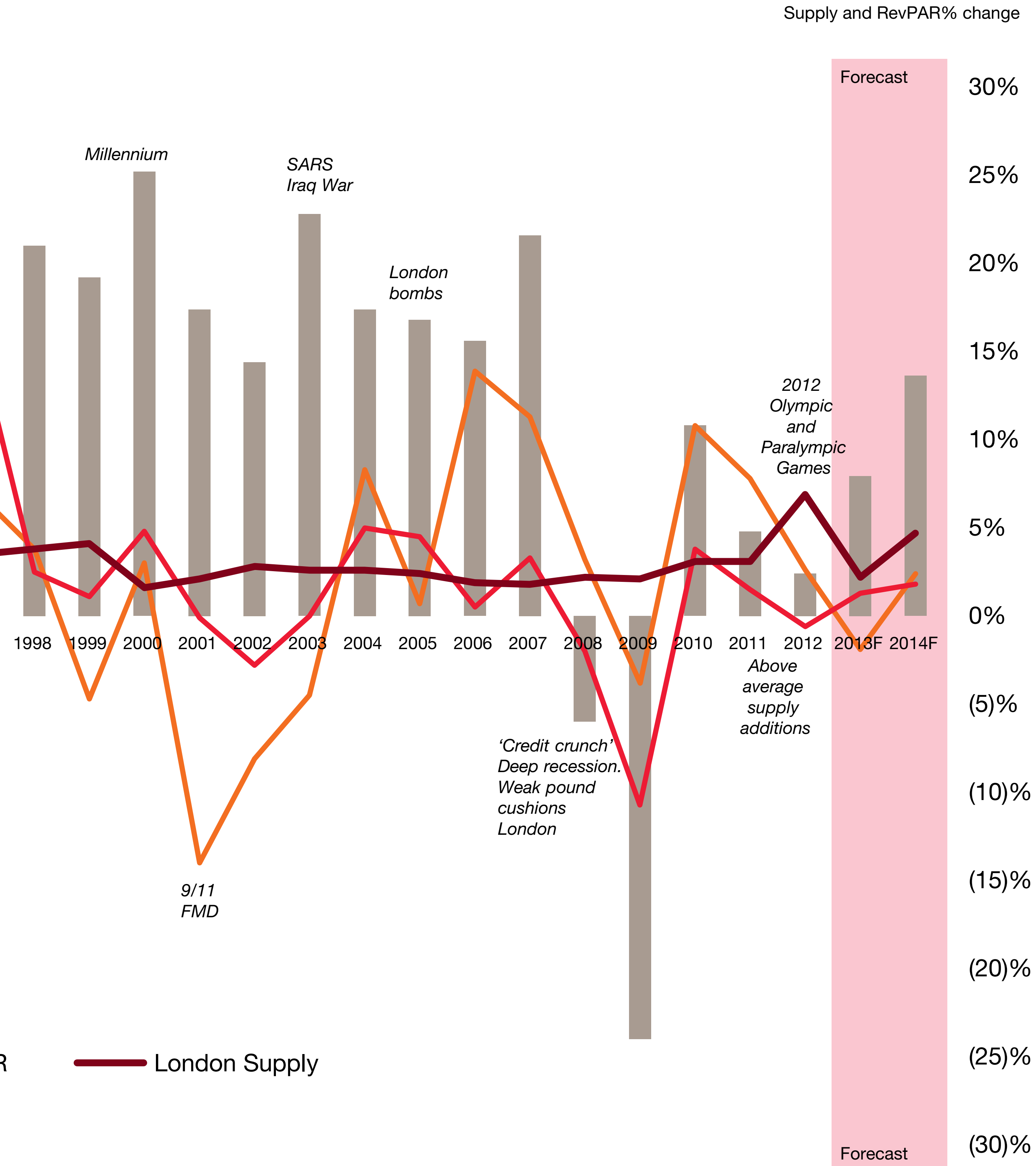
Econometric forecasts: PwC August 2013

Macroeconomic data: National Statistics

Benchmarking data: TRI Hospitality Consulting and STR Global

Supply data: AM:PM Hotels Database/Grant Thornton/PwC 2013

ups and downs



Travel outlook
Set to benefit from the economic pick-up

International inbound tourism to the UK continues to show steady growth and in H1 2013, there were 15.2 million international visits to the UK – a 4% increase over the same period in 2012 and the best first half since 2008.

A total of 2.89m **international visits** were made in July alone, according to the ONS.

VisitBritain continues to forecast modest growth of around 3% in volume terms for 2013 as a whole, with a 4.5% increase in expenditure (up from 2.5% earlier this year). Prospects are also good for 2014 and further growth is expected. North of the border, VisitScotland's 'Homecoming' campaign, the Commonwealth Games in Glasgow and the Ryder Cup at Gleneagles, should drum up travel volumes. Further south the Farnborough International Air Show should help lift Q3 performance.

In global terms, **business travel** spending is forecast by the Global Business Travel Association (GBTA) to rise by 5.4%, to reach $1.2 trillion in 2013 and by a further 8.2% in 2014 – the strongest growth in Asia Pacific and Latin America. In the UK, corporate travel is forecast to grow by 1.9% this year and 3.7% in 2014. UK business visits were 10% higher in January – May 2013, compared to the same pre-Olympic period in 2012. For 2014 a stronger economy should drive more business travel too, which is good news for hotels. However, procurement departments retain a firm grip on corporate travel policies and there is no sense that many will be returning to the 'good old days' any day yet.

On the **staycation** front, Q1 2013 saw the volume of domestic overnight trips 1% down but spend 3% up. Despite the improving economy, more than a third of Britons say they are still opting to holiday at home as a way of saving money, according to research by Webloyalty and Conlumino; this research also showed 20% of those surveyed were cutting down on the numbers of holidays taken throughout the year[4]. Improvements in the UK economy could make consumers feel more confident and they may start to travel abroad more in 2014, and certainly more than they have been in the last few years.

London hopes to see more growth in tourism over the next few years, with 2% growth this year and a further 3.7% increase in 2014, taking overnight visits to 29.4m, according to data from London and Partners. The past peak year for visitors was 2006 – and London and Partners hope London could get back to these levels in 2014. The capital benefitted from an upturn in domestic visitors in 2012 and further growth is expected in 2013 and 2014, taking overnight visits to 12.8m. International visitors are expected to reach around 16.5m by 2014, growth of 2.4% and 4.7% in 2013 and 2014 respectively. Business travel has a lot of ground to catch up and is forecast to continue its recovery with robust growth this year and in 2014 – taking overnights to 7m by 2014.

4 Leisure Management issue 3 2013

A mixed conferences and meetings market

The **conferences and meetings** market remains troubled, despite a more optimistic outlook from some of the largest operators in this sector in a recent PwC survey of meetings and conference venues and booking agencies with HBAA and Conference Centres of Excellence. Their views were often polarised but included the following observations regarding current trends:

- 'The weak getting weaker and the strong getting stronger'
- Pressure on rates
- Shorter lead times
- Popularity of hub destinations
- Shorter meetings (more day and half day events)
- Clients wanting 'more for less, in less time'
- Less residential meetings
- Lower delegate numbers
- The return of some annual events as the 'fear factor' decreases
- Need for technology investment

Hotel supply outlook
A more crowded budget landscape

With around 633,000 hotel rooms in 12,600 hotels in the UK already, the hotel landscape is about to become even more crowded[5].

Who is ticking the box on location, price and design?

Despite the funding crisis, another 20,000 rooms and almost 200 hotels will open in 2013 and 2014, i.e. within the parameters of this forecast, according to data from AM:PM Hotels Database. While the regions will see a lower rate of growth than in 2011 and 2012, it is in addition to the 18,000 rooms that opened in the UK last year. In London the annual additions remains high.

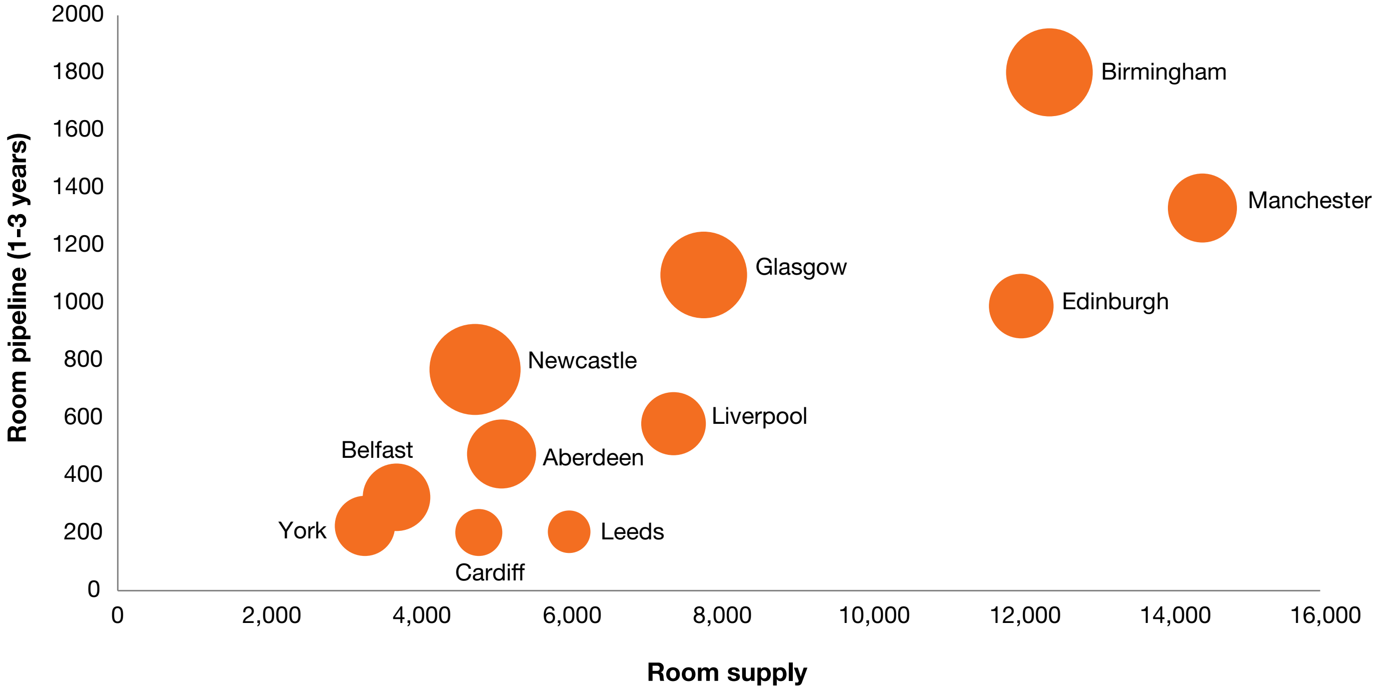
Moreover, over half of these new rooms will be budgets; a quarter will be 4 star and most will be branded. While limited service and budget hotels are helping consumers who don't want to pay the price of full service hotels, hoteliers in the mid-market especially are finding a more crowded and competitive environment. New, modern, strongly branded properties, often technology friendly, are giving consumers what they value and will make the going harder for more 'tired' products, clearly in need of investment.

Where are the rooms being built?

Chart 7 shows some hot spots for new rooms opening in the Provinces over the next three years against existing room supply. Birmingham, Manchester, Glasgow and then Edinburgh top the chart with most new rooms, followed by Newcastle and Liverpool.

Chart 7:UK room pipeline vs supply (excluding London)

The size of the bubble represents the pipeline as a percentage of existing supply



Source: AM:PM Hotels Database August 2013, PwC analysis

5 As at 5 August 2013, source AM:PM Hotels Database

Budgets turn up the heat

Budgets dominate the story around the country. In 2013 and 2014, Manchester will see a Motel One and a new Travelodge add almost 500 new budget rooms; in Birmingham a 425 room Holiday Inn Express at Birmingham Arena, a 140 room Premier Inn at New Street Station and another 75 rooms open at Birmingham South. Glasgow, getting ready for the Commonwealth Games, will see 359 new budget rooms; at Gatwick, all the new rooms are budgets (including the 245 room Bloc hotel due in Autumn 2013, a Hampton by Hilton and a Travelodge). In Newcastle there are 264 rooms (a Hampton by Hilton and a Tune Hotel). 2014 or 2015 could see the arrival in the UK, of Moxy, the IKEA and Marriott, stylish new designer budget product.

And 4 star openings polarise the pipeline

It's not just budgets, 4-star or upscale properties are also opening new rooms and will account for around 5,000 pipeline rooms in 2013 and 2014. Liverpool will see an Aloft and a Doubletree by Hilton, Glasgow and Brighton will get Hotel Indigos; Manchester, a Hotel Football, an Indigo, Hotel la Tour and INNSIDE by Melia; De Vere Village Urban Resorts open in Edinburgh, Aberdeen and Portsmouth. In London, ten 4-star hotels include Tobacco Dock (Hilton), the Mondrian, Old Street Magistrates Court, MVMNT Boutique and an independent 90 room Shepherds Bush Pavilion, according to data from AM:PM.

Outside London, **5 star hotels** will open in Bournemouth, Bath, Southampton and Sterling.

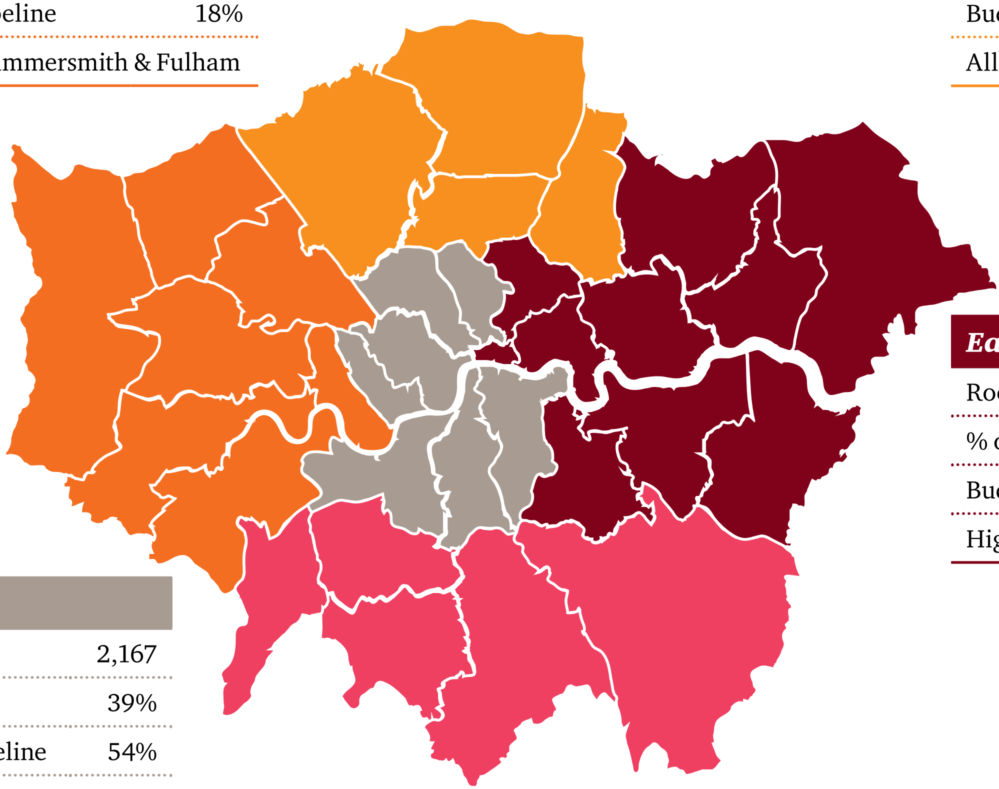
London's new supply is still moving east...

Over 1,500 rooms are set to open in 2013 with a further 5,540 rooms in 2014. A significant number of these new hotel developments in London are conversions or part of large mixed use schemes and Chart 8 shows the number and distribution of these new rooms across London next year. Significant increases continue in the east of the capital, as the City of London, Tower Hamlets and Hackney Boroughs will see almost 2,000 rooms added. The City of London alone will see almost 760 rooms. Central London boroughs including Westminster and Southwark will add over 1,500 rooms (although 500 rooms at the Trocadero may now move to 2015). Of the West's 880 rooms only 18% are budget. Travelodge has commented that the Community Infrastructure Levy in London, which is planned or in force in 19 of the 33 boroughs, could make some future budget schemes unviable.

Chart 8: London's 2014 pipeline is dominated by budget developments and an eastward drift

West	
Rooms in pipeline	881
% of total London pipeline	16%
Budget rooms as a % of this new pipeline	18%
Highest growth in Hounslow and Hammersmith & Fulham	

North	
Rooms in pipeline	99
% of total London pipeline	2%
Budget rooms as a % of this new pipeline	100%
All growth derived from Barnet	



East	
Rooms in pipeline	2,315
% of total London pipeline	42%
Budget rooms as a % of this new pipeline	75%
Highest growth in City of London and Tower Hamlets	

Central	
Rooms in pipeline	2,167
% of total London pipeline	39%
Budget rooms as a % of this new pipeline	54%
Highest growth in the City of Westminster and Southwark	

South	
Rooms in pipeline	86
% of total London pipeline	2%
Budget rooms as a % of this new pipeline	100%
All growth from Merton	

Source: AM:PM Hotels Database August 2013/PwC analysis

… and becoming more affordable, as budgets polarise with luxury in London

The budget pattern is repeating in London too, where 24 hotels and over 4,000 budget rooms will open in 2013 and 2014. These include Ibis Styles, Travelodge and Premier Inn properties, as well as a 291 room Motel One in Aldgate opening 2014; the new hub by Premier Inn opening 189 rooms in Spitalfields and 167 rooms on St Martins Lane; Qbic Hotel London with 187 rooms in Aldgate East, Hampton by Hilton at Waterloo; the independent 213 room Pocket on Shoreditch High Street and CitizenM London Tower Hill.

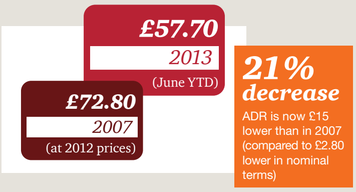
At the luxury end of the scale, London is expecting an increase of over 5,000 rooms in the 5-star segment in the next three years including the long-awaited 200 room Shangri-la at the Shard due Autumn 2013, the 70 room LaLit, also near London Bridge; Firmdale's Ham Yard and the London Edition, among many others.

Spotlight on Scotland
Glasgow, Aberdeen and Edinburgh

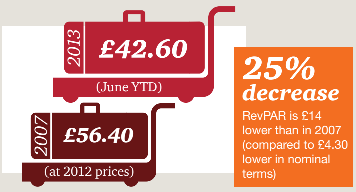
What will the Commonwealth Games hold for Glasgow?

How have Glasgow's hotels fared since winning the Games?

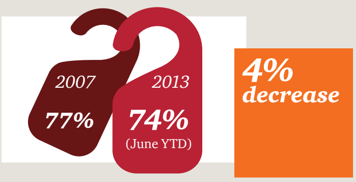
Real Average Daily Rate (ADR)



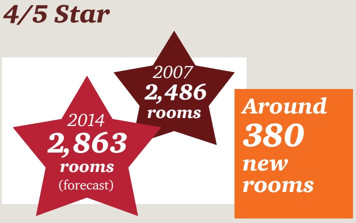
Real Revenue Per Available Room (RevPAR)



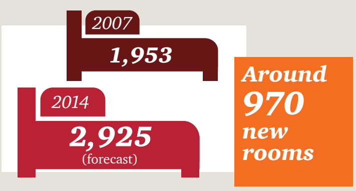
Occupancy levels



4/5 Star



Budget



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

What will the Commonwealth Games mean for Glasgow's hotels?

'People Make Glasgow' reads the new marketing slogan for the city unveiled in June this year ahead of the 2014 Commonwealth Games, but what part does the hotel sector play in making Glasgow Scotland's largest city?

Occupancy rates across the city have remained stable in the last few years although they have fallen since 2007 when it was announced the city had won the Games. See infographic. Despite not seeing a visible boost from the London Olympics, Glasgow has been able to rely on the relatively stable conferencing market and recurring corporate business more than other regional cities across the UK that are more heavily dependent on tourism. Glasgow does however have its share of tourism, with attractions including museums, architecture and shopping – the city lays claim to be the largest retail centre in the UK outside of London.

Glasgow's average occupancy rate was 74% for the first six months of 2013, 2.6% up on the same period in 2012. ADR, at almost £60, saw a 2.2% gain over 2012. 2007 – see infographic. These gains drove RevPAR 4.8% ahead of 2012, at £43.7.

In terms of supply, despite being Scotland's largest city with a population of roughly 600,000, Glasgow only has three 5-star hotels, which pales in comparison to its neighbour Edinburgh, which boasts eight. Indeed, the 7,806 hotel rooms in Glasgow are currently dominated by budget (32%), 4-star (30%) and 3-star (22%), representing the historic conferencing driver of demand in the city, compared with tourism-driven Edinburgh and the buoyant energy market in Aberdeen. At June 2013, Glasgow's conference delegate capacity per available room was 2.1 compared with 1.5 in Edinburgh, with the average conference capacity per hotel in Glasgow (171 delegates) the highest of any Scottish city.

2014 promises to be an important year for Glasgow, as it hosts the Commonwealth Games and numerous cultural events marking Homecoming Scotland 2014. Five new hotels are expected to be completed in the city in 2014, partly driven by the Commonwealth Games and the infrastructure spending in the area in preparation for the games, adding an additional 671 rooms to the city's current capacity of 7,806.

> *"There is a real buzz about Glasgow with the 13,000 seat Hydro Arena opening this year (expected to generate £130m per annum for the economy) and of course the Commonwealth Games and Ryder Cup in 2014."*
>
> *Peter Taylor, Founder and chairman, The Townhouse Collection*

The 2012 Olympic Games pushed London's RevPAR to record highs last year, and Glasgow will hope for a similar outcome next year. The last time the Commonwealth Games were held in the UK, in Manchester in 2002, 57,689 rooms were sold in the city in July alone, the highest figure ever, a trend which Glasgow will hope to replicate or surpass in 2014.

It remains to be seen what the long term effect of the Games on the city will be. As at the time of writing, there are 21 hotels planned but on hold in the city, with no finalised dates for completion. This is a theme consistent throughout the UK, as many major hoteliers struggle with financial backing and uncertainty. However, the city will be hoping that the sporting and cultural events of next year will act as a springboard so that the people and hoteliers of Glasgow can continue to drive growth.

Thriving Aberdeen's hotels challenged by 'second oil boom'

There are currently 73 hotels in Europe's energy capital, with the dominant categories being 3 and 4 star (26% and 21% respectively). Surprisingly, there are no 5 star hotels in Aberdeen at present, despite the fact that the city boasts some of the highest living costs in the country and attracts oil and gas professionals from all over the world.

There are currently 20 planned hotels in the city, with only four of these confirmed and due for completion before the end of 2014. Three are currently on hold, with the other 13 still in the speculative/unconfirmed stage.

The first half of 2013 has seen the Aberdeen hotel market boom, with the average price of a room in H1 2013 £86, compared to the UK average of £78. RevPAR was up an impressive 19% compared to the same period in 2012. This reflects an increase in occupancy of 4% year on year, coupled with an average 14% increase in room rates compared to the same period in 2012.

This boom in the market can be attributed to the fact that the economy as a whole has shown signs of recovery in 2013. This increased business activity is particularly relevant in Aberdeen, due to the buoyant oil and gas industry being a major driver in UK economic activity. Indeed, the total investment committed or in progress in the UK Continental Shelf at 2012 was £31bn, up 22% since 2010, which is a continuing positive sign for service providers in the Aberdeen area, including hoteliers.

Edinburgh off to a good start in 2013

Scotland's capital boasts a total of 177 hotels, which easily places the city in first place in terms of hotels per head of population in Scotland's major cities, catering to the thousands of international tourists who flock to the city each year.

The hotel landscape in Edinburgh is dominated by 3 and 4 star sites (29% and 19%) respectively, with another 24 in the current hotel pipeline. Of the hotels in the pipeline, only eight are actually due for completion by the end of 2015, with the remainder on hold or still unconfirmed, highlighting the affect the global economic climate has had on major international tourist attractions.

However, despite the uncertainty, 2013 has started extremely well for Edinburgh's hotel market. Room occupancy is up an average of 2% over the same period in 2012, a figure even more impressive considering room rates have also increased an average of 3% in 2013 over 2012 comparative figures.

In H1 2013 RevPAR increased by 3% compared to 2012, to £74, again highlighting the promising outlook for the industry, especially heading into the Summer, when the Edinburgh International Fringe Festival historically sees occupancy levels exceed 90% across the city.

Appendix 1

Annual hotel statistics for London, Provinces and UK 2007 – 2014 (F)

London	Actuals						Forecast	
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Occupancy %	81%	80%	81%	82%	82%	81%	81%	82%
ADR (£)	114.44	119.85	113.90	123.45	133.35	139.44	136.17	138.19
RevPAR (£)	92.45	95.37	91.73	101.61	109.50	112.32	110.16	112.80
% change on the previous year								
Occupancy	0.9%	(1.5)%	1.2%	2.2%	(0.2)%	(1.9)%	0.4%	0.9%
ADR	10.4%	4.7%	(5.0)%	8.4%	8.0%	4.6%	(2.3)%	1.5%
RevPAR	11.3%	3.2%	(3.8)%	10.8%	7.8%	2.6%	(1.9)%	2.4%
Provinces	Actuals						Forecast	
Occupancy %	71%	69%	66%	69%	71%	70%	71%	71%
ADR (£)	63.06	64.03	59.69	58.69	58.39	58.93	58.61	59.44
RevPAR (£)	44.83	43.93	39.28	40.76	41.38	41.13	41.68	42.44
% change on the previous year								
Occupancy	0.5%	(3.5)%	(4.1)%	5.5%	2.0%	(1.5)%	1.9%	0.4%
ADR	2.8%	1.5%	(6.8)%	(1.7)%	(0.5)%	0.9%	(0.5)%	1.4%
RevPAR	3.3%	(2.0)%	(10.6)%	3.8%	1.5%	(0.6)%	1.3%	1.8%
UK	Actuals						Forecast	
Occupancy %	74%	71%	70%	73%	74%	73%	74%	74%
ADR (£)	65.73	66.69	61.61	65.56	68.94	83.13	81.92	83.10
RevPAR (£)	57.76	57.72	52.84	56.89	59.70	60.56	60.56	61.75
% change on the previous year								
Occupancy	0.6%	(2.9)%	(2.6)%	4.6%	1.4%	(1.6)%	1.5%	0.5%
ADR	6.9%	1.5%	(7.6)%	6.4%	5.2%	20.6%	(1.5)%	1.4%
RevPAR	6.6%	(0.1)%	(8.5)%	7.7%	4.9%	1.4%	0.0%	2.0%

Econometric forecast: PwC August 2013
Benchmarking data: STR Global August 2013

Appendix 2

Quarterly hotel statistics for London, provinces and UK 2012Q1 – 2014Q4 (F)

London	Actuals						Forecast					
	2012Q1	**2012Q2**	**2012Q3**	**2012Q4**	**2013Q1**	**2013Q2**	**2013Q3**	**2013Q4**	**2014Q1**	**2014Q2**	**2014Q3**	**2014Q4**
Occupancy %	75.0%	83%	84%	81%	73%	86%	84%	80%	73%	86%	87%	81%
ADR (£)	125.00	142.26	155.90	134.58	120.00	143.24	145.02	136.40	125.74	145.11	143.30	138.61
RevPAR (£)	93.35	117.78	129.92	109.71	88.31	123.46	121.74	109.43	92.05	124.25	124.32	112.16
% growth on previous year												
Occupancy	(0.7)%	(2.1)%	(4.1)%	(0.5)%	(1.4)%	3.8%	0.4%	(1.3)%	(0.4)%	(0.4)%	3.3%	0.9%
ADR	3.6%	1.5%	14.7%	(1.6)%	(4.0)%	0.7%	(0.7)%	1.3%	4.8%	1.3%	(1.2)%	1.6%
RevPAR	2.8%	(1.0)%	(9.0)%	(2.0)%	(5.4)%	4.8%	(6.3)%	(0.3)%	4.2%	0.6%	2.1%	2.5%
Provinces	Actuals						Forecast					
Occupancy %	62%	73%	76%	69%	64%	76%	77%	68%	63%	75%	79%	69%
ADR (£)	56.66	59.56	61.73	57.87	55.57	60.15	61.97	57.75	56.61	60.54	62.17	58.44
RevPAR (£)	34.98	43.24	47.20	39.77	35.49	45.53	47.08	39.25	35.55	45.58	49.09	40.07
% growth on previous year												
Occupancy	(1.5)%	(1.5)%	(2.8)%	0.0%	3.2%	4.2%	1.0%	(0.8)%	(1.4)%	(0.4)%	2.3%	0.9%
ADR	(0.6)%	1.1%	2.1%	1.2%	(1.8)%	1.0%	(1.2)%	(0.2)%	1.9%	0.6%	2.0%	1.2%
RevPAR	(2.1)%	(0.5)%	(0.8)%	1.1%	1.4%	5.3%	(0.3)%	(1.3)%	0.2%	0.1%	4.3%	2.1%
UK	Actuals						Forecast					
Occupancy %	65.0%	75.2%	78%	72%	66%	78%	79%	71%	65%	78%	81%	72%
ADR (£)	77.13	84.41	90.04	80.93	74.93	85.12	86.23	81.39	77.38	85.45	86.55	82.53
RevPAR (£)	50.17	63.45	70.49	58.11	49.64	66.62	68.08	57.89	50.68	67.01	70.09	59.23
% growth on previous year												
Occupancy	(1.2)%	(1.6)%	(3.2)%	(0.2)%	1.8%	4.1%	0.8%	(0.9)%	(1.1)%	(0.4)%	2.6%	0.9%
ADR	1.4%	1.3%	8.3%	(0.2)%	(2.9)%	0.8%	(4.2)%	0.6%	3.3%	1.0%	0.4%	1.4%
RevPAR	0.4%	(0.1)%	5.1%	(0.2)%	(1.1)%	5.0%	(3.4)%	(0.4)%	2.1%	0.6%	2.9%	2.3%

Source: Econometric Forecast PwC August 2013
Benchmarking data; STR Global August 2013

Appendix 3
Glossary

Glossary of terms used in this forecast

ADR – Average Daily Room Rate
The average price a room is sold for in a hotel or group of hotels taking 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 4
PwC hotel model GDP and other economic assumptions

2013 vs 2014

	USD/GBP	EUR/GBP	GDP growth (% change p.a.)	Consumer spending (% change p.a.)	Inflation (% change p.a.)	Unemployment rate
2013	1.54	1.15	1.3%	1.5%	2.7%	7.8%
2014	1.53	1.15	2.3%	1.9%	2.4%	7.7%

Appendix 5
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.

Table 2: Final specifications of the London and Provinces models

	London	Provinces
1st stage	**Dependent variable** Growth in London hotel demand	**Dependent variable** Growth in Provinces hotel demand
	Explanatory variables • Country-weighted GDP growth in the previous quarter[6] • Growth in previous quarter London ADR • Seasonal dummies • Dummy for the Olympics • Terrorist events dummy (7/7 and 9/11)	**Explanatory variables** • UK GDP growth in the previous quarter • Growth in Provinces ADR in the previous two quarters • Seasonal dummies
2nd stage	**Dependent variable** Growth in London ADR	**Dependent variable** Growth in Provinces ADR
	Explanatory variables • Growth in London hotel demand • Growth in previous quarter London ADR • Change in previous quarter nominal Euro-GBP exchange rates • Seasonal dummies	**Explanatory variables** • Growth in Provinces hotel demand • Growth in previous quarter Provinces ADR • Dummy for the Olympics • Seasonal dummies

6 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.

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 overidentified at 5% significance level. The first stage test of instrument strength also indicates that the instruments are correlated with hotel demand and have sufficient explanatory power after controlling for other exogenous variables.

Forecasts

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

This model was used to generate forecasts through to Q4 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.

Further reading

Visit www.pwc.co.uk/hospitality-leisure or contact Liz Hall, Head of Hospitality and Leisure research

Hospitality Directions US

South African Hospitality Outlook

European Cities Hotel Forecast

Emerging Trends in Real Estate

UK Economic Outlook

Global Economy Watch

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