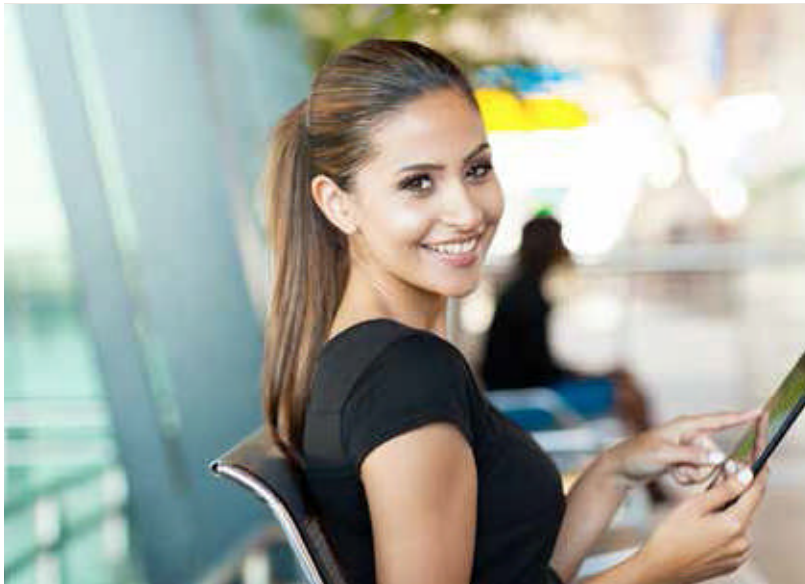


September 2015: UK hotels continue to benefit from the improving economic and travel backdrop. So far this year, the pace of growth has been variable in London but dynamic in the Provinces, driving a bumper year in the investment market. In 2016 we forecast more growth but at a slower pace.

UK hotels forecast 2016

Growth is in the air

But it's coming down to earth



Foreword

Regional growth helps UK hotels weather the Eurozone storm

The mood in this edition of our forecast is a positive one; but as always there are uncertainties looming on the horizon.

The mood in this edition of our forecast is a positive one; but as always there are uncertainties looming on the horizon.

Hotels in the Provinces (UK excluding London) are enjoying a good year. Following on from 10.4% revenue per available room (RevPAR) growth in 2014 we expect a further 6.3% growth this year and 4.2% in 2016. The Rugby World Cup should help support pricing power for hoteliers this year.

The results in London are more mixed. Growth in the first half of 2015 has disappointed and we are expecting RevPAR to expand by just 2.7% this year and a further 2.3% next year.

The UK's economic performance this year has been strong but external factors have played a part in London's slowdown in particular. The Greek crisis sent the euro plummeting against sterling, encouraging some visitors to go elsewhere. Whilst fears over the Eurozone have subsided for now, sterling has remained strong and the focus of uncertainty has now shifted to emerging markets.

Russia and Brazil are in recession and China has been rocked by financial volatility and a growth slowdown. Russia and Brazil in particular have also experienced severe currency depreciations, making overseas visits more costly

le structural shifts in the marketplace will continue to affect hotels. In this edition we look again at the rapid growth of “sharing economy” providers such as Airbnb – including research on the scale of their London operations and where competition with hotels appears to be fiercest. Hotels are also facing up to major changes in the regulatory environment – notably the li
– which could have a significant impact on costs, pricing and margins.

David Trunkfield

UK Hospitality & Leisure Leader, PwC

Dr Andrew Sentance

Senior Economic Adviser, PwC

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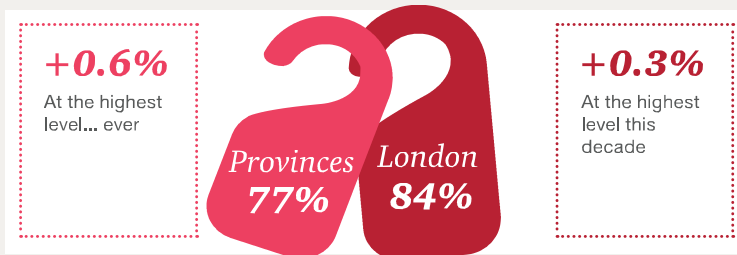


At a glance

PwC's latest UK hotels forecast predicts that UK hotels will continue to see further RevPAR growth in 2015 and 2016, with the strongest growth forecast for the Provinces (4.2%) rather than London (2.3%) which already operates at a very high level; but the pace of growth is slowing.

Figure 1: PwC's 2016 UK hotels forecast

Occupancy



Average daily rate (ADR)

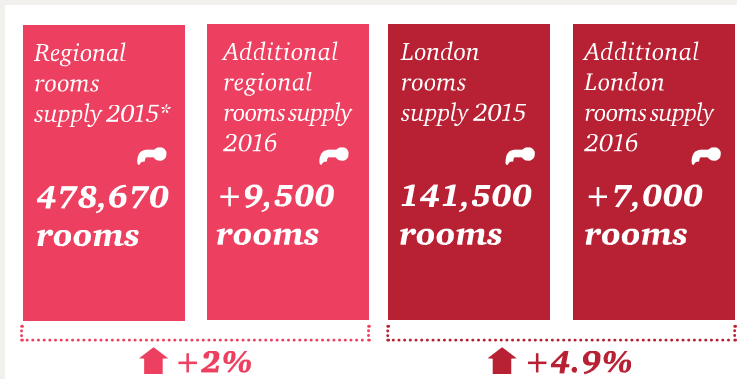


Revenue per available room (RevPAR)



Demand still outpacing supply growth

Around a half of all new rooms set to open in 2016 will be branded budget rooms



* Regions excluding London

Charts show absolute trading and percentage change on previous year

Net rooms supply (after closures) Source: AM:PM

ADR and RevPAR growth in nominal terms

Forecasts: PwC

W

Growth is still in the air and there is more to come, but the pace of growth is slowing.

London

London has had a variable trading year to date. Our forecasts for London, given a slower than expected first half in 2015, are now lower than those predicted in February this year. The forecast year-on-year growth for London occupancy is 1% in 2015 and 0.3% in 2016, taking occupancy to 84%. ADR growth is forecast to be 1.8% in 2015 and 2.2% in 2016. This growth takes ADR to £142 and £145 respectively

ly due to the Rugby World Cup in H2 2015. This drives RevPAR growth of 2.7% this year and a further 2.3% in 2016, taking RevPAR to £119 this year and £122 in 2016.

Provinces

The Provinces have experienced a very good year-to-date. Our forecasts for 2015 are broadly in line with those predicted in February, although growth in 2016 is slightly lower than forecast. The year-on-year forecast for occupancy is predicted to be 1.6% in 2015 but only 0.6% in 2016. This takes occupancy to 76% this year and 77% in 2016. ADR is predicted to see growth of 4.6% in 2015 taking it to £67. In 2016 ADR growth is predicted to fall to 3.5%. This means RevPAR growth will be 6.3% this year and a further 4.2% in 2016, nudging RevPAR to £51 in 2015 and £53 by 2016.

lowdown in the pace of growth

Growth is still in the air and there is more to come, but the pace of growth is slowing. It's not surprising, given we have seen 32 months of occupancy growth in the Provinces since November 2012; but only January this year saw double digit growth compared to six months of double digit growth in 2014. UK occupancy levels are at record highs with ADR back at past peaks in real terms in London and heading in the right direction in the Provinces. It's getting harder, but even slower growth is a good result for hotels.

Key issues impacting performance

Economic backdrop and the Euro

The GDP growth assumptions in this forecast are for 2.6% growth this year and 2.4% next year for the UK. London and the South East continue to lead the recovery, with growth of around 3% in 2015, but all other UK regions should also register positive real growth of around 1.7% in 2016. Domestic economic prospects in inbound markets are also important but relatively modest growth is projected across the leading developed economies in 2015–16, with the UK estimated to have the highest G7 growth rate again this year.

Table 1: UK hotels forecast: growth continues but the pace slows

Occupancy at record levels as ADR growth pushes up RevPAR in 2016

	London			Provinces		
A: Actual F: Forecast	2014A	2015F	2016F	2014A	2015F	2016F
Occupancy %	83%	84%	84%	75%	76%	77%
ADR (£)	140	142	145	64	67	69
RevPAR (£)	116	119	122	48	51	53
% growth on previous year						
Occupancy	0.5%	1.0%	0.3%	3.7%	1.6%	0.6%
ADR	2.8%	1.8%	2.2%	6.4%	4.6%	3.5%
RevPAR	3.4%	2.7%	2.3%	10.4%	6.3%	4.2%

Econometric Forecasts: PwC

Benchmarking Data: STR Global, August 2015

UK consumer spending and business investment will be the main growth drivers. Consumer spending growth is projected to be stronger than GDP, with consumers benefitting from low oil and food prices and positive real earnings growth. Robust consumer confidence also suggests people will be more willing to spend on leisure activities, supporting growth for hotels.

A weak euro has been a challenge for hoteliers, especially in London where European short city breaks are important. The strong dollar has been an opportunity to attract more US visitors.

Squeezed middle

Growth isn't being experienced evenly by all market segments. The recent variable performance in London in H1 2015 has shown some polarisation in performance with the middle segments hurting the most. Is it the increase in budget rooms upsetting the apple cart in London and creating this middle market squeeze?

The Rugby World Cup – up or under?

The Rugby World Cup starting in September will provide a fillip for hoteliers and we hope fears that the event could put off the corporate market at a traditionally busy time do not materialise. With many matches held at the weekend and large volumes of international visitors across the country, it should provide a large benefit.

But, in general, a lack of recent large events where hoteliers can leverage rates has been an issue. In 2016 there appear to be less than this year, although the biennial Farnborough International Airshow takes place in July and there are of course conferences and conventions. But less positively, 2016 sees two events during the summer that could compete for UK inbound visitors, with Euro 2016 close by in France and the Olympics in Rio.

Budget boom continues

In general, demand continues to outpace supply growth but supply continues to increase and above average growth is expected in 2016 – in total there are around 38,000 rooms in the active pipeline. The proportion of branded budget rooms in the active pipeline, including in London, remains high and investors continue to focus on this dynamic sector. While oversupply is a local issue the increases will impact some segments and locations. At the same time the increase in alternative accommodation such as serviced apartments, hostels and shared spaces continue to grow.

The rise and rise of shared space

The rise of shared accommodation platform brands such as Travelmob, Onefinestay, Airbnb, Tripping.com, Homestay.com, Wimdu and others has meant more travellers are aware of the brands and the opportunities of experiencing staying in shared space. In this edition we estimate the size of Airbnb property listings in London and what shared platforms in general could mean for hoteliers in a downturn. In terms of rate compression – will shared platforms and staying in private residences take the 'cream' off the milk in peak demand periods? Or, rather like the branded budget hotels over the last 30 years, are these new platforms creating a new stream of demand.

Deal talk gets louder

We anticipate that deal volumes in 2015 could far exceed the previous peak, with c.£6.5 billion transacted to date and c.£3.3 billion forecast to complete by the end of the year, including the recently reported Bulgari and Jupiter Hotels and further potential portfolio sales of Atlas hotels, Q hotels and LRG Group C. So what does 2016 have in store? There are a number of possible transactions currently rumoured in the market including the sale of Travelodge and Lone Star's Amaris group. So with some major transactions a possibility in 2016, we forecast total deal volume to remain above previous peaks, at around £6 billion, albeit below this year's forecast.

London forecast



London is the most Googled city in the world

especially for its arts and culture (London & Partners)

A mixed H1 2015

London saw a record 2014 but so far 2015 hasn't replicated this stellar performance. While average performance metrics are still very high by most global city standards, the pace of growth in London in H1 2015 has been mixed with some fluctuating monthly trading. Many hoteliers report that demand is still strong but they also tell us that the falling euro is a key issue.

The euro is an issue

London's role as a leading international tourism destination and the popularity of city breaks has meant that while there is still a considerable market for room nights in London, the decline in the euro has put pressure on hoteliers. It's a competitive arena, and as a leading leisure focused hotelier reminded us, price is not only about what the customer is prepared to pay but also the price that competitors are prepared to sell at. A lack of large events where

hoteliers can leverage rates has also been an issue. In the corporate arena, increased cost control is reported to be resurfacing amongst buyers. Some large corporates are reported to be leasing apartments to accommodate project staff to control costs.

The squeezed middle is hurting

Data show the first half trading slowdown has impacted the mid-market segment more than the luxury or budget segments. Large budget supply additions in recent years is likely exacerbating this situation. In addition, the competition is heating up and corporate and leisure visitors alike can choose from an increasingly wide range of value propositions in non-hotel accommodation across London's boroughs. This includes serviced apartments, new style hostels and shared economy spaces like Airbnb, Homeaway and Flipkey. See our Airbnb heat map later in this report.

But overseas tourism will help lift the year...

Nevertheless, 2014 saw 17.8 million overseas visits to London, up 5.8% from the previous record of 16.8 million, and more are expected this year, according to the annual Mastercard Global Destinations Cities Index. In 2015 they forecast that London will see 18.8 million international visitors, a 6% increase on 2014. While some observers have warned of a 'normalising' of tourism growth to London post the Olympics "effect", London is the most Googled city in the world, according to research from London & Partners, indicating no lack of interest.

..And there are bright spots including the Rugby World Cup to boost H2 2015

July data has shown stronger growth returning although some allowance needs to be made for the Ramadan pre/post surge this year (Ramadan finished on 16 July this year compared to 27 July in 2014). August trading data however

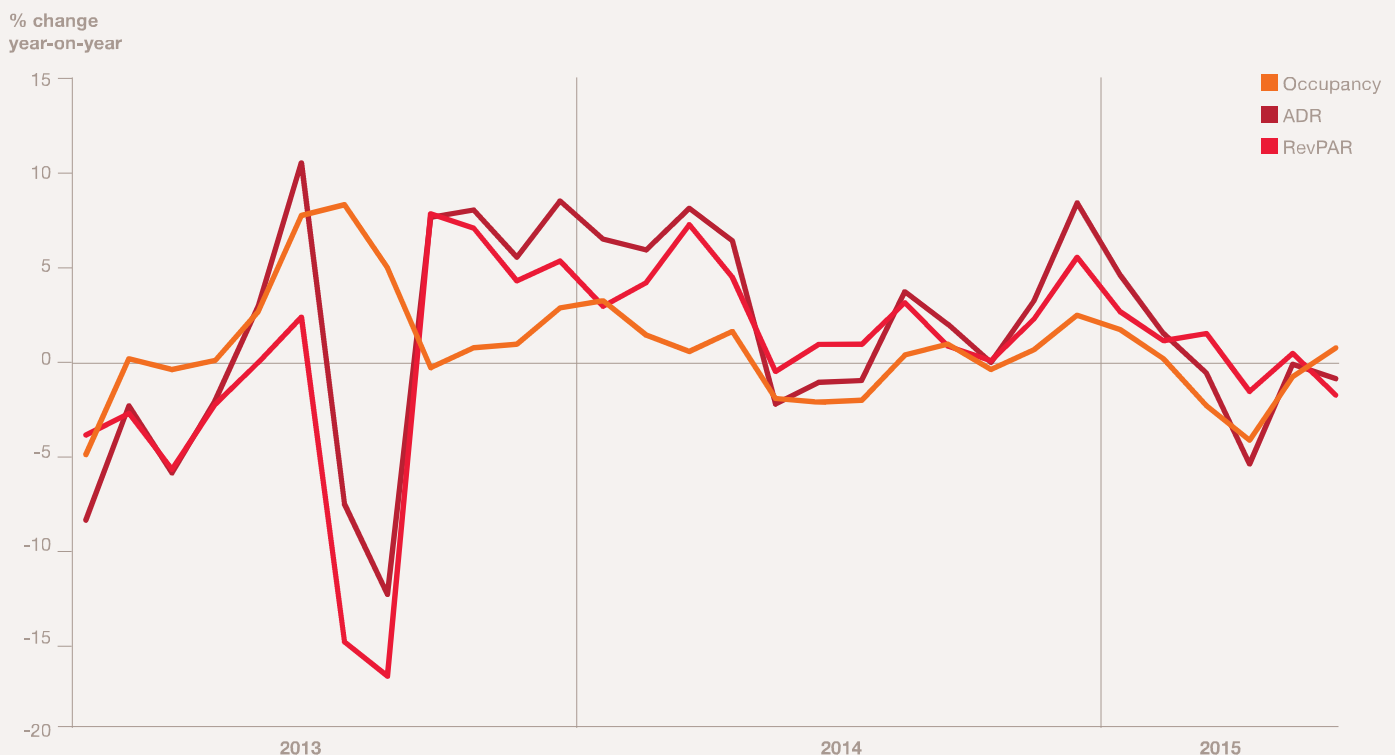
shows that trading has slipped back again. We remain optimistic as some of London's traditionally busiest tourist months fall in the second half of the year. Together with a brighter economic outlook and GDP growth above the UK average forecast, some large conventions during the summer, the continued strength of business travel volumes, short break leisure trips and the Rugby World Cup in the autumn, should all help drive visitor numbers and deli

le performance. As we forecast earlier this year the strong dollar has led to an increase in American guests and this should continue. We are encouraged that RevPAR growth of 2.7% is achievable for the year as a whole.

PwC forecast more growth for 2015 and 2016

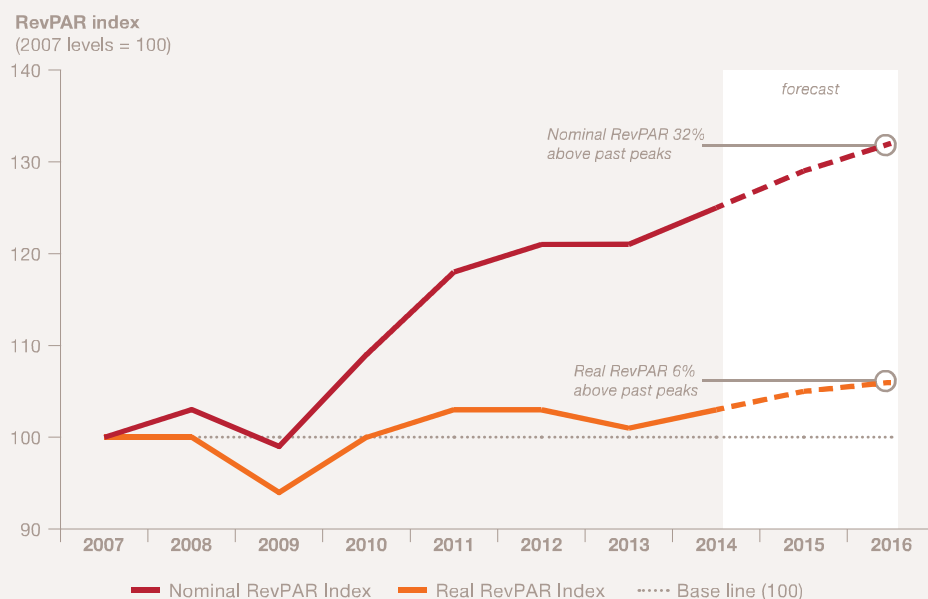
Our forecasts for London, given a slower than expected first half in 2015, are now lower than those predicted in February. W t growth though and this will propel London to exceed past peaks. An issue is that this growth is not being felt equally by all segments.

Figure 2: London monthly hotel performance – Jan 2013 to June 2015
Ups and downs in H1 2015



Source: STR Global 2015

Figure 3: In our forecast, by 2016 real London RevPAR could be 6% above the past 2007 peak in real terms



Source: PwC

Occupancies at highest this decade

London occupancies have averaged 80% or above since 2006 and our annual forecast for 84% this year and next would be the highest this decade and looking back further, the highest since the mid-1990s when supply was far lower and particularly budget hotels were less prevalent in London. While the forecast year-on-year growth for London occupancy is lower in 2015 than anticipated earlier in the year, we forecast 1.0% and 0.3% growth in 2015 and 2016, taking occupancy to 84% in 2015 and keeping it there in 2016.

ADR above pre-recession peaks in real terms

London ADR is now 22% above past peaks in nominal terms and is back in real terms too. ADR growth is forecast to be 1.8% in 2015 and 2.2% in 2016 and this growth takes ADR to £142 and £145 respectively.

RevPAR 3% ahead of pre-recession peaks in real terms

RevPAR is already back to pre-recession peaks in nominal and real terms – see Figure 3.

W .7% this year and a further 2.3% in 2016, taking RevPAR to £119 this year and £122 in 2016. By 2016 if this growth is achieved, London could be 6% above pre-recession peaks in real terms. See Figure 8.

Provinces forecast

Figure 4: Hotels in a wide number of cities will benefit from the Rugby World Cup this autumn



H1 2015 continues to see strong ADR growth

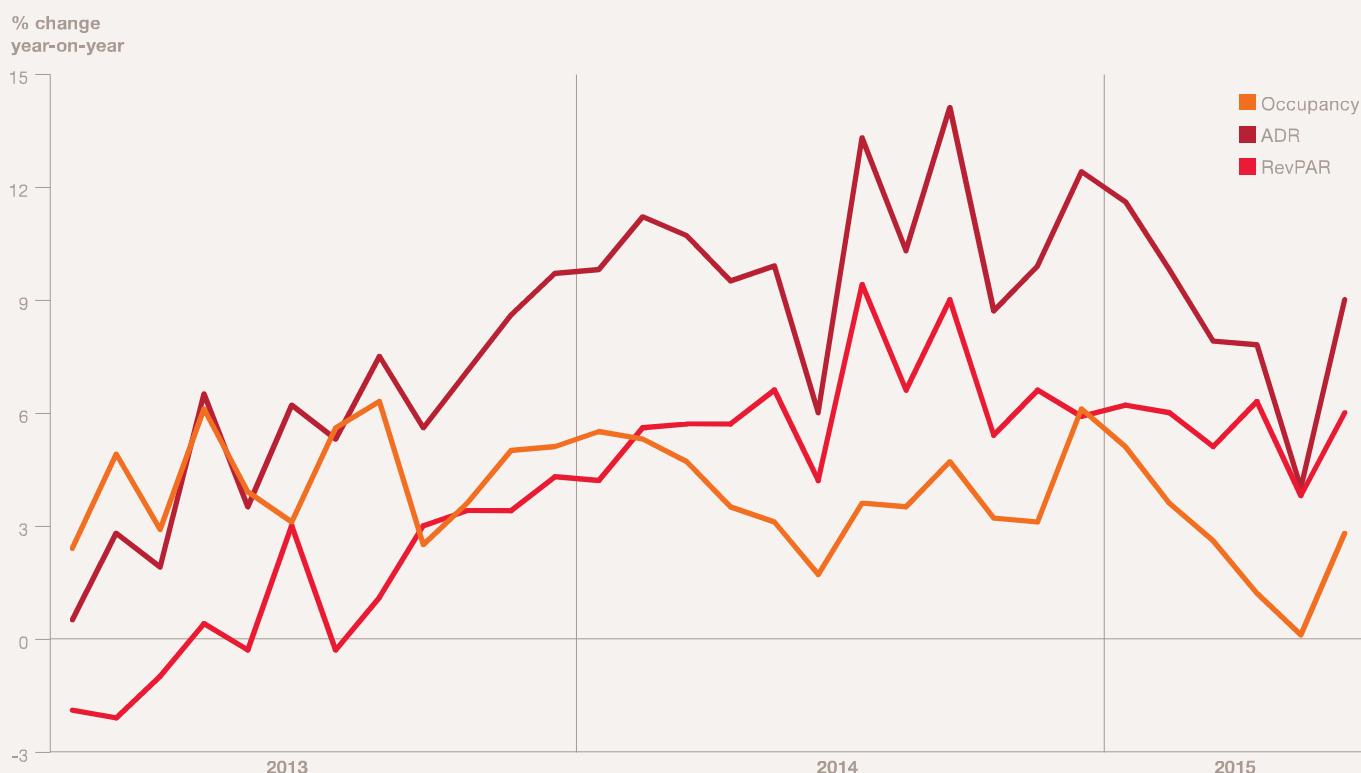
Around the country, most cities have continued to see very strong RevPAR growth this year. Growth has come from a mix of occupancy and ADR, but particularly from rates. Exceptions include Aberdeen which has seen both occupancy and ADR falls drive an 18% RevPAR decline to June. Many cities continue to see double digit RevPAR growth including Belfast, Bristol, Birmingham, Coventry, Liverpool, Nottingham Plymouth and Southampton.

Pace slowing (a bit) after 30 months occupancy growth

Overall the first half of 2015, despite strong growth in H1 2014, has seen 8% further RevPAR gains driven by 2.4% occupancy and 5.5% ADR growth. But only January so far has seen double digit RevPAR growth compared to six months of double digit growth in 2014.

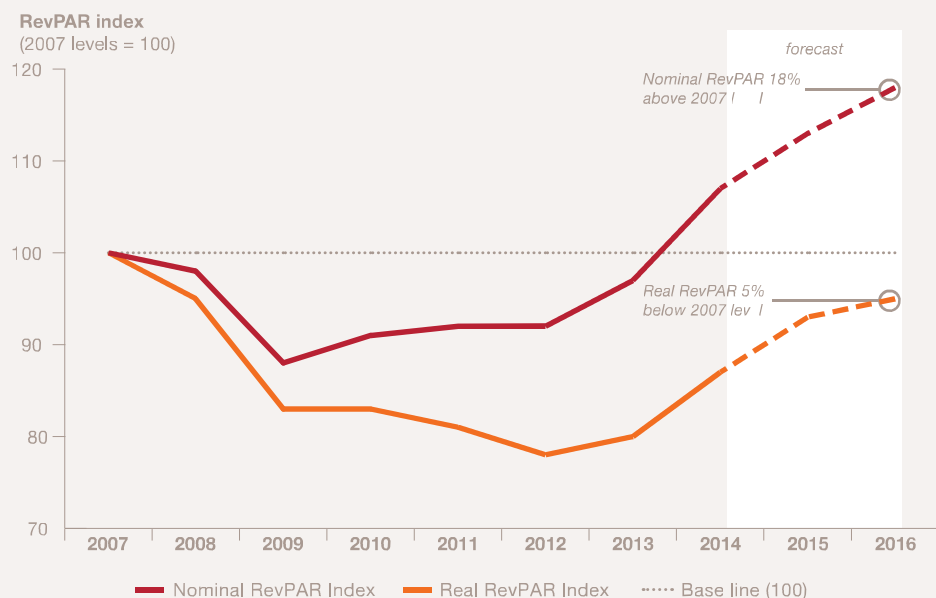
Occupancy growth is also a bit weaker than at this point in 2014 with only marginal growth in May but a recovery in June and July. However, the achievements have been significant and occupancy has seen 32 months (to July) of occupancy growth in the Provinces since November 2012.

Figure 5: Provincial monthly hotel performance Jan to June 2015 – ADR drives robust RevPAR growth in H1 2015



Source: STR Global 2015

Figure 6: Closing the gap
In our forecast Provincial RevPAR is also making up lost ground



Source: PwC

PwC forecast for 2015 and 2016

Our forecasts for 2015 are broadly in line with those predicted in February. The year-on-year forecast for occupancy growth is forecast to be 1.6% in 2015 but only 0.6% in 2016. This takes occupancy to 76% this year and 77% in 2016. ADR is predicted to slightly outperform our earlier forecast with growth at 4.6% rather than 4.4%, taking it to £67 in 2015. In 2016 ADR growth is predicted to fall to 3.5%. This means RevPAR growth will be 6.3% this year and a further 4.2% in 2016, nudging RevPAR to £51 in 2015 and £53 by 2016.

Occupancies edging up to break records further

Regional occupancies have climbed back into the 70s since 2011 and have been creeping up since then, hitting 75% in 2014. Our forecast for 76% this year and our forecast of 77% in 2016 would be the highest on record, driven partly by structural supply shifts towards a greater proportion of budget rooms.

Further scope for more ADR recovery

It is generally considered a rule of thumb that once hotels achieve occupancy above 72%, they can leverage room rates and at an average of 75% last year, we can see why Provincial hotels were able to get some lift on prices.

There still remains scope for further recovery in ADR in real terms as real ADR lags pre-recession peaks. In 2014 ADR was just above past peaks in nominal terms but it remained 17% below in real terms. Our forecast predicts the Provinces can close this gap in real terms to 12% by 2016.

RevPAR 7% ahead of past peaks in nominal terms but lags by 13% in real terms

Provincial RevPAR is already 7% ahead of pre-recession peaks in nominal terms but lags by 12% in real terms. We forecast RevPAR growth of 6.3% this year and a further 4.2% in 2016, taking RevPAR to £51 this year and £53 in 2016. If this growth is achieved in 2016 it would close the RevPAR gap to 5% below pre-recession peaks in real terms. See Figure 8.

Economic outlook

The UK economy continues to perform robustly and we expect this to carry on in 2015 and 2016. It grew by 3% in 2014 as a whole, the fastest rate since 2006 and the strongest of any G7 country.

Recent developments

We expect UK GDP growth to average around 2.6% in 2015, which could again be the fastest in the G7, before easing slightly to around 2.4% in 2016. UK growth continues to be driven primarily by services, with manufacturing and construction growth having slowed in late 2014 and early 2015.

This is however contrasted by the fact that UK growth slowed somewhat to 0.4% in the first quarter of 2015, although preliminary estimates from the ONS suggest a pick up to 0.7% in the second quarter. UK domestic demand growth remained strong in the first quarter, driven by rising employment, a pick-up in earnings growth and the benefits of lower global oil prices for UK consumers and most businesses. Business investment has shown signs of a stronger recovery in the latest official data, although this has not yet translated into stronger productivity growth.

But there have been several drags on growth – notably from external factors. Growth in the US and the Eurozone has been sluggish, whilst sterling has surged, making overseas trips cheaper relative to those in the UK. Recent currency movements saw sterling reach a six year high against the dollar in July and almost a two year high against the euro. This is a drag on growth for the hotel sector and may also negatively affect GDP more broadly through the impact on imports and exports.

Public spending cuts have slowed down somewhat over the past couple of years, but the Budget confirmed they will continue at a steady pace for the next four years. The Budget also announced net tax rises building up to around £7 billion by 2020. The impact of severe welfare cuts will be offset for some lower

earners by the new more generous National Living Wage, which is estimated to rise to over £9 per hour by 2020 for those aged 25 and over.

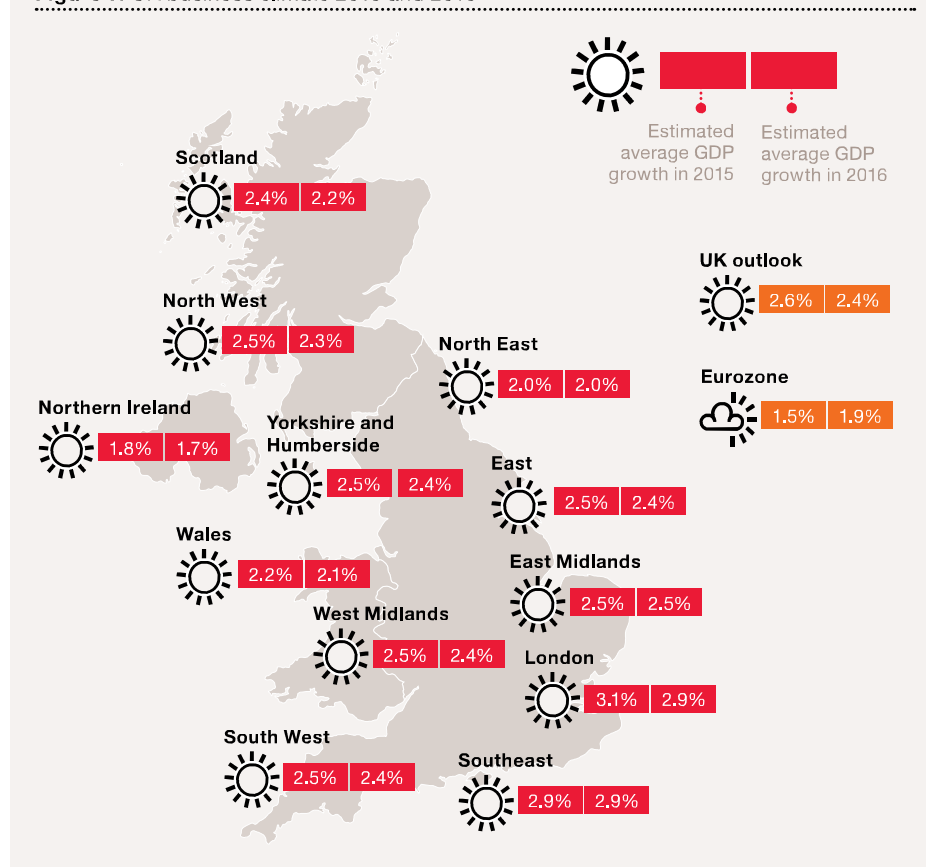
There are still considerable downside risks relating to developments in Greece and the Eurozone more generally, and in some emerging markets. But there are also upside possibilities if these problems can be contained and a virtuous circle of rising confidence and spending can be established as in past economic recoveries.

Inflationary challenges

Consumer price inflation (as measured by CPI) had been fluctuating close to deflationary levels in the first quarter of 2015 and was driven down to -0.1% in April. The primary causes of this downward trend included falls in costs of imported goods (especially food and energy) over the past year, supermarket price wars and cheaper transport services. The timing of the Easter break in April exacerbated the effect of decreased transport costs, but this was reversed in May. Inflation was zero in the year to June.

After the recession hit in 2008, average UK real earnings fell consecutively for six years. This trend has now reversed. Inflation levels fell rapidly below their target level in 2014 and early 2015, whilst nominal wage growth has picked up markedly this year as past strong employment growth reduced spare capacity in the labour market, despite continued high levels of inward migration of workers. Going forward, we expect real earnings growth to continue, though this may moderate somewhat from 2016 as inflation returns towards target.

Figure 7: UK business climate 2015 and 2016



Sources: PwC forecast, ONS

Regional prospects

London and the South East continue to lead the recovery, with growth of around 3% in 2015, but all other UK regions should also register positive growth of around 1.8–2.5% in 2015.

As shown in Figure 1, economic growth is not likely to be distributed uniformly across the regions. Our estimates for 2015 range from 2.0% growth in the North East to 3.1% in London, while projected regional growth in 2016 ranges from around 2.0% to around 2.9%. This chart demonstrates that we do not expect a dramatic shift in relative

fortunes over the next two years, with faster rates of growth again tending to be experienced in the South and Midlands. But all regions should follow the same broad upward trend in 2015–16 and the differences between regions are not large relative to the significant margins of uncertainty surrounding any such projections.

Europe

The European equity market (Euronext 100 index) had a particularly strong surge in Q1 2015 when the ECB announced its new Quantitative Easing (QE) asset purchase programme, though this levelled off in the second quarter as ongoing uncertainties around Greece took centre stage. Greece's future remains uncertain. Other Eurozone crisis economies like Spain, Ireland and Portugal are also in better shape than they were in 2011–12, as is the European banking sector more generally.

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 government debt relative to the economy continues to increase.

The status of the labour market in peripheral Europe remains difficult. Unemployment in Greece and Spain is roughly double the Eurozone average of 12%.

Other markets

The US market has had a fairly consistent underlying upward trend since 2009. However, there is more uncertainty in Asia with some concern about financial contagion effects from the sharp falls in the Chinese stock market.

Emerging market performance is projected to vary considerably, with China and India growing at around 7% this year, but with China being subject to much financial volatility, while Brazil and Russia are in recession. Global growth is projected to pick up in 2016, but this remains subject to considerable uncertainties at this early stage.

T



A largely positive backdrop

The positive travel backdrop continues to drive hotel demand, with record numbers of inbound visitors in recent years and further modest growth forecast. A weak euro has not been ideal for UK tourism including hoteliers in London and other destinations like Edinburgh. But brighter economic growth prospects mean we expect corporates and consumers to keep on travelling in the UK this year and next, both on short breaks and corporate trips. Combined with a resilient and dynamic domestic short break market as well as a solid UK business travel revival, this will help sustain the hotel recovery.



2m+ business visits in Q1 2015

The first time business visits reach this milestone since 2008

The Rugby World Cup – up or under?

The Rugby World Cup in September should provide a boost for hoteliers and we hope fears that the event could put off the corporate market at a traditionally busy time do not materialise. With around 450,000 potential international visitors and many matches held at the weekend it should prove a positive benefit.

A lack of recent large events where hoteliers can leverage rates has been an issue. In 2016 there appear to be less than this year, although the biennial Farnborough International Airshow takes place in July and there are of course conferences and conventions. But less positively, 2016 sees two events during the summer that could contest for UK inbound visitors, with Euro 2016 close by in France and the Olympics in Rio. For Star Trek fans Star Trek Celebration Europe comes back to London ExCel for the first time since 2007.

Overseas visits boost

Despite the Euro issues, the first six months of 2015 saw over 16.8 million overseas visits to the UK, a 3% increase over 2014. Despite positive overall volumes, overseas expenditure in the UK has been less consistent, perhaps reflecting budget concerns.

Visit Britain forecasts for 2015 are for a 2.5% increase in volume to 35.1 million inbound visits with a 4.5% increase in expenditure. There are considerable downside risks especially from economic uncertainty in inbound markets.

Especially business visits

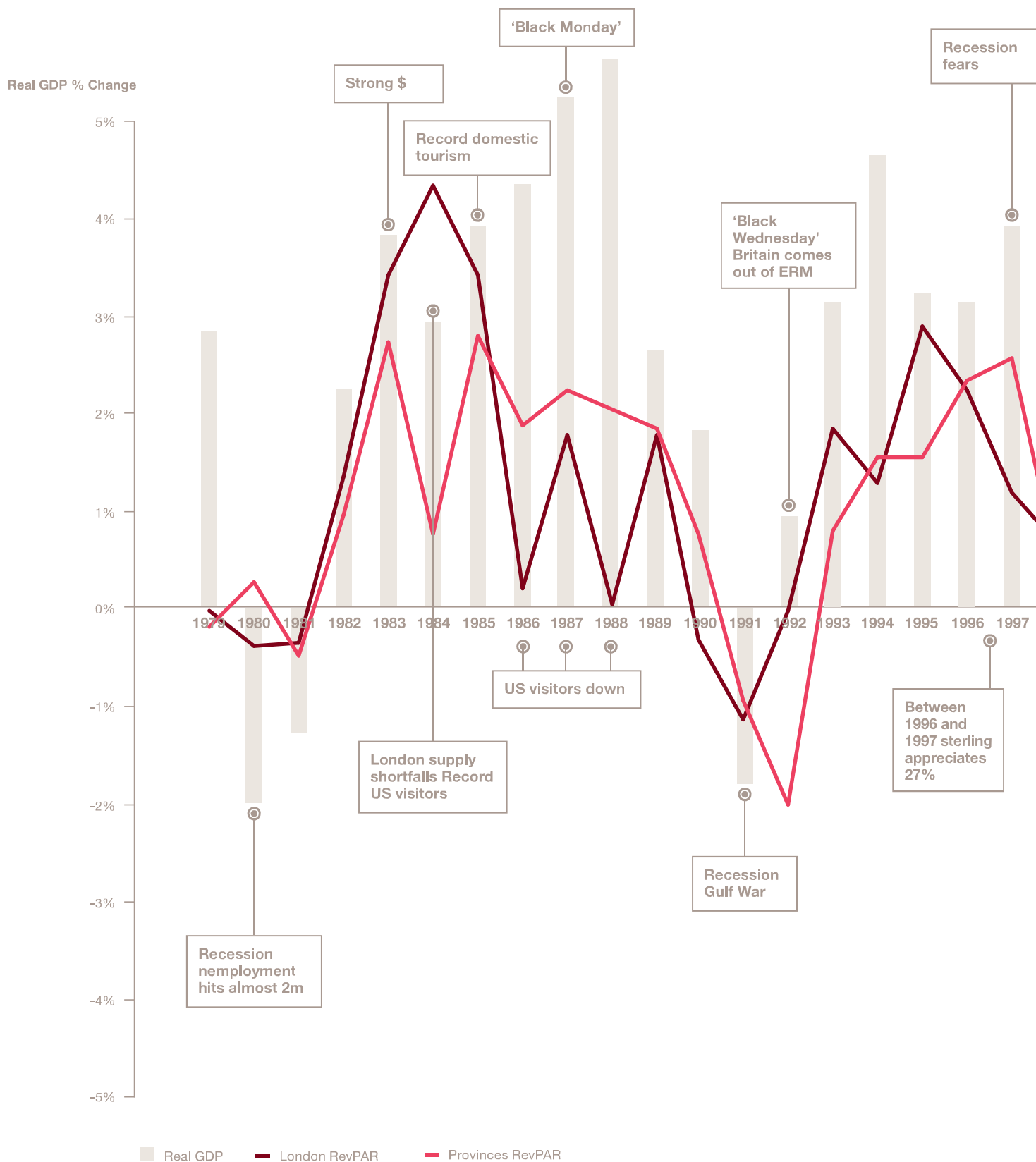
Overseas business visits continue to show a strong recovery, up 13% for the six months to June 2015. There were a little over two million business visits in the first three months of 2015 – the first time business visits have reached this milestone since 2008. Over the same period, the volume of holiday trips remained flat. Conferences and meetings is a sector still not fully recovered and corporate budgets remain under pressure and doing more with less remains the norm for organisers

While domestic tourism could lift demand

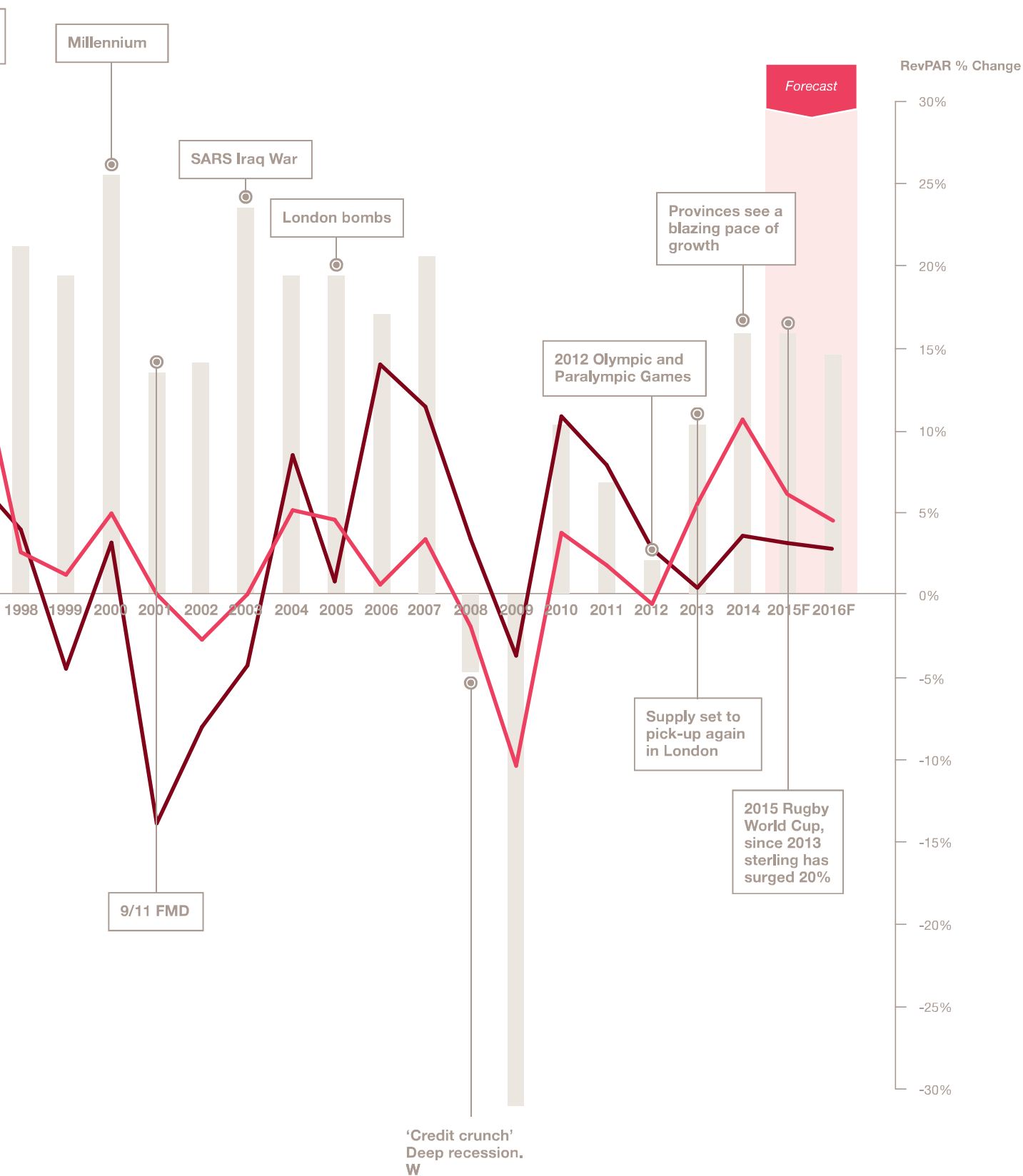
Results from the Great Britain Tourism Survey show that 28.7 million trips were recorded in England between January and April 2015 – an 18% increase year-on-year

ld Cup in September.

Figure 8: Coming down to earth?
Real GDP growth and RevPAR trends 1979–2016(f)



Source: Econometric forecasts: PwC August 2015 Macroeconomic data: National Statistics Benchmarking data: Hot Stats, STR Global



Supply outlook

Supply is the other side of the equation with growth driven by and also influencing hotel performance.

Currently, demand continues to outpace supply growth but supply continues to increase and above average growth is expected in 2016. While oversupply is a local issue, the increases will impact some segments and locations. At the same time the increase in alternative accommodation such as serviced apartments, hostels and shared spaces continue to grow.

Overall half way through the year, there are over 38,000 rooms in the UK's active pipeline, i.e. opening dates in 2015 to 2017 (including rooms already opened in 2015). Over 14,000 rooms are set to open in 2015 in total; over 16,000 rooms in 2016 and almost 8,000 rooms in 2017. There are considerably more on hold or speculative.

Above average growth ahead

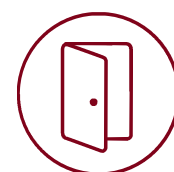
The London hotel market has seen 23.6% growth in overall net room growth between 2008 and 2014. This has been driven by growth in the four star segment and the continuing trend towards branded budgets. A

(after closures) is expected from 2015 to 2017 in London, compared with 2.7% annual a

ll, since the recession the UK Provincial hotel market saw around 9.6% growth in room supply, averaging 1.3% per annum (from 2007 to 2014). Looking ahead, above average growth is also expected in 2015 and 2016 but the active pipeline remains below average in 2017.

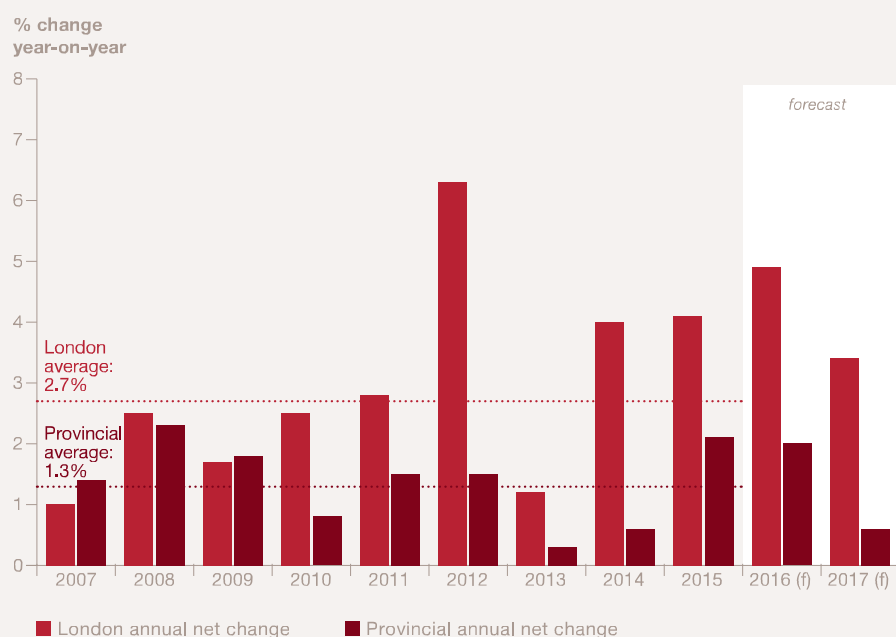
Branded budgets continue their dynamic growth

UK room supply has grown significantly over the years and while the sector remains fragmented there have been significant structural changes over the last 20 years that have accelerated more recently. lude a continuing shift towards more branded hotels of the total market, a decline in the mid-market and the independent sector – over 50,000 rooms have closed between 2000 and 2014 alone – as demand for budget products increase.



16,000 new rooms
to open in 2016

Figure 9: Annual net room growth



Sources: PwC, AM PM 2015

The rise and rise of shared space

In September 2014's edition of PwC's UK hotels forecast "Growth Beds In" we outlined how a sharing economy was resulting from the collision of four megatrends: breakthroughs in technology and connectivity, rising urbanisation, a growing environmental conscience and shifting social preferences and featured analysis on how the sharing economy might disrupt hotel business models.

M

later, interest has increased and the rise of shared accommodation platforms (private residences including house swapping) such as Travelmob, Onefinestay, Airbnb, Tripping.com, Homestay.com, Wimdu and other online accommodation sites has meant more travellers are aware of the opportunities of staying in shared space. Market research experts, BDRG Continental have reported on the increasing power of one player, Airbnb. In recent consumer research among travellers, BDRG found recall of Airbnb had leapt amongst business as well as leisure travellers and the brand had outperformed hotel brands (with a similar awareness) on usage by some margin (relative to recognition). This trend was even more prominent in the leisure market.

9% of travellers in the UK have rented space in a private home

Recent research from Phocuswright showed that the incidence of shared space rentals is increasing. 9% of travellers in the UK had rented space in a private home or apartment in the past year. This compared to 11% in France and 13% in Germany. Airbnb is attracting a wider audience, with demand from Millennials for business as well as leisure travel and increasingly the platform appeals to Millennials, Gen Xers as well as Boomers.

Hyatt have invested in Onefinestay

In our original article, we suggested hotels should be thinking about developing strategic options to ensure they were prepared for the shared rental sector and perhaps make strategic investments, acquiring a new entrant, partnering or investing or differentiating their products to justify the existing pricing structure. Since then we note that Hyatt Hotels has invested in private home rental business Onefinestay.

The rise of Airbnb in London

Should London hoteliers be worried? We have undertaken some initial research on Airbnb's presence in London as well as what this means for hotels. Airbnb has grown dramatically since being founded in 2008. Over 40 million guests are reported having stayed worldwide. In London our research shows there are around 31,000 listings available¹. While this is fewer than the number hotel rooms also available, Airbnb is growing at breakneck pace. In 2014 alone the Daily Telegraph reported that listings in

London had increased by 87%². Revisiting this space next year will be interesting.

The rise of Airbnb has opened up whole new accommodation options to consumers and in some areas increased the level of competition faced by hoteliers. PwC research in September 2014 showed that 10% of hoteliers reported experiencing negative impact of Airbnb's rise.

To understand the potential impact of Airbnb on the London market we have looked in more detail at where the apartment listings are located and how many of them there are. Figure 10 (on the next page) shows the results of our research with the darker shades indicating a higher number of listings in that borough. Some caution needs to be taken when comparing to hotel rooms. A single property might be listed multiple times – for example, as two independently-bookable rooms and as the whole place and the numbers of beds is also a more complex calculation, given the varying sizes and capacities of the listings.

¹ Based on data collected by PwC from the Airbnb website (<https://www.airbnb.co.uk/>) as on 27 July 2015.

² <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11702399/Airbnb-boss-calls-UK-the-centre-of-the-sharing-economy.html>

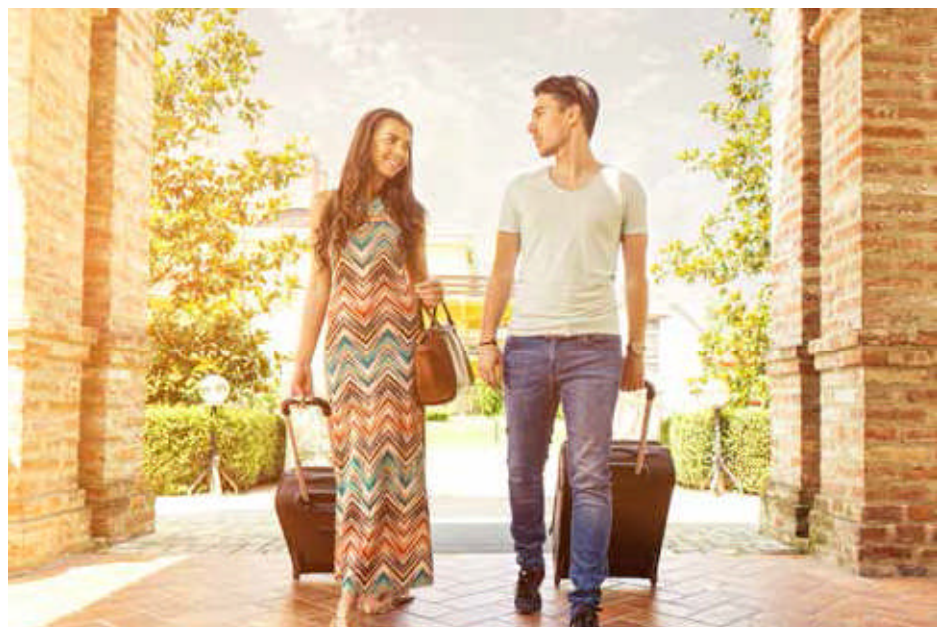
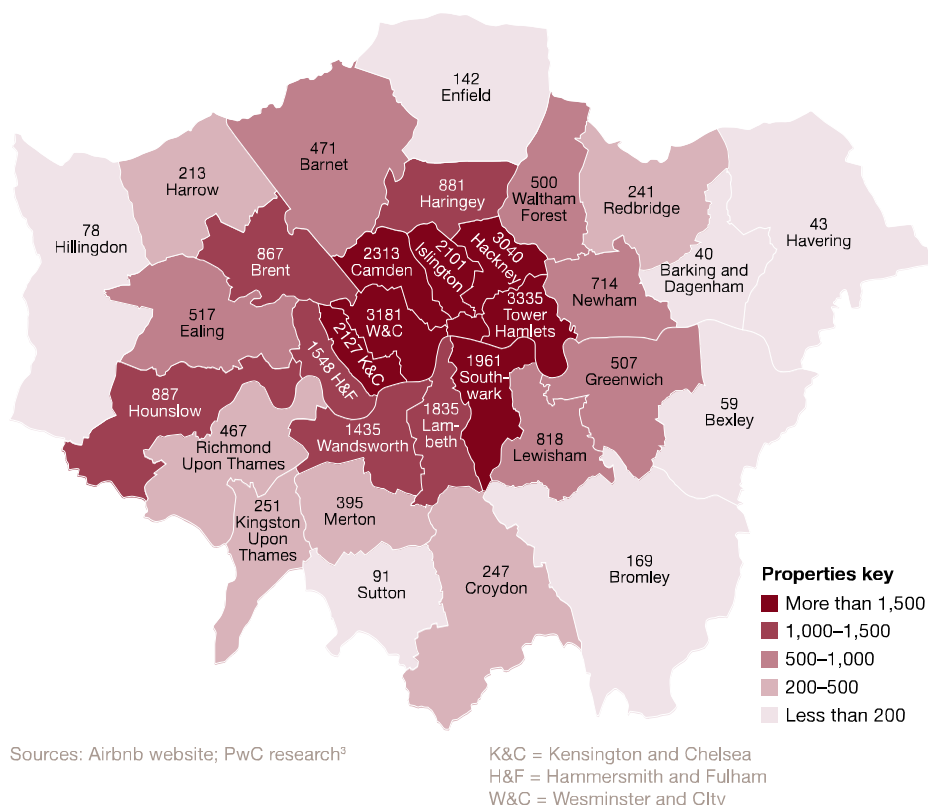


Figure 10: Airbnb heat map: listings by London borough



accessed it would increase supply substantially in the market. However, people are currently much less willing to open up their primary residences rather than their additional homes.

The boroughs that are most popular with Airbnb owners are those that are centrally located with easy access to tourist attractions and amenities. The most popular area includes the City of London and Westminster (we have combined the results for the two boroughs as the City has limited residential properties). These areas are very central and contain a number of draws for business and leisure travellers. Unsurprisingly the other central boroughs also show high numbers of listings.

We were slightly surprised by the relative popularity of some of the outer central boroughs such as Barnet, Waltham Forest, Newham, Lewisham and Hounslow. These are all located a significant distance from Central London (although some offer fast connections), but may offer better value or larger accommodation for visitors.

We also compared Airbnb listings to the number of hotel rooms across boroughs and can see some interesting contrasts (see Figure 11).

As expected the most popular leisure and business tourist areas mainly have the highest number of both Airbnb listings and hotel rooms, notably in Central London boroughs like the City and Westminster, Camden and Kensington & Chelsea. In addition, boroughs such as Tower Hamlets, Islington and Southwark are popular amongst both hoteliers and those who let Airbnb properties.

In contrast, Hillingdon stands out due to its large hotel population on the Heathrow site – but the lack of residential space within the airport fence appears to have prevented Airbnb from taking off. A similar trend appears in Newham and Croydon, which are popular with hotels, but have relatively

In a sample of six boroughs (three inner and three outer), the majority of listings comprised a private room and this was consistent in both inner and outer London boroughs. The exception was Westminster and the City where almost 67% of listings comprised the entire house. These listings are more likely to be run as commercial enterprises and as such are competing with branded hotels. Landlords might have been incentivised to move from long-term rentals to short-term rentals. In contrast, in Lewisham, over 60% of listings were private rooms, with the lowest level, among our sample, of ‘whole house’ rentals.

Those renters who use shared space to supplement their income could potentially be more disruptive for hotels than the ‘whole house’ category as they could be less price sensitive – but at the moment are likely to be a minority. This risk of disruption is higher because the scale of spare rooms will far outweigh the scale of second homes in London and so if this “hidden capacity” could be

³ A single property might be listed multiple times – for example, as two independently-bookable rooms and as the whole place – so we are aware this isn’t a totally accurate reflection of the numbers of flats/houses available.

The numbers of beds (the usual hotel measure) is also a more complex calculation, given the varying sizes and capacities of the listings.

few Airbnb listings. Newham includes City Airport, the Excel Centre, HS1 access from Stratford and Olympic related developments. Croydon offers fast links to Gatwick and Central London, and hosts substantial business clusters of its own. T

trend whereby hotels are the dominant accommodation option around transport hubs and in business centres with fewer leisure and tourist attractions.

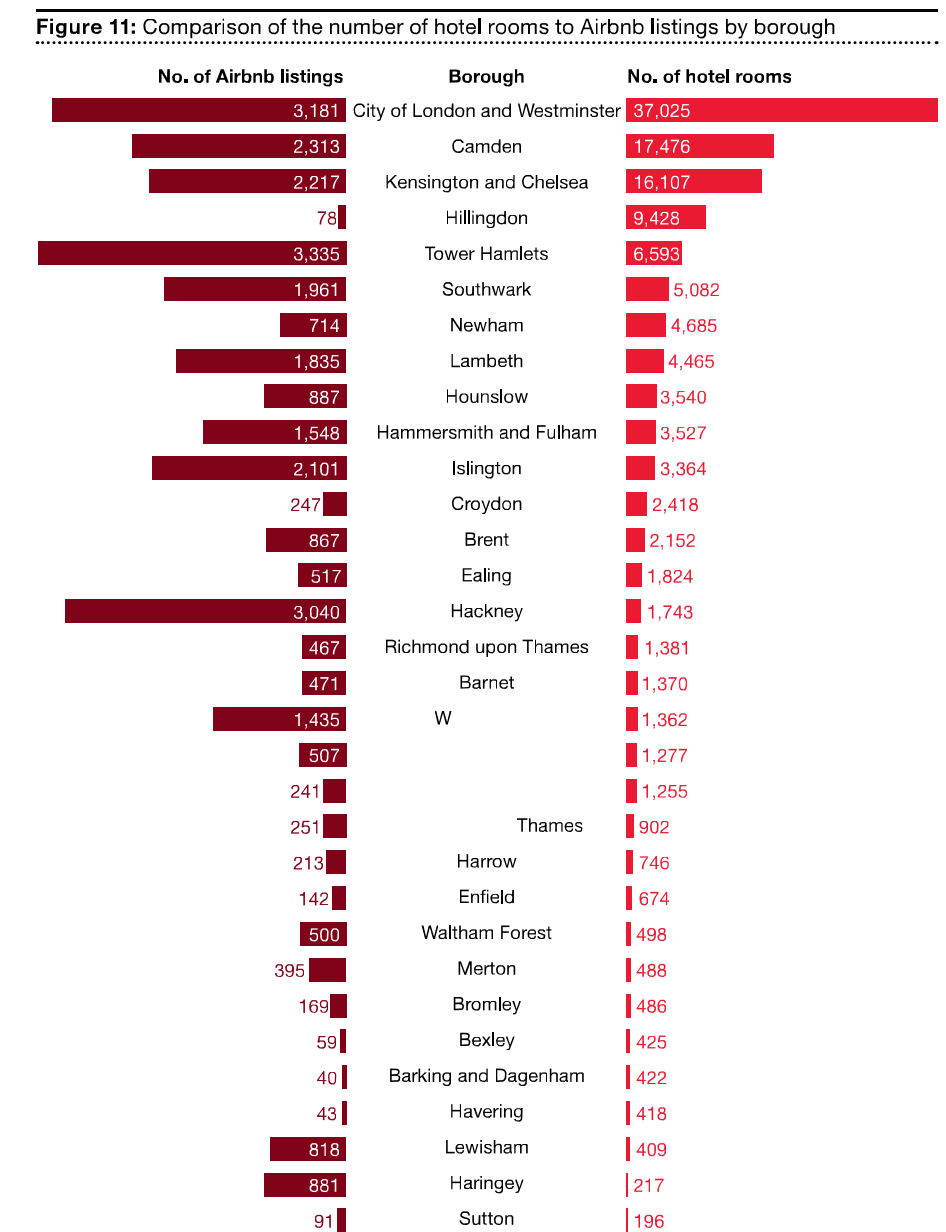
Some boroughs also appear to have a relatively high number of Airbnb listings relative to the hotel population. Haringey, Hackney and Lewisham. All three boroughs are relatively central and have fast transport links to the heart of London – but otherwise they seem to have relatively little in common. These may attract more price sensitive leisure travellers who wish to use good value accommodation and commute into the tourist attractions of Central London. Clearly other factors such as site availability, planning policy and attitude to hotel development may have influenced hotel development patterns across London.

Implications

In conclusion, we are seeing more shared space platforms, more brand awareness across different age cohorts (it's not only Millennials) and increased usage of these platforms for business and leisure stays.

In London, the numbers of Airbnb listings are increasing and this trend is likely to continue and cause localised issues for hotels, around pricing pressure and/or underutilisation, especially for undifferentiated products. Such an impact is likely to be felt more strongly by hotels in a downturn.

Do shared platforms pose a threat to hotels? Will shared platforms take the 'cream off the milk' at the times of peak demand? Or, rather like the branded budget hotels 30 years ago, will rental sites create a new stream of demand for



Note: different scales apply to each accommodation category

Source: PwC research; Airbnb website; AM PM July 2015

destinations and allow hotels to capitalise on a new type of customer? By attracting more visitors, rental sites could be good for the wider London economy.

In this edition we have tried to put a number on Airbnb property listings in London and what this could mean for hoteliers. We don't have all the answers but we hope we can encourage some debate on the issues.

Deal talk

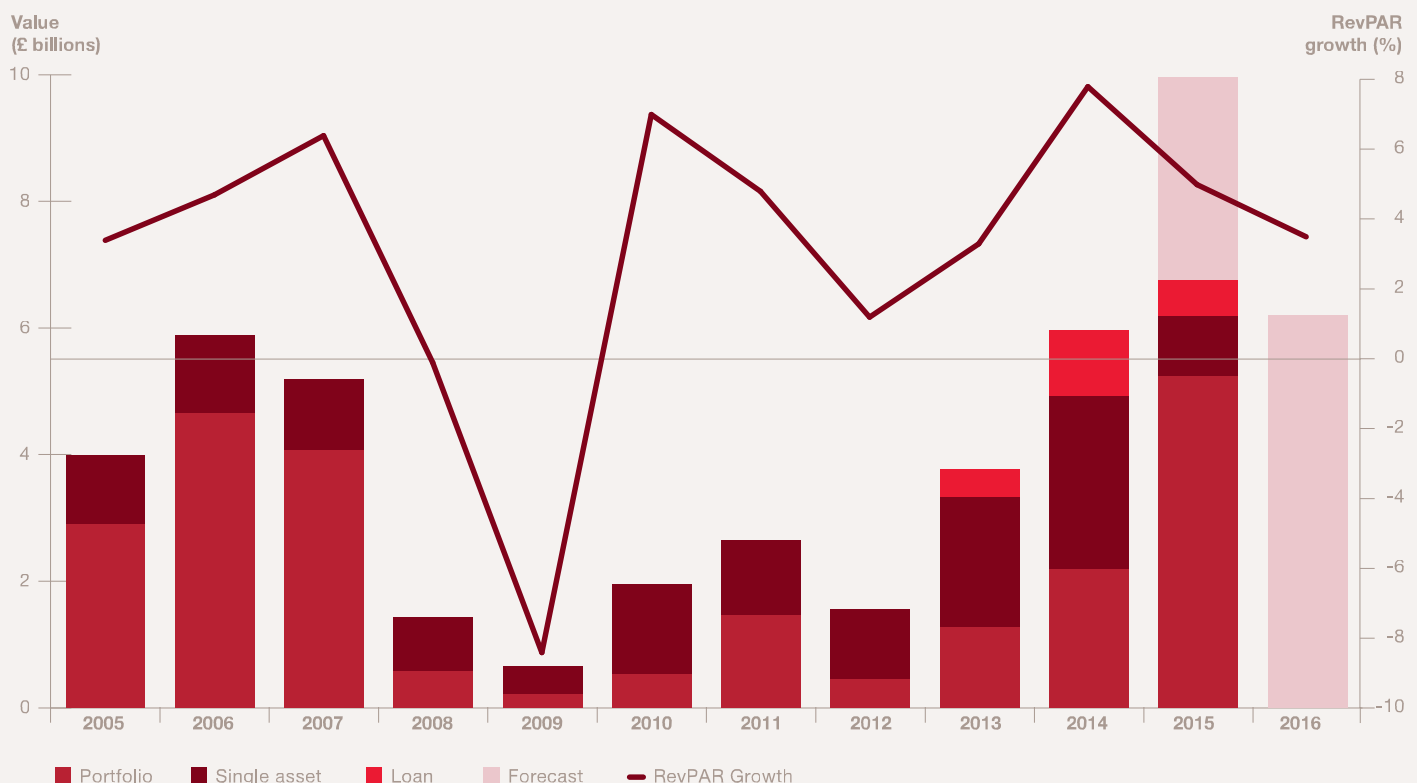
There has been a strong correlation between deal activity and market performance growth over the past eight years, and 2014 was no exception with RevPAR growth equating to 7.7% in 2014, the highest growth in recent years, and total deal volume exceeding £5.5 billion, only marginally behind the 2006 peak.

The significant growth in deal volume in 2014 was driven largely by regional hotel transactions, demonstrating a return of investor confidence in regional assets due to exceptional regional RevPAR growth (10.4% in 2014). Major portfolio transactions in 2014 included the Grove portfolio of Travelodge freeholds (c. £520 million), Village Urban Resorts (c. £500 million) and De Vere Venues (c. £230 million). There were also a number of regional single asset transactions, some of the largest being the Grand Hotel Brighton, Lowry Hotel Manchester and Turnberry Resort Ayrshire. Meanwhile, with more subdued London RevPAR growth (3.3% in 2014) major transactions in the capital included the Marriott EDITION, Marriott Grosvenor Square and Kingsway Hall Covent Garden.

2015 sets new record for UK deal activity

While 2015 was forecast to be another active year in terms of transaction deal volume, actual activity has far exceeded expectations. While RevPAR growth returned to more normalised levels (UK forecast 4.9% in 2015), deal volume has increased exponentially with 2015 forecast to reach c.£10 billion. Up to July 2015 we have seen c. £6.5 billion of transactions, already ahead of 2014 volumes. Regional transactions have been the most active, where both continued RevPAR growth (6.4% forecast for 2015) and reduced inflation pressure on operating costs are resulting in improved profitability. Major portfolio transactions year to date July 2015 include Jurys Inn (c. £675 million), Kew Green (c. £400 million), Malmaison and Hotel du Vin (c. £360 million), Moran and Bewleys (c. £320 million) and LRG Group B (c. £225 million).

Figure 12: UK hotels deal volume



Source: Dealogic, HVS, PwC analysis



Despite London RevPAR growth of only 2.7% forecast in 2015, demand from investors remains high; however a lack of supply has meant few major transactions year-to-date. The highest value transaction by far was the 64% stake in Maybourne Group (c. £1.5 billion), also St. Ermin's Westminster (c. £185 million) and Ace Hotel Shoreditch (c. £150 million).

We forecast a further c. £3.3 billion of deals to complete by the end of the year, including the recently reported Bulgari and Jupiter Hotels and further potential portfolio sales of Atlas hotels, Q hotels and LRG Group C.

What to expect for 2016

So what does 2016 have in store? There are a number of possible transactions currently rumoured in the market including the sale of Travelodge and Lone Star's Amaris group. So with some major transactions a possibility in 2016, we forecast total deal volume to remain above previous peaks (albeit behind the record level forecast for 2015) with continued activity in the regional portfolio market in particular. It remains to be seen, however, the impact of the recently announced National Living Wage on both deal values and future deal supply, as a result of potentially significant increases to current hotel payroll costs.

What is driving record deal volumes?

So as trading growth returns to more stable levels, what is driving the current transaction mania?

Overseas investor demand remains particularly strong for prime London assets which offer reasonable returns for relatively low risk; however, we have also seen an increase in overseas demand for assets outside of central London as market performance improves and investors look to achieve greater returns on investments.

Availability of finance is a significant factor, with debt financing becoming more readily available. As both the economy and the hotel industry markets continue to grow we have seen an increase in appetite from both private equity and new lenders, resulting in increased competition in the market and pressure on lenders to increase loan-to-values. In particular, we have seen a rise in mezzanine debt providers in the hotel sector as original lenders maintain LTV's of around 65%, mezzanine debt provides possibilities for increased leverage on both acquisitions and refinancings.

In addition to the availability of finance, we have seen a rise in private equity investment in the sector as a result of the low interest rate environment and continued gap between bond yields and real estate yields, resulting in the sector being appealing to investors looking for strong returns and value enhancing opportunities.



£10bn in deals

2015 is set to be a record year for deals volume at c. £10 billion

Feature Where is investor appetite coming from?

2014 transaction volumes were only marginally behind previous 2006 peak levels and are forecast to be significantly higher in 2015, so as trading fundamentals show signs of stabilising, we consider how the type of investor and origin of investors have changed over recent years.

Over the period 2012–2015 July YTD there has been a significant shift in the type of investor, with Private Equity transactions now accounting for c.28% of transactions compared to just c.12% in 2012. This shift is reflective of the change in supply-demand dynamics, as UK hotel performance has improved, and in particular regional hotel performance has experienced strong RevPAR growth, there has been an influx of demand as Private Equity opportunistic clients look for value enhancing/repositioning opportunities as demonstrated by Lone Star, Cerberus and Marathon Asset Management's acquisitions in Q1 2015. The level of HNWI/Sovereign Wealth investment also saw significant growth from c.10% in 2012 to c.35% in 2015, primarily representing the high value Maybourne Group transaction.

As well as a change in investor type entering the market, we have also seen a shift in the origin of investors. European investors have been replaced by an increase in Middle Eastern and Asian investors entering the market, as they look to the UK hotel market which offers a relatively safe haven, especially so in London, as well as greater returns than mainstream prime commercial assets. Examples including Singapore-based Fraser Hospitality's acquisition of Malmaison and Hotel du Vin, China-based CTS's acquisition of Kew Green and Taiwan-based Sunrider Group's acquisition of St Ermin's, London. The static level in North American purchasers is reflective of the replacement of hotel investor/operators with Private Equity buyers in the market including KSL, Lone Star, Cerberus and Starwood Capital, all of which have been very active in 2014/2015.

We forecast overseas investment to remain strong in 2016, in particular from Asian capital which is less impacted by the potential rise in interest rates (although it remains to be seen how the current Asian market wobbles will pan out) compared to Private Equity which may be more cautious to invest as the cycle looks to be stabilising and cost of finance could increase in the future.

Figure 13: Type of investor (% share)

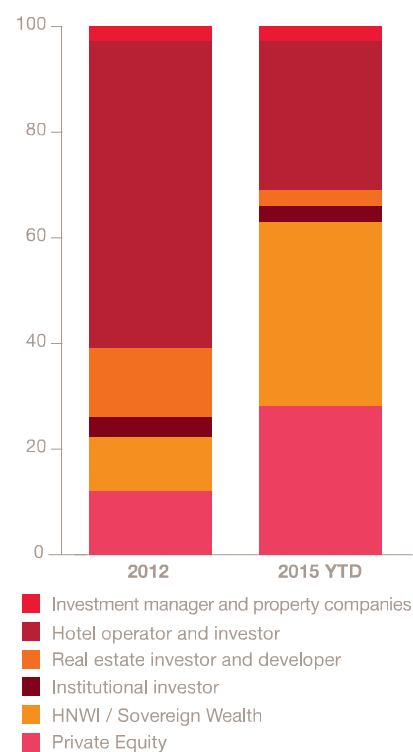
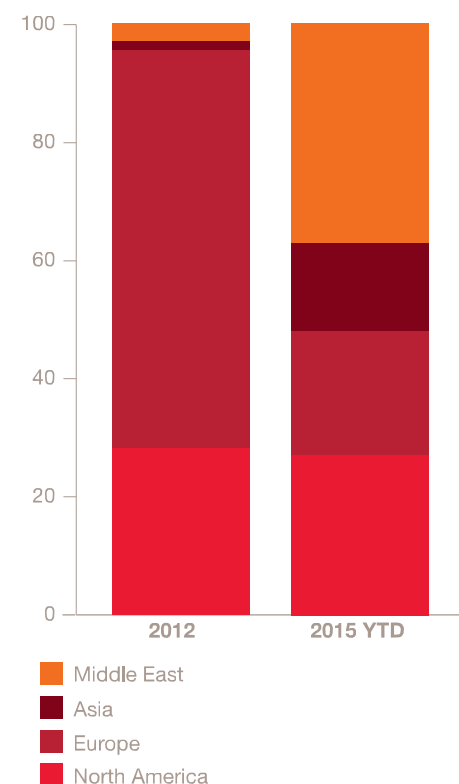


Figure 14: Origin of leading investors (% share, by region)



Source: Dealogic, HVS, PwC analysis, AM:PM Hotels and RCA

Appendices

Appendix 1

Annual hotel statistics for London, Provinces and the UK

Table 2: Annual hotel statistics for London, Provinces and the UK 2012–2016 (f)

	Actuals			Forecast	
	2012	2013	2014	2015	2016
London					
Occupancy %	81%	83%	83%	84%	84%
ADR (£)	112.20	136.01	139.83	142.29	145.35
RevPAR (£)	112.20	112.28	116.10	119.20	121.94
<i>% change on previous year</i>					
Occupancy	-1.8%	2.4%	0.5%	1.0%	0.3%
ADR	4.9%	-2.2%	2.8%	1.8%	2.2%
RevPAR	3.0%	0.1%	3.4%	2.7%	2.3%
Provinces					
Occupancy %	70%	72%	75%	76%	77%
ADR (£)	59.00	59.76	63.61	66.56	89.90
RevPAR (£)	41.14	43.32	47.81	50.83	52.94
<i>% change on previous year</i>					
Occupancy	-1.6%	4.0%	3.7%	1.6%	0.6%
ADR	0.9%	1.3%	6.4%	4.6%	3.5%
RevPAR	-0.7%	5.3%	10.4%	6.3%	4.2%
UK					
Occupancy %	72%	75%	77%	78%	79%
ADR (£)	80.57	80.29	84.14	86.96	89.49
RevPAR (£)	58.34	60.19	64.85	67.98	70.33
<i>% change on previous year</i>					
Occupancy	-1.7%	3.5%	2.8%	1.4%	0.5%
ADR	2.8%	-0.3%	4.8%	3.4%	2.9%
RevPAR	1.1%	3.2%	7.7%	4.8%	3.5%

Econometric Forecasts: PwC August 2015

Benchmarking Data: STR Global July 2015

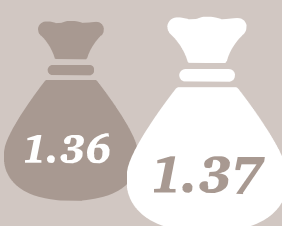
Appendix 2

PwC hotel model GDP and other economic assumptions

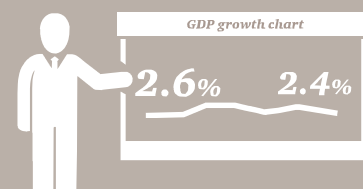
1 *USD/GBP* 2015 vs 2016



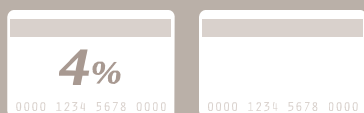
2 *EUR/GBP* 2015 vs 2016



3 *GDP growth* (% change p.a) 2015 vs 2016



4 *Consumer spending* (% change p.a) 2015 vs 2016



5 *Inflation* (% change p.a) 2015 vs 2016



6 *Unemployment rate* 2015 vs 2016



Appendix 3

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 1.

Advantages of our econometric modelling 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.

The 2SLS approach 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, unit roots 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 specifications includes quarterly dummies, the lag of GDP growth, the lag of demand and the lag of price growth as instruments. Results from the Hansen J statistic suggest that the instruments are exogenous and the model is valid at the 5% level. Equally, the t-tests in the first regression suggest

that the variables are significant at the 5% level. This suggests that the instruments are both relevant and independent of the dependent variable.

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 2016, 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.

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 <ul style="list-style-type: none"> Country-weighted GDP growth in the previous quarter⁵ Growth in London ADR in the previous year Quarterly dummies 	Explanatory variables <ul style="list-style-type: none"> UK GDP growth Growth in demand in the previous year Quarterly dummies
2nd stage	Dependent variable Growth in London ADR	Dependent variable Growth in Provinces ADR
	Explanatory variables <ul style="list-style-type: none"> Growth in London hotel demand Quarterly dummies 	Explanatory variables <ul style="list-style-type: none"> Growth in Provinces hotel demand Quarterly dummies

1 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

Further information

Further reading

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

Room for growth: European cities hotel forecast for 2015 and 2016



Emerging Trends in Real Estate® A balancing act Europe 2015



Hospitality outlook: 2015–2019 South Africa



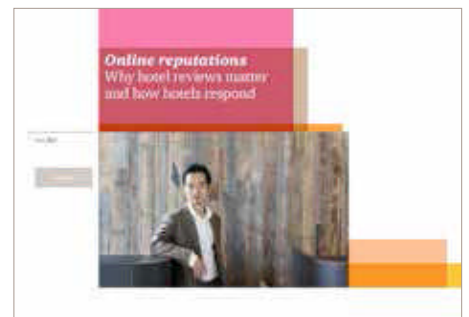
Hospitality Directions US Spotlight on connected devices



Middle East cities hotel forecast for 2015 and 2016



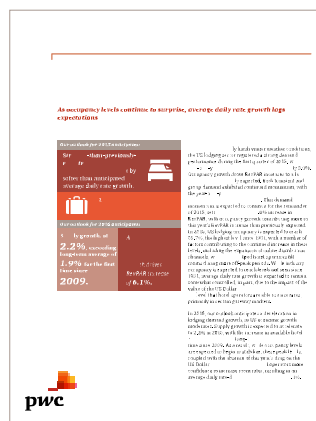
Online reputations: Why hotel reviews matter and how hotels respond



Five steps to success in the sharing economy



Hospitality Directions US Our updated lodging outlook



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

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

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

Hotel forecasts

We provide forecasts for hotel room occupancy rates and prices for the hospitality and leisure thought leadership reports. W

le East.

PwC's macroeconomic consulting services include:

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

Impact assessment and policy analysis

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

Stress testing

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

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At PwC we have advisors for every aspect of your business in the good times and through challenging economic environments. Our experts in all areas of strategic, tactical and transactional advice can bring to bear the full effect of the firm on your business.

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

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- Asset management
- Disposal
- Making the right investment choice

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