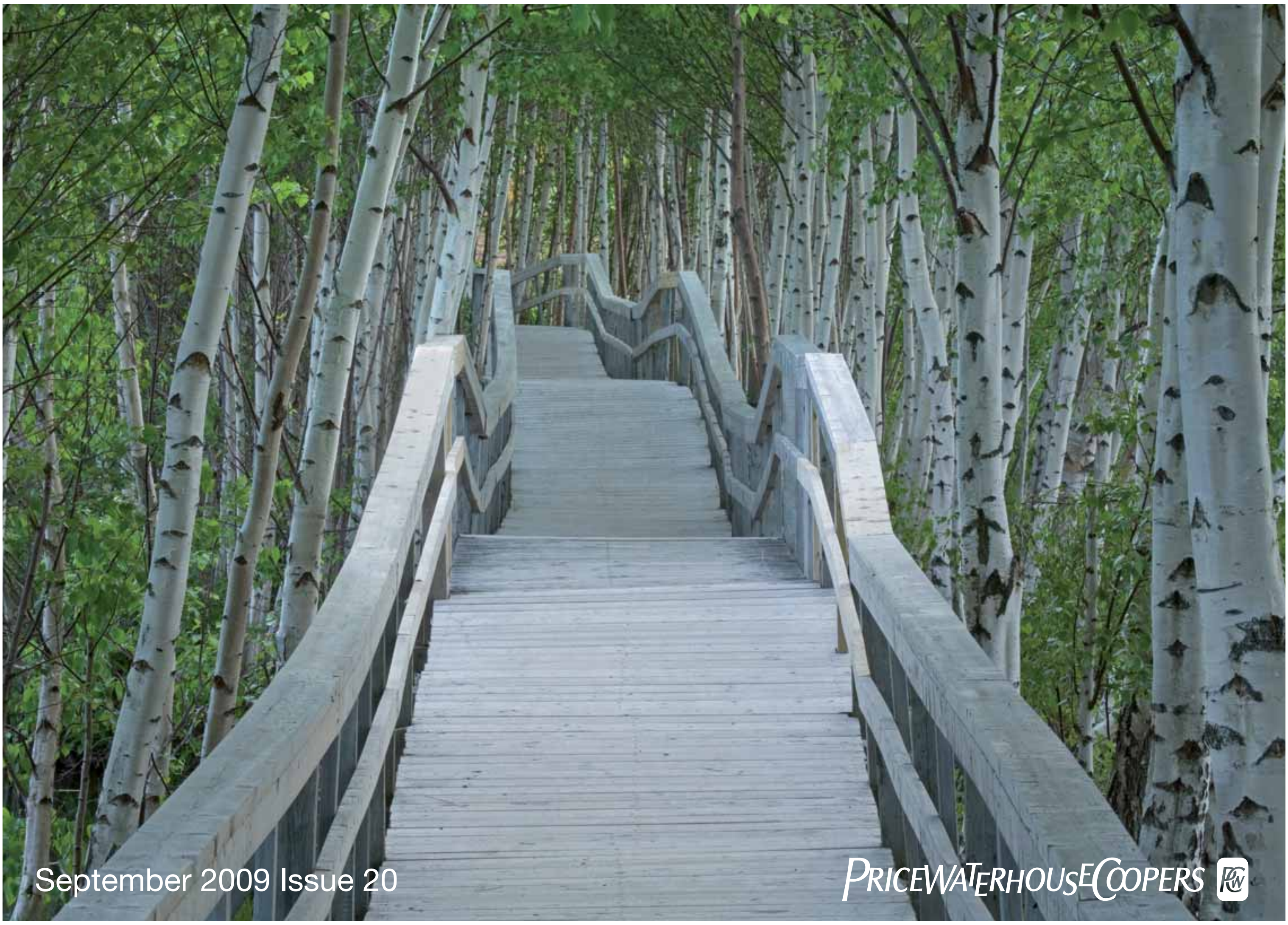
Hospitality and Leisure
Hospitality Directions Europe

UK hotels forecast:

Not out of the woods yet



September 2009 Issue 20

PricewaterhouseCoopers

The hotel sector continues to be badly bruised (or is it battered?) as the impact of the most severe UK recession in sixty years takes its toll on corporate and leisure travel volumes and entertaining.

Despite a lack of visibility on the recovery, there is talk that there are better times ahead and the mood in the hotel sector is now overwhelmingly more optimistic. Our research this summer shows three quarters of hoteliers polled recently were more optimistic than they were six months ago. But still around 36% of operators told us they have seen no green shoots yet in the hotel sector, more than twice the proportion of those that had.

Key findings

The sector is by no means out of the woods yet but a way out now looks closer. There are still unknowns that could upset things as well as a slower economic recovery delaying the revival in conferences, meetings and corporate travel.

Our latest forecast suggests the sector (especially rates) will remain under pressure into 2010; albeit we expect the rates of decline to slow substantially.

PricewaterhouseCoopers (PwC) remain cautious about future prospects for hotel and travel markets, although we are less pessimistic than at the time of our previous forecast in March this year.

Some economic commentators believe we have not yet reached a turning point and, rather than things getting better, they are merely getting worse at a slower rate. Others suggest we are seeing a levelling off rather than a recovery; and some fear a global double-dip recession. There is, however, agreement that any recovery is likely to be fragile.

Nevertheless, if the stop or pause button on the UK recession has been hit, this is encouraging news for hotels. London hotels have been very nimble in the speed of their reaction to the slump. Discounting is tightening its grip and, for many, volume has been salvaged at the expense of rate. In contrast, in some locations like airports there have been plenty of empty rooms. Corporate travellers are not expected back for a while but in the meantime domestic leisure short breaks have taken up the mantle, especially in London. With each percentage point of RevPAR decline impacting operating profits and with no prospect of a rates recovery, hotel operators and owners will be seeing the RevPAR falls translate in to substantial profit declines, despite cost saving measures.

Gradual economic recovery but significant risks ahead

The recession in the UK economy deepened in Q1 2009, and the economy contracted in Q2 2009 as well. Economists at PwC project that UK GDP in PwC's main scenario will fall by around 4.6% in 2009 (this compares to the 3.3% GDP decline we anticipated in March), but should start to pick-up later this year and into 2010, with modest growth of around 0.3% in 2010.[1]

Looking ahead, consumer spending growth is also expected to turn negative by the end of 2009 as the severe squeeze on consumer spending from high debt levels, tighter credit conditions, falling house wealth and rising unemployment continues. Given the uncertainty about jobs, consumers remain nervous of spending on non-essentials. Business investment growth is expected to fall sharply in 2009 as a result of the continuing credit crunch, while housing investment will also continue to decline.

All these factors are unlikely to drive a sharp recovery in travel demand and UK RevPAR is forecast in our main scenario to fall by around 12% in 2009. On a brighter note, this rate of decline should fall back to just over 2% in 2010.

As well as preparing an econometric forecast, over July and early August we interviewed some 60 leading chain and independent operators accounting for over 100,000 rooms in the UK. In addition we asked investors and lenders in the hotel sector for their views. Their feedback has been insightful and we thank all those who took the time to respond. The research results can be found on pages 6 to 9. While the mood has lightened, with nearly three quarters feeling more optimistic than six months ago, confidence regarding trading for the rest of 2009 and to a lesser extent 2010 remains dented, with lead times short and the downward pressure on pricing expected to see room rates falling further for a while. No one interviewed believed that we were out of the woods yet. Many pointed out that it has been an unbelievably hard period where they have successfully cut costs but have had to fight hard for every single piece of business.

1 PwC UK Economic Outlook July 2009

Key findings

Baseline forecast: no room rate growth on the horizon

Our latest central (baseline) forecast reflects the fact that GDP growth impacts our econometric model, but with a lag, and as a consequence we expect to continue to see deterioration in trading in 2009. However, London did not see RevPAR fall as far as we feared in March 2009, while the provinces suffered slightly more. As a result the outlook for London is noticeably more optimistic than in our March forecast – although we expect trading to continue to deteriorate. For a discussion of why we think our March model overestimated the recession's impact for London see the box on pages 4 and 5.

The forecast reflects the fact that room rates have been sacrificed for the sake of occupancy, with our UK baseline scenario predicting an 8.1% reduction in average rate but only a 4.3% drop in occupancy, combining to give a 12.1% fall in RevPAR in 2009. This would leave us with a RevPAR figure of just below £54, the lowest since 2004. This drops further to just over £52 in 2010.

The room rate declines are most noticeable in London, which has responded to the current crisis by switching to lower priced short break leisure business. Despite the spending cutbacks in both the corporate and leisure sectors, London is still a 'must-see' destination for both UK and global travellers. For this reason, occupancy is expected to remain at around 79% for both 2009 and 2010, a drop of only 200 bps from the peak in 2007. A return to growth in room rates, however, is still not on the horizon. In 2010, as room rate declines halve, occupancy should see a return to growth after three years of decline.

For the provinces, which (except for a few centres) don't have London's universal appeal, further discounting will not be enough to prevent occupancy rates falling to about 64% in 2009 and 2010, levels not seen since the early 1990s. Coupled with a 6.6% fall in room rates in 2009, which remain flat in 2010, our baseline scenario anticipates that RevPAR will fall by 12.3% in 2009 and drop a further 1% in 2010. See Table 1, Chart 3 and Appendix 1 for more details.

Table 1: Baseline Scenario (premised on 4.6% GDP decline in 2009 and 0.3% GDP growth in 2010) % growth on previous year

	2009			2010		
	UK	London	Provinces	UK	London	Provinces
Occupancy	-4.3	-1.2	-6.0	-0.2	1.0	-0.9
ARR	-8.1	-9.8	-6.6	-2.2	-4.7	0.0
RevPAR	-12.1	-10.9	-12.3	-2.4	-3.8	-1.0

Econometric Forecasts: PricewaterhouseCoopers August 2009

Benchmarking Data: STR Global August 2009

None of the UK operators we have consulted expect to see room rate growth this year and nearly half expect a decline of between 2% and 10% while a further 40% expect rates to fall by 10%. In 2010 a third still expect to see further declines, although around another third anticipate growth. In terms of occupancies three quarters expect a fall in 2009 and over half a 5% decline. For 2010 our respondents are more hopeful; although a quarter still expect flat occupancy and a quarter further declines, many foresee modest growth of up to 2.5%.

Downside or 'prolonged recession' scenario: revenue declines deepen in 2010 but rates fall stimulates occupancy growth

Reflecting the uncertainty in the current economic environment, our downside or 'prolonged recession' scenario involves further adverse financial shocks affecting the banking system, leading to even more severe constraints on credit for both business and consumers. This would prompt large cuts in consumer spending and business investment and a sharp increase in business failures and unemployment. A deep and prolonged recession in the US and Euroland[2] would also lead to a further fall in UK export demand in this scenario. The downside scenario anticipates that the economy could contract by as much as 5.1% in 2009 with a further GDP decline of around 2% in 2010. In such uncertain times it is prudent for businesses to scenario test. Such a scenario would see UK RevPAR fall by 14% this year and a further 4.6% in 2010.

In London RevPAR could fall by 11.5% in 2009 as rates contract by 8.5%, a smaller decline than in the baseline scenario although occupancies are hit harder. By 2010, even in this downside scenario, the rates of decline begin to slow as RevPAR declines halve in London helped by a 2.9% occupancy gain.

In the provinces in 2009 RevPAR could fall by just over 15% as occupancy declines worsen, slipping by almost 9% and rates by 6.7%. In 2010 RevPAR falls by 3.2%, largely driven by a 2.6% ARR contraction. See Table 2 and Appendix 1 for more detail.

Table 2: 'Downside' scenario (premised on 5.1% GDP decline 2009 and 2% GDP decline in 2010) % growth on previous year

	2009			2010		
	UK	London	Provinces	UK	London	Provinces
Occupancy	-6.9	-3.3	-8.9	0.7	2.9	-0.6
ARR	-7.5	-8.5	-6.7	-5.1	-8.2	-2.6
RevPAR	-14.0	-11.5	-15.1	-4.6	-5.6	-3.2

Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global August 2009

'Early recovery' scenario:

Of course in such uncertain times, a relatively optimistic 'early recovery' scenario also merits consideration. We have not prepared a hotel forecast for this but assuming financial markets stabilise more quickly such that credit conditions for businesses and households ease significantly in the latter part of 2009, then this could lead to a progressive revival of the UK and global economies in the second half of 2009. UK GDP would still fall by around 3.5% due to the downward momentum the economy still has but growth could average around 2% in 2010 and return to the long-term growth trend by the end of next year. Such a scenario could stimulate a sharp recovery in travel and hotel demand.

2 Euroland – EU countries that adopted the euro as their currency

Key findings

Looking back: the numbers tell a depressing story

A snapshot of UK hotel industry fundamentals for the first half of 2009, compared to the same period last year, according to data from STR Global, looks like this:

- Occupancy 2009: - 5.7 %
- ARR 2009: - 7.2%
- RevPAR 2009: - 12.5%

The percentage changes in performance may be depressing but these are averages and not all operators are suffering to the same extent; for some it is even worse. In terms of the geographic hit, the provinces have fared worst experiencing a 14.5% RevPAR decline. London's hotels have been kept pretty full (at the expense of rates) with an 8.9% RevPAR decline. See Table 3 below for more detail.

For the full year 'final score' we expect London RevPAR to slip further in 2009 whereas the provinces should see a modest improvement.

Table 3: RevPAR in 2009: half time score (% growth on previous year)

	January - June 2009		
	UK	London	Provinces
Occupancy	-5.7	-1.9	-7.7
ARR	-7.2	-7.1	-7.2
RevPAR	-12.5	-8.9	-14.5

Benchmarking Data: STR Global July 2009

Looking forwards: declines ease but no RevPAR growth in any quarter

What will drive the recovery? Hotels need more guests – especially corporate guests. Leisure travel has stepped in to fill up some rooms as hotels see a boost from domestic short breaks. However, it is lower rate business. The exchange rate has helped keep some tourists in the UK and also driven more visitors from abroad. Reports of a domestic uplift this summer will have helped some hotels in the right locations.

Our quarterly forecast analysis tells us that some severe declines in RevPAR are still to come, in Q3 and Q4 2009, but after that we anticipate the declines will begin to moderate throughout 2010. Q1 2010 looks like heralding the lowest RevPAR declines for some time as occupancy gains and lower ARR declines 'lift' performance. In general occupancy declines start to reduce through 2010. Q1 2010 is positive for all regions and, in London, Q4 2009 and Q1, 3 and 4 in 2010, all show some occupancy growth.

In London, we anticipate a 13.8% drop in RevPAR in Q3 2009, due in no small part to the fact that the comparative quarter produced the highest-ever RevPAR figure of £106. Q4 2009 will be almost as bad and declines don't begin to level off until Q4 2010, which we forecast to be only 0.5% down on the comparative period.

How did we do in our last forecast?

Reports of London's demise greatly exaggerated

When we prepared PwC's last forecast to the end of 2009 in February this year, the worsening economic situation suggested darkening prospects for UK hotels, particularly London. With hindsight, the dark times did indeed check-in with revenues and margins thinner and hotels badly impacted by the drought of corporate business and conferences. Rezidor's CEO Kurt Ritter, for example, commented that he has never seen a RevPAR fall of the current magnitudes (albeit the UK wasn't the worst market his group operated in).[3] Many speculated just how long it will take to restore profits to former levels.

In London our forecast was accurate for Q1 2009, but then hoteliers very nimbly replaced missing corporate travellers with lower margin leisure business from Europe and elsewhere in the UK. So, the dire baseline scenario we expected for London has (thankfully) not materialised. We discuss some of the reasons why we think this happened below.

Our forecast for the provinces has largely come to pass, although we underestimated the actual Q1 and Q2

3 CEO Kurt Ritter on a conference call to discuss the company's second quarter results

declines slightly. For the remainder of 2009, the Q3 forecast remains unchanged but Q4 is now rather more optimistic.

The flip side of the recession has seen a more affordable London for leisure travellers and for those business sectors still maintaining reasonable travel demand volumes. For corporate customers hotels appear to have agreed to several rate cuts in return for guaranteed volumes.

Re-adjusting the 'lagged' impact of the model

It is clear that the current economic conditions are unprecedented, especially in the time period covered by our hotel data set. PwC econometricians together with external advisor Dr Bjorn Hanson (Clinical Associate Professor at the Preston Robert Tisch Center for Hospitality, Tourism and Sports Management in New York) have made the following key observations:

Compared to small fluctuations, large changes in GDP are more likely to be immediate and stimulate a swifter response from hotel sector fundamentals. This effect has been observed in previous analysis of the hotels sector in the US.

Demand may exhibit a threshold or 'fixed base', so that the effect of large GDP changes on the hotel sector could be relatively less than would be predicted based on normal business cycle fluctuations. In addition, government spending as part of the UK's fiscal stimulus package may be feeding though to the hotel sector, according to industry sources.

We believe these points are highly relevant to our hotel demand forecasting. Our original model included the effect of GDP four quarters ago on current demand. Recent analysis suggests that this 'lagged' impact may be inappropriate over the forecast horizon, and as a result we have adjusted the lag structure of the models. We have accelerated the four quarter lag of GDP to two quarters, reflecting a quicker impact of economic conditions. There is little change between our February and current draft forecasts for the provinces in 2009. However, in London the econometric model established a particularly strong historical relationship between GDP and hotel performance. London now faces a less severe downturn, following on from stronger than expected H1 results.

We expect a drop of 8% in Q2 2010, which is notably higher than in the surrounding quarters. This is not due to significant adverse conditions in that quarter, but to the fact that Q2 2009 did not perform as badly as expected against a very high Q2 2008. At almost £104, Q2 2008 was the second-highest RevPAR recorded for London. While Q2 2009 decreased by 9%, this was not as bad as we expected. However, we believe that the drop in Q2 RevPAR will finally materialise in 2010, hence the further 8% forecast decrease.

For the provinces, we are forecasting that the quarterly RevPAR declines, which started in Q3 2008, will continue to Q4 2010 – making ten continuous quarters of decline through to the end of 2010. The gloom is expected to persist throughout the rest of 2009; with many people not yet seeing an end to the recession, we expect that RevPAR will decline by 13.2% and 6.7% in Q3 and Q4 respectively. However, the picture throughout 2010 is less bleak, with declines falling below one per cent in Q1 and Q2 and increasing slightly in Q3 and Q4. See Table 4, Chart 1 and Appendix 2 for more detail.

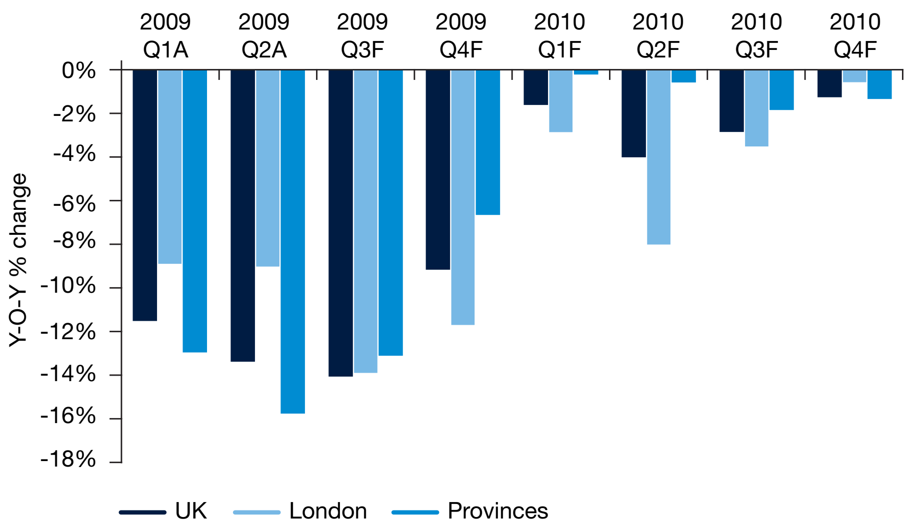
Table 4: Baseline scenario RevPAR forecast growth rates by quarter for UK, London and Provinces (% growth on same quarter of previous year)

	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
UK	-14.0	-9.2	-1.5	-3.9	-2.7	-1.2
London	-13.8	-11.6	-2.8	-8.0	-3.5	-0.5
Provinces	-13.2	-6.7	-0.1	-0.5	-1.8	-1.3

Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global August 2009

Chart 1: Baseline scenario:

RevPAR growth trends by Quarter 2009/2010



A: Actual F: Forecast

Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global August 2009

Survey results

PwC industry research survey results from almost 60 respondents and over 100,000 rooms

In July and August 2009 PwC carried out a survey of players in the hotel sector. We surveyed companies representing over 100,000 rooms in the UK, including operators from chains and independent hotels, real estate owners and lenders. In the following pages we highlight some key findings.

Over the worst?

In our March 2009 survey of hoteliers, all but one of the respondents were either 'fairly' or 'very pessimistic' in their outlook. In our latest survey, however, 71% of respondents say that they are more optimistic now than they were six months ago.

This does not necessarily mean that the end is in sight, though. When asked if they thought there were currently 'green shoots' in the hotel sector, only 20% thought that there were.

So, even if things are not yet getting any better, it seems that they haven't turned out worse than was expected six months ago.

Industry expects recovery in 2010

This timeline is reflected in our respondents' own forecasts for 2009/10: only 21% predict flat or growing occupancy at some point in 2009, while 68% think that they will see this happen in 2010. The view is even more pronounced for room rates, with only 8% anticipating a halt to the decline in 2009, but 60% expecting flat or rising rates in 2010.

This expectation of a slow improvement is reflected by our respondents: 61% predicted a U-shaped recovery, but none anticipated the swifter, V-shaped recovery. 14% thought that the recovery would be W-shaped.

This view is influenced by the fact that the hotel sector historically takes longer to recover than the economy as a whole. Our respondents agreed with this, 52% of them thinking that a recovery in the hotel sector would lag behind GDP recovery by six to twelve months and 22% thinking it would be at least a year behind.

"Leisure demand is already showing signs of green shoots"

Branded international hotel chain to PwC

71%

of respondents say that they are more optimistic now than they were six months ago

0%

of respondents say that they expect an improvement in the corporate/conferencing sector in 2009

"London is one of the most important and popular capital markets in the world - this won't change. People still want to visit but expect better value for money."

Jeremy Hill, Christie & Co to PwC

London's enduring appeal

Despite gloomy forecasts based on City job cuts and corporate belt-tightening, London's hotel bust has not been as spectacular as the preceding boom. So what is helping London and will it continue into 2010?

90% of our respondents thought that the favourable exchange rate has helped London by attracting more visitors from abroad.

More than half of our survey respondents thought that discounted leisure packages contributed to London's relative resilience. Previously thought by many to be an expensive option, London hotels have tempted travellers away from the provinces with discounted leisure deals, often encompassing theatre or sporting events. This seems to be the ideal time to see the bright lights of the capital, but it remains to be seen for how long London hotels will be able to continue such heavy discounting.

Budget sector not stealing the show this time

One of the surprises of this recession is the fact that budget hotels have not performed as well as expected and have not taken market share as expected either. Everyone has found it hard to swim upstream. Operators had hoped that they would be able to attract customers, particularly corporates, who were looking to make a show of 'trading down'. Ian Burnley, CEO of Expotel, has commented that although budgets have made a lot of noise around their very good rates, often in practice a limited supply of these offers has meant that better prices can be found elsewhere.

Survey respondents have also indicated that the midscale market has been able to compete with the budgets on price, especially at weekends, while offering a more appealing product. Customers have also been able to negotiate discounts at their usual locations rather than switching to a cheaper option, thereby feeling that they are getting all-important value for money.

The challenge for the budget hotels is therefore to show that they offer a quality product as well as a cheaper option.

Survey results

"This downturn has made operators become more familiar with every cost line of the business"

74%

of our respondents foresee further declines in the corporate sector in 2009

Are hoteliers fit for recovery?

We asked our survey participants what was keeping them awake at night. Their responses suggested that the mood had changed from our last survey. In March, many respondents said that they were looking at cutting costs by reducing headcount and trimming capital expenditure budgets.

Now, many of our respondents, having done all they can internally, are looking to how they present themselves to their customers. 57% have said that their focus is on "keeping rates and occupancy up in the face of falling demand" and 65% are already looking ahead to "finding ways to build up rates again".

A great deal of focus is also being placed on customer satisfaction. With customers becoming increasingly discerning about where they spend their money, it is vital that hotels don't lose any marks in this area.

Ensuring repeat custom is also key to keeping occupancies up. As one of our respondents says: "If you never lost a customer, you would never have to look for one".

Time to raise rates?

A recent report suggested that, with London hotels performing relatively well in terms of occupancy because of room rate discounts, now is the time for them to increase their rates. However, the view from our survey respondents was that while this is what they are working towards, now is not the time.

One respondent highlighted the fact that corporate rates have been negotiated downwards since the recession hit and that he would have to wait at least until the next round of negotiations, in a year's time, before he could hope to push through rate increases.

Another noted that many hotels see high occupancies as a key influence on morale within a hotel. Also, with so many customers booking at short notice, keeping rates low will make it easier to attract last-minute incremental revenue, so it might be some time before we see rate increases.

Those who adapt to the recession will emerge strongest

It is said that recessions are the mother of innovation and, with many people now looking ahead to recovery, we asked what hoteliers will be doing to ensure that they are best placed to profit when business improves.

46% of our respondents said that "adapting the business model to change" is a priority as part of recovery, with one saying that: "Damage minimisation is today's problem, business enhancements are for tomorrow".

Hotel owners and operators will also need to ensure that any cost-cutting they undergo will be sustainable and not detrimental to the quality of the product on offer. Flexibility in staffing and other costs will also enable hoteliers to respond better to future downturns. Indeed, a change in labour models for 3 and 4 star hotels was seen by one hotelier as a key game changer to emerge from this recession.

The internet will continue to play a key part in this process, as a means of managing occupancy and enabling hotels to offer last-minute bookings, as holidaymakers are increasingly waiting until they feel they can get the best price before committing to a trip.

One significant change since the last recession is that hoteliers have been making greater use of booking websites. However, the challenge is for hotels to attract customers to their own websites and thereby avoid the fees charged by third party booking agents.

Corporate segment vital

53% of our survey respondents said that they expected short-stay leisure bookings to improve during the rest of this year, while none expected any improvement in the valuable corporate and conferencing segment. In fact, nearly three quarters of our respondents predicted further declines in the corporate sector in 2009.

Looking ahead to 2010, there is more optimism for the corporate market, with nearly a third of our respondents expecting some improvement in this area and less than a quarter expecting further declines. However, that is still far from a ringing endorsement and there is a long way to go before pre-recession levels are regained.

The corporate sector is also seen as a vital part of the overall hotel sector recovery. As one of our respondents said: "Leisure will not move the market, merely hold the status quo; recovery has to be corporate-based".

"Damage minimisation is today's problem, business enhancements are for tomorrow"

Rod Taylor, Taylor Global Advisors

46%

of our respondents said that "adapting the business model to change" is a priority

UK forecast

A savage and challenging environment

UK hotels continue to feel the pressure as reduced corporate travel and conference volume impacts hotel revenues, management fees and profits. As we have seen in the research results, the challenge is survival, with competition intense. Some businesses report stabilising occupancy declines but accelerating room rate falls. And of course, behind the averages, some provincial markets are doing better and some, where there has been oversupply, are doing worse. Hotel half year reports show revenues and profits down and luxury and upper upscale brands hurt as customers trade down. Some brand standards are being relaxed as hotels struggle to contain costs. The budget sector has been hurt especially in town and at weekends.

> "Budget hotel groups have obviously been marketing their special low rates very hard. However, room availability at the best rates has often been a problem with budget properties and the midmarket groups have been able to stay very competitive and hold their share."
>
> Ian Burnley, CEO Expotel

So what is the outlook for 2009 and 2010? Some companies saw a pretty strong H1 2008 which carried them through until trading collapsed around November. Since then the situation has worsened and some may find it harder to trade on. Economic and travel fundamentals remain weak and despite accelerating cost cutting programmes mitigating some revenue losses, the evidence points to competitive trading through 2009 and into 2010.

In terms of business failures and financial restructuring so far we are seeing a relatively small number of insolvencies at the smaller end of the hotel market, mainly in the regions. Lenders appear, in the main, to have adopted a longer-term hold approach with larger lends, and are often prepared to consider swopping debt for equity in anticipation of a recovery in values. This also avoids the need for increasing debt write downs at this time. The speed of recovery in values remains an issue, and there is also the question of whether values will ever return to the record levels seen in recent years due to the change in market fundamentals, particularly the free availability of relatively cheap debt. Our initial research tells us that after the recession of the 1990s values took between five and seven years to recover – very much in line with RevPAR performance.

Weak travel fundamentals

Overseas visits down 9% as scarce business travellers and the spectre of swine flu hovers

According to provisional data from the Office for National Statistics, overseas tourism into the UK over the first six months of 2009 (not seasonally adjusted) showed a 9% decline in visits overall compared with the same six months in 2008, with June itself down 14% on June 2008. For the first six months of 2009 visits from North America fell by 20% and from Europe by 6%; although numbers from the EU15 countries slipped only 2% - reflecting the lifeline of a strong euro. The volume of visits from some eastern and central European countries was impacted considerably harder. Overall spend in the UK fell less severely as the exchange rate helped prop up spending. Leisure visitors took advantage of a double whammy: the novelty of their euros stretching further and also London's lower hotel prices. Eurostar H1 2009 sales (like the overall visitor profile), were impacted by fewer corporate travellers. Earlier in 2009, VisitBritain warned that, despite the exchange rate boost, there is 'significant potential' that inbound visits will decline by as much as 5% to 30.3m this year, but this may be revised.[4]

As we move into the autumn, the spectre of swine flu hovering over travel threatens to shape an even less encouraging global outlook. Air travel is expected to contract further. Passenger travel is falling sharply in 2009, according to the International Air Transport Association (IATA). IATA expects passenger demand will contract by 8% to 2.06 billion travellers this year, compared to 2.24 billion in 2008. Association of European Airlines figures show passenger traffic in May was "severely negative" and is warning that preliminary June figures look only marginally better.

4 E-tid 19 June 2009

No recovery in sight for conferences and meetings

Confirming our research among hoteliers, market research group BDRC anticipate little change in external conference and meetings demand over the next year. In fact they anticipate budgets for external events are likely to fall further. However, their recent research shows that the vast majority of bookers will seek lower rates from their preferred venue supplier before trading down to lower class venues. Based on the rates BDRC collect over the phone, they report seeing some variation in the recent trend across the UK which may be a useful barometer of how close the sector is to a recovery. In London, the average rate quoted rose for the first time in over a year in July. The South East also saw a fractional increase in July, after several months of slowing in decline. Other provincial locations continue to see month-on-month declines.

In terms of volume over the next 12 months, 34% of agents think they will organise fewer events, compared to 29% of corporate planners and 22% of associations. Being primarily not-for-profit, it is no surprise that associations remain the most resilient segment of the market.

> "Only very small minorities of bookers anticipate an increase in volume over the next 12 months, so we can perhaps draw the conclusion that we may be nearing the bottom of the market, but the recovery in demand is not yet in sight. This emphasis on negotiation, combined with the likelihood of further decline in demand is likely to mean continuing pressure on rate"
>
> Matt Costin, Director of Hotels and Hospitality, BDRC

UK forecast

Price war hots up …but hotels get better at managing revenues...

There is evidence that although blanket discounting may be less problematic than in the last recession there is still an aggressive price war raging out there. Recently the battle lines were drawn publicly between some of the budget brands too. According to TRI data, in the last recession hoteliers oversaw rate declines of around 11% in 1992. It was not easy to claw back rates as, having educated customers to expect cheap rooms, growth did not start again until 1994. In cash terms provincial average room rates did not exceed the 1991 level again until 1996. So far, in this recession (at the end of H1 2009) the provinces have experienced over a 7.1% decline in average room rates. In London, following the 2001/2 falls, it took six long years for room rates to recover and supersede 2000 levels.

This time round though there is an argument to suggest that rates may recover faster because of the more targeted and selective use of discounting and the ability to change rates quickly and cheaply via the internet. The transparency and speed of communication provided by the internet and the savvy approach of hoteliers is also likely to mitigate the impact.

> "Hotels are using short term tactical offers to attract business and will look to withdraw these rates as soon as occupancy levels show signs of firming up. As a result, they will hope to recover rates more quickly than after the last recession"
>
> Ian Burnley, CEO Expotel
>
> "We will be playing rate catch-up for a few years yet"
>
> International hotel chain to PwC

…as supply growth slows down...

Supply developments throughout the UK have, understandably, slowed down and there are reports of postponements and cancellations as new projects fail to secure funds. Some respondents to our survey suggested that this was one positive outcome from the recession.

> "The quantum of rooms with planning permission 12 months ago was simply untenable"
>
> Survey respondent to PwC

Nevertheless, there is still plenty of stylish new supply planned or recently opened and, with the cost of construction and tendering slowing more could be likely. To illustrate, the first Missoni opened in Edinburgh in June. Norwich will be home to Hilton's second Garden Inn hotel in the UK alongside the Hilton Garden Inn Luton. Rezidor Hotel Group has opened a 4 star 252-room flagship Park Inn hotel in Manchester. A 'new look' Courtyard by Marriott has opened at Gatwick. Hilton has signed a franchise agreement with Hotel MK to open a new 127 room Doubletree hotel at the Milton Keynes Dons stadium. See PwC Hospitality Directions Europe article *'Rooms with a view: why are so many sports venues opening hotels?'* Issue 16 September 2007.

…but could standards and service slip?

There have been reports of a selected reduction in brand standards among chains as hotels seek to contain costs. Some 4 and 5 star hotels are reported to be anxious to reduce their star ratings in order to cut unnecessary expenditure or service in areas like newspaper provision etc. It's a fight for survival so cutting out any service that consumers don't value is sensible and, while it is suggested many are temporary cost saving measures in extreme times, of course change often sticks – particularly if it is actually what consumers want!

2009 RevPAR fall mirrors 1992 but rate of decline set to moderate in 2010

Overall the UK saw a 12.2% decline in RevPAR to June this year. We expect the year as a whole to pretty much mirror this with a baseline scenario forecast for a 12.1% RevPAR decline for 2009, as average room rates shrink by over 8%. ARR declines should begin to moderate in 2010 to around 2.2% meaning a RevPAR decline of 2.4% in 2010. We last saw a room rate fall of 2009's magnitude in 2002 when rates fell almost 6%. Before that you would need to go back to 1991 when there was a whacking 10% decline in rates. See Table 5, Charts 2 & 3 and Appendix 1 for more details.

Downside scenario sends rates into a faster spin

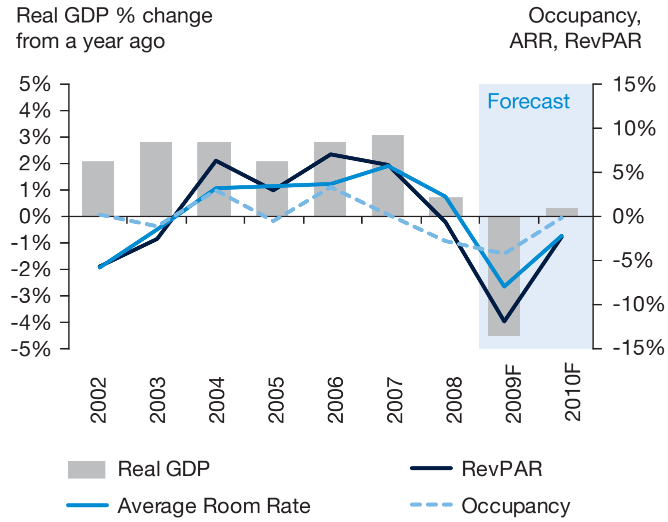
Risks around recovery in our main scenario remain significant and we have prepared a downside scenario that assumes a 5.1% GDP contraction this year and a further 2% GDP decline in 2010. This scenario would mean that ARR declines of 7.5% and steep occupancy falls approaching 7% drive RevPAR declines of 14% in 2009. By 2010 demand starts to recover, but rates continue to struggle and tumble by 5% driving a 5% RevPAR decline. See Appendix 1.

Table 5: PricewaterhouseCoopers latest forecast for UK September 2009

	2008	2009F	2010F
Occupancy (%)	72.15	69.06	68.89
% Change	-2.9%	-4.3%	-0.2%
ARR (£)	84.53	77.69	76.00
% Change	2.30%	-8.10%	-2.20%
RevPAR (£)	61.07	53.67	52.38
% Change	-0.70%	-12.10%	-2.40%

Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global July 2009

Chart 2: UK hotel performance 2002 to 2010
Real GDP, revenue-per-available-room, average room rate, and occupancy growth rates



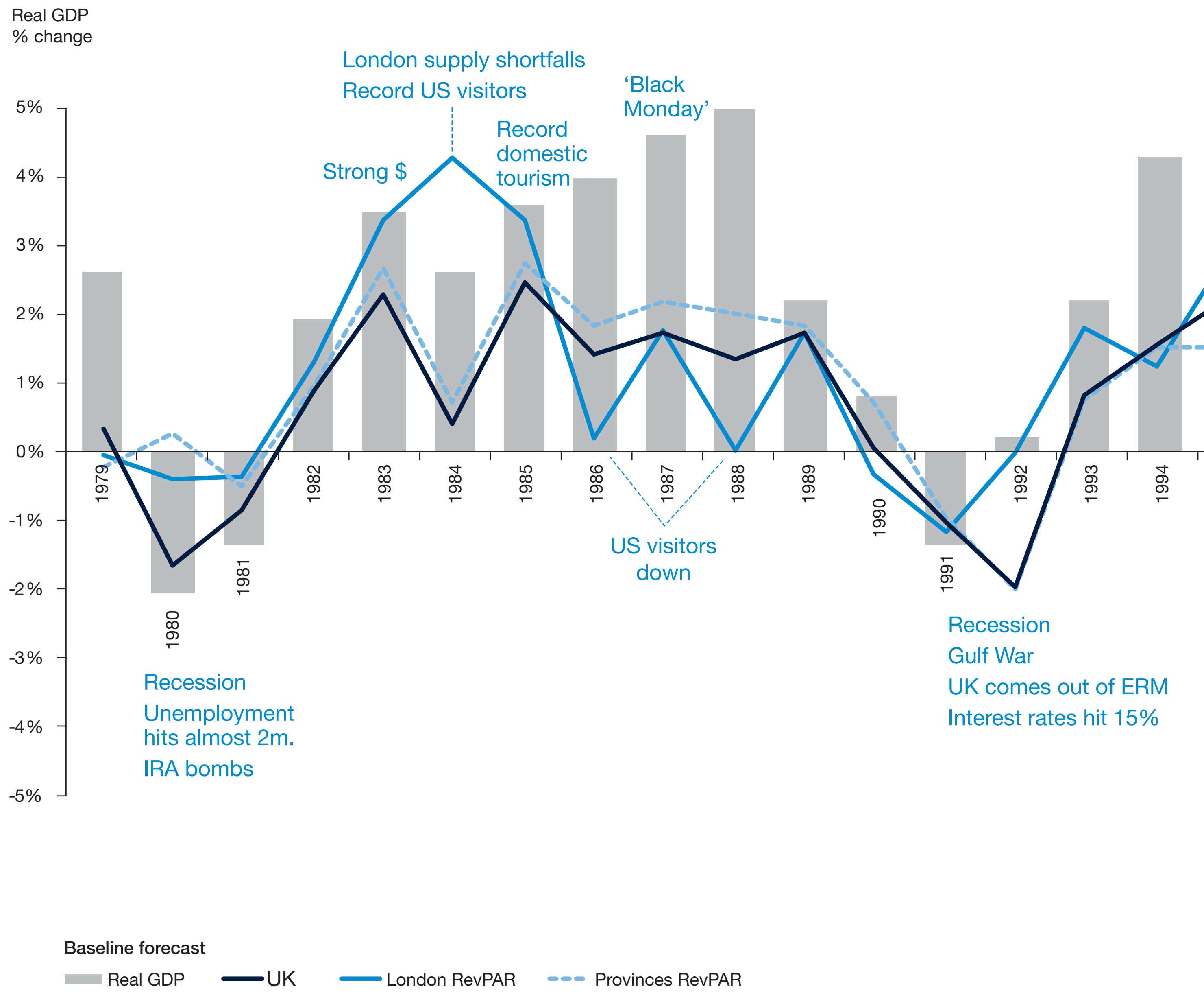
F: Forecast

Econometric Forecasts: PricewaterhouseCoopers August 2009
Macroeconomic Data: National Statistics
Benchmarking Data: TRI Hospitality Consulting 1979 - 2000. STR Global 2001-2008

UK forecast

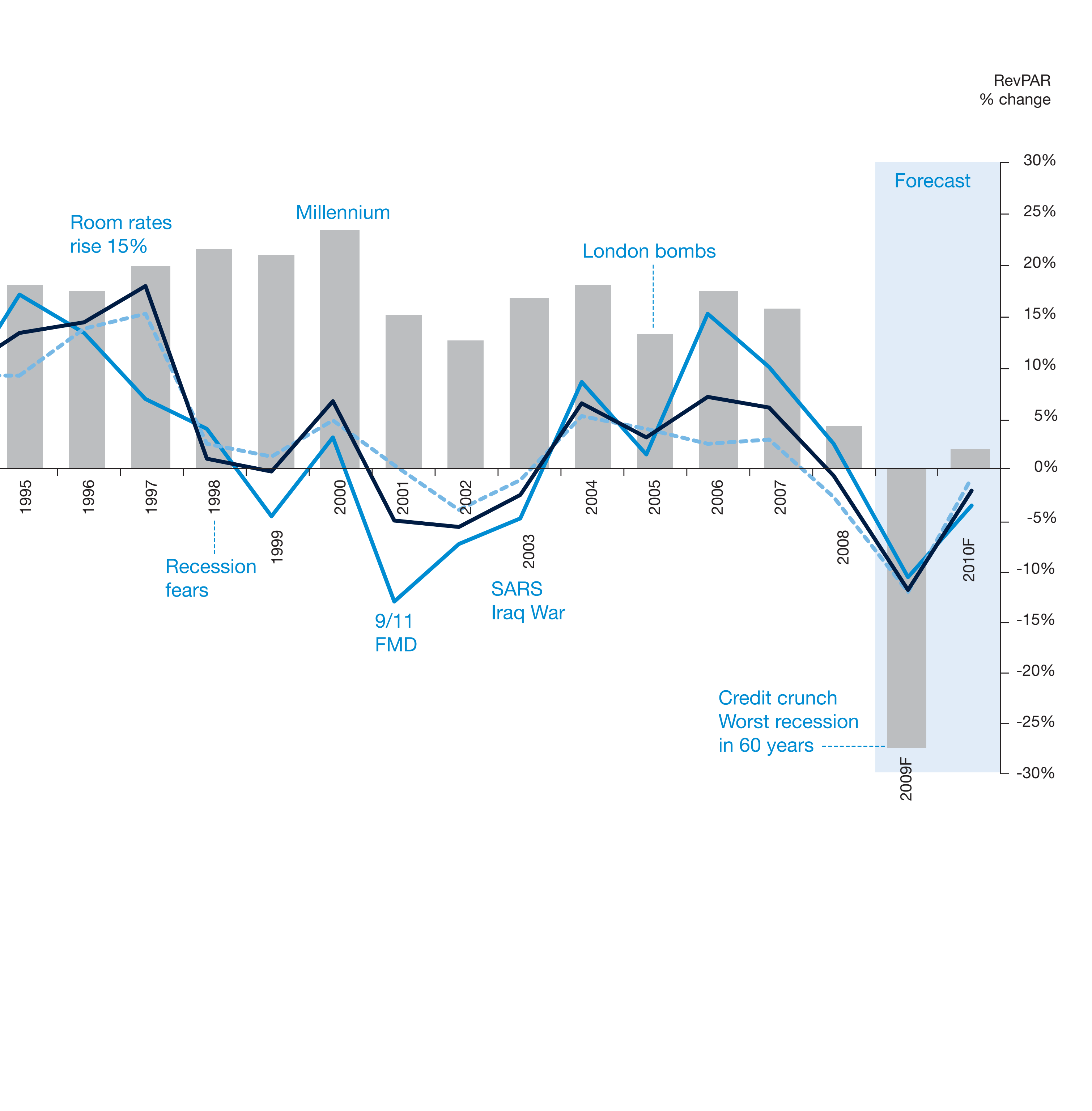
UK hotels: best and worst of times

Chart 3: Real GDP, UK, London and Provincial RevPAR growth rates 1979-2010 (F)



F: Forecast

Econometric Forecasts: PricewaterhouseCoopers August 2009
Macroeconomic Data: National Statistics
Benchmarking Data: TRI Hospitality Consulting 1979 - 2000. STR Global 2001-2008


RevPAR
% change
30%
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-30%
Forecast
Room rates
rise 15%
Millennium
London bombs
Recession
fears
9/11
FMD
SARS
Iraq War
Credit crunch
Worst recession
in 60 years
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009F
2010F

London forecast

The price is right: capital loses pricing power but stays busy

First, we should stress that yes it is bad in London, but it is not as bad as it could be, or indeed as bad as it portended in January this year. London has been extremely successful at keeping up volume - albeit prices have had to come down to achieve this. London has been successful at sucking in European tourists fuelled by the weak pound but also has attracted considerable UK business from the provinces. Visitors are keen to visit to take advantage of this lower priced London. The City fell down a league table of the world's most expensive cities, sliding from second to 22nd.[5] Average room rates had been rising for five consecutive years until 2009. Now a room will cost £10 less than in 2008 and could cost almost £20 less by next year. Not such good news for hoteliers' profits though as London sees RevPAR slide around 9% in the year to the end of June 2009, compared to the same period in 12 months earlier.

Olympic clock ticking as London gets ready

Looking further ahead to 2012 - a year and a half ago they were just breaking soil at the Olympic Village and now, in less than three years, the Olympic and Paralympic Games will be here. Europe's biggest construction site in Stratford is ahead of schedule and the Javelin train shuttling visitors to Stratford from St Pancras is operational. Over 13,000 new rooms are reported likely to enter the market by 2012.

For hotels, location is everything and a revamp of Leicester Square will include an iconic 194 room W hotel. Thistle's former Bloomsbury Hotel has reopened as The Kingsley following a £10m refurbishment. Plans have been submitted for a luxury hotel development on the Thames at Blackfriars to replace Mermaid House. Four Seasons has announced plans for a third hotel in London to be located on Bishopsgate and part of the Heron Plaza. The largest Holiday Inn Express in Europe will open at Heathrow Terminal 5 in May 2011. The first 125 of 300 rooms will be ready a year before then, as work has already started on turning an existing 128-room hotel at the airport into the Holiday Inn Express London Heathrow Terminal 5. InterContinental Hotels Group has signed a franchise agreement on the hotel with the Crimson Hotels Group. A large supply addition, the Park Plaza Westminster Bridge, will see over 1,000 new rooms in 2010. It will be London's largest hotel to open in a decade.

5 So you think London is expensive? It isn't anymore, *The Times*, 20 August 2009

Latest London forecast

In our baseline forecast for London, trading declines are expected to continue the pattern set so far this year. As London hoteliers continue to lose pricing power, ARR declines of almost 10% will continue to prop up occupancy at just below 80% for the year overall. ARR recovers somewhat in 2010 as the rate of declines halve to around 4.7%. This translates into a 10.9% RevPAR decline for 2009 with a further 3.8% fall likely in 2010. Average hotel room rates peaked at around £122 in 2008 but have fallen rapidly and are likely to average around £111 this year and £105 next year, £20 less than 2008. See Table 6, Charts 3 & 4 and Appendix 1.

Downside scenario

Risks around recovery in our main scenario remain significant and we have prepared a downside scenario that assumes a 5.1% GDP contraction this year and a further 2% GDP decline in 2010. If this comes about then RevPAR could slip by 11.5% rather than the 10.9% fall expected in our baseline scenario, with a further 5.6% fall in 2010 (compared to a 3.8% decline in the baseline). In this scenario, ARR falls would not moderate in 2010 but would average 8.5% and 8.2% in 2009 and 2010, respectively taking average rates to £103 in 2010. However the lower room rate pushes occupancy growth up into positive territory next year with an almost 3% gain to nearly 80%. Finding ways to build rate again and raise margins will prove tougher. See Appendix 1.

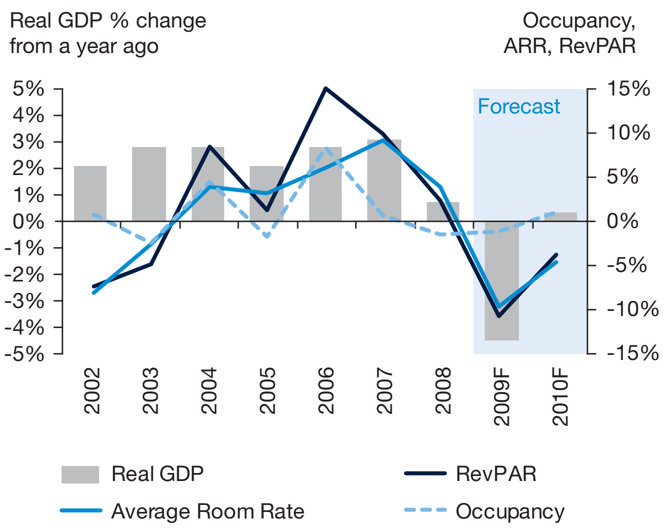
Table 6: PricewaterhouseCoopers latest forecast for London September 2009

	2008	2009F	2010F
Occupancy (%)	79.73	78.78	79.54
% Change	-1.5%	-1.2%	1.0%
ARR (£)	122.25	110.75	105.50
% Change	3.90%	-9.80%	-4.70%
RevPAR (£)	98.00	87.30	83.96
% Change	2.40%	-10.90%	-3.80%

Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global July 2009

Chart 4: London hotel performance 2002 to 2010

Real GDP, revenue-per-available-room, average room rate, and occupancy growth rates



F: Forecast

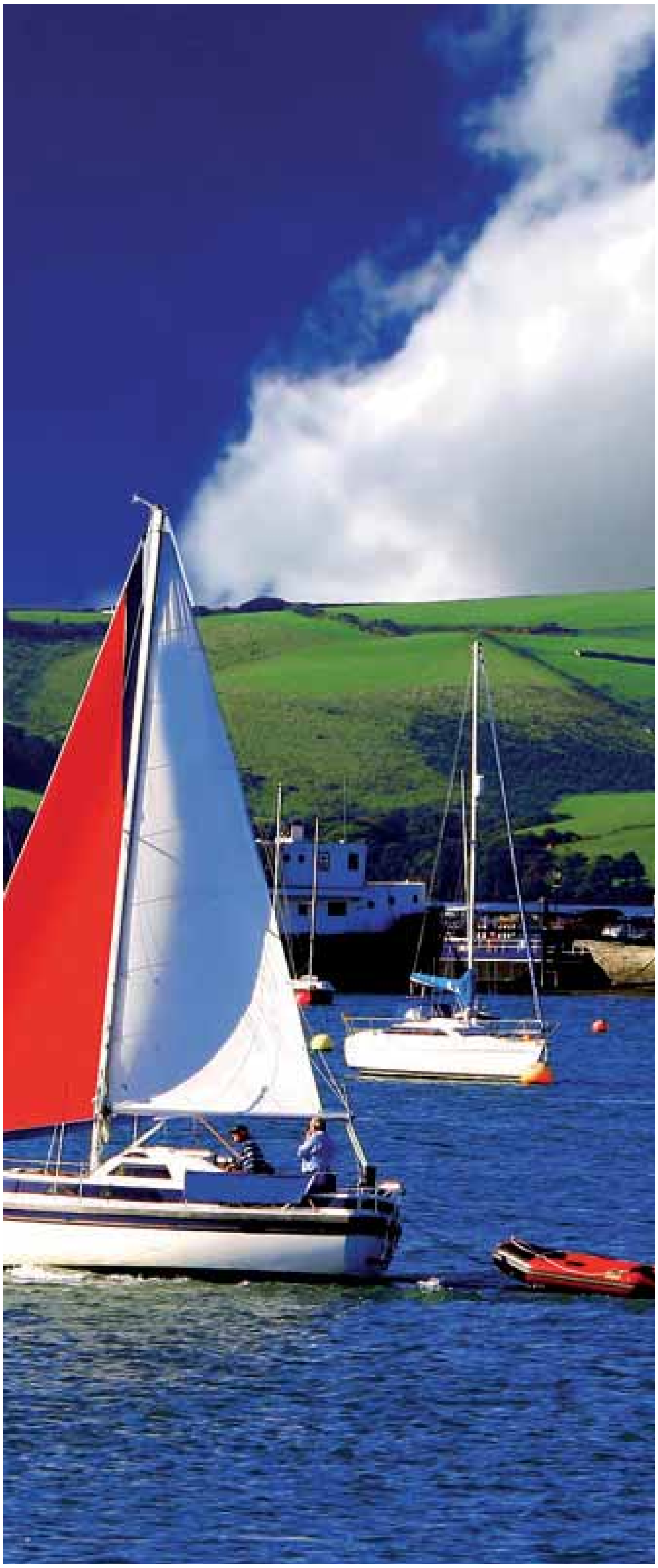
Econometric Forecasts: PricewaterhouseCoopers August 2009
Macroeconomic Data: National Statistics
Benchmarking Data: TRI Hospitality Consulting 1979 - 2000. STR Global 2001-2008

Provinces Forecast

Widespread severe revenue declines despite a ‘mini-tourism boom’ in some centres

Performance has depended on where and what segment operators are serving (and often which brands). Some cities, such as Edinburgh, are reported to be enjoying a tourist boom as the weak pound and new air routes encourage European visitors and ‘stay-at-home’ domestic holidaymakers to come to the Edinburgh Festival and Fringe. Not all of the regions have fared so well and overall the provinces have seen a 14.5% drop in RevPAR during the first 6 months of the year with ARR and occupancy contracting by around 7% apiece. Many airport hotels have been high on the misery index. Liverpool is another area suffering and Manchester is reported down too. Other cities faring better include Glasgow and Newcastle.

Supply may have slowed but there is still considerable new development around the regions. Earlier in the summer Marriott opened a 218 room Courtyard by Marriott at Gatwick Airport, the first upgraded new-look site under the brand in Europe. The company also opened a 165 room hotel at Twickenham Rugby Stadium. City Inn open a new 333 room hotel this month, in the Granary Wharf area of Leeds. Rezidor is to rebrand the former 87 room Purple Hotel in Doncaster as a Park Inn property under a management agreement. Scotland has seen some significant recent investment in hotels. For example, Leisurecorp, a division of Nakheel Leisure has bought Turnberry which closed in November 2008 for the start of a major refurbishment. Staying in Scotland, in Glasgow Principal Hayley acquired the currently closed Central Hotel (the former Quality Hotel Glasgow) which is to reopen, once it has been refurbished and an additional 30 bedrooms added, in February 2010 as the Grand Central Hotel. Also in Glasgow the 5 star, 100 bedroom hotel called Blythswood Square has been developed within the former Royal Scottish Automobile Club premises by well known Scottish hotel entrepreneur Peter Taylor and is due to open in September 2009. The Aviemore Highland Resort has been acquired out of administration by Macdonald Hotels. In Wales, St David’s Hotel in Harlech is to be demolished and a new 130 room five-star hotel is planned to replace it.



Provinces forecast – getting worse before things get better

Our latest forecast for the provinces for 2009 remains largely unchanged from our last forecast in March. We expect a large room rate fall of 6.6% this year as well as an occupancy decline of 6% to push RevPAR downwards by 12.3% to £40.07. The rate of decline mirrors the previous record RevPAR decline in 1992. 2010 should see improvement as occupancy declines only marginally and rates stabilise to give a further 1% RevPAR decline. This takes RevPAR to £39.69 in 2010. Whilst we expect to see room rates stabilise in 2010, occupancies, at 64%, will remain sluggish and at their lowest level since 1994. See Table 7, Chart 5 and Appendix 1

Downside scenario

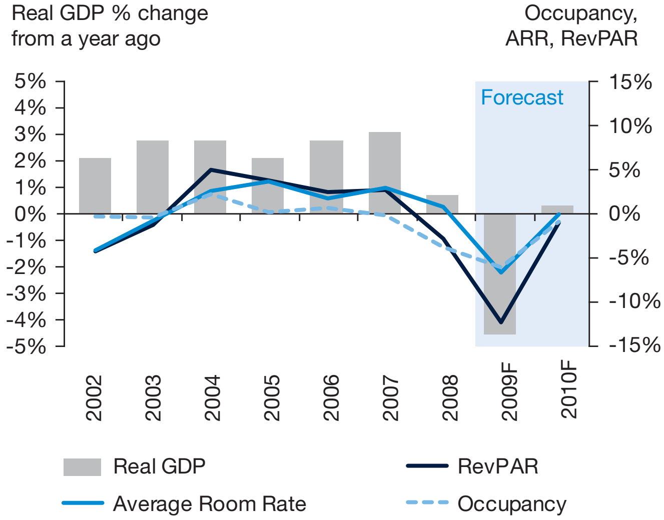
Risks around recovery in our main scenario remain significant and we have prepared a downside scenario that assumes a 5.1% GDP contraction this year and a further 2% GDP decline in 2010. In this scenario the rate of RevPAR decline could be as high as 15.1% this year before moderating to 3.2% in 2010. In this downside scenario, occupancies fall more severely than in the baseline scenario, contracting by almost 9% this year and 0.6% in 2010. Occupancies could then fall as low as 62% in both 2009 and 2010. In this scenario room rates would not stabilise in 2010, as they are expected to do in our baseline scenario; rather they would slide by a further 2.6% to £60.51.

Table 7: PricewaterhouseCoopers latest forecast for Provinces September 2009

	2008	2009F	2010F
Occupancy (%)	68.58	64.48	63.88
% Change	-3.7%	-6.0%	-0.9%
ARR (£)	66.55	62.14	62.11
% Change	0.90%	-6.60%	0.00%
RevPAR (£)	45.69	40.07	39.69
% Change	-2.80%	-12.30%	-1.00%

Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global July 2009

Chart 5: Provinces hotel performance 2002 to 2010
Real GDP, revenue-per-available-room, average room rate, and occupancy growth rates



F: Forecast

Econometric Forecasts: PricewaterhouseCoopers August 2009
Macroeconomic Data: National Statistics
Benchmarking Data: TRI Hospitality Consulting 1979 - 2000. STR Global 2001-2008

Appendix 1: Annual Hotel Statistics for UK, London and Provinces 2004-2010

Baseline Scenario	2004R	2005R	2006R	2007R	2008R	2009F	2010F
UK							
Occupancy %	72.20	71.83	74.21	74.33	72.15	69.06	68.89
% change	3.0	-0.5	3.3	0.2	-2.9	-4.3	-0.2
ARR £	72.82	75.38	78.14	82.64	84.53	77.69	76.00
% change	3.2	3.5	3.7	5.8	2.3	-8.1	-2.2
RevPAR £	52.61	54.19	58.05	61.47	61.07	53.67	52.38
% change	6.4	3.0	7.1	5.9	-0.7	-12.1	-2.4
London							
Occupancy %	75.44	74.06	80.38	80.93	79.73	78.78	79.54
% change	4.5	-1.8	8.5	0.7	-1.5	-1.2	1.0
ARR	98.72	101.87	108.1	118.12	122.75	110.75	105.50
% change	4.0	3.2	6.1	9.3	3.9	-9.6	-4.7
RevPAR £	74.52	75.51	87.02	95.70	98.00	87.30	83.96
% change	8.6	1.3	15.2	10.0	2.4	-10.9	-3.8
Provinces							
Occupancy %	70.68	70.78	71.31	71.23	68.58	64.48	63.88
% change	2.3	0.2	0.7	-0.1	-3.7	-6.0	-0.9
ARR £	60.63	62.91	64.04	65.95	66.55	62.14	62.11
% change	2.7	3.8	1.8	3.0	0.9	-6.6	0.0
RevPAR £	42.88	44.57	45.70	47.00	45.69	40.07	39.69
% change	5.1	3.9	2.5	2.8	-2.8	-12.3	-1.0
Downside Scenario	2004R	2005R	2006R	2007R	2008R	2009F	2010F
UK							
Occupancy %	72.20	71.83	74.21	74.33	72.15	67.15	67.60
% change	3.0	-0.5	3.3	0.2	-2.9	-6.9	0.7
ARR £	72.82	75.38	78.14	82.64	84.53	78.16	74.15
% change	3.2	3.5	3.7	5.8	2.3	-7.5	-5.1
RevPAR £	52.61	54.19	58.05	61.47	61.07	52.53	50.13
% change	6.4	3.0	7.1	5.9	-0.7	-14.0	-4.6
London							
Occupancy %	75.44	74.06	80.38	80.93	79.73	77.10	79.33
% change	4.5	-1.8	8.5	0.7	-1.5	-3.3	2.9
ARR £	98.72	101.87	108.1	118.12	122.75	112.3	103.50
% change	4.0	3.2	6.1	9.3	3.9	-8.5	-8.2
RevPAR £	74.52	75.51	87.02	95.70	98.00	86.72	81.84
% change	8.6	1.3	15.2	10.0	2.4	-11.5	-5.6
Provinces							
Occupancy %	70.68	70.78	71.31	71.23	68.58	62.46	62.07
% change	2.3	0.2	0.7	-0.1	-3.7	-8.9	-0.6
ARR £	60.63	62.91	64.04	65.95	66.55	62.1	60.51
% change	2.7	3.8	1.8	3.0	0.9	-6.7	-2.6
RevPAR £	42.88	44.57	45.70	47.00	45.69	38.8	37.56
% change	5.1	3.9	2.5	2.8	-2.8	-15.1	-3.2

R: Revised F: Forecast
Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global July 2009

Appendix 2: Quarterly Hotel Statistics for UK, London and Provinces 2009-2010

Baseline Scenario	2009 Q1 R	2009 Q2 R	2009 Q3 F	2009 Q4 F	2010 Q1 F	2010 Q2 F	2010 Q3 F	2010 Q4 F
UK	% change compared to same quarter of prior year							
Occupancy	-6.5	-5.0	-4.7	-1.0	2.0	-1.7	-0.4	-0.6
ARR	-5.3	-8.8	-9.7	-8.3	-3.5	-2.2	-2.4	-0.6
RevPAR	-11.5	-13.4	-14.0	-9.2	-1.5	-3.9	-2.7	-1.2
London								
Occupancy	-4.0	0.0	-1.3	0.4	4.2	-2.0	1.0	1.1
ARR	-5.1	-9.0	-12.7	-12.0	-6.7	-6.1	-4.4	-1.6
RevPAR	-8.9	-9.0	-13.8	-11.6	-2.8	-8.0	-3.5	-0.5
Provinces								
Occupancy	-7.8	-7.7	-6.5	-1.8	0.7	-1.6	-1.1	-1.5
ARR	-5.6	-8.7	-7.1	-5.0	-0.7	1.1	-0.7	0.2
RevPAR	-13.0	-15.7	-13.2	-6.7	-0.1	-0.5	-1.8	-1.3
Downside Scenario	**2009 Q1 R**	**2009 Q2 R**	**2009 Q3 F**	**2009 Q4 F**	**2010 Q1 F**	**2010 Q2 F**	**2010 Q3 F**	**2010 Q4 F**
UK	% change compared to same quarter of prior year							
Occupancy	-6.5	-5.0	-5.6	-2.0	0.6	-3.5	-1.3	-1.9
ARR	-5.3	-8.8	-10.1	-9.2	-4.8	-4.2	-4.9	-3.1
RevPAR	-11.5	-13.4	-15.2	-11.0	-4.2	-7.6	-6.1	-4.9
London								
Occupancy	-4.0	0.0	-2.0	0.3	4.1	-2.4	1.5	0.9
ARR	-5.1	-9.0	-12.8	-12.3	-7.5	-7.7	-6.9	-4.9
RevPAR	-8.9	-9.0	-14.6	-12.0	-3.7	-10.0	-5.4	-4.0
Provinces								
Occupancy	-7.8	-7.7	-7.6	-3.4	-1.4	-4.1	-3.0	-3.5
ARR	-5.6	-8.7	-7.6	-6.4	-2.5	-1.1	-3.2	-1.6
RevPAR	-13.0	-15.7	-14.6	-9.6	-3.9	-5.2	-6.1	-5.1

R: Revised F: Forecast
Econometric Forecasts: PricewaterhouseCoopers August 2009
Benchmarking Data: STR Global July 2009

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